CORPORATE GOVERNANCE IN ASIA

Recent Evidence from Indonesia, Republic of Korea, Malaysia, and Thailand

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Contents

Preface ..... **vii**

Executive Summary **1**

1. Introduction **5**

2. Corporate Governance Reform in Asia **11**
- Key Corporate Governance Problems and Trends in Regulatory Reform 11
- Role of Shareholders in Corporate Governance 15
- Effectiveness of Boards of Directors 32
- Role of Banks and Reform of Bankruptcy Proceedings 38
- Remaining Challenges 41

3. Questionnaire Survey of Corporate Governance Practices **45**
- Objectives and Nature of the Survey 45
- Sample Firms and Respondents 47

4. Evaluation of Shareholders' Rights and Effectiveness of Boards of Directors **55**
- Shareholders' Rights and Disclosure of Information 55
- Effectiveness of Boards of Directors 60
- Survey Results 64

5. Linkage Between the Quality of Corporate Governance and Firm Performance **89**
- Existing Evidence 90
- Scoring Corporate Governance Practices 94
- Analytical Framework 111
- Regression Results 113

6. Potential Role of Stakeholders 127
Underlying Forces Shaping Corporate Governance 127
Role of Stakeholders 131
Survey Results 137
Analyses 158

7. Conclusion 167

Appendixes 173
A. Survey Questions 173
B. Scoring Corporate Governance Practices and Opinions 190

References 193

Tables

1. Shareholder Rights and Equitable Treatment of Shareholders: Regulatory Frameworks 17
2. Corporate Board of Directors: Regulatory Frameworks 34
3. Field Survey Sample Size by Country 50
4. General Information on Respondent Firms 51
5. General Information Provided by Respondent Directors 53
6. Shareholder Rights and Disclosure of Information: Factual Information 66
7. Effectiveness of the Board of Directors: Factual Information 72
8. Effectiveness of the Board of Directors: Opinion Survey 78
9. Corporate Governance Score by Country 98
10. Distribution of Corporate Governance Score by Subcategory and Country 99
11. Distribution of Firm Performance and Corporate Governance Scores 103
12. Correlation Coefficients among Major Variables 104
13. Corporate Governance Scores (CGS) by Ownership and CEO Type 107
14. Average Values of Key Variables by Country and Industry 109
15. Corporate Governance Score (CGS) and Tobin's q 110

16. Regression Results for Corporate Governance Scores 114
17. Regression for Tobin's q: Basic Equations 116
18. Regression for Tobin's q: With Weighted Average Overall Corporate Governance Scores 118
19. Regression for Tobin's q: With Separate Corporate Governance Scores for Firms Controlled by Single Domestic Owner and Other Firms 120
20. Regression for Tobin's q: With Country-Specific Corporate Governance Scores 121
21. Regression for ROA 123
22. Regression for Firm Performance by Country 124
23. Potential Role of Stakeholders in Corporate Governance: Opinion Survey 138
24. Human Resources and Employee Involvement Practices: Factual Information 152
25. Regression for Tobin's q: With Employee Participation Variables . 157
26. Firms Appreciating the Corporate Governance Role of Banks 160
27. JLMC Incidence and Corporate Governance Role of Employees .. 164

Figures

1. Corporate Governance Score by Country 100
2. Distribution of Corporate Governance Scores: Shareholder Rights vs. Board Effectiveness 101
3. Relationship between Scores for Board Effectiveness 102
4. Corporate Governance Scores by Ownership and Control Pattern . 108

Preface

Corporate governance has been one of the key research areas at the Asian Development Bank Institute since its establishment in late 1997 in the belief that the Asian financial crisis was to a large extent attributable to poor corporate governance. This study covering Indonesia, Republic of Korea, Malaysia, and Thailand is based on an extensive questionnaire survey of companies listed on their countries' stock exchanges and on a review of relevant regulatory frameworks. Micro-level surveys are indispensable for a good understanding of actual corporate practices rather than of rules and regulations that may not be followed in practice.

The survey has two main elements: shareholders' rights and information disclosure and the effectiveness of boards of directors. Corporate secretaries responded to the questionnaire for the first element, while for the second element, corporate secretaries responded in relation to factual information and executive directors and independent directors were asked to provide opinions. The opinion survey was useful for gaining a deeper understanding of observed behavior and respondents' perceptions.

In each country, a collaborating institution conducted the survey: the Forum for Corporate Governance in Indonesia, the KDI (Korea Development Institute) School of Public Policy and Management, the Malaysian Institute of Corporate Governance, and the Thai Institute of Directors.

We hope our study will be a good reference for further efforts aimed at enhancing corporate governance in Asian countries.

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Executive Summary

Poor corporate governance is widely viewed as one of the structural weaknesses that were responsible for the outbreak of the 1997 Asian crisis. In companies controlled by family owners, these owners could pursue their private interests relatively easily and often at the expense of minority shareholders and firms' profits. Postcrisis policy packages have given high priority to putting sound regulatory frameworks in place; however, some critics believe that the reform measures, which are based largely on the Anglo-American model, are likely to be cosmetic because of the concentrated ownership structure and the embedded institutional and sociocultural norms in local economies. In addition, little convincing evidence has been provided about the beneficial effect of good corporate governance on firms' values and performance in these economies. Many observers suggest that, in the Asian culture, stakeholders other than shareholders, especially employees and creditor banks, can also play a useful role in corporate governance.

To address these questions, we conducted a firm-level questionnaire survey in four countries particularly hard hit by the Asian crisis: Indonesia, Republic of Korea (henceforth referred to as Korea), Malaysia, and Thailand. The sample firms consist of 307 companies listed on their countries' stock exchanges, most of which are in seven selected industries. In addition to factual information obtained from these firms, 596 directors or commissioners (286 executive directors and 310 independent directors mostly from the sample firms) participated in an opinion survey.

The firms in these countries are doing relatively well in allowing shareholders to participate in decisionmaking and to exercise other shareholders' rights. Minority shareholders, however, seem to encounter difficulties in calling special shareholders' meetings, putting issues on the agenda of a shareholders'

meeting, or voting by mail and are inadequately protected with priority subscription rights, rights to approve major related-party transactions, and dissenters' rights. Moreover, they play a small role in the election of directors and suffer from poor information disclosure and transparency.

Board sizes vary significantly among the sample countries, with the median being 12 in Thailand, 8-10 in Malaysia, 6-7 in Korea, and 4 in Indonesia. The share of independent directors or commissioners on boards is typically between 25% and 50%. Unlike in Korean firms, the chief executive officer (CEO) position and board chairmanship are separated in more than 80% of Malaysian and Thai firms, and also in all Indonesian firms because of their two-tier board system. The true independence of independent directors is somewhat doubtful, especially in Korea, most likely because the CEO or controlling owner effectively selects directors and not because of personal relationships or behavioral norms. In all four countries, boards are relatively weak at selecting, monitoring, and replacing CEOs; reviewing the remuneration of key executives and directors; and supporting outside directors by providing necessary information, access to outside professional services, education, and so on, so that they can contribute effectively to the boards' work.

Creditor banks and employees have strong incentives to monitor the firms they lend to or work for, as well as certain comparative advantages in doing so. Corporate directors and commissioners in the countries surveyed seem to be relatively sympathetic with the roles of such broader stakeholders. Roughly 60% of corporate directors and commissioners in each country strongly agree that one of the goals of a corporation is to enhance the well-being of various stakeholders in addition to making profits for shareholders. They also tend to acknowledge the potential corporate governance role of stakeholders.

Banks have certainly strengthened the monitoring of their corporate clients since the Asian crisis. Companies are interested in having a close, long-term relationship with their creditor banks, particularly in Indonesia and Thailand, in expectation of better access to credit, mitigation of temporary liquidity shortages, and avoidance of premature liquidation in cases of serious financial distress. The prevalence of joint labor-management committees—probably the most promising channel for employee participation—is relatively high: 84% in Korea, 73% in Indonesia, and 20-30% in Malaysia and Thailand. However, these committees seem to play only a limited role in relation to corporate governance, because they are largely preoccupied with labor-related

issues. Nevertheless, there seems to be substantial potential for a governance role by employees in the future, given their high level of education, their relatively long tenure, and the existence of widespread mechanisms for facilitating an enhanced role by employees.

Corporate governance scores based on the factual information collected by the survey show that Malaysian firms are doing much better than firms in the other three countries, particularly in terms of board effectiveness. The scores are worst for Korean firms, followed by Indonesian firms. Corporate governance appears to be better in larger firms, and a more effective board of directors was observed in firms that are substantially foreign owned or have professional managers as their CEOs. Firms with relatively more nonfixed capital and those affiliated with a business group also tend to be associated with high corporate governance scores, probably resulting from attempts to mitigate associated high information asymmetry.

The survey results show that corporate governance, particularly board effectiveness, matters greatly in Indonesia and Korea, where the quality of governance is generally poor. Little such evidence could be found for Malaysian and Thai firms. Our analysis based on sample firms from Indonesia, Korea, and Thailand (the Malaysian sample was somewhat incongruous with the other samples) suggests the following. First, gains from better corporate governance in terms of market valuation are substantial. Improving the scores for board effectiveness or overall corporate governance practices from the median to the highest 25% is associated with a 13-15% increase in firms' market value. Second, the market seems to discount the quality of corporate governance by about 30% in the case of firms controlled by a single, domestic owner, probably because it suspects expropriation of minority shareholders. Third, corporate governance matters more in countries where the legal and judicial systems to protect investors are weak. Finally, among the various components of corporate governance practices, the most significant seems to be information access and other support for (and evaluation of) directors. However, the components of corporate governance practices that a market focuses on appear to differ from one country to another.

The foregoing findings indicate that the Anglo-American corporate governance model works. Even though the firms in the four crisis-hit countries are far from embracing the model in a wholehearted way, their markets obviously discriminate among firms according to the model's standards, indicating that

firms will move toward meeting more of those standards. That does not necessarily imply that stakeholders other than shareholders have no role to play, although they play but a small role at present; however, the stakeholder model is likely to be a complement rather than an alternative to the Anglo-American shareholder model.[†]

† The authors are grateful to John Weiss, the anonymous referee, and participants at the workshop on 9 June 2003 and the seminar on 10 November 2003 for their valuable comments. They also appreciate the generous contributions of Takao Kato and the excellent research assistance of Norimichi Goishi.

1 *Introduction*

In Asian countries, particularly newly industrializing economies, more attention needs to be paid to the corporate governance problem arising from the separation of control from ownership. With most large corporations owned and controlled by families and with family members holding key managerial positions, however, the major agency problem exists not between the management and owners in general, but between the management (the controlling family) and minority shareholders. The existence of large shareholders may by itself not be a matter of concern, or may even be a blessing,[1] but the beneficial effect of large shareholders should be expected only when management is separated from ownership or when proper corporate governance mechanisms are in place so that outside shareholders can effectively check misbehavior by controlling owners. These conditions are generally not met in most Asian enterprises.[2] The agency problem between controlling and outside shareholders is potentially serious, particularly for large firms with many subsidiaries (Bertrand, Mehta, and Mullainathan 2000; Claessens and others 1999; Johnson and others 2000; Nam 2001a, 2001b; Patrick 2001).

Poor corporate governance has been widely viewed as one of the structural weaknesses that were responsible for the onset of the 1997 Asian financial crisis. Family-controlled large businesses have indeed been inadequately

1. Many empirical studies show that firms with large shareholders tend to perform better, because they have a strong incentive to closely monitor their firms and are thus less likely to suffer from the free-rider problem (Jensen and Meckling 1976; Shleifer and Vishny 1986, 1997).

2. The fact that controlling owners are typically preoccupied with conducting the managerial function themselves may be due to the perceived agency problem when management is separated (with limited transparency and disclosure, poor rule of law, and poor corporate governance) or to any potential rents expected from the managerial function.

supervised or monitored by outside shareholders, boards of directors, creditor banks, or markets for corporate control. Corporate management has lacked transparency because of inadequate accounting and disclosure standards. In managing their firms and business groups, controlling family owners have been able to pursue their private interests relatively easily, often at the expense of minority shareholders and their firms' profits. Even though economic growth in some of the crisis-hit Asian countries rebounded strongly despite seemingly limited progress in improving corporate governance, this should not be taken as evidence that corporate governance matters little. Without strengthening corporate governance, economic growth is unlikely to be sustainable and may be vulnerable to another crisis in the future.

Understandably, postcrisis policy packages have given high priority to corporate governance reform. Major regulatory changes in the crisis-hit Asian countries have already been extensively documented and discussed (ADB 2000, 2001).[3] Reform measures have included improving specific governance mechanisms both within corporations and in external markets; strengthening the rights of small shareholders by making it easier for them to exercise such rights, for example, initiating litigation against board members and requesting inspections of account books; mandating that boards of companies listed on stock exchanges have a minimum number of outside or independent directors; and simplifying procedures for mergers and acquisitions to foster a market for corporate control.

These and other reform efforts along the lines of the Anglo-American model will certainly help improve corporate governance in the crisis-hit Asian economies. Indeed, controlling families seem to be constrained in pursuing their private interests in the presence of outside directors and the increased risk of shareholder litigation in the case of a breach of fiduciary duties by directors. Additional efforts directed toward enhancing managerial transparency by improving accounting and auditing standards and strengthening disclosure requirements would provide a better environment for stronger corporate governance.

Nevertheless, many people doubt that these corporate governance reforms have been taking root in the crisis-hit economies. They are skeptical that the Anglo-

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3. In addition, the Organization for Economic Co-operation and Development (OECD) has held the Asian Roundtable on Corporate Governance annually since 1999 in collaboration with the World Bank.

American model will work in these economies, because its efficacy, which is based on the principle of shareholder sovereignty, is often questioned even in those countries where it originated. Critics observe that many of the changes introduced are cosmetic, because embedded institutional and sociocultural norms and values limit the effectiveness of the newly instituted mechanisms.

For instance, a board of directors chaired by the controlling owner-manager and consisting largely of either insiders or outsiders hand picked by the owner-manager is unlikely to challenge management proposals, especially in an Asian culture that discourages overt opposition to authority. Similarly, hostile takeovers are unlikely to emerge as an important mechanism for disciplining poor management given the extensive cross-shareholding among the subsidiaries of family-based business groups, heavy corporate dependence on borrowing, and the potentially strong opposition from labor. In addition, institutional investors are unlikely to play much of a role because of conflicts of interest in the case of private investment funds and limited investment by public investment funds.

Given this situation, some observers suggest that even though shareholders should have the strongest incentives to monitor their firms, other stakeholders, in particular, employees and creditor banks, can also play a role in corporate governance. These stakeholders have not been playing a meaningful role in corporate governance to date because of repressive labor practices or extensive government interference in banking operations. Nevertheless, as circumstances change so that employees' human capital becomes the most critical factor for corporate success, labor rights are further promoted, and banks are run more autonomously, they might have some role to play.

Despite significant efforts to put a regulatory framework for corporate governance in place in many Asian countries, in-depth investigation of corporate governance practices at the firm level and of their effects on firm performance is largely lacking. This study aims to fill this gap by means of a questionnaire survey in four countries strongly affected by the financial crisis of the late 1990s: Indonesia, Republic of Korea (henceforth referred to as Korea), Malaysia, and Thailand.

The survey had the following three broad objectives:

- Investigating corporate governance practices at the firm level in comparison with the relevant regulatory framework. For a deeper understanding of

corporate governance, the survey gathered both factual information and board members' opinions.

- Evaluating the relationship between corporate governance practices and firm performance. The corporate governance practices obtained from the survey were scored and analyzed to see whether the scores had any positive association with firm performance.

- Assessing the potential roles of stakeholders other than shareholders in corporate governance. This was based on factual information about corporate human resources and the opinions of corporate directors about the roles of employees and creditor banks.

Policymakers, securities and fair trade regulators, and stock exchanges should be interested in the survey's findings. If they are better informed about actual practices at the corporate level and how their country's practices compare with those of other countries, they will be better able to direct their own policymaking and regulatory efforts. Others who should be interested in the survey's findings include global, regional, and national agencies concerned with strengthening corporate governance and protecting shareholders and other stakeholders more effectively.

The survey's results indicate that the gap between the regulatory framework and formal corporate governance practices is probably not particularly large, but that a substantial gap exists between the regulatory framework and practices in substance or spirit. Larger gaps and variations are apparent in areas where regulations or guidelines are less demanding or enforcement is difficult, such as requirements pertaining to the provision of information to and support for directors and the functions and activities of the board or of board committees. For the sample firms as a whole, the evidence clearly shows that corporate governance matters. In evaluating the quality of firms' corporate governance, the market seems to differentiate largely on the basis of substance, discount for the observed quality of corporate governance for firms run by controlling families, and take into account good corporate governance in countries where the legal and judicial systems for investor protection are weak.

These findings suggest that the Anglo-American corporate governance model works. While firms in the four countries under review may be far from embracing the model in a wholehearted way, the market nevertheless discriminates among firms according to the standards of the model, indicating

that firms will move toward meeting more of these standards. However, that does not mean that other stakeholders have no role to play, although they play little of such a role at present. Corporate directors in the four countries tend to be rather sympathetic toward the interests of broader stakeholders and their participation in corporate decisionmaking. Given that a large proportion of workers in these countries are highly educated, long-term employees and that human capital is an increasingly critical factor for corporate success, the potential for a greater role for employees seems to be large.

This paper is set out as follows. Section 2 discusses regulatory reform efforts in relation to better corporate governance in the countries under study since the Asian crisis. Section 3 describes the survey together with some characteristics of the sample firms. Sections 4–6 present and discuss the survey's results as they relate to the three objectives cited earlier. Section 7 presents overall conclusions and policy implications.

2 *Corporate Governance Reform in Asia*

Indonesia, Korea, Malaysia, and Thailand, the four East Asian countries hard hit by the 1997 economic crisis, shared several common characteristics in varying degrees, such as the dominance of family-controlled conglomerates, the weak governance of companies affiliated with conglomerates, the close relationship between large conglomerates and banks, the poor governance of banks that led to large numbers of nonperforming loans, and the absence of mergers and acquisitions markets and of effective bankruptcy proceedings. To address these problems, starting in 1998, these countries have introduced an extensive set of reform measures.

This section briefly describes the most prominent corporate governance problems in the four countries and reviews the legal infrastructure reforms pertaining to corporate governance that have taken place in recent years. It also compares the current regulatory frameworks of the four countries regarding shareholder protection and boards of directors.

Key Corporate Governance Problems and Trends in Regulatory Reform

Consensus about what caused the financial and economic crisis that swept through Indonesia, Korea, Malaysia and Thailand in 1997 and 1998 is lacking; however, poor corporate governance was clearly one of the culprits. While several factors accounted for the poor corporate governance, the most important was the countries' failure to establish appropriate rules of the game for managing corporations that were built up with funds provided by multiple investors.

From the perspective of corporate governance, ownership and control by a single investor is the most efficient arrangement in the sense that there is no

agency problem, but such an ownership structure imposes limits on a firm's ultimate size. Thus in most cases, firms that seek to grow to realize the profit potential associated with economies of scale must attract multiple investors. Ownership by multiple investors presents agency problems that arise from the divergence of ownership and control. This can result in a serious loss of efficiency and in expropriation of shareholders who do not participate in management. Furthermore, when such expropriation and the consequent loss of firm value are expected, investors will be reluctant to invest their money in firms, making it difficult to set up firms that realize economies of scale.

Good corporate governance is needed to prevent the expropriation of shareholders by managers and to ensure the efficient management of a company that has multiple owners. It is also needed to attract the capital needed to pursue large and worthwhile projects. The four countries succeeded in building up many large firms that their countries needed for economic development funded by many economic agents; however, they failed to put in place a sound governance mechanism that could effectively solve the problems that arose from the divergence of ownership and control. In particular, Indonesia, Korea, and Thailand often allowed dominant shareholders to run firms as if they were sole shareholders. As a result, these countries frequently failed to maximize the potential gains realizable from establishing large firms. Their failure to install adequate collective decisionmaking processes in corporations frequently resulted in severe asset dissipation and even the total collapse of many large firms. In addition, firm size was limited by the lack of reliable governance mechanisms, because investors were reluctant to invest in large, potentially lucrative projects. Legal infrastructure to regulate corporate governance was incomplete and inadequate, leaving firms vulnerable to expropriation by managers and dominant shareholders. Furthermore, laws and regulations were not rigorously enforced, so that such expropriations were frequently ignored and were rarely penalized.

In more mature economies, inefficient operation and expropriation of firms by managers are unlikely to persist, because sooner or later, such firms will run into financial difficulties. Few banks would be willing to extend them credit, and creditors would also be able to file for bankruptcy proceedings, thereby threatening dominant shareholders or managers with the prospect of losing many of their shares or their control of the firms. Firms under inefficient management would also be subject to takeover threats in the markets for corporate control. However, such market forces were largely absent in

Indonesia, Korea, and Thailand. In these economies, banks and financial institutions operated under distorted governance structures themselves and kept on lending more money to financially troubled companies. Financial supervision was also weak and allowed banks' weak governance and inefficient loan decisions to continue. Bankruptcy proceedings were incomplete, did not function properly, and were not relied upon or extensively used by creditors or firms. Markets for corporate control were almost nonexistent. The combination of these deficiencies in their financial systems allowed inefficiencies of large firms to persist, as did the ownership and governance structure of large firms tightly controlled by a few families.

In all four of the countries under review, families controlled most large firms and many of these families had controlling interests in multiple firms. As a result, they had the incentives and means to divert resources from the companies under their control. In particular, they were in a position to use transactions between affiliated companies to divert resources from them. Indeed, investigators found that dominant shareholders were associated with most of the corporate governance problems in the crisis-affected Asian countries.

