1

DO WESTERN CODES OF CORPORATE GOVERNANCE APPLY IN ASIA?

This chapter makes the case that good corporate governance (CG) does matter, but that adopting Western codes of CG without understanding the underlying differences in market structures, types of ownership and culture may lead to unexpected problems in implementation within the board in many Asian markets.

Why CG Matters

As a general principle, CG matters because investors are vulnerable to conflicts of interest and managerial incompetence. They are not well protected by contract and so have to rely on the law to protect them from conflicts of interest and on good CG to protect them from managerial incompetence.[1] If good CG protects shareholders from managerial incompetence, it should lead to better performance, justifying any interest third parties have in how the company is run.

Although there is a fair amount of evidence to suggest that good CG does have a positive impact, there is also evidence to the contrary.[2] On balance, it seems that good CG does in fact lead to better results in terms of higher profits and better dividends. Also the cost of debt (using bond yield spreads as a proxy) would appear to be lower the more independent the board[3]—one of the indicators of good CG.

When investors think of the benefits created for them by good CG, they split into three groups:

- The first group believes that companies with good CG will perform better over time—that over the long term good CG will translate into higher stock prices, yielding higher upside potential. Studies in the US,[4] Germany[5] and, most recently, India[6] tend to support this point of view.
- The second group sees good CG as a means of limiting or reducing the risks to which a company is exposed. They believe the existence of good CG will reduce the chances of bad things happening to the company and, if they do materialize, the company will recover faster because it has good CG in place to deal with the problems as they arise.
- The third group recognizes the importance of self-fulfilling prophecies. They regard CG as a fad, but go along with it because so many investors increasingly think it matters, and therefore they expect share prices to reflect this fact.[7]

Perhaps the most convincing reason for believing that good CG leads to superior shareholder value comes from an American study which argues that companies can be thought of as republics.[8] Those companies that had boards that felt less accountable to the shareholders did less well than the companies where boards took their responsibilities to shareholders more seriously. Companies can choose to be like democracies—granting great powers to the voters; or they can choose to be like dictatorships—protecting the management from being accountable to the voters. Consequently, the study looked at the "democracies" and compared how they have performed in contrast to the "dictatorships." The "democracies"—the companies with the lowest management power and the highest shareholder rights—appear to have outperformed the "dictatorships" by a "statistically significant 8.5 percent per year" in firm valuations.[9]

In addition, firms with lower shareholder rights were less profitable and had lower sales growth than other firms in their industry. The study also shows that a dollar invested on September 1, 1990 would have grown to US$3.39 in the "dictatorship" portfolio by December 31, 1999, but would have grown to US$7.07 in the "democracy" portfolio—representing an annual growth rate in value of 14 percent and 23.3 percent, respectively, with the "democracies" outperforming "dictatorships" by 9.3 percent per annum.[10] Two possible factors contributing to these findings might be:

- *Bad investment decisions*: The more firmly entrenched the managers are, the more protected they are from hostile takeover and the more likely they are to invest unwisely from a shareholder's perspective.[11]
- *Agency costs*: One of the most important sets of agency costs arise as a result of acquisitions, where the acquiring firm is subjected to negative returns. So value-destroying capital expenditure for acquisitions may be one of the reasons for the poorer performance of "dictatorships," particularly when some of the other agency problems are found to be caused by low managerial ownership, high free cash flow and diversifications.[12] Indeed, the evidence suggests that during the 1990s the "dictatorship" firms did in fact indulge in inefficient acquisitions, not so much to create empires but, rather, in an apparent attempt to stave off imminent collapse.[13] Presumably, shareholders in the "democracies" would not have agreed.

German experience[14] supports this, as follows:

- Firms with higher governance ratings delivered higher market-to-book ratios, with an increase in the firm's corporate governance index of three points (out of a total of 30) leading to an increase in the firm's market capitalization of 2.8 percent. This translated into a 12.5 percent increase of market capitalization of the company's book asset value.
- Buying high corporate-governance rated (CGR) firms and shorting low CGR firms would have earned higher returns of around 12 percent per year during the period under review.
- Firm-specific CG affects asset pricing because it is treated as a risk premium for which investors require added returns to compensate for the risk they take. Firms with better CG and engaged investors can deliver lower ROE and still interest shareholders.[15]

The Indian study supported these findings with the following conclusions.[16] Provided companies exceeded a certain CG threshold score then:

- The better-governed firms command a higher market valuation and are less leveraged and have higher interest cover.
- They provide higher return on net worth and capital employed and their profit margins are more stable.
- Their P/E ratios and dividend yields were higher than those in firms whose CG scores are lower.

Portfolio Turnover Affects the Value Placed on CG . . .

