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## **Corporate Governance Statement**

By J. Mark Mobius

With the Enron disaster facing the United States (US) equity market, the US can no longer hold its head high and claim that it is the benchmark for corporate governance in emerging markets or any other markets, for that matter. The reality is that the problems of fraud, faulty audits, misleading accounts, lack of transparency, conflicts of interest, criminal destruction of records and a long list of other corporate governance violations, are not limited to emerging markets but are very much in evidence in developed markets as well. The defenders of governance in developed markets may say that at least in the developed markets the legal mechanisms are in place to bring violators to justice. However the reply to that contention would be that in the past penalties meted out were mild and the real losers, the small investors and pensioners, were not adequately compensated for the losses.

Given recent events, the importance of sound corporate governance is becoming increasingly apparent. The Asian Development Bank (ADB) has been promoting sound Corporate Governance practices in its investee enterprises and investment funds operations. International organizations like the OECD, the World Bank and the International Corporate Governance Network (ICGN), along with major fund managers, are also formulating sets of codes and principles that can be applied globally. It is also clear, however, that governments have generally done a poor job of policing the complex world of finance and that the greater part of the task will be left to self-policing on the part of the participants.

Templeton places the utmost importance on corporate governance practices. We believe that in order for a company to be successful, efforts must be made on this front. Our investment process places great emphasis on this area and we do not invest in companies that do not have sound corporate governance policies and respect shareholders' rights.

We believe that when a minority shareholder invests in a security, there should be an implied sense of commitment or a sense of trust. The investor should be able to invest freely without having to ponder upon whether his investment will one day disappear due to mismanagement, corruption or downright deception. We have seen many cases where minority investors have been burned, either due to the lack of corporate governance and shareholder protection or if rules and regulations do exist, enforcement is non-existent.

While we agree that emerging markets still have a long way to go, it is encouraging to note that many governments have begun to recognize the importance of good corporate governance standards. The reasons for the slow progress are quite complex. If one considers the entire movement for corporate governance, one can see that emerging markets are now at a stage where there is awareness of the concept but not effective implementation. To date, the focus has been on raising awareness but not on removing the inertia, which restricts the realization of sound practices. Reluctance or inability to do so is based on

some very complex reasons, which, if they are to overcome, need to be further explored.

The People's Republic of China (PRC) has clearly made substantial improvements in corporate governance. In the long-term, I would not be surprised if the PRC emerged as the leader in corporate governance in Asia. Though, it should be noted that the PRC has a low base when compared to its counterparts. The dominance of state-owned companies as opposed to family-owned companies has clearly worked in its favor, as it allows the government to accelerate corporate governance reforms. On the other hand, nations such as the Philippines, Thailand, Indonesia and Malaysia have yet to expedite efforts.

There is no doubt about it: sound corporate governance pays. Several studies undertaken by various organizations have shown that: a) Investors have greater confidence in companies that are responsible and b) good discipline and regarding shareholders views improves the companies' performance.

Good corporate governance brings with it monitored transparency and accountability that serve to govern those who control the company's affairs. This oversight creates a system whereby the managers are discouraged from mismanaging the company, be it though a lack of diligence or care, excessive spending (including their own remuneration packages), improper decision-making, or even intentioned unconscionable behavior. This deterrence clearly stems from the fact that the managers and their actions can be, and indeed are, scrutinized by a board of directors that serves all shareholders when their performance is poor.

Thus, it brings about better management and more prudent allocations of the company's resources; the combination of which goes towards enhancing corporate performance. The earnings from this enhanced performance, which contributes significantly to the company's share price, would increase the value of a shareholder's holdings. Hence, there could be a strong fundamental bond between good corporate governance and strong corporate performance. Needless to say, for these reasons, good corporate governance can also lead to increases in the demand for, and price of, company shares.

One study that appears to support this was made in 1994 by the pension consultant Wilshire Associates. This study was undertaken for the California pension organization, CALPERS, which is well known for its active corporate governance policies in the US. The Wilshire Associates study focused on the effects of the pension fund's investments in 62 companies that had, in the five years prior to the making of the investments, lagged the S&P 500 index by an average of 85%. Five years after the pension fund had invested in these companies and influenced their management with their shareholder activism for corporate governance, the share price of those same companies outperformed the same S&P 500 index by an average of 33%. CALPERS has since estimated that the improvement in those 62 companies led to about US\$150 million in added returns.

This causal relationship between good governance and strong corporate performance works to increase the attractiveness of investing in a company as illustrated by rising share prices. In fact, when a company's management is known to be better than its peers in its accountability to minority shareholders and in its competence (to deliver good earnings & returns for shareholders), a premium for that company's stock often develops.

To improve corporate governance practices, we believe that both governments and corporates need to work together to ensure the implementation of the following:

- A change in attitude by governments and their officials to one of activity rather than apathy. Governments need to realize that the flow of foreign funds will not continue unless the promised reforms are made and continue to be made. Officials, on the other hand, need to be prepared to confront local business leaders to enforce the rights of all shareholders.
- Full and complete disclosure of all corporate activity, which impact the value of shareholders' equity.
- The establishment of *equal rights for all shareholders*. This includes the right to engage in preemptive buying and to be allowed to voice our opinion and vote on major issues regarding the dealings of the company.
- Once given, the rights of all shareholders need to be enforced rigorously. This means giving the regulatory bodies the teeth to administer commensurate punishment for violators of those rights and adequate compensation for the losses incurred.

As fund managers we face a particularly difficult challenge because very often we will face the dilemma of taking actions on behalf of our own clients which could be detrimental to other investors. For this reason, industry-wide regulation is needed which will provide a level playing field for all.