In Korea, the owners of *chaebol* (family-controlled business groups) were able to maintain control over a number of affiliated firms with relatively small equity stakes of their own by forcing the firms to acquire and maintain large shares in other affiliated firms, often by using funds those firms borrowed from financial institutions. These families had a strong incentive to expand the assets of the affiliated firms even if doing so would have lowered the firms' profitability as long as they could maintain control rights. Transfer of control was unlikely unless all affiliated firms simultaneously encountered serious financial difficulties, and even then, bankruptcy proceedings or markets for corporate control did not work.

Expropriation by dominant shareholders was also the most crucial source of governance problems in companies in the other three countries, but the incentives of dominant shareholders of large companies to divert money from their companies were weaker than the incentives of dominant shareholders of *chaebol* firms in Korea for two reasons. First, the gap between control rights and cash flow rights was much smaller than in Korea. Second, the companies in these three countries had lower debt-equity ratios than their counterparts in Korea.

All four countries introduced wide-ranging reform measures to address the various problems. They reformed bankruptcy proceedings and financial supervision and opened up stock markets to foreign investors, thereby subjecting corporations to tighter market discipline. Most important, they made fundamental changes to the laws and regulations governing corporations' collective decisionmaking processes with the aim of bringing such processes more in line with the maximization of firm value.

Of the four countries, Korea has instituted the most sweeping changes, whereas Indonesia and Thailand seem to have implemented reforms of their legal infrastructure more gradually. Korea's more sweeping changes are understandable given the large divergence between cash flow rights and dominant shareholders' control rights, as well as the huge number of nonperforming loans accumulated in the country's banking system. Thus Korea had the strongest motives to reform its corporate governance system. Malaysia, by contrast, had a relatively sound system of corporate governance before 1997 and fell victim to a milder crisis. Consequently, it did not attempt drastic changes of its regulatory framework and has recently been focusing more on effective disclosure requirements. The areas in which these economies introduced extensive reform measures include

- Improving the quality of information that management is required to provide to shareholders and the general public
- Enhancing minority shareholders' participation in corporate decisionmaking
- Making boards of directors more effective and more independent of management
- Reducing the likelihood of related-party transactions that would hurt minority shareholders[4]
- Making banks more efficient and more responsible as lenders
- Reforming bankruptcy proceedings.

Many of the reform measures have focused on addressing the problems arising from the presence of dominant shareholders who control several affiliated firms. The countries have instituted measures to reduce dominant shareholders' ability to appoint directors and to instruct directors and managers to make

4. A related-party transaction is a transaction with someone who has a close, and possibly privileged, relationship with the company, including controlling owners or directors of the company, their immediate families, and other companies that they control.

decisions that promote their interests at the expense of the firm's interests or the interests of other shareholders. The countries have also strengthened regulations governing transactions between a firm and parties that are closely related to the firm's dominant shareholder. The remainder of this section reviews these reform measures in greater detail. Tables 1 and 2 compare regulatory frameworks governing shareholders' rights and equitable treatment of shareholders and frameworks pertaining to corporate boards of directors in the four countries.

Role of Shareholders in Corporate Governance

One crucial cause of the poor performance of many corporations in East Asia was the inability to prevent dominant shareholders from making key decisions single-handedly. Consequently, reform efforts emphasized giving greater decisionmaking power to other shareholders. Laws and regulations were amended to facilitate the participation of minority shareholders in decisionmaking on important issues and to force managers to provide more accurate information to shareholders so that they could make better decisions. Furthermore, reform measures enabled shareholders to seek stronger remedies when their rights were violated. The following subsections summarize key reform measures in each of the four countries and compare their legal infrastructure.

Right to Vote

Shareholders' rights to attend general shareholders' meetings and cast votes on various agenda items were reasonably well protected in the four countries even before the economic crisis. Shareholders were notified of shareholders' meetings in advance and faced few problems in attending the meetings and casting their votes. Proxy voting was generally allowed. In all four countries, shareholders now have the right to vote on the following items: appointing and removing directors and auditors, authorizing and issuing share capital, amending the company's articles of association, engaging in major corporate transactions, and entering into transactions with related parties.

Even though few institutional barriers stood in the way of shareholder participation in decisionmaking on key issues before the economic crisis, few minority shareholders participated actively in decisionmaking before 1997, because their incentives to attend general shareholders' meetings and exercise

their rights were weak. This free-rider problem facing minority shareholders is universal and is not unique to these Asian countries.

After the crisis, Korea attempted to reduce shareholders' costs of participating in the decisionmaking process by allowing voting by mail, and shareholders can now cast their votes on the agenda items of shareholders' meetings by mail if their companies adopt the new voting system. The other three countries do not yet allow voting by mail. Whereas voting by mail can be effective in reducing the free-rider problem small shareholders face, many firms in Korea have not actually implemented the new voting system, thus voting by mail has not yet had a noticeable effect, but perhaps it will do so as corporate governance reforms proceed further and the practice becomes more widespread. None of the four countries allow telephone voting, but discussions about voting using the Internet or telephones are under way. It appears to be only a matter of time before firms permit shareholders to vote in various ways without actually attending shareholders' meetings, thereby further protecting shareholders' voting rights.

Election and Removal of Directors and Cumulative Voting

The right to vote for directors is one of the most important shareholders' rights, as directors actually make most key business decisions on behalf of shareholders. In the four countries studied, before 1997, the dominant shareholders of most corporations could appoint virtually 100% of directors even though their own shares were usually far less than 100%. While divergence between cash flow rights and the right to appoint directors can be seen in most large corporations around the world and is not unique to Asian countries, the four countries paid special attention to the appointment of directors who are independent of dominant shareholders for good reasons. Dominant shareholders in the four countries control managers in their companies more tightly than their counterparts in more advanced countries, based upon their ownership or control of the majority of voting shares. In addition, law enforcement is still much weaker in the East Asian countries than in more advanced Western countries. Consequently, the presence of directors whose incentives are not aligned with those of dominant shareholders and who can monitor and participate in decisionmaking became important.

The gap between cash flow rights and the right to appoint directors was widest in Korea. A complete set of data on the ownership structure of large companies

Table 1
Shareholder Rights and Equitable Treatment of Shareholders: Regulatory Frameworks

	Thailand	**Malaysia**	**Korea**	**Indonesia**
Effective participation of shareholders in decision-making (for exchange-listed firms)				
Days of advance notice for shareholders' meeting	7 days; 14 days for some issues: ESOP, discounted securities offering, delisting, etc.	21 days for AGM; 14/21 days for EGM	14 days	28 days for announcement; 14 days for invitation
Thresholds for requesting an extraordinary shareholders' meeting	20% of issued shares; or 25 shareholders holding 10% of issued shares or more	10% of voting rights	3% of voting rights	10% of voting rights
Thresholds for placing items on the shareholders' meeting agenda	1/3 of issued shares	5% of total voting rights; or 100 shareholders each holding more than RM500 (US$130)	1% holding for six months (0.5% for large firms)	10% of voting rights
Can shareholders vote by mail?	No	No	Yes, allowed by law	No
Any other major impediments to effective participation in shareholders' meeting?	Nothing particular	Nothing particular	Filibustering (in favor of the company)	Shareholders' domicile spread throughout wide regions
How active are institutional investors or minority shareholder protection groups?	Weak, but growing: Investors Association, and Institutional Investors Alliance, established in 1989 & 2002, respectively	Growing activities of a few government-related agencies including the Minority Shareholders Watchdog Group	Fairly active: Peoples Solidarity for Participatory Democracy being most prominent	Fairly weak, but growing

Table 1 cont.

	Thailand	Malaysia	Korea	Indonesia
Election of directors and other rights of shareholders				
Is cumulative voting for the election of directors allowed?	Yes, but mostly opted out by articles of association	No	Yes, but mostly opted out by articles of association	Yes, but usually not acknowledged in corporate articles of association
Approving appointment of directors and auditors	50% majority voting rights of attending shareholders	50%+ majority share-holders present (in cases of show of hands) 50%+ majority votes (in cases of poll)	50% majority voting rights of attending shareholders, and 25% of total equity	No regulation by Corporate Law, but most firms apply a 50% majority vote (of attending shareholders) rule for directors. Shareholders usually authorize directors and commissioners to appoint auditors.
Approving removal of directors	75% of attending shareholders, and 50% of shares held by all attending shareholders	50%+ majority votes with 28 days notice	2/3 majority voting rights of attending shareholders, and 1/3 of total equity	Attended by shareholders with at least 2/3 of total voting rights, and 2/3 majority votes
Approving removal of auditors	50% majority voting rights of attending shareholders	50%+ majority votes with 28 days notice	2/3 majority voting rights of attending shareholders, and 1/3 of total equity	No regulation by Corporate Law, but most firms apply a 50% majority vote rule.
Can shareholders inspect the firm's account books or	Yes, by any shareholder	No	Yes, for shareholders owning 1% of shares (for account books) or 3% of	Yes, when proposed by at least 10% of shareholders with voting rights

corporate affairs and property?			shares (for corporate affairs and property)	
Approving amendment of founding documents (articles of association)	75% majority voting rights of attending shareholders	75% majority share-holders present (in cases of show of hands) 75% majority voting rights (in cases of poll)	2/3 majority voting rights of attending shareholders, and 1/3 of total equity	Attended by shareholders with at least 2/3 of total voting rights, and 2/3 majority votes
Approval of major corporate transactions such as a merger, and major sale/acquisition of assets	75% majority voting rights of attending shareholders (if the acquisition/disposal exceeds 50% of total assets)	Yes, if the transaction exceeds 25% of net tangible assets (net profits, equity shares issued, or cost of investment, etc.): 50%+ majority votes	2/3 majority voting rights of attending shareholders, and 1/3 of total equity	Attended by shareholders with at least 75% of total voting rights, and 75% majority votes
What self-dealing or related-party transactions must be approved by shareholders or disclosed?	Approval: transactions exceeding 10 million Baht or 3% of net tangible assets: 75% majority voting rights Disclosure: those exceeding 1 million baht or 0.03% of net tangible assets	Approval: those above 5% of net tangible assets (net profits, equity shares issued, or cost of investment, etc.) threshold: 50%+ majority votes Disclosure: all related-party transactions	Approval: grant of stock options (related-party transactions not subject to shareholder approval) Disclosure: those exceeding 1% of total sales/assets, or cumulatively exceeding 5% with the same person	Approval and disclosure: those amounting to at least 10% of corporate revenue or 20% of equity; and those involving conflicts of interest for a director, commissioner or principal shareholder
Approval of remuneration of board members	2/3 majority voting rights of attending shareholders	Only required for directors' fees: 50%+ majority votes	Usually only the ceiling (50% majority voting rights of attending shareholders, and 25% of total equity)	A 50% majority vote rule for most firms

Table 1 cont.

	Thailand	Malaysia	Korea	Indonesia
Do shareholders approve new share issues?	75% majority voting rights of attending shareholders	Yes: 50%+ majority votes	No: BOD resolution (within the authorized limit, whose change requires revision of articles of association)	Yes, 50% majority votes (of attending shareholders)
Are priority subscription rights given to existing shareholders for the issuance of common shares (or convertible bonds)?	Not guaranteed; company may have a choice when setting terms of new issues.	Yes, but the right may be denied by shareholder approval (50% + majority votes) for public issues or private placement.	Yes, but disapplication may be approved by 2/3 majority voting rights of attending shareholders, and 1/3 of total equity.	Yes, but it should be stated clearly in Articles of Association (AoA).
Threshold shares for requiring a mandatory tender offer for all shares	25%, 50%, 75% of total issued shares	33% of total issued shares	No mandatory bid requirement	25% of total issued shares
Are there any defenses against, or impediment to, takeover?	Nothing particular	Directors of target companies may issue circulars to advise shareholders to accept or reject takeover bid.	Strong labor unions of target companies	Mandatory tender offer; Law on Monopolistic Practices and Unfair Competition
Are dissenters' rights (or appraisal rights) of shareholders honored?	Yes, in case of a merger; shareholders also given a veto right on such issues as ESOP and discounted securities offering	No	Yes, in cases of a merger, consolidation, and sale or acquisition of whole business	Yes, in cases of AoA amendment; sale, guarantee, or exchange of substantial property; or mergers, consolidation or acquisition

Shareholder actions against directors for breaches of fiduciary duties (for exchange-listed firms)				
Maximum penalties for the offence of insider trading (civil liability and imprisonment)	Twice the acquired benefits; 2 years of imprisonment	10 years of imprisonment; RM1 million (RM3 million in cases of fraud or misleading disclosure)	Value of the shares purchased or sold; 10 years	10 years
Maximum administrative fine	No administrative fine	RM1 million	20 million won	15 billion rupiahs
Derivative suit	Yes, for those holding at least 5% of issued shares	No specific provisions	Yes, for those owning more than 0.01% of shares	Yes, for those owning at least 10% of shares
Class action suit	In progress (draft bill being reviewed by the Council of State)	No specific provisions	To be introduced from January 2005 for companies with assets of more than 2 trillion won	No specific provisions applied to securities transactions, accounting, disclosure, etc.
Petitioning (the court) for dismissal of directors	Yes; for those owning at least 5% of shares (requesting a court order)	Yes, for those with more than 5% of total voting rights; or 100 shareholders each holding more than RM500 (US$130)	Yes, for those owning more than 0.5% of shares	Yes, for those owning at least 10% of shares
Disclosure and transparency				
Who appoints external auditors?	Shareholders at AGM upon proposition by the Audit Committee	Shareholders upon nomination by the Board; The board in the case of filling casual vacancy	Shareholders upon recommendation of the Audit Committee or the External Auditor Recom-mendation Committee	Shareholders upon proposition by the Audit Committee

Table 1 cont.

	Thailand	**Malaysia**	**Korea**	**Indonesia**
Is there a maximum period for external auditors to serve for a company?	Only for banks: up to five years	No	Not currently; but a six year limit under review for introduction	Yes, 3 years for public accountants, and 5 years for public accounting firms
By when should audited annual reports be published after the end of the business year?	Within 110 days; 60 days for financial statements	Within 4 months	Within 90 days	Within 3 months
Maximum penalties for non-compliance with disclosure rules (annual, semi-annual, quarterly reporting; that of price-sensitive information, etc.)	100,000 baht plus 3,000 baht per day of contravention	RM1 million	Imprisonment 1 year, or 5M won fine; For false statement, 5 year imprisonment or 30M won fine	Imprisonment 3 years; administrative fine of 5 billion rupiahs

Note: For Malaysia, 50% + majority votes means 50% + 1 share majority votes.

in the four countries is not available; however, studies of ownership concentration in Asian companies generally show that it is highest in Indonesia, followed by Malaysia and Thailand, and is least concentrated in Korea. For instance, La Porta and others (1998) show that ownership concentration (average ownership by the three largest shareholders in the 10 largest non-financial private domestic firms in the mid-1990s) was 53% in Indonesia, 46% in Malaysia, 44% in Thailand, and 23% in Korea. Even though the monopoly of dominant shareholders over the appointment of directors was one of fundamental causes of poor corporate governance in these countries, it has not really been challenged and little has changed since the crisis. The reasons for this differ between Korea and the other three countries. In Indonesia, Malaysia, and Thailand, it is due to the large equity ownership by dominant shareholders. In Korea, it is the cross-shareholding by affiliated firms, which accounts for more than 40% of the shares of affiliated firms.

Indonesia, Korea, and Thailand introduced cumulative voting (defined in footnote 23) in an attempt to correct this asymmetry between cash flow rights and control rights. Cumulative voting can lead to improvements in the governance of a firm that has a dominant shareholder if the dominant shareholder agrees to its adoption. However, few firms in the three countries actually adopted cumulative voting even after legal reforms had made it possible, and it is unlikely to be adopted in companies in which dominant shareholders face the possibility of losing their power over the appointment of directors. In other words, cumulative voting is a good example of a reform measure that has the potential to promote minority shareholders' rights, but has little chance of actually being implemented. Note that Malaysia, which has fared better than the other three countries in relation to corporate governance issues, still does not recognize cumulative voting, perhaps because it is not interested in measures that are ineffective in inducing genuine changes.

In all four countries, directors are appointed based on a simple majority vote by shareholders present at the relevant meeting, with votes allotted in proportion to shares held. Korea has an additional requirement that a candidate for a directorship must receive at least 25% of the total votes. In Korea, Malaysia, and Thailand, rules about the election of directors are governed by laws, but Indonesia does not have any laws that specify the rules for shareholder approval of the appointment of directors or commissioners. Instead, companies can come up with their own rules and usually base appointments on simple majority votes by attending shareholders.

In Indonesia, Korea, and Thailand, removing a director from the board requires a much higher percentage of votes. In Thailand, it requires the approval of 75% of attending shareholders and 50% of the shares held by all attending shareholders. In Korea, approval by two-thirds of attending shareholders with voting rights and one-third of total outstanding voting shares is needed. In Indonesia, two-thirds of the voting rights must be present at the shareholders' meeting, and approval by two-thirds of voting shares present at the meeting is needed. In Malaysia, however, all that is required to remove a director is a simple majority vote, the same as for appointing a director.

Thus for minority shareholders to remove directors is clearly difficult, even when they believe the directors are not performing their duties properly. In Korea, in which dominant shareholders control nearly 50% of voting shares through cross-shareholdings of affiliated firms, for minority shareholders to remove a director without the approval of dominant shareholders is virtually impossible.

Appointment and Removal of Internal Auditors

In all four countries, the conditions for appointing an internal auditor are the same as those for appointing a director, as are the conditions required for removing an auditor. In practice, as in the case of directors before 1997, dominant shareholders were in a position to decide who would be appointed as auditors. As a result, auditors in many companies did not perform their duties properly and were not independent of management. Since the economic crisis, most large companies in the countries under study have been replacing internal auditors with audit committees as the main internal auditing body. Internal auditors are generally required to report to audit committees if audit committees exist or to boards of directors in the absence of an audit committee.

Threshold Ownership

Shareholders also have various rights that they can exercise when they represent a certain percentage of shares, including the right to inspect accounting books and records, the right to make a proposal at shareholders' meetings, and the right to convene a special shareholders' meeting. All four countries recognize these rights, but certain minimum shareholdings are required to exercise them. For instance, to call an emergency shareholders' meeting in Indonesia and Malaysia, shareholders are required to collectively

own at least 10% of voting shares; in Thailand they must own 20% of voting shares (or 10% if at least 25 shareholders are involved); and in Korea they must own 3% of voting shares. Shareholders rarely exercised these rights before 1997. The threshold ownership for placing items on the agenda of a shareholders' meeting is quite high at 33% in Thailand and 10% in Indonesia, while it is 5% (or 100 shareholders each holding more than RM500) in Malaysia, and just 1% (holding for at least six months) in Korea.

Critics maintained that the thresholds were too high for minority shareholders to exercise their rights. Korea substantially relaxed the minimum threshold shares needed to make it easier for minority shareholders to exercise their rights. For instance, the threshold shares needed to exercise the right to call for an emergency shareholders' meeting was lowered from 5% to 3%. The minimum threshold shares to exercise the right to inspect accounting books, which used to be 5% before 1997, was lowered several times and eventually to 0.1% in 2001. The thresholds for the rights to demand dismissal of a director or an auditor and to bring a derivative suit were lowered from 5% before the crisis to 0.5% and 0.01%, respectively, by 1999 for listed corporations.

Information Disclosure

Timely disclosure of accurate information on important firm-related matters is crucial for the protection of shareholders' rights for two main reasons. First, shareholders need to have access to information about important matters to make decisions that are in their interests. Second, information disclosure is crucial in preventing managers and dominant shareholders from engaging in activities that are illegal or are detrimental to minority shareholders. Managers and dominant shareholders will be more reluctant to undertake such activities when they expect that shareholders will find out about them and may take action against them. Managers and dominant shareholders will also run the risk of violating laws when they fail to disclose information about such activities.

Before the crisis, information disclosure was deemed to be incomplete and seriously flawed in Indonesia, Korea, and Thailand. The three countries introduced a wide range of reform measures to improve information disclosed to shareholders and to the general public. Malaysia has also been engaging in efforts aimed at improving disclosure. The reform measures adopted by the East Asian countries since the economic crisis encompass the auditing process,

the timing of disclosure, and the types of information that must be disclosed.

Before 1997, all four countries had laws that required corporations to publish audited annual reports shortly after the end of the business year. Listed companies were required to publish their audited annual reports within 3 months of the end of the business year in Indonesia, 90 days in Korea, 110 days in Thailand, and 4 months in Malaysia. In Thailand, financial statements were to be publicly available within 60 days of the end of the business year. All four countries began requiring more frequent disclosure following the economic crisis. They now require quarterly submission of financial reports and immediate reporting of information that might influence stock prices.

Some East Asian countries also introduced reform measures aimed at ensuring more effective auditing of reports submitted by companies. Most countries made audit committees mandatory or are considering making them mandatory. Korea and Malaysia are introducing measures that require listed companies' audit committees to include an expert on finance or accounting.

The countries also attempted to improve the reliability and independence of auditing by external auditors. Even before the economic crisis, shareholders officially appointed external auditors at general shareholders' meetings, but dominant shareholders had the ability to actually select the external auditors because they controlled the majority of voting shares. As a result, in many companies the independence of auditing firms was seriously undermined. Some auditing firms colluded with the management of their client firms and did not perform their duties properly, because they wanted to continue to provide auditing services to these firms in the future.

Indonesia and Korea have been introducing measures aimed at discouraging collusion by management and external auditors by limiting the period during which an auditor can audit a company. Indonesia has now set the maximum time for which the same auditing firm can audit a company at 5 years. The limit is 6 years in Korea. Malaysia does not impose any restrictions. Thailand only has a limit for banks, which is 5 years.

Auditing standards in the four countries have been enhanced to meet international standards so that there is little material divergence between their national standards and the Generally Accepted Accounting Principles (GAAP) in the United States. In addition, penalties for violating laws and regulations on auditing, which had existed for a long time but had rarely been enforced

before 1997, are now more severe and are being enforced more rigorously. In Korea and Malaysia, auditors and companies that violate laws and regulations on auditing and information disclosure can face suspension of auditing licenses and delisting of companies, in addition to fines and warnings. For instance, a couple of auditing firms were closed in Korea after they were found to have been responsible for improper auditing of some of the large *chaebols* that encountered serious financial difficulties. As a consequence, auditing firms now have a greater incentive to perform their jobs more rigorously. Penalties for violations are weaker in Indonesia and Thailand.