However, there is an important caveat: good CG does not interest all shareholders equally. Investors with a low portfolio turnover—defined as selling between 0 and 40 percent of their portfolio in the space of a year—were willing to pay a 12 percent premium on average. The reason for this is that they were in the stock for longer, and good governance pays off over the longer term. Investors who regard the market as a casino are "punting" on a stock, and they are only interested in the very short term. In markets where there are no capital gains taxes, investors can quite literally buy and sell a stock several times in a day. Thus investors with a high turnover rate—defined as selling between 41 percent and 100 percent—were only willing to pay a 7 percent premium. As long as their profits exceed their commission costs, they are ahead.[17] "Stir-frying," as this activity is called in Hong Kong for example, is not about good governance; it is about gambling.

. . . as does the Asset-Management Philosophy

Value investors are interested in the long term and so are more likely to appreciate good CG than growth investors where the growth in the company can hide failures of CG. Although these errors might cause profits to be lower than they otherwise should be, this does not matter so much when there are high price-earnings multiples justified by prospective profit growth. In fact, the difference in the two attitudes is best illustrated by the two quotes below, cited in a McKinsey research paper:[18]

Value investor: "A good board may help lift an underperforming stock and capture hidden value."

Growth investor: "One major shareholder . . . said that he did not want to talk about governance or anything else and had bought our stock only because of a growth trend he foresaw in the industry as a whole."

It is perhaps no accident that the greatest CG failures have occurred either in markets that were growing rapidly—ASEAN before the 1997 Asian Financial Crisis, China in the period 1995–2003[19]—or in sectors where growth was taken for granted, as in IT, telecoms and energy in the US before the crunch time when failures in CG were discovered to have been systemic and occurring over a period of several years before the economy turned down.[20]

The 2007–08 financial crisis followed the same pattern, with unbelievable rates of growth in asset-backed securities and credit-default swaps hiding the basic flaws of CG in the system.[21]

We can conclude that CG does matter to investors for the following reasons:

- It provides them with some protection they otherwise would not have, other than through expensive legal recourse.
- There is some evidence to suggest that good CG delivers better shareholder value over the long term *within* given markets.
- There is also evidence to suggest that markets with a better reputation for CG require a lower risk premium than those that have a less good image.

However, other things being equal, the importance attached to good CG depends on the time horizons of investors—a function of their assets, portfolios and investment philosophies—and whether they are growth investors or value investors. Growth investors care less about CG than value investors, as growth can compensate for failures of CG.

Yet this does not deal with the more difficult question; namely, does a system of good CG developed in one jurisdiction work well in another or are there additional factors that must be taken into account for good CG to happen?

Anglo-Saxon CG may not Apply Everywhere

The Anglo-Saxon system of CG depends on three pillars being in place: self-discipline, market discipline, and regulatory discipline.

Self-discipline

Of these three pillars, self-discipline is the most important as it is the foundation of ethical business practices. At the heart of the Anglo-Saxon capitalist system were the concepts of deferred gratification (the basis of any investment decision), savings and reciprocity or mutual trust, best expressed in the phrase "My word is my bond." These foundations of the capitalist system were first developed in Calvin's Geneva and were written about by Max Weber when he developed the concept of the Protestant work ethic.[22]

Since the 1960s, with the advent of the credit card, followed by the instant news of the CNN world we live in today, the idea of deferred gratification has been under attack and we now live in a society that values instant gratification instead, best exemplified by the values of Gen Y.

This explains the importance of consumption in the Anglo-Saxon economies and it also helps explain the extraordinary packages that CEOs, traders and celebrities receive at the expense of those members of society who are engaged in building the social and economic foundations for the next generation.

More seriously, the focus on the present at the expense of the future has led to justifying the risky behaviors of the financial-services industry that put the entire economic and financial system at risk. The fact that many Americans no longer seem to believe in the Protestant virtues but, rather, in so-called Prosperity Christianity may explain why they cast common sense aside and borrowed to the hilt,[23] when encouraged to do so by unscrupulous mortgage brokers, aided and abetted by conflicted credit rating agencies and financial engineers who created the toxic financial assets that brought down Bear Stearns, Lehman Brothers, Merrill Lynch, and AIG.

My concern is that unless we rediscover the importance of deferred gratification we will continue to undermine the foundations of capitalism and that exhortations by the West to Asia to spend more and save less will only encourage a shift of bad behavior from one hemisphere to the other, leading to future failures of CG.

Market discipline

This is the idea that the market would punish egregious behavior, for which there was some evidence already discussed earlier in the chapter. Companies that are badly governed will attract fewer investors; have to pay a higher premium in terms of ROE for the investors they do attract; and could be subject to hostile takeovers by companies that are better managed. That, at least, was the theory. In practice this has not happened as often as theory predicted, and it certainly did not happen in markets that were not liquid and that had concentrated ownership structures, making it difficult for raiders to buy enough shares to change the management.

So the Anglo-Saxon model did not quite work the way it was supposed to in markets with dispersed ownership; and it certainly did not work the way it was supposed to in markets with concentrated ownership because the majority shareholders could do what they wanted at the expense of minorities.[24] While CG is a critical issue in markets where there is neither liquidity nor dispersed ownership, these very factors make it extremely difficult for independent directors on boards to fulfill their roles as expected in the Anglo-Saxon codes.

The structure of many Asian markets makes market discipline more problematic. Although Asian capital markets have changed from those of old, many of today's constituents still include closely held family firms, which in certain instances and under certain circumstances can be seen to act as though there are no conflicts of interest between their objectives as owners and their goals as managers. However, a more recent development is the emergence of state-owned or -influenced entities and public-listed companies where the managers and the owners may have differing priorities and objectives.

Each of these situations poses a different set of CG challenges to the owners, investors, regulators, and managers involved.

Family-owned public-listed companies affect market discipline . . .

Once owner-entrepreneurs or partners, for that matter, have decided to go to the market to access capital, divergence between the objectives of the dominant shareholder (the former owner or owner's family) and those of the other shareholders—minority shareholders—often arise.

In these circumstances, some former owner-entrepreneurs have at times continued operating as if nothing had changed. On occasion, owners have undertaken transactions of which the other investors had no knowledge; sometimes, those transactions were simply not what the new investors had put their money into the enterprise for. At other times, related party transactions moved money raised by public listings into private hands—and this was clearly not what the new investors had bought into.

. . . So does "National Service" in government-related entities

CG priorities become less clear-cut in countries where government-linked entities or enterprises in which the government has a serious stake are required to do "national service," investing in projects of perhaps weak financial viability, but of importance either politically or as part of a nation-building agenda.

In 2003, South Korean banks appear to have been "requested" by the government to assist with the restructuring of the banking industry without due regard for the best interests of their shareholders, on grounds that "national service" required them to do so. For example, when there was a credit-card liquidity crisis, Kookmin Bank "volunteered" to buy credit-card debt—a move believed to be the result of government pressure, and not the best solution for generating shareholder value.[25]

The prolonged saga of the Hynix restructuring in 2003 is another one that only makes sense when seen in terms of "national service" (see Appendix A). The difficulties faced in resolving the SK Global crisis, where creditors automatically assumed it was the duty of SK Corp and SK Telecom to provide financial assistance, shows how much there is a traditional expectation that the South Korean *chaebols* will come to the help of distressed sibling organizations—regardless of whether such an action is in the interests of their shareholders.

Among these conflicts of interest in the web of cross-holdings and non-transparency, there are signs that change is on the way. When the SK saga resurfaced in June 2003, this time Kookmin Bank began to make discounted sales of SK Global stock in order to write off debt and disentangle itself from the problems surrounding this particular *chaebol* (see Appendix B).

Regulatory discipline

This is the set of rules and laws that are designed to help the functioning of the capital market so that it can be vibrant, efficient, and fair. The CG regulatory landscape has changed quite dramatically in the last 20 years, as can be seen by comparing Figure 1.1 and Figure 1.2. It is also clear that Asia has caught up with the developed capital markets, at least in terms of laws and codes.

Malaysia's journey in CG began with the introduction of the Malaysian Code in 1999, followed by the establishment of the Minority Shareholder Watchdog Group (MSWG) in 2000. In 2001, Bursa Malaysia (the stock exchange) revamped the listing requirements to include a specific section in the annual report on CG, requiring companies to comply with the Code or explain why they did not do so. In 2004, the securities laws were amended to incorporate whistle-blowing provisions and redress mechanisms for breaches in securities laws. This was followed in 2005 by Bank Negara Malaysia (the central bank) publishing "Guidelines on Corporate Governance for Licensed Institutions" dealing with banks and insurance companies and the introduction of the so-called Green Book by the Putrajaya Committee on GLC High Performance to upgrade the effectiveness of GLC Boards (discussed further in Chapter 3). In 2007, the Malaysian Code was revised as was the Companies Act to tighten up further on CG (the impact of the revised code is discussed in Chapter 4).