The items for which information must be disclosed have also been expanded significantly. In addition to the usual items such as financial information, companies in all four countries are now required to disclose information on such items as corporate governance structure and practices, education and professional experience of directors and key executives, remuneration of directors and key executives, any deviation from corporate governance codes, and forward-looking statements of the company. Furthermore, listed companies are now required to disclose detailed information about accounting matters that had been more discretionary before the economic crisis, such as the contents and valuation of accounts receivables, asset swap transactions, and equity investments in illiquid stocks. Companies are also required to disclose much more detailed information than in the past about related-party transactions.

Another area in which significant improvements have been made in relation to information disclosure is the provision of information about directors. Shareholders need to have accurate information on directors and how they perform as directors, especially because the role of directors has become increasingly important since the economic crisis. In Korea, for example, companies must now disclose information to shareholders about the process whereby directors were elected and their attendance at board meetings. Before 1997, only their names and brief personal histories were disclosed.

Related-Party Transactions

As already noted, the most salient feature of the corporate governance problems of the East Asian countries is the presence of dominant shareholders who control a group of firms and who were behind many of the illegal or inappropriate actions of managers that resulted in asset dissipation,

expropriation of minority shareholders, and lack of transparency in information disclosure before 1997. Consequently, when reforming their legal infrastructure, most East Asian countries paid special attention to preventing expropriation by dominant shareholders.

Since 1999, Thailand has required complete disclosure of related-party transactions. Malaysia has also enhanced regulations governing related-party transactions and now requires management to fully inform shareholders about all related-party transactions involving money or assets that exceed a certain level. Furthermore, management is required to appoint an independent adviser to ensure that related-party transactions involving such amounts are carried out on a fair and reasonable basis. In addition, advance shareholder approval is needed for such transactions.

Korea reinforced its existing regulations on related-party transactions after the economic crisis. A company's board of directors must now approve related-party transactions involving amounts in excess of 1% of a company's annual revenues or total asset value, and such transactions must be reported to shareholders at a general shareholders' meeting. A set of transactions whose combined total amount exceeds 5% of the annual revenue or total asset value is also subject to the regulation. In addition to this regulation, which applies to all listed companies, the Monopoly Regulation and Fair Trade Act requires firms belonging to large *chaebol* groups to obtain approval from their boards of directors for certain transactions involving sums in excess of 1% of the firm's equity or W10 billion with affiliated firms and to disclose them to shareholders.

Korea is the only country of the four that directly regulates transactions between firms under the control of the same dominant shareholder. The reason for regulating intra-*chaebol* transactions is that before the economic crisis, dominant shareholders used such transactions extensively to divert resources from some affiliated firms to others. The Monopoly Regulation and Fair Trade Act also subjects large *chaebol* groups and their affiliated firms to some additional constraints: large *chaebol* groups are required to limit the amounts of money that an affiliated firm can invest in the equities of other affiliated firms to a certain percentage of the firm's equity, loan guarantees among affiliated firms are generally prohibited, and cross-subsidies by a *chaebol* firm to other affiliated firms are usually banned.[5]

5. The official rationale for this regulation is that such cross-subsidies can unfairly help the firms that receive subsidies in markets where the recipient firms operate, thereby distorting

Violations and Enforcement

The biggest challenge to the East Asian countries that fell victim to the economic crisis was, and still is, the implementation of various rules and requirements pertaining to corporate governance as prescribed by laws, articles of association, and guidelines. While prior to 1997, laws and regulations in Indonesia, Korea, and Thailand certainly had some deficiencies and were incomplete, had the managers of large firms in these countries abided by them, large corporations would have fared significantly better before 1997. The main reason that corporate managers did not follow the rules and requirements was generally weak penalties for violations.

Enforcement suffered from two different problems. First, penalties for violations that had been prescribed by law before 1997 were, in many cases, insufficient to deter serious violations. For instance, penalties for stock issuers violating Korea's Securities and Exchange Act were limited to W5 million, less than US$7,000, or imprisonment for 1 year, or both. Such penalties were clearly insufficient to deter criminal activities by managers and dominant shareholders that could give them illegal profits worth several hundred times the amount of the maximum fine. Second, the penalties prescribed by laws were rarely enforced.

All four countries increased the penalties for violations after the crisis. Penalties for insider trading have been strengthened substantially and those engaged in insider trading face both administrative and criminal penalties. Violators face prison terms of up to 10 years in Indonesia, Korea, and Malaysia and up to 2 years in Thailand. Fines can amount to Rp15 billion in Indonesia, up to W20 million in Korea, a minimum of RM1 million in Malaysia, and a minimum of B500,000 and maximum of twice the profits made in Thailand.[6] Civil liabilities are also possible in all the countries except Indonesia. Penalties in civil suits can be as high as RM500,000 or triple the profits made in Malaysia and up to the value of the shares purchased or sold in Korea.

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competition in those markets. This rationale is similar to that underlying regulations in connection with predatory pricing. However, when handling actual cases, the Korea Fair Trade Commission seems to focus more on the subsidies' detrimental effect on the minority shareholders of the firms that provided the subsidies.

6. US$ 1 at the end of September 2004 is equivalent to: Rp9,170, W1,152, RM3.8, and B41.5.

Penalties for various other criminal offenses committed by directors and managers have also been substantially increased. For instance, Korea has increased penalties for stock issuers violating the Securities and Exchange Act to a fine of W30 million and 5 years in prison. In Thailand, penalties for criminal offenses committed by directors or managers can include up to 10 years in prison and a fine of B1 million.

Corporate directors who fail to carry out their fiduciary duties properly may also be subject to other forms of penalties in addition to criminal penalties and civil liabilities. Derivative suits are available in Indonesia, Korea, and Thailand, although the threshold ownership requirement for initiating a derivative suit differs widely: 10% in Indonesia, 5% in Thailand, and just 0.01% in Korea. Thus minority shareholders now have a mechanism for forcing directors who caused serious harm to their firms to pay for such damage. Note, however, that minority shareholders do not have a strong incentive to initiate a derivative suit, because any award would go to the company while they would bear most of the costs of litigation. This explains why few derivative lawsuits have been filed against directors in these countries.

Class action suits can be a more effective deterrent to violations, as they give a strong pecuniary incentive to law firms, which can earn substantial amounts of money by representing minority shareholders in suits against directors, but class action suits are not currently available in any of the four countries. Indonesia and Malaysia have no specific provisions for class actions suits related to securities; Thailand's Council of State is reviewing a draft bill; and Korea is scheduled to introduce class action suits in 2005, but only for large firms and for a limited class of cases involving securities fraud, such as stock price manipulation, accounting fraud, and provision of false information (smaller firms and audit-related violations are scheduled to be subject to class action suits in 2007).

Preemptive Rights

Preemptive rights or priority subscription rights were not well protected in the East Asian countries under study until recently. In Korea and Thailand, dominant shareholders have often been suspected of having used the issuance of new shares as a way to transfer wealth from minority shareholders to themselves or their families. After the crisis, some of the countries began to protect preemptive rights by amending their commercial codes. These rights

are formally acknowledged in all the countries studied except for Thailand, where companies have choices when they set the terms of new issues. In Indonesia, the rights have to be clearly stated in the articles of association for the shareholders to be protected. In Korea and Malaysia, the rights are protected unless majority shareholders approve their denial (by a simple majority in Malaysia and a two-thirds majority in Korea).

Mergers and Acquisitions

Thin markets for corporate control were one of the main factors that led to the persistence of poor governance structures in many companies in the East Asian countries before 1997. Facilitating takeovers increases the chances that a firm will be run by more efficient management and also provides shareholders with an opportunity to increase the value of their shares. All four countries require that anyone who purchases 5% or more of a company's shares must notify the shareholders (OECD 2003, appendix A). In addition, most of the countries either have or used to have provisions that require anyone who wishes to purchase shares in an amount close to giving them control of a firm to purchase all or more than a certain percentage of shares at a particular price.

Such provisions have two opposite effects. On the one hand, they promote the interests of minority shareholders by giving all shareholders an equal opportunity to sell their shares to a prospective purchaser. On the other, they may work as a barrier to takeovers, as they may lead some prospective purchasers who face liquidity constraints or who are reluctant to purchase too large a proportion of a firm's shares to give up their attempt to buy a sizable proportion of shares.

Predicting ahead of time which effect is dominant is difficult. All the countries except Korea seem to believe that the former effect dominates the latter in their countries. Indonesia and Malaysia each require a prospective purchaser who wants to purchase at least 25% and 33%, respectively, of a firm's shares to purchase all the shares at the same price. Thailand has a similar requirement that allows multiple trigger threshold shares of 25%, 50%, and 75%. By contrast, Korea eliminated mandatory stock purchase requirements in 2002 to facilitate mergers and acquisitions. Before the 2002 amendment of the Securities and Exchange Act, anyone who was purchasing over 25% of the shares of a listed company was required to purchase at least 50% of the shares.

Even after the changes in the laws and regulations governing mergers and acquisitions, the markets for corporate control are still inactive in the four countries. The underdevelopment of the markets for corporate control reflects the heavy concentration of ownership or control rights in these countries as well as the underdevelopment of the financial market in general. This situation is likely to persist for some time.

Effectiveness of Boards of Directors

In the wake of the Asian financial crisis, it became apparent that in many companies boards of directors did not function according to relevant laws and the spirit behind those laws. The board of a corporation represents the shareholders and is intended to make decisions that are in the best interests of the corporation and of its shareholders. In reality, however, the boards of many companies in Indonesia, Korea, and Thailand worked primarily for the interests of dominant shareholders and frequently made decisions that were detrimental to the interests of minority shareholders and of the firm itself. Following the economic crisis, the East Asian countries have introduced an extensive set of reform measures to make boards more responsible and more effective.

Board Structure

All the countries except Indonesia have a unitary board system. Indonesia has a dual board system whereby a corporation has a board of commissioners and a board of directors. The board of commissioners performs the supervisory and advisory roles, while the board of directors performs the executive roles. In particular, the board of commissioners supervises the performance of the board of directors and its policies; however, critics note that the distinction between the two boards is often unclear in practice (see, for instance, Kurniawan and Indriantoro 2000).

Board Functions and Responsibilities

The laws of all four countries defined the functions and responsibilities of boards of directors quite clearly before the economic crisis. These functions and responsibilities generally included reviewing and making final decisions on appointments of senior management, compensation for senior management, budgets, financial statements, corporate strategies, major transactions, disposal

of key assets, changes to capital structures, disclosure processes, risk management policy, and related-party transactions. These responsibilities are similar to those of boards in most other market-based economies.

Of particular interest is the board's role in reviewing and making decisions about related-party transactions. Controlling shareholders in many companies in East Asian countries were able to force managers to enter into transactions that benefited the former even when they were not officially serving as directors. Thus properly defining related-party transactions that are subject to regulation is crucial. In Korea, related-party transactions include transactions with controlling shareholders; transactions with people who have a special relationship with controlling shareholders, such as relatives; and transactions with other companies under the control of the same dominant shareholders.

The other three countries seem to be more concerned about transactions involving directors or firms controlled by directors and less willing than Korea to regulate transactions between firms affiliated with the same dominant shareholders. The different approaches toward related-party transactions likely reflect the fact that related-party transactions between affiliated firms are more common and have caused more serious harm in Korea than in the other three countries.

All four East Asian countries generally require that related-party transactions be reported to boards of directors as well as to general shareholders' meetings. Shareholder approval is required for related-party transactions exceeding a certain specified size in Thailand (3% of assets or B10 million), Malaysia (5% of assets, profits, equity shares, or investment), and Indonesia (10% of corporate revenue or 20% of equity). Korea, however, does not require shareholder approval of related-party transactions and requires only the approval of the board of directors. In all four countries, most related-party transactions have to be disclosed.[7] In addition, Indonesia, Malaysia, and Thailand require related-party transactions to be reported to the stock exchange or securities exchange commission.

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7. Public disclosure is required for related-party transactions exceeding 0.03% of net tangible assets or B1 million in Thailand, and for those exceeding 1% of total sales or assets for each transaction and 5% of total sales or assets of a set of transactions with the same person within 1 year in Korea. The threshold for disclosure is the same as that required for shareholder approval in Indonesia. In Malaysia, all related-party transactions have to be disclosed.

Table 2
Corporate Board of Directors: Regulatory Frameworks

	Thailand	Malaysia	Korea	Indonesia
Board structure	Unitary	Unitary	Unitary	Dual boards: board of directors and board of commissioners
Minimum number of directors	5 directors	2 directors (with their permanent residence in Malaysia)	3 directors (if total capital is at least 500 million won)	2 commissioners
Minimum number of independent directors	2 directors	2 directors or 1/3 of the board	25%; 3 directors and majority for banks or companies with total assets exceeding 2 trillion won	Independent commissioners should be at least 30% of the total
Any restrictions on appointing non-residents or foreigners to the board?	At least 1/2 of board members should be residents	At least 2 directors with permanent domestic residency	None	Not allowed except for firms of foreign direct investment
Separation of Chairman and CEO required?	No	No	No	Yes, by the nature of the dual boards
Maximum election term for directors	3 years (1 year for cumulative voting)	3 years	3 years, unlimited re-election	No; it is to be specified in the Articles of Association of the respective company

Are any board committees mandatory?	Audit committee	Audit committee (and risk management committee for financial or insurance companies)	Audit committee and nomination committee (if total assets exceed 2 trillion won)	Audit committee
Minimum number of board meetings	4 times a year	None (although minimum 4 times a year is the usual rule for approving the quarterly reports)	None	None
Any restrictions on the number of boards on which an individual may serve?	None (maximum 5 for bank directors)	Maximum 25 boards: 10 for listed companies, and 15 for unlisted companies	Maximum 2 for non-executive directors	None; but in the banking sector, an individual may hold a position as director or commissioner in only one bank.
Any age restrictions for directors?	None	Minimum 21 and maximum 70 unless voted in by 75% majority shareholders (subject to re-election each year)	None	Minimum 21 years old
Continuing training required for directors?	No	Yes	No	No

Independence of Directors and Establishment of Audit Committees

The appointment of independent directors and the establishment of audit committees are key reform measures that can significantly increase the independence of boards and make them more effective in pursuing the interests of firms and all shareholders instead of just the interests of dominant shareholders. All four countries require the election of independent directors to the board. An independent director is generally defined as a director who is not an employee of the company, is not a relative of the dominant shareholder or top managers, and does not have serious business interests in the company. Of course, a director can meet all these conditions and still not act independently of the management.

All four countries require that boards have a minimum number of independent directors. Indonesia requires that independent commissioners account for at least 30% of the total number of board members; Korea requires 25% of board members to be outside directors, but corporations with asset values exceeding W2 trillion must appoint three or more outside directors and maintain a 50% minimum of outside directors on their boards; Malaysia requires that two directors or one-third of board members be independent directors; and Thailand requires that at least two board members be independent directors.

All the countries except Indonesia have made audit committees mandatory.[8] In Korea, however, audit committees are only mandatory for large companies whose assets exceed W2 trillion. Furthermore, there are restrictions on the composition of audit committees to ensure that they function properly, that is, independently of management. Thailand requires that each listed company have an audit committee with at least three members, each of whom must be independent, and that at least one of them must have knowledge of accounting or finance. Malaysia requires that all listed companies have an audit committee comprising at least three members, the majority of whom must be independent. In Korea, large corporations are required to appoint at least two-thirds of the members of their audit committees from among outside directors. In both Korea and Malaysia, the chairpersons of audit committees must be outside directors.

In all four countries, the functions of audit committees generally include the following: reviewing the adequacy of the company's internal control and risk

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8. An earlier requirement imposed by the Bank of Indonesia on banks to have audit committees has been revoked (see Mak 2001 for more details).

management systems, overseeing financial reporting processes, reviewing internal audit functions, selecting and supervising external auditors, and reviewing related-party transactions. Audit committees in some of the countries are also charged with overseeing compliance with relevant laws, regulations, and internal guidelines.

Other committees that are frequently present in corporations in more advanced countries, such as remuneration and nomination committees, are not mandatory in the four countries. Korea recently mandated that large, listed companies have a nomination committee for recommending outside directors. Under this system, the committee selects candidates for outside directors and announces them at a general shareholders' meeting. In addition, the committee must announce at the general shareholders' meeting those candidates who were recommended by minority shareholders who collectively own at least 1% of the voting shares or 0.5% of the voting shares for companies with total asset values exceeding W100 billion. Thus minority shareholders who hold a certain percentage of shares can recommend their own candidates at general shareholders' meetings (though their candidates are unlikely to be elected).

Korea also requires listed companies to disclose the attendance and voting records of all outside directors. This measure can be useful in evaluating the performance of outside directors and the degree of a board's independence. The other three countries do not require such disclosure.

De facto or Shadow Directors

One of the peculiar features of many East Asian companies was that dominant shareholders often controlled firms without holding an official management position or having any legal responsibilities in the firms, and managers and directors followed their instruction because the dominant shareholders owned or controlled close to the majority of voting shares and had the ability to influence the welfare and careers of the managers and directors. Thus dominant shareholders often escaped penalties, while the managers who committed illegal activities on their behalf took the blame. Korea and Malaysia introduced measures designed to hold dominant shareholders legally responsible for decisions they make even when they are not officially members of the board of directors or part of the management.

The Companies Act of Malaysia defines such "shadow directors" as people who can make companies follow their instructions or directions and tries to

impose on shadow directors most of the duties that are normally imposed on directors. Korea defines "de facto directors" similarly and imposes similar duties on de facto directors.

Liabilities of Boards and Directors

Directors are liable for their actions individually as directors and collectively as a board. Penalties for insider trading and violation of laws pertaining to disclosure have already been explained. Note, however, that uncertainty about the interpretation and implementation of laws regarding the liability of directors appears to be significant in most of the countries under review. Few actual cases have occurred in which directors were found to have breached their duties and were forced to pay penalties.

Role of Banks and Reform of Bankruptcy Proceedings

Most of the reform measures described earlier concern the rules of the game for minority shareholders, directors, managers, and dominant shareholders. The idea behind those reform measures was that by changing the rules of the game in relation to information provision, appointment of directors, authority and responsibilities of boards and general shareholders' meetings, and penalties for violating the rules countries could change the corporate governance practices of directors, managers, and dominant shareholders in a way that was more consistent with the maximization of firm value or shareholder value.

While the reforms that have taken place in the four countries since the mid-1990s are extensive and have resulted in significant improvements in corporate governance practices within firms and in firms' performance, enforcement of the new measures, as well of measures that had existed before the economic crisis, is still weak. As a consequence, the effects of the reforms have been limited.

One crucial factor behind the weak enforcement is the overall state of the legal system in the East Asian countries. Securities exchange authorities, financial regulators, prosecutors' offices, and even the courts appear to be far less active in detecting and penalizing those who seriously violate the rules of the corporate governance game than their counterparts in more advanced countries that have longer histories with a market-based economy. Legal enforcement in the East Asian countries will probably improve over time, although the time period could be considerably long.

Another important factor underlying weak legal enforcement is the shortage or absence of stakeholders who have strong incentives to ensure that participants adhere to the rules of the corporate governance game. Minority shareholders or managers who receive their salaries from dominant shareholder are unlikely to have strong incentives to do so.

One group of stakeholders who might have strong incentives to ensure that firms are under reliable corporate governance is creditors. Creditors can also play an important role in the corporate governance of large debtor firms without interfering in the internal governance of the firms in normal times. By conducting credit evaluations or monitoring the firms closely, they can significantly improve the governance of large firms that borrowed substantial amounts of money from them or that might rely on bank loans to overcome liquidity problems in the future. As mentioned before, banks in Indonesia, Korea, and Thailand failed to play the role of creditors effectively because they were under a weak governance structure themselves.

Extensive intervention by politicians or bureaucrats in banks' operations was largely responsible for the ineffectiveness of bank governance and resulted in the mass failure of banks as well as of a host of large debtor firms in Korea. Banks in Indonesia and Thailand suffered from a different form of governance problem. Most of them belonged to either the government or to conglomerates and were forced to make loans on easy terms to firms that had good connections with powerful politicians or bureaucrats or to affiliated firms under the control of the same dominant shareholder. In short, many banks in Indonesia and Thailand were used to channel their depositors' funds to their dominant shareholders or to affiliated firms. Banks in Malaysia performed better, because only a few banks belonged to conglomerates and because financial regulation was more effective. In particular, prohibitions on loans to related parties were enforced more strictly.

In all four countries, reform of the banking sector has focused on more effective governance and more stringent bank regulations.[9] The governance of banks has been made more effective by general reforms of the legal infrastructure related to the corporate governance of corporations, including many banks. Some countries introduced reform measures that were more specifically

9. The governments of some countries, including Korea and Malaysia, have also been pushing for bank mergers to make banks larger and more competitive by achieving economies of scale and scope.

tailored to banks. For instance, both Malaysia and Thailand recently began requiring banks, but not firms in the nonfinancial sector, to set up risk management, remuneration, and nomination committees. Thailand required bank boards to have at least nine members, with fewer than two-thirds of them drawn from the management. Most countries also made restrictions on related-party loans more stringent.