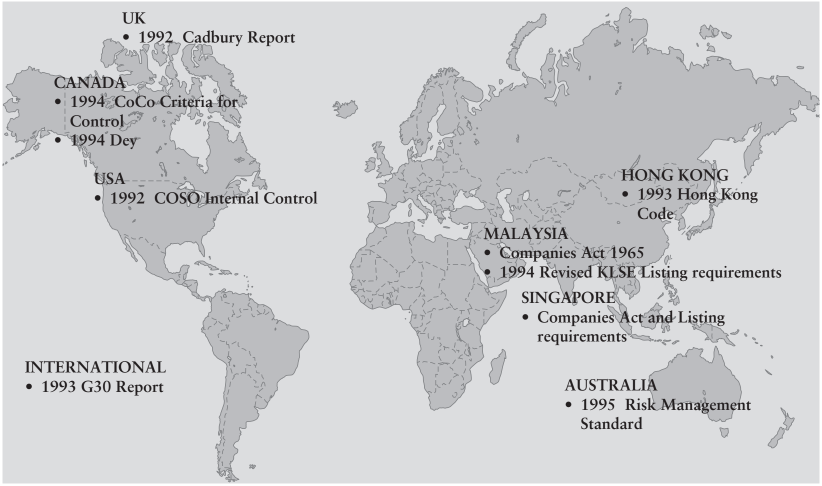

FIGURE 1.1 The evolving CG landscape
The global landscape less than 15 years ago
Source: SIDC-PWC Non-Executive Director Development Seminar: "Is it Worth the Risk?" (2009).

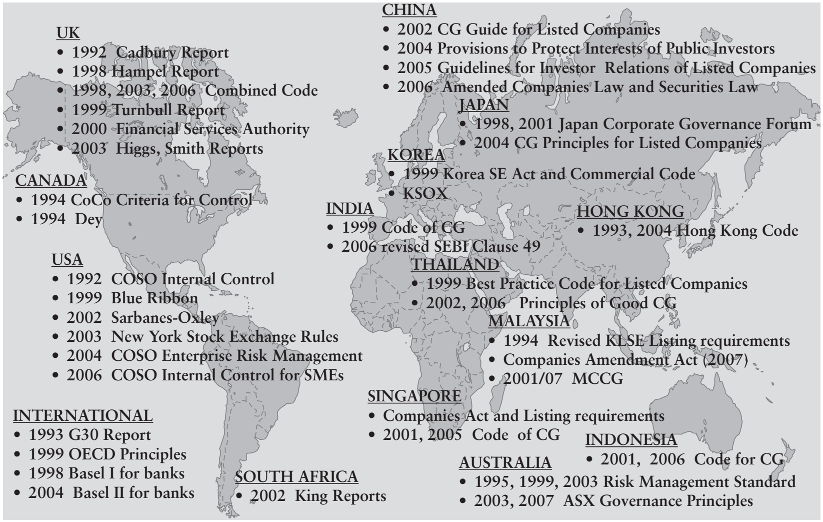

FIGURE 1.2 The evolving CG landscape
The global landscape in recent years
Source: SIDC-PWC Non-Executive Director Development Seminar: "Is it Worth the Risk?" (2009).

Enforcement in much of Asia is often another matter and that is because of a climate of ignorance or indifference regarding the seriousness of white-collar crimes. When the media lionize Nick Leeson or Jerome Kerviel it becomes difficult for junior magistrates and even circuit court judges to think that white-collar crime needs to be punished severely—after all, it appears to be a victimless crime. Added to that is the fact that white-collar crime is often very tricky to prove, and it becomes only too apparent that in many Asian jurisdictions, the penalties are not sufficient to deter; indeed, they are almost an invitation to commit the crime. This is a problem for the US and UK as well, though it must be said in the US's favor that people do go to jail, regardless of their social or political standing.

In Asia the predominance of partly listed family-owned businesses and government-linked entities creates a totally different context for a CG model to operate in. The quite different system of regulation and demands for transparency that apply in the Anglo-Saxon shareholder capitalist model would actually provide information to the competitors of the family firms, as well as reduce the family's or government's ability to run the company.[26] Figure 1.3 below shows the difference in the two contexts very clearly:

In Asia, Latin America, and much of Europe the model is about achieving and retaining control, rather than allowing the market to operate freely, through:

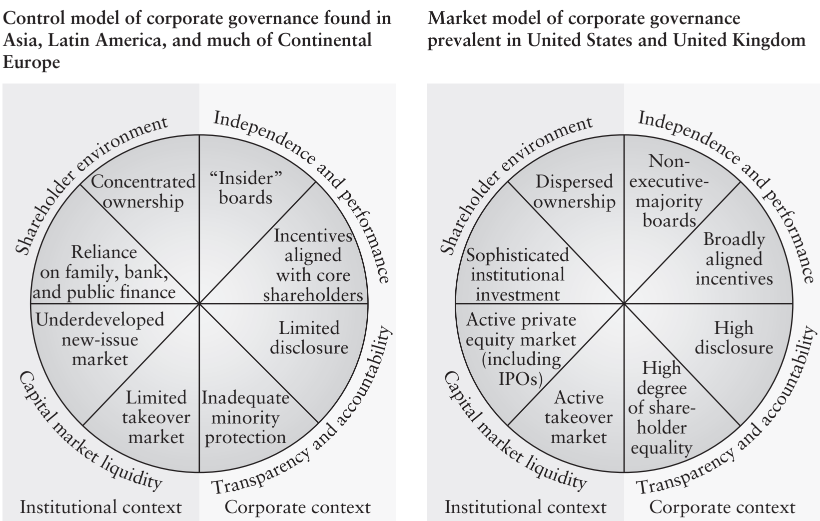

FIGURE 1.3 Two models, a world apart
Source: Coombes and Watson (2001) cited in Wallace and Zinkin (2005).

- Concentrated ownership and a reliance on family or bank finance (public or private), which determine the shareholder context.
- Boards with aligned incentives such that the board is dependent on the same outcomes as the controlling shareholders.
- Limited disclosure and inadequate minority protection.
- Illiquid capital markets with restricted takeover activities and an underdeveloped new-issue market.

This is different from the underlying assumptions operating in Anglo-Saxon stock markets where there are:

- Dispersed shareholdings and sophisticated institutional investors who look at the fundamentals rather than treating the market and its stocks as a way to make short-term profits (at least in theory, though some of the momentum trades by hedge funds are not that different from the syndicate manipulations of penny stocks in some Asian jurisdictions) to create a quite different shareholder environment—one where shareholders have equal rights and minority shareholders can expect to have some form of protection.
- A somewhat different role and structure for the board in order to do this—with non-executive, independent directors in the majority, and the incentives of board members not so closely aligned with those of the dominant or controlling shareholder (if there is one) but, rather, aligned with the interests of the absent owners represented by all holders of non-preferential shares—however few shares they actually hold.

As a result, in the Anglo-Saxon model, transparency and accountability are extremely important and shareholders are, in principle, expected to be treated equally and are also entitled to have access to a great deal of information, which could indeed aid competitors.

The Need to Localize CG to Meet Asian Conditions

In Asia, the fact that family firms or family interests are so important—more so than in the UK and the US—makes it difficult to argue that what is right in a highly liquid market with extremely dispersed ownership is correct for relatively illiquid markets with highly concentrated ownership structures and a greater dependence on family or bank finance rather than equity.

Even if family firms were not the only complicating factor, many Asian markets also have entities upon which the government can apply pressure in the interests of "national service" at the expense of individual shareholders. This is more serious because, in the case of many of these markets, the countries are young, and the governments believe they have a duty to build their nations through "pillar industries" and other forms of direction of capital to projects whose justification is not only economic. They are therefore unlikely to abandon the practice because they still see it as part of the nation-building agenda. In the past 30 years there was no such pressure in the UK or the US, though a developed country like France exhibits similar tendencies, and the US is now exhibiting many of the same behaviors as a result of the global financial crisis, with the bailouts of GM and Chrysler.

The importance attached to good CG depends on the time horizons of investors—which is, as mentioned earlier, a function of their assets, portfolios, and investment philosophies (whether they are growth or value investors). However, there are signs that things are changing for the better.[27] This message is reinforced by the recent research undertaken by CFO Research Services in collaboration with the ACCA in June 2006 on Corporate Governance, Business Ethics and the CFO. Their findings were as follows:

- CFOs acknowledge that a good ethical culture has become a requirement in business, as it affects the overall reputation and brand of the company. It improves relationships with banks, institutional investors, suppliers, and employees (p.5).
- However, implementing ethical codes is still a challenge in Asia, especially when they are dealing with smaller companies in less well-developed countries (p.6).[28] Part of this is the problem that so much of Asian business culture is "person-driven" rather than "process-driven" (p.16).[29] Relationships also matter more in Asia than in the West and this affects how business is done between companies, as is acknowledged by DuPont's CFO.[30] Whether we are talking about a large SME, Mulitex, or one of the leading multinationals, it would appear that global standards still need to be localized—with the attendant problems this can pose.
- Nevertheless, three-quarters of the 160 respondents say their companies have instituted written codes of ethics and 54 percent have systems in place for assessing adherence to their codes (p.17).
- The pressure for improvements does not come from institutional investors—only 6.8 percent of the respondents say they feel

pressure from investors above all else. Shareholders in Asia seem to be more interested in profit and dividends, or just simple growth prospects (p.23).[31]

- Surprisingly, Sarbanes–Oxley has made a difference, forcing companies to rethink their processes, and despite the high costs of compliance, 48 percent of the respondents thought it had a positive effect on the development of an ethical culture for all companies, regardless of whether they were listed in the US; 24 percent felt it only enabled those listed in the US to improve their ethical culture.