Korea has implemented the most extensive changes to the ownership and governance structure of commercial banks since the economic crisis. It has attempted to privatize commercial banks that encountered serious financial difficulties and ended up becoming public enterprises because of the infusion of public funds by the government. At the same time, Korea has also tried to make the firewall between banks and firms more effective. A series of amendments to the Banking Act gradually relaxed regulations on the ownership of banks and increased room for control by strategic investors who own large blocks of shares. While the principle of an individual corporate ownership ceiling of 4% was maintained, exceptions have been introduced to allow larger ownership by investors who specialize in financial institutions. Regulations on bank ownership by industrial capitals (large business groups with diversified operation in nonfinancial sectors) have been gradually strengthened to discourage *chaebols* from trying to take control of banks in an effort to secure loans on easy terms. Industrial capitals are prohibited from purchasing more than 4% of the shares of a bank with borrowed money and are required to obtain permission from the government even when they want to purchase more than 4% with their own equity.[10]

Banks in the East Asian countries hit by the economic crisis, however, have played an important role in the corporate governance of firms. A plethora of insolvent large firms in these countries during and after the crisis ultimately forced banks to play a greater role in the corporate governance and restructuring of insolvent firms. Banks became dominant or large shareholders of those debtor firms that became bankrupt or fell into deep financial difficulties through

10. Recently, the government raised the ceiling for unconditional individual ownership, which does not require permission from the Financial Supervisory Commission, to 10% of the shares of a bank for investors that are not industrial capitals. Even when an industrial capital gets the commission's permission to purchase more than 4% of a bank's shares, it is still prohibited from exercising its shareholding rights in excess of 4%. In addition, the commission can order a bank shareholder who owns more than 10% of the shares to sell its shares in excess of 10% if the commission decides that this would be appropriate.

debt-equity swaps, which were the key component of the corporate restructuring packages widely used in Indonesia, Korea, and Thailand.

Laws and regulations on bankruptcy proceedings and the corporate governance of banks have been amended extensively to enhance efficiency in the reallocation of resources belonging to financially troubled companies and to allow banks to play a leading role in restructuring such companies.[11] All three countries adversely affected by the economic crisis have amended their bankruptcy laws.[12] Indonesia amended its Bankruptcy Law in 1998, and Thailand amended its Bankruptcy Act that same year. Korea has amended all three acts related to bankruptcy—the Reorganization Act, the Composition Act, and the Bankruptcy Act—three times since the economic crisis. Furthermore, all three countries also used informal workouts led by the banks.[13]

As a result of the reform, firms that are unable to repay their debts are more likely than before to face liquidation or forced reorganization through debt-equity swaps. Conditions for debt-equity swaps are now also more in line with the absolute priority rule to treat creditors more fairly. Dominant shareholders face the prospect of losing control of insolvent companies more often than in the past. At the same time, creditors can now take legal action against bankrupt debtor firms more easily and can expect to get more of their money back from the debtor firms. Thus firms are subject to a more stringent market principle in relation to their creditors than before.

Remaining Challenges

The extensive reform measures introduced since 1998 coupled with shareholder activism have led to significant improvements in the corporate governance of large firms in the four countries. As a result, the interests of minority

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11. In Korea, the Banking Act was amended to allow banks to own more than 10% of the shares of a firm, a restriction that had been enforced for a long time prior to 1998. The amendment was necessary to enable them to implement the debt-equity swaps that were an indispensable part of the rescue packages used for many ailing firms.

12. For a detailed discussion of bankruptcy proceedings in the four countries, see Nam and Oh (2001), who provide a comparative analysis of bankruptcy proceedings in Indonesia, Korea, Malaysia, Philippines, Singapore, and Thailand.

13. Korea also recently enacted the Corporate Restructuring Act, which made workouts more official. The act provides some firm legal grounds for workout agreements among creditors of a debtor firm, something that had been lacking in the past.

shareholders are better protected than they were before the crisis. The survey results summarized later show that directors and managers of listed companies in these countries agree that significant improvements have taken place in both legal infrastructure and implementation of the laws and regulations. Nevertheless, few believe that the governance of large firms has been fundamentally changed in terms of the role of dominant shareholders in relation to key issues, including the appointment of directors and chief executive officers (CEOs). Also few believe that the reforms have halted the diversion of resources among affiliated firms and the accounting irregularities that were characteristic of large conglomerates in Indonesia, Korea, and Thailand.

The laws and regulations governing corporate governance in the four countries are comparable to those in more advanced countries, though room for improvement exists. The introduction of fully fledged class action suits may act as an effective deterrent to expropriation by dominant shareholders and could enhance the corporate governance of many corporations in the four countries. Laws and regulations on mergers and acquisitions and bankruptcy of large firms need to be reformed further to allow various investors to compete more freely for the control of large corporations. Regulations governing banks and other financial institutions must be further strengthened to provide more adequate checks and balances in relation to dominant shareholders and managers of large firms. In particular, firewalls between large firms and affiliated financial institutions must be made more effective. In addition, efforts should be made to facilitate shareholder participation in important corporate decisions by taking advantage of information technology. Voting by mail, the Internet, and other similar channels should be permitted.

Furthermore, laws and regulations in the four countries must address the problems that are endemic to the East Asian countries. Cumulative voting may not be needed in companies in which management has few opportunities to become entrenched; however, in companies where the ownership structure makes entrenchment by dominant shareholders inevitable and divergence between cash flow rights and control rights is severe, mandatory cumulative voting may lead to more effective boards. Penalties for the violation of laws pertaining to corporate governance by dominant shareholders and managers who act on their behalf also need to be strengthened to give them incentives to obey such laws.

The biggest challenge facing the four countries is enforcement. Effective enforcement requires more stringent efforts by regulators and law enforcement

agencies, but fundamental change within such agencies takes time. One possible solution that may lead to more rapid results would be to make use of the profit incentives of institutional investors. Institutional investors have substantial investments in firms and have a much stronger incentive than agencies to monitor managers' and directors' behavior and to seek remedies when they detect illegal or irregular activities. Foreign institutional investors are already major shareholders of many large companies in the four countries—in Korea, for instance, they own more than 40% of listed firms—and can play an active role in the corporate governance of the companies in which they hold significant shares. However, domestic institutional investors do not seem to be well developed in the four countries. To develop strong, domestic institutional investors, countries must install effective governance structures in large pension funds and such nonbank financial institutions as insurance companies and investment trusts. This is crucial for the efficient management of the institutional investors themselves as well as for the efficient and equitable governance of corporations. But it may take time and further efforts for domestic private institutional investors to undertake such a role actively, because many of them are affiliated with industrial groups.

3 *Questionnaire Survey of Corporate Governance Practices*

This study is based mainly on a questionnaire survey that looks at corporate practices at the firm level and on directors' opinions about various aspects of corporate governance. The survey's results are used to examine the three main subjects of this study: shareholders' rights and the effectiveness of boards, linkage between the quality of corporate governance and firm performance, and stakeholders' potential role. This section discusses the objectives and nature of the survey and describes the conduct of the survey, the sample industries and firms, and the ownership and control characteristics of the sample firms.

Objectives and Nature of the Survey

Surveys at the country or corporate levels can vary. The World Bank conducts assessments of countries' corporate governance using the Organization for Economic Co-operation and Development's (OECD's) principles of corporate governance. It carries out these assessments as part of the joint World Bank and International Monetary Fund initiative in relation to reports on the observance of standards and codes, which are designed to help lay the groundwork for a stronger international financial architecture. The reports are based on a template completed following a review of relevant laws and regulations and interviews with pertinent people.

In the private sector, at the request of individual companies, Standard & Poor's conducts interactive assessments of their corporate governance standards and practices. Its assessments also use the OECD principles as the analytical framework. Standard & Poor's scores are based on interactive, independent research and focus on a company's practices rather than on what local laws and regulations require and on the substance rather than the form of corporate governance.

This study differs from both types of surveys in several respects. First, the questionnaire survey for this study pays particular attention to actual corporate governance practices at the micro level rather than to the laws and regulations governing them. As the OECD (2003) observes, most Asian jurisdictions have substantially reformed their laws and regulations largely in the spirit of the OECD principles, but because of poor implementation and enforcement or other reasons, actual practices usually fall short of the new rules. Companies may simply ignore some regulations and guidelines or comply only in superficial way in form but not in substance. Independent directors may be far from being independent and effective, and small shareholders may be frustrated in their efforts to exercise their rights as set out by law.

In other cases, corporations may adopt governance practices whose standards are higher than the minimum required or that are not required by law, perhaps to signal the market of their intent to protect the interests of minority shareholders. Without a comprehensive, firm-level investigation, evaluating the extent of deviation between the regulatory framework and actual practices is difficult. As such, the approach and methodology of the survey is closer to those of Standard & Poor's, although corporate-level governance practices are discussed with close reference to the relevant laws and regulations in individual countries.

Second, the survey does not restrict itself to the framework of the OECD principles, which is based primarily on shareholder sovereignty. The principles do not ignore the role of stakeholders in corporate governance. They state that the corporate governance framework should recognize the rights of stakeholders as established by law and encourage active cooperation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises. The principles also say that the corporate governance framework should permit performance-enhancing mechanisms for stakeholder participation. The annotations to the principles note examples of mechanisms for stakeholder participation, such as employee representation on boards, employee stock ownership plans or other profit sharing mechanisms, governance processes that take stakeholders' viewpoints into account in certain key decisions, and creditors' involvement in governance in the context of insolvency proceedings.

Despite the formal recognition of the role of stakeholders in corporate governance, the principles pay little attention to stakeholders other than

shareholders. This is also true for the *White Paper on Corporate Governance in Asia* (OECD 2003), which recognizes stakeholders mainly with respect to their right to be protected rather than in relation to their role as participants in corporate decisionmaking or governance. Neither the World Bank and International Monetary Fund's reports on the observance of standards and codes nor Standard & Poor's corporate governance scores discuss the role of stakeholders other than shareholders as potential players in corporate governance. This survey attempts to evaluate the participatory roles of other stakeholders in corporate governance as well as those of shareholders.

Finally, the survey, while focusing mainly on firm-level practices, ensures objectivity as well as easy comparison across countries by using a common set of questions across countries and firms. To enhance the reliability or representability of the assessment, the questionnaire survey covers 60-110 listed companies in each country. To further enhance comparability and to control for any industry effects, the survey is confined to several industries (except in Malaysia).

The assessment based on this survey is therefore likely to minimize any bias that may be introduced by the subjective judgments of individuals who evaluate corporate governance practices. The survey questions include both factual information and opinions. Opinions are often essential to a better understanding of the actual workings of certain corporate governance mechanisms. Another advantage of a large sample questionnaire survey is that it permits a quantitative investigation of the association between corporate governance practices and firm performance. Using the same dataset, this study also investigates the determinants of the quality of corporate governance practices at the corporate level.

Sample Firms and Respondents

The questionnaire survey was conducted in Indonesia, Korea, Malaysia, and Thailand for the most part during July-October 2003.[14] The questionnaires were mailed to corporate secretaries, executive directors, and outside/independent directors, and the responses were received mainly by mail (see Appendix A for the survey questions).

14. Local consultants included the Forum for Corporate Governance in Indonesia, the KDI (Korea Development Institute) School of Public Policy and Management in Korea, the Malaysian Institute of Corporate Governance, and the Thai Institute of Directors. In the case of Malaysia, the survey was conducted partly in late 2003 and partly in early 2004.

Two different sets of questions were prepared for the survey. One set collected factual information and was to be answered by corporate secretaries or the equivalent, and included general information about the firm and questions on shareholders' rights and information disclosure, effectiveness of the board of directors, and human resources. This information was supplemented by questions about regulatory frameworks related to shareholders' rights and boards of directors and commissioners in each country. The other set of questions comprised an opinion survey to be answered by executive and independent directors and gathered general information about the firm and about the respondents and included questions about the effectiveness of the board of directors and the role of stakeholders. The same set of questions was given to both executive directors and independent directors to evaluate any differences in their views and to check potential bias in the responses of executive directors, who might represent or be favorably disposed towards controlling owners.

In addition, each collaborating institution compiled information about the responding companies that included each company's market and book values of equity, debt-equity ratio, total assets, total fixed assets, sales, return on assets, and years in business and years listed. These data were mainly for carrying out quantitative analyses of the determinants of the quality of corporate governance at the firm level and the linkage between this quality and firm performance.

The sample firms represent seven selected industries and their shares are traded on local stock exchanges. The number of industries was limited to control for industry effects, especially in the quantitative analyses of the survey results. Unfortunately, the Malaysian survey was conducted without limiting the industries.[15] The seven industries are food and beverages, textiles and clothing, chemicals, iron and metal products, electrical and electronics products, transport equipment, and commerce and trade. The selection was designed to include industries with different levels of capital intensity and technology sophistication and to ensure that enough companies were listed in each industry.

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15. The survey was less successful in Malaysia than in the other countries because it was delayed for a few months and was conducted without limiting the sample companies to selected industries. However, careful scrutiny of the Malaysian survey results suggests that it was not biased by the inclusion of firms in other industries. Thus the Malaysian survey results are included in the cross-country comparison of corporate governance practices, but the regression analyses exclude Malaysia because of the heterogeneity of the sample firms. When regressions are run for all sample firms including the Malaysian ones, however, in most cases the results are not significantly different from those without the Malaysian sample.

A potential problem with this type of survey is selection bias, in that firms with better corporate governance are likely to be more willing to respond to this kind of questionnaire than those with poor corporate governance. However, the selection bias may not be serious, at least for Indonesia and Thailand, because the proportion of responding firms was 59% and 52%, respectively, of the total number of listed companies in the industries selected. In the case of Korea, the proportion was 29%.

Excluding a few response sets with many missing answers, information was collected for a total of 307 firms from the four survey countries: 66 in Indonesia, 111 in Korea, 69 in Malaysia, and 61 in Thailand (Table 3). This does not mean that three complete sets of responses were collected from each company, though this was largely the case for Korea, Malaysia, and Thailand. Collecting complete data was not an easy task for Indonesia, mainly because Indonesian companies tend to have fewer board members than the other countries. In some cases, mostly for Thailand, responses from directors were collected without gathering factual information from the companies' corporate secretaries and two executive directors or two independent directors responded for a firm instead of one each. A total of 596 directors or commissioners participated in the survey: 286 executive directors and 310 independent or outside directors, or 85 for Indonesia, 214 for Korea, 128 for Malaysia, and 169 for Thailand.

Table 4 shows the ownership and other characteristics of the firms that participated in the survey. Diffuse ownership is rare in the four economies and accounts for only 6% of the Korean and Indonesian sample firms, 15% of the Thai firms, and 23% of the Malaysian firms. The CEOs of almost 60% of the Indonesian and Korean firms are either the founder or members of the founder's family. The ratio is lower in the other two countries: 32% for the Malaysian firms and 39% for the Thai firms. Two out of three of the firms in Korea are stand-alone firms, compared with about one in two firms in Indonesia and Thailand and roughly one in three firms in Malaysia, and approximately one out of four firms is affiliated with a family group or holding company in Korea, Malaysia, and Thailand, compared with 35% in Indonesia. More than 30% of the Indonesian and Korean firms and 40% of the Thai firms say they are substantially owned by foreigners. These firms are mostly controlled by foreign shareholders in Indonesia, while there is virtually no foreign management control in Korea. Sample firms with substantial foreign ownership represent less than 20% of the participating firms in Malaysia.

Table 3
Field Survey Sample Size by Country [1]

	Thailand	Korea	Indonesia	Malaysia	Total
Factual information and both executive and independent director (ED, ID) opinions	55	100	16	59	230
Factual information and ED opinion	3	11	16	3	33
Factual information and ID opinion	2	0	34	7	43
Factual information only	1	0	0	0	1
Subtotal	**61**	**111**	**66**	**69**	**307**
ED and ID opinions	6	1	1	0	8
ED opinion only	4	0	1	0	5
ID opinion only	15	1	0	0	16
Total	**86**	**113**	**68**	**69**	**336**
Number of sample firms by industry (firms with corporate factual information)					
Food and beverages	14	11	10	7	42
Textiles and clothes	7	16	15	2	40
Chemicals	8	21	6	3	38
Iron and metal products	12 [2]	13	5	6	36
Electrical/electronics products	8	16	6	3	33
Transport equipment	4	19	10	3	36
Distribution and trade	8	15	14	4	41
Others	0	0	0	41 [3]	41
Number of opinion survey responses from executive and independent directors					
Executive directors	78	112	34	62	286
Independent directors	91	102	51	66	310
Total	**169**	**214**	**85**	**128**	**596**

Notes: 1. Among the response sets received, several were excluded due to too many missing answers: 1 Thai firm and 1 Korean firm for all three sets of responses; 1 Korean firm for factual information and executive director opinion; and 1 Indonesian firm for factual information.
For Indonesia, ED and ID indicate executive commissioners and independent commissioners, respectively, as are also the case in other tables.
2. Includes seven firms in building materials.
3. Includes 10 conglomerates or holding companies.

Table 4
General Information on Respondent Firms

	Responses	THA	KOR	INO	MAL [1]
Number of firms responded [2]		61	111	66	69
1. Ownership & control structure	Concentrated ownership/control	33	72	42	46
	Concentrated control	5	28	4	3
	Collective control	13	1	13	4
	Diffuse ownership	9	7	4	16
	Others	1	3	3	0
2. Stand-alone or part of a business group or holding company?	Stand-alone firm	32	74	31	24
	Family group firm	7	21	10	3
	Non-family group firm	5	8	9	5
	Part of family holding company	9	7	13	13
	Part of non-family holding company	8	1	3	24
3. Owned and controlled by the government?	No	54	104	64	45
	Substantially owned/controlled	1	3	0	9
	Partly owned with little control	3	2	2	13
	Others	1	1	0	2
4. Owned and controlled by foreign firms?	Little owned	27	73	39	42
	Substantially owned/controlled	11	2	17	4
	Substantially owned with little control	14	33	3	8
	Others	9	2	7	15
5. Relation of CEO with the largest shareholder	Founder	11	20	17	5
	Founder's family	13	44	22	17
	Professional manager	31	43	26	44
	Others	5	4	1	3
6. Major creditor bank: its ownership & control structure	Mainly government-owned	15	49	12	2
	Belong to the same business group	5	1	3	7
	Belong to a different business group	24	8	22	51
	Owned/controlled by foreign banks	4	12	22	2
	Owned by small shareholders	6	33	0	3
	Others	0	3	2	0
7. Have a labor union?	Yes	12	73	52	25
	No	49	38	13	37

Notes: 1. THA, KOR, INO, and MAL indicates Thailand, Korea, Indonesia and Malaysia, respectively.

2. Numbers of responses do not usually sum up to the total number of firms due to missing responses, allowance of multiple selection for some questions, and simply inconsistent responses.

As Table 4 also shows, the major creditor banks of sample firms have diverse ownership and control structures. Since the economic crisis, Korean firms deal mainly with government-owned or diffusely-owned banks. In the other three countries, ownership by a business group is common, particularly in Malaysia, but the major creditor bank rarely belongs to the same business group as the firm in any of the countries surveyed. In Indonesia, the major creditor banks are just as likely to be foreign controlled as to be controlled by business groups. As for unions, these are found in 80% of the Indonesian firms, 66% of the Korean firms, 40% of the Malaysian firms, and only 20% of the Thai firms.

While only 26% of the Korean directors (both executive and independent directors) who responded to the survey serve on more than one board, 56% of the Indonesian commissioners, 77% of the Malaysian directors, and 67% of the Thai directors serve on multiple boards (Table 5). With respect to the career backgrounds of the independent directors, these are most commonly business executives in Indonesia, Korea, and Thailand and public servants in Malaysia. When comparing the relative quality of their corporate governance compared with that of other listed companies, most of the Malaysian directors and almost three out of four Thai directors say that their firm is much or slightly better, while such responses account for 34% of the Indonesian commissioners and 50% of the Korean directors.[16] When compared with corporate governance three years ago, virtually all the Malaysian directors and more than 90% of the Thai directors say it is better, while about 70% of the Indonesian commissioners and 55% of the Korean directors give such responses.

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16. If this subjective evaluation has any reliable information content, it may be an indication of the degree of any selection bias, and a comparison of corporate governance scores across countries should be made with caution. The simple correlation coefficient between the overall corporate governance score and the responses to this question (4 for "much better," 3 for "slightly better," 2 for "about the same," and 1 for "worse") is 0.29 for Thailand (significant at a 3% level, and 0.50 for Korea (significant at a 1% level). This may be weak evidence that the Thai sample firms indeed represent those with relatively better corporate governance.

Table 5

General Information Provided by Respondent Directors:

Executive Directors (ED) and Independent Directors (ID)

	Responses	Thailand		Korea		Indonesia		Malaysia	
		ED	ID	ED	ID	ED	ID	ED	ID
Number of respondents		78	91	112	102	34	51	62	66
1. Information on respondent									
1.1 Number of corporate boards served by the respondent	1	23	30	84	72	17	20	20	6
	2	11	22	17	25	8	13	7	13
	3	11	18	6	4	2	8	12	14
	4	8	6	2	0	2	4	5	10
	5	5	2	1	0	2	5	1	7
	6 - 10	5	6	0	0	2	1	8	10
	11 or more	9	5	0	0	1	0	0	2
1.2 Background of the respondent	Business executive		29		29		22		8
	Financial institution		25		14		6		11
	Academic		7		16		3		3
	Public servant		14		7		5		21
	Other professional		13		26		8		16
	Other		2		6		5		4
2. Competitive environment of the firm									
2.1 Number of competing companies	Many	57	47	37	42	22	28	30	27
	A few	21	29	70	58	12	22	29	37
	None	0	1	4	2	0	1	0	0
2.2 Business in international markets?	Yes	64	74	98	89	20	36	43	45
	No	14	16	14	12	14	15	17	18

Table 5 (cont.)