Finally there is the problem of the different expectations owners have of their independent non-executive directors (INEDs). Being an effective INED is hard, even in the UK, as has been recognized in the Higgs Report and now in the Walker Report.[32] It is that much harder in Asia, because the boardroom reality is different, as is shown in Table 1.1 below.

TABLE 1.1 Expectations Compared

Anglo-Saxon Expectations	Asian Expectations
1) To represent the interests of the owners (especially minority shareholders) the INED must be independent, for without independence the INED cannot be effective through the process of fearless, but constructive challenge.	1) In family-founded and -led companies, the families know better than minority shareholders where the best interests of the organization lie, so there is no need for INEDs who, in any case, do not understand the business, because they cannot give it the time and attention it requires.
a. Independence of thought guarantees effectiveness as it allows the INED to bring fresh insight to the Board, allowing the positions taken by the executives to be examined from a perspective that does not reflect vested interests.	a. INEDs do not have sufficient access to people to understand the determinants of decisions; and if they were to be granted the access, it would undermine the chain of command and mislead managers about lines of authority.
b. The process of challenge and scrutiny by the INED leads to better-informed decision-making and so raises the effectiveness of the organization.	b. Harmony is important and challenge may lead to conflict—something to be avoided in most Asian cultures—so, in practice, Asian INEDs will not challenge.

(*continued*)

TABLE 1.1 (*continued*)

Anglo-Saxon Expectations	Asian Expectations
c. Diversity of views and backgrounds serves to create a better debate of ideas and approaches put forward by the CEO.	c. Since the Asian crisis, organizations must react faster than before and do not have the luxury of time to debate ideas.
d. The INED's independence from the organization allows fundamental questioning of the organization's "ends" and the "executive limitations" placed on the CEO, because independence means that the INED has no stake in the shape of the organization or in choosing the beneficiaries it seeks to serve.	d. In "High Power Distance" cultures, people do not question their superiors, by virtue of their position rank and title. Thus even though the INED has the freedom to question, in practice this goes against cultural norms.
2) The presence of INEDs reminds the board that its fiduciary duty is to the shareholders as owners, hence the appointment of INEDs to chair the key committees of the board. Independence is essential if there is to be a system of checks and balances on executive power.	2) The best guarantors of the interests of the shareholders are the founding family, whose investment in the firm and commitment to the firm over the long term is greater than that of minority shareholders who are only interested in short-term performance.
3) To be effective, INEDs must	3) Effective INEDs are not independent.
a. Have access to information in a timely, accurate manner so that informed decisions can be made based on appropriate challenges of the assumptions made by the CEO.	a. The Higgs Report (2003) recognized that non-executive chairmen cannot be regarded as independent because they are so intimately linked to the organization—the same is true for INEDs.
b. Spend sufficient time on the organization's issues, so the number of boards they can sit on must be limited, and they must be involved in, and care about, the decisions taken by boards on which they sit.	b. For INEDs to spend the time and effort needed to be effective, they must be paid appropriately by the company. Once they are paid properly, and can only sit on a limited number of boards, they lose their independence.

Source: Non-Executive Director Development Series; directors training program run by SIDC and PWC for listed companies on the Malaysian stock exchange.

So can we really apply Anglo-Saxon codes of CG in Asia? Perhaps the best answer to this difficult question was given by Jaime Zobel de Ayala II, the seventh-generation president and CEO of Ayala Corporation in the Philippines, in an interview with McKinsey in 2002:

> In the West, the pendulum seems to swing between the model of the tightly controlled family company and that of the widely held public company. I feel strongly that between these two extremes lies the most sustainable model. There is an ever-increasing tension between the institutional investors' focus on quarterly results and the need for long-term strategy and stability. Widely held public companies are seeing a dramatic rise in their CEO turnover, often because there is no single large institution willing to tell the CEO, "Look, hang in there. Let's agree on our long-term strategy. Even if it takes a short-term hit, you know we'll back you up." . . . What we try to do at Ayala is to structure partnerships that can agree on a long-term vision and to provide stability at the board level. By going public at the same time, we get the dynamic tension from the outside institutional-investor community to deliver financial returns over the short to medium term.[33]

Conclusion

Clearly there are grounds for some optimism. The regulatory infrastructure is becoming ever more supportive of good CG. Increasingly, countries have to worry about the "beauty parades" conducted by external consultancies and analysts on the state of CG in each market. CG and ESG[34] indices are being developed in country after country, and there is a steadily increasing demand by both boards and regulators for training in what makes for a high-performance board.

However, this does not mean that what works in the US and UK should be adopted in its entirety in Asia. The structural and cultural conditions of each market must be taken into account, as must the social and political context in which business operates. If countries have government-linked companies listed on the stock exchange, and if the reality is that families dominate that which is not government-linked, then the dynamics of the board are going to be different from what can be expected in New York or London. This makes implementing good CG more complicated, but not impossible.

Endnotes

1 "If the position of stockholders cannot be well protected by contract, then how is it made viable? There are two mechanisms in particular that serve this function. One is the law: rules that require managers

(agents) to act in the best interests of stockholders (principals). *The other is governance: a set of provisions that enable the stockholders by exercising voting power to compel those in operating control of the firm to respect their interests.* Legal rules can best address relatively clear conflicts of interests; *managerial competence, except in occasional cases such as Enron and Parmalat, falls in the domain of governance.*" [emphasis added] From Scott, K. 2002, "Agency Costs and Corporate Governance" in *The New Palgrave Dictionary of Economics and the Law*, London: Palgrave Macmillan: 26–7, cited in Wallace P. and Zinkin, J. 2005, *Corporate Governance*, John Wiley & Sons (Asia): Singapore: 2–3.

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8 Gompers, Ishii and Metrick, op. cit.

9 Ibid.: 110.

10 Ibid.: 120.

11 Ibid.: 131.

12 Ibid.: 132.
13 Ibid.: 134.
14 Drobetz, Schillhofer and Zimmermann, op. cit.: 23–32.
15 Rather, with adequate disclosure and transparency standards in place, it is ultimately the capital market which rewards good governance practices (high CGRs) and punishes bad ones (low CGRs). To this end, corporate governance should be understood as an opportunity and not an obligation from a firm's perspective: "However, with governance being a more popular topic for the management and supervision of firms, we believe that professional investors will become more active in shareholder engagement programs in the future . . . this will ultimately lead to higher expected returns and lower valuations for those firms with governance deficits, since investors want to be compensated for their increased monitoring and second opinion activities. Similarly, by removing certain governance malfunctions, large investors are able to achieve a higher valuation for their assets, since the required return becomes lower."—Drobetz *et al.*: 32–3.
16 Banerjee, op. cit.
17 Felton, Hudnut and Van Heeckeren, op. cit.: 171.
18 Ibid.: 172.
19 This refers to the many cases in the Asia region such as the influence of the *chaebol* in South Korea but also the many complicated links that existed between the political and business spheres in Thailand, the Philippines, Indonesia and Malaysia. The GDP growth rate in the region in the five years leading up to the 1998 financial crisis was between 5 percent at the lowest, for the Philippines, and 9 percent at the highest, for Malaysia. In China, one of the main sources of CG scandals has been the banking industry. Although graft and bad lending were supposed to be a thing of the past, as recently as May 2003, Liu Jinbao, Chief Executive of Bank of China, was detained on charges of corruption and illegal lending.
20 Patsuris, P. 2002, "The Corporate Scandal Sheet," Forbes, at: http://www.forbes.com/2002/07/25/accountingtracker.html, August 26.
21 Turner, A., 2010, "Household and unincorporated business borrowing from the banking and building society sectors grew from about 14 percent of GDP to 76 percent of GDP, while deposits grew also, but less dramatically from 39 percent to 72 percent . . . Thus the total balance sheet of the UK banking system, defined to include all legal banking entities operating in London, had by 2007 reached around 500 percent of GDP, compared with 34 percent in 1964. What do banks do, what should they do and what public policies are needed to ensure best results for the real economy." Lecture given on March 17, 2010 at the Cass Business School.

22 Weber, M., 1905, *The Protestant Ethic and the Spirit of Capitalism* (New York: Charles Scribner and Sons, 1958).

23 "In his book *Something for Nothing*, Jackson Lears describes two starkly different manifestations of the American dream, each intertwined with religious faith. The traditional Protestant hero is a self-made man. He is disciplined and hardworking, and believes that his 'success comes through careful cultivation of (implicitly Protestant) virtues in cooperation with a Providential plan.' The hero of the second American narrative is a kind of gambling man—a 'speculative confidence man,' Lears calls him, who prefers 'risky ventures in real estate,' and a more 'fluid, mobile democracy.' The self-made man imagines a coherent universe where earthly rewards match merits. The confidence man lives in a culture of chance, with 'grace as a kind of spiritual luck, a free gift from God.' The Gilded Age launched the myth of the self-made man, as the Rockefellers and other powerful men in the pews connected their wealth to their own virtue. In these boom-and-crash years, the more reckless alter ego dominates. In his book, Lears quotes a reverend named Jeffrey Black: 'The whole hope of a human being is that somehow, in spite of the things I've done wrong, there will be an episode when grace and fate shower down on me and an unearned blessing will come to me—that I'll be the one.'" Hanna Rosin, "Did Christianity Cause the Crash," *The Atlantic*, December 2009, at: http://www.theatlantic.com/doc/200912/rosin-prosperity-gospel?pid=ynews.