	Responses	Thailand		Korea		Indonesia		Malaysia	
		ED	**ID**	**ED**	**ID**	**ED**	**ID**	**ED**	**ID**
2.3 Major basis of corporate competition	Price	30	28	33	25	9	22	8	7
	Overall quality	37	46	64	59	15	32	30	36
	Innovative products	4	4	9	6	10	9	7	9
	Specific customer needs	7	12	15	16	6	9	13	12
3. Relative quality of corporate governance	Much better	22	31	28	21	3	3	41	35
	Slightly better	32	40	33	25	9	14	20	28
	About the same	23	16	46	51	22	33	1	3
	Slightly worse	1	2	5	5	0	1	0	0
	Much worse	0	1	0	0	0	0	0	0
4. Corporate governance compared to 3 years ago	Much better	44	50	25	19	7	11	46	44
	Slightly better	29	33	41	31	18	23	15	21
	About the same	5	7	45	51	9	17	1	1
	Worse	0	0	0	0	0	0	0	0

4 Evaluation of Shareholders' Rights and Effectiveness of Boards of Directors

This section first discusses the key components of corporate governance mechanisms and practices: their significance and generally agreed standards. This discussion serves as a background for explaining the selection of survey questions and the scoring of survey responses. Some of the practices, particularly those pertaining to shareholders' rights, show little variations across firms in a country because they are subject to tight rules and regulations. Thus the survey results are discussed together with discussion of the relevant regulatory frameworks.

Shareholders' Rights and Disclosure of Information

The typical corporate governance framework views shareholders as the *principal*, and the objective of the management of a corporation is to maximize the interests of the shareholders. Even though shareholders entrust the board of directors to guide and monitor the management, they are given rights and opportunities to participate directly in monitoring their firms. Their basic rights include obtaining relevant corporate information on a timely and regular basis, participating in and voting at general shareholders' meetings, and electing board members (OECD 1999).

In family-controlled enterprises, corporate management tends to consist of controlling owners, who might try to maximize their own interests, often at the expense of minority shareholders. Nevertheless, minority shareholders have little incentive to monitor their firms because of the free-rider problem, making them all the more vulnerable to expropriation by the controlling owners. Thus the focus of shareholders' role in the governance of family-based corporations should be on providing minority shareholders with effective mechanisms for protecting their interests from abuses by controlling owners or management.

Many Asian countries, especially after the economic crisis, introduced a range of provisions geared toward providing more effective protection of the rights of minority shareholders. This survey is mainly concerned with effective participation in decisionmaking, with election of directors and other shareholders' rights, with actions against directors for breaches of their fiduciary duties, and with information disclosure and transparency.

Effective Participation in Decisionmaking

Shareholders have a fundamental right to vote at shareholders' meetings and all shareholders in a given class are supposed to be treated the same way.[17] Moreover, major deterrents should not stand in the way of shareholder participation in decisionmaking at shareholders' meetings. Even if shareholders cannot physically attend meetings, they should be able to participate in decisionmaking through such means as designating proxies or voting by mail. Institutional investors and minority shareholder protection groups should be allowed to play an active role in the voting process.[18] Other barriers in the notice of, registration requirement for, timing of, and venue of meetings should also be minimized. Furthermore, shareholders should be provided with adequate information about agenda items and be encouraged to ask questions, make comments, and raise issues at meetings. Thus the length of shareholders' meetings and the number of shareholders in attendance might yield information about the effectiveness of shareholders' meetings.

Election of Directors and Other Rights of Minority Shareholders

Once shareholders are given the opportunity to participate in corporate decisionmaking, important questions are what items shareholders have the

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17. Companies often issue preferred stocks, usually without voting rights, in return for favored treatment in relation to dividend payment. While these kinds of shares represent a deviation from the one share/one vote rule, they may actually be effective in distributing risks and rewards according to the preferences of corporations and shareholders (OECD 1999).

18. However, institutional investors tend to be passive in their corporate governance role for various reasons: they shun antimanagement activism because of conflicts of interest, many of them are not large enough to overcome the free-rider problem, pension funds often suffer from their own agency problem, and fund managers lack monitoring incentives because they have no direct financial stake in the firms they invest in (Becht, Bolton, and Roell 2002; Harm 2000). Empirical evidence concerning shareholder activism in the United States shows that it has a negligible impact on corporate performance regardless of its form or aim (for empirical surveys, see Black 1998; Gillan and Starks 1998; Karpoff 1998; Romano 2001).

right to vote on and what majority is required for approving items. Particularly important for the protection of minority shareholders are their preemptive rights in relation to new share issues,[19] approval of related-party transactions,[20] mandatory bid requirements,[21] and dissenters' rights.[22] Also minority shareholders should be able to inspect a firm's account books, corporate affairs, and property and request that the firm hold a shareholders' meeting without too much difficulty. Probably the most important role of the annual shareholders' meeting is to select the members of the board, particularly independent directors. Because shareholders' meetings cannot be held often, the board of directors makes most major corporate decisions on behalf of the shareholders (and other stakeholders). Thus pertinent issues are whether shareholders are fully informed about candidates for directorships before they vote; whether they can nominate their own candidates; and whether cumulative voting is permissible, whereby minority shareholders acting as a group could elect their choice of candidate.[23]

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19. Preemptive rights (or subscription rights) are the rights of current shareholders to maintain their percentage in the ownership of a company by buying a proportional number of shares of any future issue of common stock. Companies may have some limited exceptions to these rights upon the approval of shareholders when a new issue is small or shares are allocated to employees for stock option grants. For the protection of existing shareholders against a contingent ownership dilution, the rights should also be applied to convertible bond issues. These rights do not pertain to public offerings at a market price.

20. In practice, only major related-party transactions are to be approved by noninterested shareholders because of the associated inconvenience, delay, and cost.

21. A mandatory bid requirement (or a mandatory tender offer) obliges any shareholder obtaining a shareholding level in a company, say 25%, that is deemed to be a controlling interest to tender for the remaining shares in the company on comparable terms to the most recently acquired shares. Although the requirement may discourage takeover bids, it can be an important protection for minority shareholders against a change of control in which they do not have the opportunity to participate.

22. Dissenters' rights (or appraisal rights) are shareholders' rights to have the company redeem all the shares they own if they did not vote in favor of a merger, a sale or exchange of most of the company's assets, or material and adverse charter amendments. It provides protection to minority shareholders in transactions where they might be unfairly treated; however, it may constrain management in undertaking major corporate restructuring transactions if the cost of meeting the demands of dissenting shareholders is high.

23. Cumulative voting is a method of voting for corporate directors whereby each shareholder can multiply the number of shares owned by the number of directorships being voted on. The shareholder can then cast the entire total for only one director (or any other distribution the shareholder wants). It is a potentially important mechanism for large minority shareholders, particularly institutional investors, to have an effective voice; however, the

Shareholder Actions Against Directors for Breaches of Fiduciary Duties

To protect shareholders' rights adequately, they should have effective means for obtaining redress for grievances at a reasonable cost and without delay. Shareholders' grievances are usually directed toward board directors. Corporate boards have two major fiduciary duties: duty of loyalty and duty of care. Duty of loyalty means that directors should act in the interests of the company and not in their own interests, and duty of care requires directors to try to make good decisions.[24] When shareholders find that directors have not carried out their fiduciary duties properly, they should be able to resort to such means as petitioning for the dismissal of directors and auditors or the injunction of director's illegal acts, and filing derivative suits or class action suits for damage done to the company or shareholders. Even in cases where collective action suits are introduced, however, practical impediments might limit the effectiveness of this kind of legal instrument, such as requirements that plaintiffs hold a high minimum number of shares, high court filing fees, and prohibitions against lawyers charging fees on a contingency basis, few private benefits or a free-rider problem, and procedural complexities.[25]

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mechanism has also given rise to some concerns about the possibility of board deadlock and antagonism between the board and management. Also the purpose of cumulative voting can be defeated by reducing the size of the board or using staggered terms of office.

24. To fulfill the duty of loyalty in countries with a weak tradition of independent directors, greater cultural tolerance for conflict of interest transactions, and weak courts, transactions involving a conflict of interest could be approved by non-interested shareholders as well as by noninterested directors (Black 2001). Duty of care requires directors to attend meetings, pay attention, and make rational (or not completely irrational) decisions. They are usually not held liable for their business decisions. Black (2001) also adds two additional core duties of the board: duty of disclosure in cases where shareholders are asked to vote or when the company enters into a transaction involving a conflict of interest, and duty of extra care when the company is the target of a takeover.

25. A derivative suit is filed by one or more shareholders on behalf of the company against directors to recover losses incurred by the company. The suit usually lacks private incentives because the burden of proof lies with the plaintiff; legal costs are borne by the plaintiff; and, even in cases where the plaintiff wins, the award is paid to the company and claiming legal costs may require another lawsuit; and management may not take any action against the directors. A shareholder class action suit is filed by a group of shareholders directly against the directors or others for damage done to the shareholders. Unlike derivative suits, there are strong incentives for shareholders (and lawyers specializing in such litigation) and they may present a credible threat to directors because the burden of proof is on defendant directors, lawyer fees are usually contingent on the outcome, awards are paid to plaintiff shareholders, and the ruling is applied to all participating shareholders subject to the same case unless they have opted out. However, few countries have introduced this kind of lawsuit for fear of its drawbacks: potential for

As a complement to any actions shareholders can take, regulatory authorities should be prepared to deal with such unfair practices as insider trading, price manipulation, and unfair related-party transactions through such means as serious investigation, substantial penalties, and outright prohibition of certain types of transactions.[26] For shareholders to be more vigilant against violations of the directors' duty of loyalty, they should be able to identify the sources of ultimate ownership and control of the firm. Pyramid structures and complicated cross-shareholdings can give large shareholders a control right disproportionate with their equity ownership.

Transparency and Disclosure of Information

The disclosure of relevant corporate information is an essential element of market-based monitoring of companies. Disclosure and transparency induce corporations to better protect investors, and thereby enhance investor confidence in capital markets. For disclosure to be meaningful, it should be timely, accurate, and informative. Any activities that could act against the interests of minority shareholders should be disclosed.[27] How frequently a firm discloses its financial statements and regular business reports and whether subsidiaries of a business group disclose consolidated financial statements both matter. Because formal business reports are usually issued only annually or semiannually, time-sensitive information should better be reported to the regulatory authorities and posted on the company's website without delay. Use of the Internet and other information technologies can be helpful for the timely and cost-effective dissemination of information and can also facilitate action by shareholders. In relation to the reliability of disclosed information, companies must adopt internationally recognized accounting and audit standards and assure the independence of the audit process. Executive directors

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abusive or frivolous litigation and limited disclosure and overly cautious projections by management on business prospects for fear of litigation.

26. Some argue that arbitration, administrative hearings, or mediation organized by securities regulators or other regulatory bodies may be a more efficient alternative to shareholder litigation. This may be particularly true in Asian business cultures, which often prefer quiet, informal dispute resolution so that the parties involved can save face (OECD 2003).

27. OECD (1999) lists the following as the minimum material information that should be disclosed: financial and operating results of the company, company objectives, major share ownership and voting rights, members of the board and key executives and their remuneration, foreseeable risks, issues regarding employees and other stakeholders, and governance structure and policies.

or controlling shareholders should not be able to influence the appointment of internal and external auditors and audit committee members.

Effectiveness of Boards of Directors

The board of directors is the central corporate governance mechanism that the shareholders entrust to monitor and to provide strategic guidance to the management of a corporation. In the Anglo-American model, the board's major objective is supposed to be maximizing the value of the firm or the interests of all shareholders.[28] In most Asian countries, however, executive, inside directors, mostly hand picked by controlling shareholders, used to dominate boards. As such, boards of directors in family-based enterprises tended to serve primarily the interests of controlling families rather than of all shareholders. This abusive behavior could not be effectively curbed and was one of the causes of the 1997 Asian crisis.

The postcrisis programs to reform corporate governance placed high priority on restructuring corporate boards, including mandating outside directors and various committees and requiring directors to be more accountable to shareholders. However, whether these reform efforts are taking root to make boards a forum for serious deliberation of all major corporate issues and to prevent controlling owners from expropriating minority shareholders is not clear. The survey is concerned mainly with board structure and independence, functions of the board and its committees, support for directors, and director compensation and liability.

Board Structure and Independence

Board size and composition are important determinants of board effectiveness. The size should be large enough to secure sufficient expertise on the board, but not so large that productive discussion is impossible and free-riding among directors is prevalent.[29] A board should have a mix of inside/executive and

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28. However, even Anglo-American firms are increasingly sensitive to the interests of stakeholders, which may help maximize shareholder value in the long run. For instance, the mission statement of the board of directors of General Motors states that "the board's responsibilities to shareholders as well as customers, employees, suppliers and the communities in which the corporation operates are all founded upon the successful perpetuation of the business."

29. Salmon (2000) suggests that the optimum size of a board is between 8 and 15 people for large, publicly traded companies. With fewer than eight members, a board is likely to have

outside/independent directors with a variety of experience and core competence if it is to be effective in judging the management's performance objectively.[30] For the purpose of board independence, a substantial share of a board should consist of independent directors.[31] Having the board chairperson be someone other than the CEO is also believed to enhance the board's independence on the ground that the roles of supervisor and supervised should not be combined, though the separation might result in side-effects that could have a detrimental effect on firm performance.[32] Finally, for firms with many foreign shareholders, having foreigners represented on the board may be another indication of board independence.

The behavior of independent directors may also be directly observed. For example, do they often meet without inside directors to discuss corporate matters, actively participate in board discussions, sometimes alter or add to board meeting agendas, or ask for the minutes of board meetings?

To improve the board's vigilance and to ensure continued independence, restricting the dismissals of directors and introducing fixed term limits, particularly for outside directors, may be necessary (Warther 1998). However, the extent of board independence, which often defies direct observation, may

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difficulty staffing audit, compensation, and other committees. Salmon also suggests that in relation to inside directors, only three executives be members of the board: the CEO, the chief operating officer, and possibly the chief financial officer.

30. Independent directors should not have any significant family or business relationship with the management or with controlling owners that might interfere with the exercise of independent judgment. Employees or representatives of affiliated companies, suppliers, providers of professional services, and important customers should also be disqualified on the grounds of conflict of interest (Salmon 2000). However, OECD (2003) notes that "however precise the definition of 'independence', or rigorous its enforcement, legal norms by themselves cannot ensure that 'independent' directors will act independently." (p.50)

31. OECD (1999) emphasizes that a sufficient number of nonexecutives capable of exercising independent judgment on corporate affairs be assigned to tasks where there is a potential for conflicts of interest, such as financial reporting, nomination, and executive and board remuneration.

32. Mandatory separation of the CEO and chairperson positions might undermine the strategic leadership and accountability of corporations and might trigger damaging power struggles at the top ranks of corporations (OECD 2003). Stewardship theorists argue that managers are the steward of a company's assets, not an agent of shareholders, and that the economic performance of a firm increases when power and authority are concentrated in the same person acting as CEO and chairperson, whose depth of knowledge, information, and technical expertise as well as commitment are critical requirements for a successful firm (Davis, Shoorman, and Donaldson 1997; Donaldson and Davis 1991; Muth and Donaldson 1998).

be better assessed by gathering subjective opinions about why independent directors might not be behaving independently. This may be due to the CEO's influence over the choice and reappointment of directors, outside directors' limited knowledge and information, directors' limited financial stake in the firm, or cultural reasons.

Functions of the Board and of Board Committees

The board's overall role and specific functions may have to be assessed on the basis of the subjective opinions of directors. Specific functions include formulating long-term corporate strategies; selecting, monitoring, and replacing the CEO; reviewing the remuneration of executives and directors; overseeing potential conflicts of interest; and ensuring the integrity of financial reporting, the proper disclosure of information, and the effectiveness of various governance practices (OECD 1999). As a practical matter, how much time and effort directors devote to board meetings may also be an indicator of board effectiveness, for instance, the frequency and length of board meetings, the directors' attendance rate, and the number of boards on which directors serve.

Certain important board functions are often better performed by board committees, especially if the board is so large that decisionmaking is inefficient. Committees also allow for a division of labor based on the expertise of individual directors and help the board have more clearly defined mandates, particularly in relation to monitoring management.[33] The independence and effectiveness of the audit committee is particularly important and may be assessed by its composition (share of independent directors, presence of accounting or finance experts, and whether or not the committee chair is an independent director) and practices (meeting minutes, members' remuneration, written rules for the audit process, role in the selection of internal and external auditors, and quality of the working relationship with the auditors). Board compensation and nomination committees should, without undue influence by the CEO or controlling owners, formally review the performance and

33. Thus the role of independent directors is deemed especially important in such committees as audit, compensation, and nomination committees that deal with conflicts of interest. It may be advisable that all board committees include at least one or a majority of independent directors in the expectation that this would enhance the objectivity and transparency of committee decisionmaking and enable the independent directors to develop expertise in technical aspects of corporate management that will help them perform their overall oversight functions better (Coudert Brothers and others 2000).

compensation packages of senior executives and other directors and play a major role in the selection and dismissal of the CEO and independent directors. Stock options for executives that align their interests with those of shareholders are believed to be one of the most powerful corporate governance mechanisms, although they may also be abused and inefficient.[34]

Access to Information and General Support for Independent Directors

For the board of directors to function properly the directors, especially the independent directors, must have access to relevant information. This means that independent directors should be able to meet freely for discussions with the company's managers and workers, have access to business records and books of account, receive detailed information about board meeting agendas, and obtain necessary outside professional services at the company's expense. Firms should also designate a contact person to provide support to outside directors. Even more critical may be the provision of relevant education and training for directors, because many of them may be unfamiliar with the roles of directors, in which case the controlling owner of the firm may easily be able to manipulate the board.

Director Compensation and Liability

Directors need to be adequately compensated, and the compensation package may include stock options or company shares as a way of better aligning their interests with those of shareholders. Moreover, directors' compensation could be based on a formal mechanism for evaluating their performance. Their compensation should take into account their potential liability for the company's breach of fiduciary duties. Some companies pay to have their directors covered by insurance for any personal liability. While this practice may help recruit better qualified outside directors by eliminating any risk of catastrophic personal losses, it is likely to weaken their attention to their fiduciary duties.[35]

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34. For instance, management can manipulate corporate earnings and stock prices (Yermack 1997) and may time the flow of good and bad news prior to granting the option (Aboody and Kasznik 2000). Options are inefficient if they are not based on a performance measure pertinent to the industry or on market averages. Furthermore, evidence indicates that firms subject to blockholder monitoring or with representatives of the controlling family on the board are less likely to implement stock option plans (Kole 1997; Mehran 1995).

35. A solution may be to provide indemnification (insurance) to directors and officers for breach of the duty to care, but let them be responsible for certain expenses, such as actual

Survey Results

This section briefly summarizes the main findings of the survey on shareholders' rights and the equitable treatment of shareholders and the effectiveness of the board of directors or commissioners. It is based mainly on the firm-level questionnaire survey.

The surveyed firms are doing relatively well in allowing shareholders to participate effectively in decisionmaking and to exercise other shareholders' rights. Minority shareholders, however, seem to encounter difficulties in calling special shareholders' meetings, putting issues on meeting agendas, and participating in corporate decisionmaking through voting by mail. They are also inadequately protected with such rights as priority subscription, approval of major related-party transactions, and dissenters' rights and take little part in the process of selecting directors. Sample firms perform relatively poorly in the areas of information disclosure and transparency, particularly in relation to matters that might involve self-dealing or related-party transactions, other conflicts of interest, or undermining of the independence of external auditors. Firms are not yet making full use of web sites to disclose information in a timely fashion and to enhance transparency.

The size and composition of boards varies widely among the countries surveyed. The independence of independent directors is questionable, particularly in Korea judging from their behavior in relation to setting board agendas. The factor most responsible for such lack of independence seems to be that the CEO or controlling owner effectively selects directors rather than any cultural values or other behavioral norms. The boards in the countries under review are generally weak in performing their functions, particularly those pertaining to selecting, monitoring, and replacing the CEO and reviewing the remuneration of key executives and directors, and tend not to have active board committees. They appear to be particularly poor in evaluating directors' performance and supporting outside directors with access to information, outside professional services, secretarial assistance, education and training, and incentive compensation.

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awards of damages (Coudert Brothers and others 2000). Alternatively, in cases where directors have acted in good faith, their personal losses could be limited to a multiple of their total annual compensation, as proposed by the American Law Institute (1994).

Shareholders' Rights and Equitable Treatment of Shareholders— Factual Information

Section 2 discussed regulatory frameworks related to the workings of shareholders' meetings, other rights of shareholders, and information disclosure and transparency (see Table 1). This section mainly discusses the results of the questionnaire survey directed at the corporate secretaries of respondent firms (Table 6). Survey questions were mostly restricted to those likely to reveal variations in practices among different firms in a country. In discussing the survey results the paper also refers to relevant regulatory frameworks.

Effective Participation by Shareholders in Decisionmaking

On the regulatory side, shareholders in Thai firms seem to be more handicapped in relation to effective participation in decisionmaking than those in the other countries. They are given short notice (7 days) for an annual shareholders' meeting, and the thresholds for requiring an extraordinary shareholders' meeting (20% or 25 shareholders) and for placing items on the shareholders' meeting agenda (one-third of shareholders) are much higher than in the other three countries surveyed (see Table 1). Given the typically high ownership concentration, the high thresholds may effectively block minority Thai shareholders from these forms of shareholder initiatives.

In other respects, however, shareholders in the other three countries seem to face more constraints than Thai shareholders. In Indonesia, corporate directors and commissioners are not eligible for serving as proxies. In Korea, the time for asking questions and placing issues at a shareholders' meeting is often inadequate, and related-party transactions are not fully discussed at Korean shareholders' meetings. Indeed, in Korea, related-party transactions are not subject to shareholder approval.

Shareholders' meetings tend to be better attended in Korea and Malaysia, partly reflecting the larger number of shareholders, while few shareholders' meetings in Indonesia and Thailand are attended by more than 100 shareholders. More than 70% of shareholders' meetings in Malaysia run longer than an hour, while the percentage stands at 23% in Korea, 30% in Thailand, and 35% in Indonesia. Obviously, shareholders' meetings in countries like Korea are far from being a forum for the serious exchange of corporate information and discussion of policies.

Table 6
Shareholder Rights and Disclosure of Information
Factual Information

	Responses	**THA**	**KOR**	**INO**	**MAL** [1]
1. One-share one-vote rule observed?	No deviation	59	95	66	39
	Non-voting preferred stock	2	14	0	28
2.1 Voting by mail allowed?	Yes [2]	12	34	25	42
	No	46	74	39	27
2.2 Can anybody serve as a proxy?	Yes	60	101	25	65
	No	0	8	39	4
3.1 Adequate information on agenda items of shareholders' meeting?	Y+	38	46	51	46
	Y	23	54	15	23
	0	0	10	0	0
	N	0	1	0	0
	N+	0	0	0	0
3.2 Adequate time for asking questions and placing issues at shareholders' meeting?	Y+	44	47	43	46
	Y	17	51	22	23
	0	0	12	1	0
	N	0	0	0	0
	N+	0	0	0	0
3.3 Priority subscription right adequately protected?	Y+	25	60	31	45
	Y	24	41	31	22
	0	8	7	4	2
	N	0	0	0	0
	N+	1	0	0	0
3.4 Related-party transactions fully discussed?	Y+	24	45	29	39
	Y	28	35	34	30
	0	5	24	2	0
	N	4	3	0	0
	N+	0	0	1	0
3.5 Not difficult to know the extent of voting right control by major shareholders?	Y+	22	55	32	44
	Y	29	42	31	24
	0	5	9	2	1
	N	1	3	0	0
	N+	2	0	1	0
4. Nominating candidates and electing outside directors					
4.1 Prior disclosure of director candidates?	Yes	49	102	49	64
	No	12	8	17	5
4.2 Can minority shareholders nominate director candidates?	Yes	50	60	57	54
	No	11	49	9	12

	Responses	THA	KOR	INO	MAL
4.3 Cumulative voting allowed?	Introduced, and has been exercised	6	1	13	
	Introduced, but not yet exercised	10	7	26	
	Opted out	36	102	26	
4.4 Can director candidates proposed by management be rejected?	Sometimes	0	1	9	7
	Rarely	30	41	37	31
	Unthinkable	31	67	20	29
5.1 Length of shareholders' meeting	Less than 30 minutes	12	22	1	5
	30-60 minutes	31	64	42	13
	1-2 hours	16	9	20	38
	2-3 hours	1	16	2	7
	Over 3 hours	1	0	1	4
5.2 Number of shareholders attending	25 or less	2	16	37	0
	26 -100	48	56	27	15
	More than 100	8	34	2	41
6. Disclosure of corporate information					
6.1 Self-dealing, related-party transactions	Web	10	19	1	7
	Report to regulatory agencies (RR)	50	100	51	60
	Annual report (AR)	51	51	45	66
	No disclosure	3	1	1	0
6.2 Directors' selling or buying shares of their company	Web	4	17	0	11
	RR	55	100	23	66
	AR	29	41	49	65
	No disclosure	0	2	15	0
6.3 Resume or background of directors	Web	12	22	9	54
	RR	44	82	45	48
	AR	51	55	23	69
	No disclosure	1	6	5	0
6.4 Directors' remuneration	Web	8	14	2	8
	RR	40	68	45	45
	AR	56	69	15	69
	No disclosure	0	2	15	0
6.5 Fees paid to external auditors, advisors & other related parties	Web	4	8	0	4
	RR	35	57	20	43
	AR	39	61	7	67
	No disclosure	9	11	42	2
6.6 Major contingent liabilities	Web	5	16	1	2
	RR	33	91	56	43
	AR	45	62	42	66
	No disclosure	1	0	2	0

Table 6 cont.

	Responses	THA	KOR	INO	MAL
6.7 Policies on risk management	Web	7	7	1	19
	RR	33	39	52	30
	AR	48	44	22	69
	No disclosure	4	37	6	0
6.8 Significant changes in ownership	Web	11	24	6	19
	RR	49	99	52	66
	AR	45	53	54	63
	No disclosure	2	4	3	0
6.9 Governance structures and policies	Web	13	10	4	17
	RR	38	51	58	33
	AR	44	37	21	68
	No disclosure	6	32	4	0
6.10 Observance of established governance standards	Web	10	3	2	12
	RR	36	32	49	46
	AR	43	24	18	68
	No disclosure	2	53	9	0
7.1 Disclose semi-annual reports?	Yes	7	111	61	29
	No	49	0	5	40
7.2 Disclose quarterly financial statements?	Yes	57	111	64	68
	No	0	0	2	1
7.3 Company web-site informative both in local language and English?	Informative in both languages	35	57	30	64
	Limited information in English	6	24	7	0
	Informative, but none in English	2	23	3	0
	Not informative, none in English	3	6	6	0
	No web-site	15	1	20	5
8. International standards for accounting and audit ?	Virtually the same	51	62	54	68
	Some relaxation	7	40	4	1
	Substantially lower	0	2	0	0
	Not sure	3	7	8	0

Notes: 1. THA, KOR, INO, and MAL indicates Thailand, Korea, Indonesia and Malaysia, respectively.

2. Voting by mail is not explicitly acknowledged in Thailand and Indonesia. Nevertheless, some firms seem to allow this practice in these countries. It was also suggested by the local consultants that some of the positive responses could be due to respondents' confusion with the nomination of proxies by mail.

When asked about the adequacy of information provided in relation to agenda items for shareholders' meetings and the sufficiency of time for questions and placing issues at meetings, virtually all sample firms responded positively except for 10% of the Korean firms. All four countries seem to observe the one share/one vote rule except for nonvoting preferred stocks, whose issuance is relatively common in Malaysia (42%) and not uncommon in Korea (13%).

Other Rights of Shareholders

In the selection of directors, all four countries rarely use cumulative voting, and Korean minority shareholders seem to be less able to nominate director candidates and block unqualified candidates proposed by the management. Although cumulative voting is acknowledged in all the survey countries except for Malaysia, more than 90% of the Korean firms and almost 70% of the Thai firms opted out by means of their articles of association, while the figure is lower at 40% for the Indonesian firms. The firms that have actually exercised cumulative voting for the selection of directors account for 12% of the firms in Thailand and 20% in Indonesia. Minority shareholders can nominate director candidates in 86% of the Indonesian and 82% of the Malaysian and Thai firms, while they can do so in only 55% of the Korean firms. When asked whether director candidates proposed by management may be rejected at a shareholders' meeting, 61% of the Korean and 51% of the Thai firms responded "unthinkable," while such responses were 43% and 30% for Malaysian and Indonesian firms, respectively.

Approval of director and commissioner remuneration and new share issues is more difficult in Thailand (requiring two-thirds and three-quarters majority voting rights of attending shareholders, respectively) than in the other three countries. Shareholders in Indonesia and Thailand seem to be poorly protected in relation to priority subscription rights in cases of share and convertible bond issues (see Table 1). While 65% of the Malaysian firms and 56% of the Korean firms respond that priority subscription rights are very well (Y+) protected, only 47% of the Indonesian and 43% of the Thai firms give such a strong positive response. To the question of whether related-party transactions are fully discussed at shareholders' meetings, all the Malaysian firms, 95% of the Indonesian firms, and 85% of the Thai firms responded positively, compared with 75% of the Korean firms. In all four countries surveyed, most firms responded positively about the transparency of voting right control by major shareholders.

Minority shareholders in the countries are protected by mandatory tender offers when anyone acquires shares above a certain threshold (except in Korea), dissidents' rights (except in Malaysia), and derivative suits (except in Malaysia). However, the practical benefits of these rights seem to be limited because of poor enforcement and inadequate incentives. None of the countries currently use securities class action suits, but Korea is to introduce them in 2005 and Thailand is also considering the introduction of such suits.

Information Disclosure and Transparency

Disclosure of corporate information seems to be relatively good for such information as self-dealing or related-party transactions, significant changes in ownership, directors' trading of their company shares, resumes of directors, and directors' remuneration. Most of the Malaysian and Thai firms seem to disclose all major corporate information either to the regulatory agency or in their annual reports; however, unlike in the other two countries, they do not issue or disclose semi-annual reports.

Except for the Malaysian firms, disclosure of such information as fees paid to external auditors, advisers, and other related parties is less common, as are observance of established governance standards, policies on risk management, and governance structures and policies. The Indonesian firms tend not to disclose information about commissioners trading their company shares and their remuneration. Relatively more Korean respondents say that their companies' accounting and audit practices are not up to international standards.

The use of company web sites for information disclosure is relatively rare for the Indonesian firms and much more common for the Malaysian firms. Virtually all the Korean and 93% of the Malaysian sample firms have web sites, while 30% of the Indonesian and 25% of the Thai firms do not. However, 48% of the Korean firms note that their web sites have no or limited information in English. While reports to regulatory agencies as a means of information disclosure seem to be more prevalent than information disclosure by means of annual reports in Indonesia and Korea, the opposite is generally the case in Malaysia and Thailand.

Effectiveness of the Board of Directors or Commissioners

Effectiveness of the board is evaluated by both factual information about the board of directors or commissioners and the opinions of executive and independent directors or commissioners on the workings of the board.

Factual Information

Table 7 presents factual information about boards of directors, which may be evaluated together with the information on regulatory frameworks about the boards presented in Table 2.

Board structure. The size of boards in the sample countries differs widely. The median board size is around 12 in Thailand, 8-10 in Malaysia, 6-7 in Korea, and 4 in Indonesia. Of the Indonesian firms, 80% have five or fewer board members, compared with 39% of the Korean firms and virtually none of the Malaysian and Thai firms. While 67% of the Thai firms have more than 10 directors, this is the case for 22% of the Malaysian firms, less than 5% of the Korean firms, and virtually none of the Indonesian firms. The small size of the Indonesian boards is partly due to the dual board system.

The share of independent directors or commissioners on boards is typically between 25% and 50%, although in 37% of the Thai boards independent directors account for fewer than 25% of board members. Independent directors account for half or more of total board members in almost 30% of the Malaysian firms, about 20% of the Indonesian and Korean firms, and only 12% of the Thai firms.[36] While the positions of CEO and board chairperson are separate for 88% of the Malaysian firms and 82% of the Thai firms (and 100% of the Indonesian firms because of the dual board system), this is the case for only 7% of the Korean firms. Foreign nationals are represented on 59% of the Thai boards, compared with only 33% of the Indonesian boards, 22% of the Malaysian boards, and 9% of the Korean boards.

The boards in the countries surveyed often include directors from affiliated companies (about half of the Indonesian firms and almost one-third in the other three countries), which may cause conflicts of interest. Malaysian and Thai boards tend to have more stakeholders represented, probably because of

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36. The minimum number of directors or commissioners is regulated at five for Thailand, three for Korea (firms with total capital of more than W500 million), and two for Indonesia and Malaysia. The regulated minimum number of independent directors or commissioners is 25% of the total board size (or three and a majority for banks or firms with total assets of more than W2 trillion) in Korea, 30% in Indonesia, two directors in Thailand, and two directors or one-third of the total in Malaysia. In Korea, nonexecutive directors are restricted to serving on no more than two corporate boards, while Indonesia and Thailand have no such restrictions. In Malaysia, an individual may serve on a maximum of 25 boards: 10 boards of listed companies and 15 boards of unlisted companies.

Table 7
Effectiveness of the Board of Directors
Factual Information

	Responses	**THA**	**KOR**	**INO**	**MAL**[1]
1. Board size and composition					
1.1 Board size	1 - 3	0	6	30	2
	4 - 5	2	37	23	2
	6 - 7	3	32	11	14
	8 - 10	15	31	1	34
	11 - 13	19	3	1	11
	14 - 16	17	2	0	3
	17 and more	4	0	0	1
1.2 Share of outside directors	0.5 or more	19	22	14	51
	0.25-0.5	23	87	51	14
	Less than 0.25	17	2	1	3
1.3 Share of independent directors	0.5 or more	7	22	14	20
	0.25-0.5	30	87	51	45
	Less than 0.25	22	2	1	3
1.4 Foreign nationals on the board?	Yes	36	10	22	15
	No	25	101	44	52
1.5 Is CEO also board Chairman?	Yes	11	103	0	8
	No	50	8	66	59
2.1 Directors from creditor financial institutions?	Yes	13	10	6	16
	No	48	98	60	53
2.2 Directors representing labor?	Yes	0	1	2	7
	No	61	105	64	61
2.3 Directors from affiliated companies?	Yes	19	34	31	21
	No	42	73	32	48
2.4 Directors from supplier or customer companies?	Yes	11	3	3	4
	No	50	103	63	65
2.5 Directors from providers of professional services?	Yes	10	16	4	24
	No	51	92	62	45
3. Independent directors and board independence					
3.1 Independent directors meeting without management?	Often	19	7	5	19
	Sometimes	21	23	36	34
	Rarely	9	53	18	8
	Never	12	28	7	8

	Responses	THA	KOR	INO	MAL
3.2 Independent directors having some influence in setting board meeting agenda?	Often	8	0	2	10
	Sometimes	23	23	39	26
	Rarely	18	64	16	25
	Never	12	24	9	8
3.3 Independent directors actively participating in board discussions?	Often	53	47	25	64
	Sometimes	7	41	34	4
	Rarely	1	21	3	1
	Never	0	1	4	0
3.4 Independent directors sometimes disapproving agenda items?	Often	1	0	0	8
	Sometimes	14	17	23	27
	Rarely	22	74	32	29
	Never	24	20	10	5
3.5 Detailed minutes of board meetings?	Often	35	15	49	37
	Sometimes	11	27	8	11
	Rarely	3	53	4	18
	Never	12	15	5	3
4. Term of independent directors	1-3 years	58	107	39	54
	More than 3 years	2	1	27	4
5. Board committees and the proportion of independent directors					
5.1 Audit committee	Less than 50%	18	1	47	12
	50-75%	4	7	5	35
	75% or more	30	16	0	19
	No audit committee	1	83	10	0
5.2 Compensation committee	Less than 50%	12	1	2	13
	50-75%	4	0	0	29
	75% or more	1	1	0	17
	No compensation committee	38	104	64	7
5.3 Nomination committee	Less than 50%	6	5	2	11
	50-75%	1	16	0	30
	75% or more	1	3	0	20
	No nomination committee	51	81	64	5
6. Effectiveness and independence of audit committees					
6.1 Have accounting or finance specialists?	Yes	60	28	55	69
	No	1	2	1	0
6.2 Chaired by independent director?	Yes	59	26	56	69
	No	2	5	0	0
6.3 Minutes written?	Yes	60	27	51	68
	No	0	3	5	0
6.4 Members' pay separately approved by shareholders ?	Yes	27	4	30	51
	No	32	25	26	18

Table 6 cont.

	Responses	THA	KOR	INO	MAL
6.5 Written rules governing audit function?	Yes	58	25	38	68
	No	2	2	18	1
6.6 Select & supervise external auditor?	Very much so	39	11	13	47
	To some extent	17	13	37	22
	Hardly	3	5	6	0
6.7 Select & supervise internal auditor?	Very much so	42	12	16	48
	To some extent	17	14	34	21
	Hardly	1	3	6	0
7. Evaluation and compensation of CEO					
7.1 Evaluate CEO performance?	Yes, as a routine	20	20	32	51
	Sometimes	10	20	20	14
	Rarely	7	20	6	3
	Never	23	44	8	0
7.2 Review CEO compensation?	Yes, as a routine	22	18	29	48
	Sometimes	10	22	19	17
	Rarely	9	25	10	3
	Never	18	38	8	0
7.3 CEO given a stock option?	Substantially	3	4	4	26
	Some	5	10	5	29
	None	52	88	55	12
8.1 Frequency of board meetings	2-3 times	3	1	31	3
	4-5 times	29	8	24	28
	6-7 times	12	18	4	16
	8 times or more	17	82	7	20
8.2 Length of board meetings	1 hour or less	1	42	12	4
	1-2 hours	30	55	38	49
	2-3 hours	28	9	12	6
	3-4 hours	1	2	4	6
	Over 4 hours	1	1	0	3
8.3 Board meeting attendance rate	90-100%	23	54	19	48
	80-90%	22	23	27	19
	70-80%	11	22	16	1
	60-70%	3	10	4	0
	50-60%	1	0	0	0
9. Education/training for directors (beyond what is mandatory)?	Active	12	23	0	43
	Occasional	42	77	35	26
	Never	7	11	31	0
10. Contact person for outside directors?	Yes	45	45	23	64
	No	16	66	43	4
11. Stock-based pay for outside directors?	Yes	3	12	1	41
	No	58	98	65	28

	Responses	THA	KOR	INO	MAL
12. Formal mechanism for evaluating director performance?	Yes, and effective	5	20	4	53
	Yes, but ineffective	3	15	11	5
	No formal mechanism	53	76	51	11
13. Directors covered by insurance?	None	38	74	57	11
	Yes, but only partially	7	6	6	35
	Yes, fully	16	31	3	23

Note: 1. THA, KOR, INO, and MAL indicates Thailand, Korea, Indonesia and Malaysia, respectively.

their bigger size, that is, creditor financial institutions and providers of professional services (also supplier or customer companies in Thailand). None or few of the boards of directors surveyed have members representing labor, though they represent 10% of the total in Malaysia.

Board independence. The observed behavior of independent directors indicates that Korean independent directors are far less independent than those in the other three countries. While 62% of the Indonesian firms, 52-77% of the Malaysian firms, and 51-66% of the Thai firms respond positively ("often" or "sometimes") to the questions whether independent directors meet without management to discuss corporate matters and alter or add to board meeting agendas, such positive responses account for 21-27% of the Korean firms. Strong positive ("often") responses to the question of how actively independent directors participate in board discussions account for around 90% of the Malaysian and Thai firms, in contrast to about 40% of the Indonesian and Korean firms. However, in response to the question of how likely independent directors are to disapprove agenda items at board meetings, about 50% of the Malaysian firms and 35% of the Indonesian firms responded positively, compared with 25% of the Thai firms and 15% of the Korean firms.

Compiling detailed minutes of board meeting discussions may encourage independent directors to behave more independently and enhance their performance. Individual directors' positions on board meeting agenda items are recorded "often or sometimes" in the minutes in 86% of the Indonesian firms, 75% of the Thai firms, 70% of the Malaysian firms, and 38% of the Korean firms. A relatively short term of service of independent directors may also help them perform better. Indonesian firms are free to set the terms of

directors in their articles of association (terms exceeded 3 years for 41% of the surveyed firms), while firms in the other countries are subject to regulations that prescribe a 3-year maximum term.

Board functions and committees. Audit committees are mandatory in all the countries under study except for Korea, where audit and nomination committees are required only for large firms with total assets exceeding W2 trillion (see Table 2). The survey results show that virtually all the Malaysian and Thai boards and 84% of the Indonesian boards have audit committees, in sharp contrast with 22% of the Korean boards of directors. However, independent directors are in the minority in most of the audit committees in Indonesia, while they constitute a majority in virtually all the Korean committees, more than 80% of the Malaysian committees, and 65% of the Thai committees. Compensation committees are in place in almost 90% of the Malaysian boards and 31% of the Thai boards, but are virtually absent in the Indonesian and Korean boards. Nomination committees are found in more than 90% of the Malaysian boards, but exist in only 23% of the Korean boards and 14% of the Thai boards, and are virtually nonexistent in the Indonesian firms. Nonindependent directors tend to dominate Thai compensation and nomination committees, while the opposite is the case in Malaysia.

Virtually all the audit committees in the survey countries have accounting or finance specialists; are chaired by a genuine independent director; take minutes of committee meetings; and, with some exceptions for Indonesian committees, have written rules governing the overall audit function. Compensation for audit committee members is separately approved at shareholders' meetings in 74% of the Malaysian firms with an audit committee, 54% of the Indonesian firms, and 46% of the Thai firms, while the practice is relatively rare in Korea. Almost 70% of the Malaysian and Thai firms with audit committees responded that the committees "very much" select and supervise external and internal auditors, compared with about 40% in Korea and 23-29% in Indonesia.

The Malaysian boards are relatively active in evaluating CEO performance and compensation, as are the boards of commissioners in Indonesia, probably because of the dual board system. Most of the Malaysian firms and 73-79% of the Indonesian firms undertake this task "as a routine" or "sometimes", in contrast with 50-54% of the Thai firms and a little less than 40% of the Korean firms. Over 80% of surveyed firms in Malaysia give their CEO a stock option, while 13-14% do so in each of the other three countries.

The survey results reveal that almost half of the Indonesian firms had three or fewer board meetings in 2002, while almost all the firms in other three countries had four or more meetings. Korean firms tended to have more frequent but shorter board meetings. Malaysia and Thailand averaged five or six board meetings a year. The share of firms with an average board meeting attendance rate of more than 80% was virtually 100% in Malaysia, 75% in Thailand, and about 70% in Indonesia and Korea.

General support, compensation, and liability. More than 60% of the Malaysian firms and about 20% of the Korean and Thai firms "actively" provide their directors with education or training opportunities (beyond what is mandatory), while no Indonesian firms give such a positive response. Mandatory training for board members is required only in Malaysia. Contact personnel are designated to support outside directors in most of the Malaysian firms, 74% of the Thai firms, 41% of the Korean firms, and 35% of the Indonesian firms.

Outside directors receive stock-based pay in almost 60% of the Malaysian firms, but only 11% of the Korean firms and almost none of the Indonesian and Thai firms. A formal mechanism for evaluating directors' performance seems to be operating effectively in more than 75% of firms in Malaysia, but in less than 20% of the firms in Korea and less than 10% of the firms in Indonesia and Thailand. Insurance coverage at the firms' expense for directors' personal liability is still uncommon except in Malaysia, where more than 80% of the firms provide such protection.

Opinion Survey

Opinions are subjective, but may be more useful than factual information. The degree of effectiveness of certain rules and practices and their underlying reasons may be obtainable only by asking opinions. An opinion survey can also obtain respondents' perspectives about priority tasks for enhancing corporate governance. The survey results are presented in Table 8.

Independence of independent directors. To the question of whether independent directors are truly independent, slightly fewer than 60% of the Korean directors respond positively, while most directors in the other countries do so. However, the figure for those who strongly agree stands at 65% for Malaysia, 40% for Thailand, 29% for Indonesia, and 16% for Korea. The poor result for Korea is consistent with the relatively low marks scored for the behavioral patterns and performance of independent directors in the factual survey.