24 "Obviously, corporate governance is not a problem for the 100 percent-owner-manager of a business. Nor is it much of a problem for the majority stockholder (or group) which controls the Board of Directors and can fire the managers at any time. (Protection for minority interests in such a firm will have to come primarily from legal rights, since their voting power is generally ineffectual.) So CG is an issue mainly for minority stockholders, in a firm controlled by the managers where there are no significant stockholders that can easily work together. In that situation, the stockholders potentially can still exert control to protect their interests, but face formidable difficulties (in terms of transaction costs and inadequate incentives) in actually acting together." (Scott, 2002: 26–27), cited in Wallace and Zinkin 2005, op. cit.: 2–3.

25 A better choice would have been to privatize its 75 percent subsidiary Kookmin Credit Card. This move would have allowed Kookmin Credit Card to cut the costs of funding as a result of leveraging the parent's bigger balance sheet and better credit rating—to the benefit of the minority shareholders of both Kookmin Credit Card and the bank itself. Source: Credit Lyonnais Securities, 2003 Emerging Markets Corporate Governance Watch.

26 Coombes, P. and Watson, M. 2001, "Corporate Reform in the Developing World," *McKinsey Quarterly* 4, "Emerging Markets": 90.

27 "Perhaps most encouraging is the fact that a number of companies in Thailand are already following best practices in many areas of CG and have been rewarded by the market with higher valuations. Market incentives of this kind provide local benchmarks and encourage more companies to improve their CG practices once they come to the realization that good governance actually pays." Hoschka, T. C., Nast, G. R. and Villinger, R. 2002, "Better Boards in Thailand," *McKinsey Quarterly* 3: 23–6.

28 "Perhaps we need a two-tier system, with global standards in key ethical areas underscored by room for flexibility at the local level. Each country has its cultural values, its upbringing, and so it's very difficult to bring in a motherhood ethical governance system. A customized system could enable companies to project themselves internationally but keep customers and suppliers happy closer to home." Sriram, K., Group Manager of Internal Audit for Hong Kong Garment Trader Mulitex ("Corporate Governance, Business Ethics and the CFO": 6).

29 "Internal relationships matter even more. Sriram describes the culture at Mulitex as 'person-driven,' with an emphasis on one-to-one interaction. This he notes is at odds with the global push for process-driven governance. 'In a process-driven environment, what you learn on courses or from textbooks can really be put into practice,' he says. 'In a person-driven environment it's difficult to get into formal structures and compartmentalization.' The company's directors value loyalty of their staff, and are reluctant to make changes that smack of heavy-handedness."—Ibid.: 16.

30 "But if much has changed since 1863 [when DuPont began trading in gunpowder in China] some things remain the same. 'A lot of business is still done through relationships,' observes Daniel Leung, DuPont's regional finance director for Greater China. 'The giving and receiving of token gifts is an important part of the culture and generally seen as part of the relationship-building process.' . . . [T]o help staff negotiate tricky cross-cultural mores, policies on so-called 'business courtesies' are laid out in a 20-page Business Conduct Guide that is distributed in all 70 countries where the company operates . . . As Leung points out: 'A black and white approach is just not practical in China. While standards are global, you have to ensure that the local organization understand the standards in the context of the local environment.'"—Ibid.: 24.

31 "At least one CFO wasn't surprised. 'I just look at the recent IPO of the Bank of China in Hong Kong, a world record subscription,' he said. 'Many of the subscribers were institutional investors—Western mutual finds—even though the Western media have been vocal in their criticism of past wrongdoings at the BOC. How come people forgot all that?' But he also regards this as a form of myopia that may apply to

investors worldwide. 'To me this suggests that whether they are Asian or European or American, investors are really only interested in growth prospects.'"—Ibid.: 23.

32 Walker, D. 2009, "A review of corporate governance in UK banks and other financial industry entities," July 16, 2009.

33 Gibson, K. 2002, "A Case for the Family-Owned Conglomerate," *McKinsey Quarterly* 4: 133–4.

34 ESG = Environment, Sustainability, and Governance.