Table 8

Effectiveness of the Board of Directors

Opinion Survey

	Responses	**Thailand**		**Korea**		**Indonesia**		**Malaysia**	
		ED	**ID**	**ED**	**ID**	**ED**	**ID**	**ED**	**ID**
1. Are "independent" directors truly independent?	Y+	25	43	17	18	11	13	40	43
	Y	44	39	47	42	13	34	20	22
	O	4	5	34	25	9	3	1	0
	N	3	2	11	16	0	1	0	1
	N+	1	2	2	1	0	0	0	0
2. Why not fully independent from the CEO or the controlling owner?									
2.1 Because CEO effectively selects board members	Y+	12	15	14	10	0	1	7	11
	Y	28	42	49	50	8	10	11	28
	O	13	14	17	16	6	8	21	6
	N	13	12	10	13	11	26	20	11
	N+	8	4	9	3	9	6	3	10
2.2 Because of concern over personal relationship with other directors	Y+	5	8	0	0	0	0	8	9
	Y	37	46	12	8	11	10	17	23
	O	15	17	36	27	7	9	21	9
	N	12	12	28	47	12	28	10	15
	N+	4	4	21	9	4	4	6	10
2.3 Because of conflict with behavioral norm	Y+	2	2	0	0	0	0	6	8
	Y	20	31	12	8	3	3	9	20
	O	27	25	34	32	10	8	22	11
	N	21	20	31	39	17	34	22	18
	N+	4	6	21	13	4	6	3	9

2.4 Because CEO effectively decides extension or termination of the directorship	Y+	6	6	3	6	0	2	5	7
	Y	16	26	32	27	5	6	8	11
	O	11	21	30	36	6	6	20	25
	N	28	19	18	17	15	28	24	12
	N+	12	13	15	6	8	9	5	11
2.5 Because of concern of future responsibility when their opinion deviates from consensus	Y+	4	4	0	1	0	1	5	5
	Y	19	22	17	14	3	6	20	25
	O	14	28	41	31	11	10	16	8
	N	30	23	26	37	17	29	16	17
	N+	5	10	13	9	3	5	5	11
2.6 Because management is better informed and has better judgment	Y+	10	8	13	8	0	0	7	9
	Y	32	36	44	38	10	17	21	23
	O	17	18	21	29	10	8	18	10
	N	13	20	12	11	12	19	14	17
	N+	2	4	8	4	2	7	2	7
3. Strongest voice in selecting or dismissing independent directors	Board or nomination committee	45	38	36	37	12	20	44	49
	CEO	10	15	53	47	2	2	2	1
	Controlling owner	22	38	22	18	16	29	16	16
4.1 Is your board a forum of serious discussion for all significant corporate matters?	Y+	26	35	43	37	7	12	39	43
	Y	48	41	54	44	21	30	22	22
	O	4	8	9	14	3	3	1	1
	N	0	6	5	7	3	6	0	0
	N+	0	1	0	0	0	0	0	0
4.2 Is your board rather perfunctory?	Y+	0	0	0	3	2	0	1	1
	Y	3	6	18	16	2	3	2	1
	O	5	10	22	23	6	8	9	5
	N	40	43	40	35	13	26	21	24
	N+	29	30	29	24	11	14	27	3

Table 8 cont.

	Responses	Thailand		Korea		Indonesia		Malaysia	
		ED	ID	ED	ID	ED	ID	ED	ID
5. Is your board active in, and making much contribution to, the following tasks?									
5.1 Formulating long-term strategies	Y+	24	21	26	20	5	12	34	31
	Y	37	54	71	52	21	35	27	34
	O	12	7	12	22	5	1	0	0
	N	5	8	2	8	2	0	1	1
	N+	0	1	0	0	1	3	0	0
5.2 Selecting, monitoring, and replacing CEO?	Y+	9	6	6	5	6	6	31	30
	Y	34	33	36	25	18	18	24	27
	O	20	32	42	33	8	20	4	2
	N	12	15	23	32	2	4	2	5
	N+	3	2	5	7	0	3	1	2
5.3 Reviewing key executive & director remuneration	Y+	8	7	9	6	6	6	35	37
	Y	39	43	47	32	18	25	23	23
	O	19	17	40	43	6	12	4	1
	N	9	19	15	19	3	6	0	5
	N+	3	4	1	2	1	2	0	0
5.4 Overseeing potential conflicts of interest including related-party transactions	Y+	20	25	13	11	4	12	37	37
	Y	46	45	62	36	22	34	25	28
	O	7	9	30	42	7	1	0	1
	N	5	8	7	12	0	4	0	0
	N+	0	1	0	1	1	0	0	0
5.5 Ensuring the integrity of firm's financial reporting	Y+	44	41	27	22	6	13	39	41
	Y	32	46	70	52	23	35	23	23
	O	1	3	12	24	5	3	0	0
	N	0	0	2	3	0	0	0	2
	N+	1	0	1	0	0	0	0	0

5.6 Ensuring proper disclosure and communication with shareholders & other stakeholders	Y+	36	38	16	10	3	11	42	41
	Y	36	46	64	54	26	32	20	25
	O	3	5	26	31	4	7	0	0
	N	2	2	6	6	0	1	0	0
	N+	1	0	0	0	0	0	0	0
5.7 Ensuring the effectiveness of various governance practices	Y+	23	32	10	6	5	11	44	45
	Y	50	52	51	45	19	33	17	21
	O	4	5	42	32	8	6	1	0
	N	1	2	8	16	1	1	0	0
	N+	0	0	0	2	0	0	0	0
6 Strongest voice in removing a poorly performing CEO and selecting a new CEO	Board of directors	37	44	22	16	12	8	37	41
	Owner + board	38	47	66	55	26	32	33	29
	Owner + manager	6	7	18	20	6	8	4	2
	Controlling owner	11	19	15	19	0	9	4	1
	Other	3	7	0	0	1	4	0	2
7. How good is access to information for independent directors?									
7.1 Contact with managers and workers	Often	18	21	24	11	1	7	31	29
	Sometimes	45	51	59	58	22	33	25	28
	Rarely	9	13	28	25	11	9	5	8
	Never	5	6	1	8	0	2	1	1
7.2 Access to business records and books of account	No restriction at all	64	65	99	90	24	38	59	51
	Somewhat limited	11	22	13	8	7	13	3	15
	Very limited	2	3	0	4	3	0	0	0
7.3 Adequate information in time for digestion before board meetings	Very much so	53	60	96	78	14	29	53	49
	Not always	23	28	14	19	20	18	8	17
	Rarely	1	2	2	5	0	4	1	0

Table 8 cont.

	Responses	Thailand		Korea		Indonesia		Malaysia	
		ED	ID	ED	ID	ED	ID	ED	ID
7.4 Obtain outside professional services at the firm's expense?	Yes	43	55	71	56	10	18	45	44
	Only exceptionally	26	23	32	36	20	26	17	22
	Never	8	10	9	10	4	7	0	0
8. Compensation for independent directors	Overpaid	3	2	0	0	0	0	0	0
	Adequate	65	69	94	76	33	43	56	47
	Inadequate	10	18	17	25	1	8	6	19
9. Concern about potential director liability	Very serious	19	35	1	2	6	10	32	43
	Serious	35	32	29	19	23	33	26	19
	Slightly concerned	19	19	57	61	2	5	3	3
	Not concerned	5	5	25	20	2	3	0	1
10. Priorities for a more effective board									
10.1 Selecting more of better qualified, truly independent directors	Y+	27	38	19	22	6	7	39	44
	Y	39	32	72	60	20	37	19	19
	O	5	14	17	17	7	5	2	1
	N	5	5	2	3	1	1	2	2
	N+	1	0	2	0	0	0	0	0
10.2 Separating CEO from the board chairman position	Y+	32	31	9	16			43	51
	Y	25	32	42	29			16	12
	O	10	21	38	31			1	1
	N	6	4	18	20			1	2
	N+	3	0	4	6			1	0
10.3 Promoting board room culture encouraging constructive criticism and alternative views	Y+	28	38	19	20	6	14	42	46
	Y	41	47	71	60	24	33	19	20
	O	7	3	18	18	4	3	0	0

	N	0	1	2	3	0	0	1	0
	N+	0	0	2	1	0	0	0	0
10.4 Timely provision of relevant information to the directors	Y+	32	41	21	24	6	15	42	41
	Y	41	46	67	54	24	32	19	25
	O	2	2	18	22	4	3	1	0
	N	1	0	2	1	0	0	0	0
	N+	0	0	2	1	0	0	0	0
10.5 Providing education programs and adopting codes of conduct for directors	Y+	21	30	12	16	3	9	40	45
	Y	47	47	57	43	20	34	20	18
	O	7	12	32	33	9	7	1	0
	N	1	0	9	8	2	0	0	2
	N+	0	0	2	1	0	0	1	1
10.6 Formal annual evaluation of the board and directors	Y+	12	21	9	15	4	11	41	43
	Y	46	49	64	42	25	34	20	23
	O	16	14	26	31	5	5	1	0
	N	1	4	11	10	0	0	0	0
	N+	1	0	2	4	0	0	0	0
10.7 Formal CEO evaluation by the board	Y+	13	30	6	14	5	11	43	47
	Y	44	42	54	36	24	34	18	14
	O	16	17	38	33	5	5	1	1
	N	2	0	12	12	0	0	0	4
	N+	1	0	2	5	0	0	0	0
10.8 Giving directors better and more performance-based compensation	Y+	8	17	9	15	2	9	30	32
	Y	25	35	72	49	22	33	19	20
	O	31	29	26	31	9	7	12	11
	N	10	8	2	5	1	1	0	3
	N+	2	0	1	1	0	0	1	0

Table 8 cont.

	Responses	Thailand		Korea		Indonesia		Malaysia	
		ED	**ID**	**ED**	**ID**	**ED**	**ID**	**ED**	**ID**
10.9 Better disclosure of board activity	Y+	12	17	9	15	2	8	40	45
	Y	43	54	53	47	26	38	21	17
	O	19	12	40	32	6	4	0	1
	N	1	3	9	6	0	0	1	3
	N+	0	0	1	1	0	0	0	0
11. Will the following contribute to the better performance of outside directors?									
11.1 Better attendance at board meetings	Y+	31	37	13	17	9	17	43	50
	Y	42	38	66	49	23	27	18	16
	O	2	10	27	29	1	3	1	0
	N	1	1	6	3	1	4	0	0
	N+	0	0	0	3	0	0	0	0
11.2 Better preparation for, and more active participation in, board discussion	Y+	32	35	16	27	9	18	45	51
	Y	43	44	80	61	24	33	17	15
	O	1	5	14	9	1	0	0	0
	N	0	1	2	4	0	0	0	0
	N+	0	0	0	0	0	0	0	0
11.3 Better knowledge of the business of the firm	Y+	39	40	15	28	12	21	47	56
	Y	34	43	81	57	20	30	15	10
	O	3	2	14	15	1	0	0	0
	N	0	1	1	2	1	0	0	0
	N+	0	0	0	0	0	0	0	0
11.4 Better awareness of their fiduciary duties to all shareholders	Y+	30	33	16	21	7	14	43	48
	Y	41	48	67	52	24	35	16	17
	O	5	7	24	23	3	2	3	1
	N	0	0	5	6	0	0	0	0
	N+	0	0	0	0	0	0	0	0

As for the reasons why the independent directors may not be fully independent, the responses for Korea and Thailand are similar. More than 60% of them respond positively to the statement that it is because of CEOs' effective selection of board members, and about 35% of them respond positively to the statement that it is because CEOs decide on the extension or termination of the directorships. Such responses are substantially fewer for the Malaysian directors, and rare for the Indonesian commissioners, probably because of the dual board system. Also about 55% of the Korean and Thai directors, a little less than 50% of the Malaysian directors, and 32% of the Indonesian commissioners respond positively to the reason that the CEO and the management team are better informed about most issues and have better judgment. For the Malaysian and Thai directors, concerns about personal relationships with other directors seem to be an important factor, but the Indonesian commissioners, and the Korean directors in particular, generally disagree that the lack of independence is due to personal relationships among directors or commissioners or conflicting behavioral norms.

In the selection of independent directors or commissioners, the strongest voice seems to be with the board of directors in Malaysia (73%) and Thailand (49%), but with the controlling owner in Indonesia (56%) and the CEO in Korea (47%). However, this difference may be of little significance given that Thai boards have the smallest share of independent directors and that most Korean CEOs are either controlling owners are or handpicked by them.

Board roles and functions. More than 80% of the directors in all four countries agree that their boards are a forum for serious discussion for all significant corporate matters, although almost 20% of the Korean directors respond that their boards are rather perfunctory.

In the case of Malaysia, respondents give virtually no negative or neutral responses in relation to all major board tasks except for selecting, monitoring, and replacing CEOs (13%) and reviewing key executive and director remuneration (8%). The boards in the other three countries seem to be doing a relatively good job of ensuring the integrity of corporate financial reporting (with 80-97% positive responses), formulating long-term corporate strategies (79-86%), and ensuring proper disclosure to and communication with shareholders and other stakeholders (68-92%). However, they tend not to play any significant role in selecting, monitoring, and replacing CEOs (34-56%) and reviewing key executive and director remuneration (44-65%). Also only

53-57% of the Korean directors respond that their boards are doing well in ensuring the effectiveness of governance practices and overseeing potential conflicts of interest, compared with more than 80% of the Indonesian and Thai directors. Controlling owners seem to have the strongest voice in removing a poorly performing CEO and selecting a new CEO, with the boards playing only a secondary role, with the likely exception of Malaysia.

Support for directors. Concerning access to information, 12% of the Malaysian directors, 20% of the Thai directors, and 26-28% of the Indonesian and Korean directors say that independent directors never or rarely have contact with managers or workers, and about 25% of Indonesian and Thai respondents indicate that independent directors have limited access to business records or books of account. Indonesian independent commissioners seem to face more constraints than independent directors in the other three countries in their access to information about board meeting agendas and to outside professional services. To the question of whether adequate information is provided sufficiently ahead of board meetings for directors to be able to read and understand it, the Indonesian respondents show a 51% positive response rate, compared with about 80% for Korea and Malaysia and 68% for Thailand. As for access to outside professional services at the company's expense, only 33% of the Indonesian commissioners respond positively, compared with 70% of the Malaysian directors and 59% of the Korean and Thai directors.

Most of the directors believe that the compensation for independent directors is adequate, although 11-20% of them think that it is inadequate. As for potential director liability for breach of the duty of care, most of the directors or commissioners in Indonesia, Malaysia, and Thailand (72-94%) are fairly concerned, while relatively few Korean directors (24%) show such concern. Apparently Korean directors are not fully aware of their fiduciary duties, probably because of the poor protection of minority shareholders against the breach of such duties.

Priorities for more effective boards and better performance by outside directors. The respondents in the four countries generally agree that the highest priorities for a more effective board are the timely provision of relevant information to directors and the promotion of a boardroom culture that encourages constructive criticism and alternative views. Other priorities include selecting more better qualified, truly independent directors; carrying out formal evaluations of the board and directors; providing education to

directors; and adopting codes of conduct for directors. Support is relatively weak for separating the CEO from the position of board chairperson (except in Malaysia, and particularly in Korea), and for giving directors better and more performance-based compensation (particularly in Thailand).

In relation to better performance by outside/independent directors, the respondents strongly indicate the importance of knowledge of the business of the firm, adequate preparation, and active participation in board discussions. Other priorities also generally supported by the respondents include better attendance at board meetings and better awareness of their fiduciary duties to all shareholders, including minority shareholders.

5 *Linkage Between the Quality of Corporate Governance and Firm Performance*

Better corporate governance is supposed to lead to better corporate performance by preventing the expropriation of controlling shareholders and ensuring better decisionmaking. In expectation of such an improvement, the stock price may respond instantaneously to news indicating better corporate governance. However, quantitative evidence supporting the existence of a link between the quality of corporate governance and firm performance is relatively scanty. On the basis of the questionnaire survey, this study attempts to assess the existence of such a link. To this end, the corporate practices revealed in the survey responses have to be scored and an appropriate analytical model has to be used.

The results show that for all the firms surveyed, corporate governance scores are strongly associated with firm performance as measured by Tobin's q (measured as the ratio of market value to book value of a firm). Although the score for shareholders' rights alone does not show any significant association with firm performance, scores for board effectiveness and overall scores (average scores for shareholders' rights and board effectiveness) turn out to be significant. The market seems to discount the quality of corporate governance by about 30% in the case of firms controlled by a single, domestic owner. The evidence also supports the view that corporate governance matters more in countries where the legal and judicial systems for protecting investors are weak. Finally, the components of corporate governance practices that the market pays most attention to appear to differ across countries; however, the most important component for all sample firms seems to be the various forms of support for directors, that is, the area in which the sample firms score most poorly.

Existing Evidence

Good governance means little expropriation of corporate resources by managers or controlling shareholders, which contributes to better allocation of resources and better performance. As investors and lenders will be more willing to put their money in firms with good governance, they will face lower costs of capital, another source of better firm performance. Other stakeholders, including employees and suppliers, will also want to be associated with and enter into business relationships with such firms, as the relationships are likely to be more prosperous, fairer, and longer lasting than those with firms with less effective governance.

Implications for the economy as a whole are also obvious. Economic growth will be more sustainable, because the economy is less vulnerable to a systemic risk. With better protection of investors at the firm level, the capital market will also be boosted and become more developed, which is essential for sustained economic growth. At the same time, good corporate governance is critical for building a just and corruption-free society. Poor corporate governance in big businesses is fertile soil for corruption and corruptive symbiosis between business and political circles. Less expropriation of minority shareholders and fewer corruptive links between big businesses and political power may result in a more favorable business environment for smaller enterprises and more equitable income distribution.

According to a survey by McKinsey & Company (2002), in 2002, 78% of professional investors in Asia said that they were willing to pay a premium for a well-governed company. The average premium these investors were willing to pay generally ranged from 20% to 25%. Many scholars have attempted to investigate the relationship between good governance and firm performance in a more rigorous way.

Specific Corporate Governance Practices and Firm Performance

The agency theory says that better corporate governance should lead to higher stock prices or better long-term performance, because managers are better supervised and agency costs are decreased. However, as Gompers, Ishii, and Metrick (2001) suggest, the evidence of a positive association between corporate governance and firm performance may have little to do with the agency explanation.[37] In connection with the relationship between corporate

37. First, prescient managers may deliberately choose some corporate governance practices.

governance and firm value, the most studied governance practices include board composition and size and takeover defenses.

Board Composition

Empirical studies of the effect of board membership and structure on firm value or performance generally show results either mixed or opposite to what would be expected from the agency cost argument. While some studies find better performance for firms with boards of directors dominated by outsiders (Ellingson 1996; Millstein and MacAvoy 1998; Rosenstein and Wyatt 1990; Weisbach 1988),[38] others find no such relationship in terms of accounting profits or firm value (Bhagat and Black 2000; Hermalin and Weisbach 1991; Johnson 1996; Klein 1998; MacAvoy and others 1983; Mehran 1995; Rosenstein and Wyatt 1997; Weir and Laing 2001). Dalton and others (1998) provide meta-analyses of 54 empirical studies of board composition and 31 empirical studies of board leadership structure and their relationships to firm financial performance. They find little evidence of a relationship between board composition or leadership and firm financial performance. (For other pertinent surveys see Bhagat and Black 1999 and Hermalin and Weisbach 2001.)

As has been the case in many family-based Asian corporations, boards dominated by insiders are not expected to play their role as effective monitors and supervisors of management. This is particularly so when the board chairperson is also the firm's CEO. In addition, outside directors provide firms with windows or links to the outside world, thereby helping to secure critical resources and expand networking. By contrast, if we assume, as stewardship theory argues, that managers are inherently trustworthy, outsider-dominated boards may not do their job any better. While outside directors bring a breadth of knowledge and expertise to the firm, they may have a limited understanding of the firm's business, which would impede their ability to guide and supervise

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For example, in expectation of business deterioration, managers might adopt anti-takeover defenses or ban cumulative voting to protect their jobs. Second, the quality of corporate governance may simply be a signal or symptom of a firm's agency cost or managerial power. Furthermore, poor firm performance might lead to increases in board independence. This reverse causality may, in a cross-sectional analysis, result in a finding that better corporate governance is associated with poor firm performance (Hermalin and Weisbach 1998).

38. Millstein and MacAvoy (1998), for example, find that large, publicly traded, American firms with a professional (active and independent) board had higher "economic profit" (operating earnings in excess of the costs of capital) during the first half of the 1990s.

the management (Donaldson and Davis 1991), and could even stifle strategic action and result in excessive monitoring. Thus the finding that board composition does not matter much may not be surprising.[39] However, Black (2000) suggests that these results are likely to be coming from relatively small variations in corporate governance practices in the United States and other industrial countries, while a host of factors affect firm performance. Moreover, Heracleous (2001) notes that different types of organizations may need different corporate governance practices and suggests that more attention should be given to behavioral observations and in-depth interviews.

In the case of a sample of 228 small, private firms in Shanghai in the People's Republic of China, Liang and Li (1999) report that the presence of outside directors is positively associated with higher returns on investment, though they do not find such a relationship for board size or the separation of the positions of CEO and board chairperson. Furthermore, Bhagat, Carey, and Elson (1999) show that the amount of stock owned by individual outside directors is significantly correlated with various measures of firm performance as well as CEO turnovers (believed to be for a disciplinary purpose) in poorly-performing companies.[40]

Board Size

Unlike for board composition, a fairly clear negative relationship appears to exist between board size and firm value (Eisenberg, Sundgren, and Wells 1998; Yermack 1996). Too big a board is likely to be less effective in substantive discussion of major issues (Jensen 1993; Lipton and Lorsch 1992) and to suffer from free-rider problems among directors in their supervision of management (Hermalin and Weisbach 2001).

Anti-Takeover Provisions

Gompers, Ishii, and Metrick (2001) find that firms with strong shareholders' rights in relation to provisions for defending against takeovers perform better

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39. See Treichler (1995) for a discussion of the advantages and disadvantages of different types of board composition and Stiles (2001) for alternative theories about the roles and contributions of boards of directors.

40. They believe that these results provide empirical support for the notion of an equity-based director duty of care. However, they also note that the positive association between the amount of stock owned by outside directors and firm performance does not necessarily indicates better monitoring of management by the board, because the directors may adjust their stockholdings on the basis of their inside information about the firm's prospects.

and have a higher market valuation. Bertrand and Mullainathan (1999a, 1999b, 2003) find that the presence of state takeover laws decreases plant-level efficiency in terms of total factor productivity or return on capital. They show that this result is at least partly due to increased agency costs evidenced by increased compensation for CEOs and employees. Sundaramurthy, Mahoney, and Mahoney (1997) show that negative market reactions to anti-takeover provisions vary depending on firms' board structure. Separation of the positions of CEO and chairperson of the board reduces the negative effects, while increased outsider representation increases negative market reactions.

Shareholder Activism

Nesbitt (1994) and Smith (1996) report positive performance effects for the shareholder activism of the California Public Employees' Retirement System (CalPERS).[41] Karpoff, Malatesta, and Walking (1996) find little evidence that corporate governance resolutions initiated by shareholders lead to better firm performance. Carleton, Nelson, and Weisbach (1998) show that financial institutions can be fairly effective in pushing target companies to take steps to comply with their corporate governance proposals. They also find that any short-term valuation effects resulting from activism are dependent on the specific type of governance issue targeted. Gillan and Starks (2000) find that shareholder proposals by individuals have small, positive announcement effects, while proposals by institutional investors have a small but significant negative effect on stock prices. Overall, the empirical literature on shareholder activism in the United States seems to indicate that it has a negligible impact on corporate performance (Black 1998; Gillan and Starks 1998; Karpoff 1998; Romano 2001).

Overall Quality of Corporate Governance and Firm Performance in Emerging Markets

Most empirical studies of corporate governance practices and firm performance pertain to the industrial countries, and empirical evidence for emerging markets is scanty. The limited empirical investigations in these economies are more

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41. CalPERS is the largest public retirement system in the US and is well-known for being an active shareholder who assertively provides direction to the management of firms they have holdings in. In addition to watching over the behavior of firms it invests in, CalPERS also has an active interest in broad issues such as encouraging good governance practices and good financial reporting practices.

concerned with the overall quality of corporate governance rather than with any particular practices or features of such governance.

For example, for a sample of 17 Russian public companies that vary significantly in terms of corporate governance practices, Black (2000) finds that good governance practices are strongly correlated with higher firm value as measured by the ratio of actual market capitalization to theoretical Western market capitalization.

Black, Jang, and Kim (2003) and Campos, Newell, and Wilson (2002) cite similar results. Black, Jang, and Kim's results are based on an overall corporate governance index obtained from an extensive survey dataset for 540 firms compiled by the Korea Stock Exchange. Campos, Newell, and Wilson's sample consists of 188 companies from six emerging markets (India, Korea, Malaysia, Mexico, Taipei,China, and Turkey). Both groups of investigators find that good governance is rewarded with a higher market valuation even after controlling for a company's financial performance and other firm characteristics. Using corporate governance rankings for 495 firms in 25 emerging markets compiled by the Credit Lyonnais Securities Asia in 2001, Klapper and Love (2002) show that better corporate governance is highly correlated with better operating performance and market valuation.

Klapper and Love (2002) also find that corporate governance provisions at the firm level matter more in countries with weak legal environments. As Doidge, Karolyi, and Stulz (2001) suggest, controlling shareholders in countries with poor investor protection are giving up (and returning to outside shareholders) potentially large private gains by putting good corporate governance practices in place. Thus investors in these countries appreciate good corporate governance practices more than investors in countries with strong legal environments.

Scoring Corporate Governance Practices

Each study has its own way of constructing corporate governance scores depending on the authors' views on particular governance practices and the degree of deviation among the firms surveyed. For example, the corporate governance rankings by the investment bank Brunswick Warburg that Black (2000) uses are based on eight corporate governance elements with different weights: disclosure and transparency, dilution through share issuance, asset stripping and transfer pricing, dilution through a merger or restructuring,

bankruptcy, limits on foreign ownership, management attitude toward shareholders, and registrar risk.

Black, Jang, and Kim (2003) choose 42 items from 123 survey questions, excluding those asking management's views rather than facts, those irrelevant to corporate governance, those that are ambiguous as to whether they represent good or bad corporate governance, and those to which the answers vary little from firm to firm. They then classify the 42 items into four categories, each of which has an equal weight of 0.25: shareholders' rights, board of directors in general, outside directors, and disclosure and transparency.

The survey Klapper and Love (2002) use has a total of 57 questions with yes or no answers. They are classified into the following seven categories: discipline, transparency, independence, accountability, responsibility, fairness, and social awareness. Each category has a weight of 0.15 except for the last one, which has a weight of 0.10.

The scores for Campos, Newell, and Wilson (2002) are based on the following 15 elements of good governance derived from the OECD's principles of corporate governance (OECD 1999):

- Ownership and shareholder protection: dispersed ownership, transparent ownership, one share/one vote, anti-takeover defenses, and meeting notification
- Board of directors: board size, outside directors, independent directors, written board guidelines, and board committees
- Disclosure and transparency: disclosure, accounting standards, independent audits, broad disclosure, and timely disclosure.

Opinion surveys of professional investors may provide some guidance on the construction of corporate governance scores. McKinsey & Company's (2002) survey respondents say that for corporations, timely and broad disclosure is the highest priority, followed by independent boards, effective board practices, and performance-related compensation for directors and management. The survey also shows that priority areas for policymakers include strengthening shareholders' rights, improving accounting standards, making disclosure more effective, and ensuring stronger enforcement.

Investors' responses will, of course, reflect their major concerns given realities in particular regions or countries. A survey by PricewaterhouseCoopers Indonesia

and the Jakarta Stock Exchange (2002) reports that what Indonesian institutional investors value most highly includes disclosure of related-party transactions and corporate governance practices. The existence of corporate governance codes and business ethics, as well as the quality and independence of external auditors, audit committees, and commissioners and directors, is also important. The existence of nomination and remuneration committees and the number of independent commissioners seem to be less essential for their investment decisions.

Scoring the quality of corporate governance is subjective and can be controversial. Analysts are unlikely to agree on whether or not a certain aspect of corporate governance should be included, how much weight should be given to each aspect, and what scores should be given to responses to individual questions. However, because our survey includes many questions on various elements of corporate governance and aggregate scores are based on a large number of questions, the problem of subjectivity in scoring is likely to be mitigated. Appendix B presents specific questions included in scoring by category, weights given to survey questions, and scores for responses to individual questions.[42]

On shareholders' rights based on factual information, the questions are grouped into the following three categories:

- EP: effective participation of shareholders in decisionmaking
- OR: election of directors and other shareholders' rights
- DT: disclosure of information and transparency.

Weights for individual questions are given so that each category's full score is 100. To obtain the aggregate score for shareholders' rights (SHR), the scores for EP, OR, and DT are simply averaged.

Two sets of survey questions pertain to the effectiveness of boards of directors, one based on factual information and the other based on the opinion survey of executive directors and independent directors. Both sets of questions have the following three scoring categories:

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42. Rules and regulations concerning shareholders' rights and board effectiveness that are supposed to impose the same practices for most firms in a country were not included in the survey, and thus in the scoring. The effects of these differences across countries on firm performance will be reflected in the coefficients of country dummy variables included in the equations. In cases where two executive directors or two independent directors from a company responded (as in Thailand), the scores for the two responses were averaged.

- CI: board composition and independence
- BF: functions of the board and the activities of board committees
- IS: access to information, general support and compensation for and liability of directors.

Again, weights for individual questions are assigned so that each of these categories has a full score of 100. By simply averaging the scores for CI, BF, and IS, an aggregate score for board effectiveness (BE) is obtained. There are three different scores for BE: one based on factual information (denoted simply as BE), one based on the opinions of executive directors (BE-ed), and the third based on the opinions of independent directors (BE-id).

Without any information about which scores might be more important, the overall score used is the simple average of the scores for SHR and BE, referred to as CGS. However, the study attempts to search for the "right" weights from the estimation of firm performance equations with the various components of corporate governance scores as independent variables.

Tables 9 and 10 and Figure 1 present corporate governance scores by country and category. The overall score (CGS) for Malaysia is far better than that for the other three countries. Among the other countries, the score is highest for Thailand and lowest for Korea. The scores for the Malaysian and Thai firms show a smaller dispersion than for the Korean and Indonesian firms. There are relatively small differences in scores for SHR among countries, as well as among sample firms within a country. Differences in the overall corporate governance scores are due mainly to differences in scores for board effectiveness based on factual information (BE). As expected, firms with higher SHR scores also tend to have higher scores for BE, and a positive relationship is apparent between BE-ed and BE-id. However, these positive relationships are not very strong and for the Thai firms, no positive association is noted between BE and BE-ed or BE-id (Figures 2 and 3).[43]

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43. The lack of a discernible positive relationship between BE and BE-ed or ED-id for the Thai firms may partly be due to poor quality of some of these scores. Given that a positive association is still observed between BE-ed and BE-id, these scores might be more reliable than BE as a measure of board effectiveness for the Thai firms.

Table 9
Corporate Governance Score by Country

	Thailand		Korea		Indonesia		Malaysia	
Overall Corporate Governance Scores: CGS [1] and CGSw [2]								
	CGS	CGSw	CGS	CGSw	CGS	CGSw	CGS	
90-100	0	0	0	0	0	0	0	
80-90	0	0	0	1	0	0	14	
70-80	6	0	6	2	1	0	34	
60-70	20	11	12	12	6	2	17	
50-60	29	18	38	23	35	7	4	
40-50	6	23	33	29	21	17	0	
30-40	0	6	22	36	3	33	0	
20-30	0	3	0	8	0	7	0	
10-20	0	0	0	0	0	0	0	
0-10	0	0	0	0	0	0	0	
Average	**59.1**	**49.6**	**50.2**	**45.5**	**52.5**	**39.2**	**73.8**	
Scores for Shareholder Rights (SHR) and Board Effectiveness (BE)								
	SHR	BE	SHR	BE	SHR	BE	SHR	BE
90-100	0	0	0	0	0	0	1	1
80-90	1	0	3	0	4	0	22	12
70-80	21	1	30	3	12	0	28	31
60-70	24	12	36	4	35	1	17	19
50-60	15	21	38	13	14	6	1	4
40-50	0	18	4	20	1	19	0	1
30-40	0	9	0	26	0	31	0	1
20-30	0	0	0	34	0	7	0	0
10-20	0	0	0	11	0	2	0	0
0-10	0	0	0	0	0	0	0	0
Average	**66.8**	**51.4**	**63.9**	**36.6**	**66.2**	**38.8**	**75.8**	**71.8**

Notes: 1. CGS is the average of the scores for shareholder rights (SHR) and for board effectiveness (BE).

2. CGSw is a weight average of some of the components of the SHR and BE, where the weights were derived from an estimated equation measuring the effect of corporate governance on firm performance. Specifically, CGSw = 0.22 EP + 0.19 DT + 0.10 CI + 0.49 IS, where EP is the score for effective participation of shareholders in decision-making, DT is the score for disclosure and transparency, CI is the score for board composition and independence, and IS is the score for information access and support for directors.

Table 10

Distribution of Corporate Governance Score by Subcategory and Country

Shareholder Rights:
Effective Participation (EP), Other Rights (OR), Disclosure & Transparency (DT)

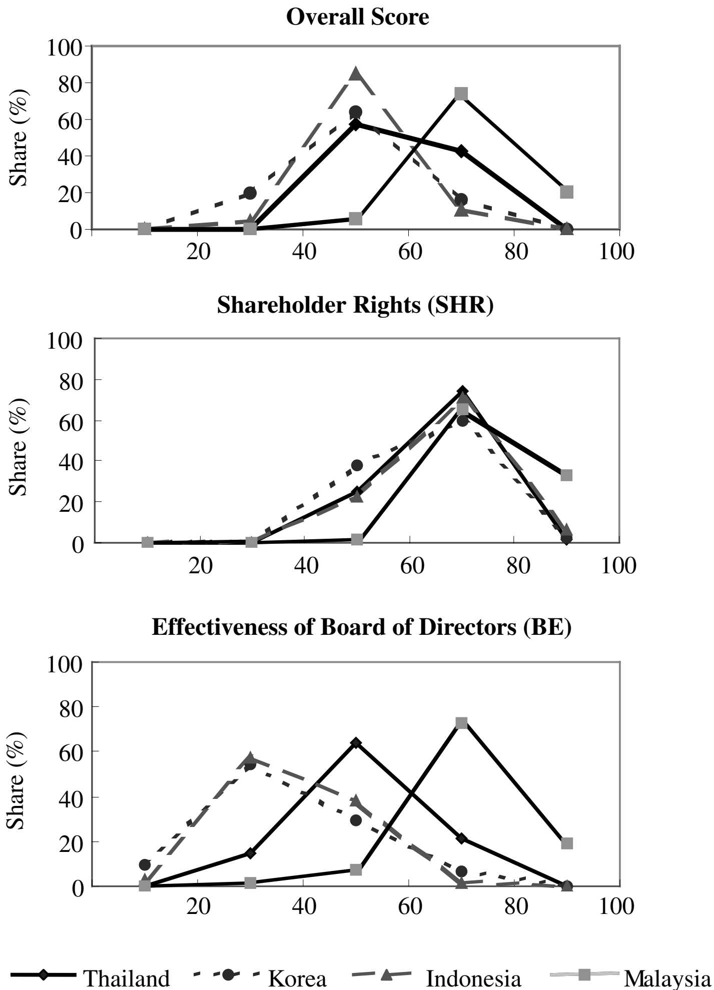
	Thailand			**Korea**			**Indonesia**			**Malaysia**		
Score	**EP**	**OR**	**DT**	**EP**	**OR**	**DT**	**EP**	**OR**	**DT**	**EP**	**OR**	**DT**
90-100	0	0	0	3	1	2	3	3	0	16	5	1
80-90	13	10	2	20	10	5	3	15	0	21	23	10
70-80	24	19	11	30	25	16	16	25	16	9	22	33
60-70	24	13	18	34	34	27	15	16	21	16	14	21
50-60	0	13	29	22	26	28	25	4	17	6	4	3
40-50	0	4	0	2	11	24	4	2	8	1	1	1
30-40	0	2	1	0	4	8	0	1	4	0	0	0
20-30	0	0	0	0	0	1	0	0	0	0	0	0
10-20	0	0	0	0	0	0	0	0	0	0	0	0
0-10	0	0	0	0	0	0	0	0	0	0	0	0
Average	**73.2**	**66.6**	**60.5**	**70.0**	**63.2**	**58.5**	**65.2**	**72.8**	**60.5**	**78.7**	**76.7**	**72.0**

Effectiveness of Board of Directors: Factual Information
Composition & Independence (CI), Functions (BF), Information Access & Supports (IS)

	Thailand			**Korea**			**Indonesia**			**Malaysia**		
Score	**CI**	**BF**	**IS**	**CI**	**BF**	**IS**	**CI**	**BF**	**IS**	**CI**	**BF**	**IS**
90-100	0	0	0	0	1	0	0	0	0	1	8	18
80-90	3	4	0	0	0	1	1	0	0	6	32	7
70-80	17	11	0	3	6	2	9	0	0	20	17	13
60-70	18	15	2	17	6	5	11	16	0	15	10	11
50-60	19	13	13	22	10	16	14	17	3	20	2	11
40-50	1	8	10	42	5	17	14	16	3	7	0	5
30-40	2	10	6	19	23	9	13	11	7	0	0	1
20-30	1	0	18	7	27	17	4	6	10	0	0	2
10-20	0	0	1	1	33	11	0	0	10	0	0	0
0-10	0	0	11	0	0	33	0	0	33	0	0	1
Average	**64.1**	**58.2**	**31.9**	**47.4**	**33.3**	**29.1**	**51.3**	**48.5**	**16.7**	**64.8**	**79.6**	**71.2**

Looking at the category of shareholders' rights, the Malaysian firms are better than firms in all the other countries in all categories (Table 10). In the three other counties, the Thai firms are better in EP and the Indonesian firms do relatively well in OR. The Korean firms are not bad in EP, but score poorly in both OR and DT. As for the scores for board effectiveness, the Malaysian firms are far better than firms in the other countries in BF and IS. For CI, the Thai firms are almost as good as the Malaysian firms. The Korean firms are

Figure 1
Corporate Governance Score by Country



particularly poor in the area of BF. The IS scores are poor for all the countries except Malaysia, but particularly for the Indonesian firms.

Table 11 presents a rough picture of the distribution of various corporate governance scores and firm performance measured in Tobin's q and return on assets (ROA). The standard deviation of scores for SHR and BE is much larger for the Korean firms than for the other countries. The median value of

Figure 2

Distribution of Corporate Governanace Scores

Shareholder Rights vs. Board Effectiveness

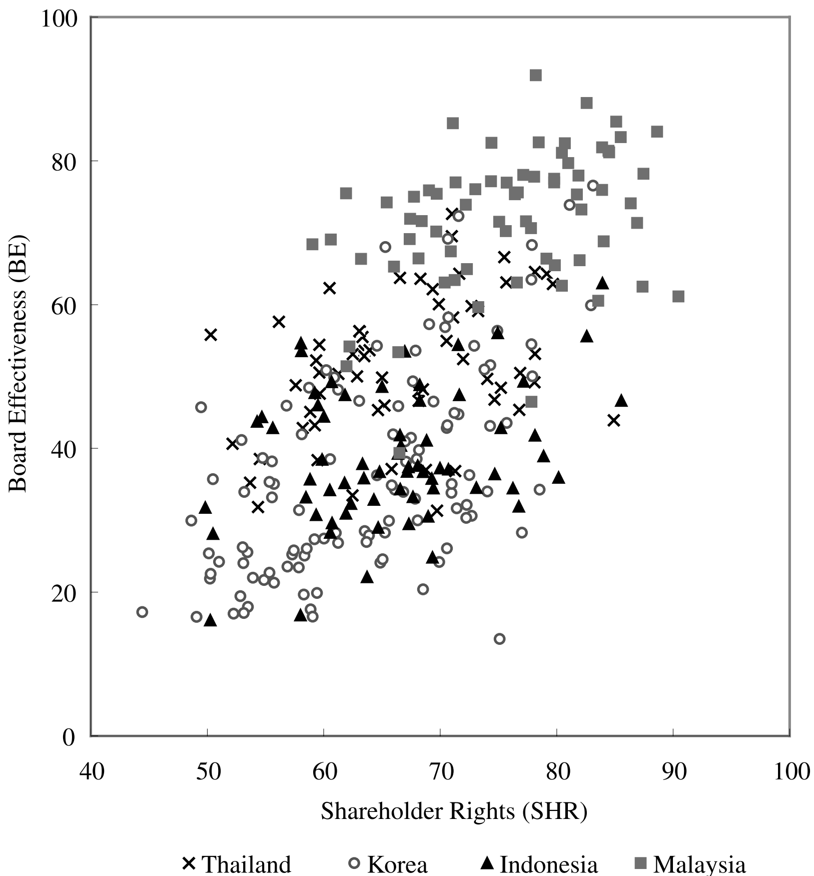
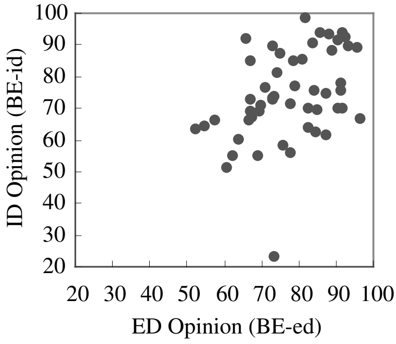
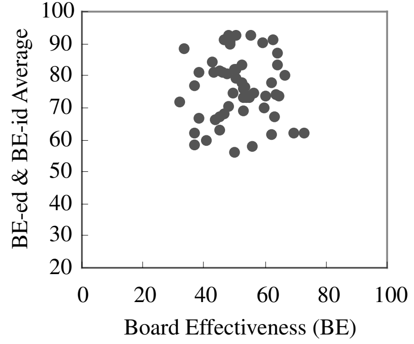


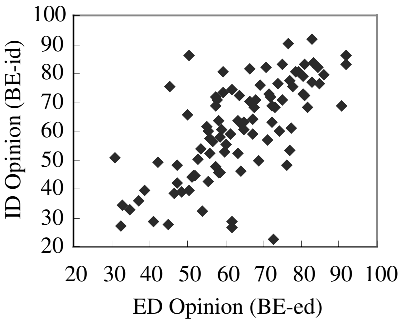
Figure 3
Relationship between Scores for Board Effectiveness

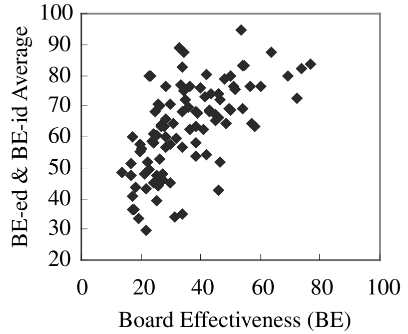
Thailand



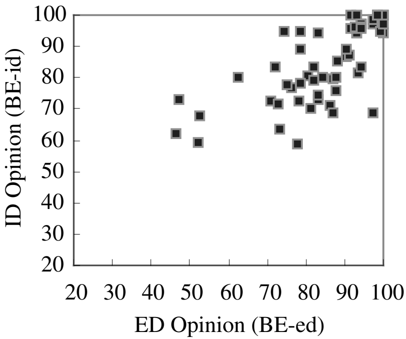


Korea





Malaysia



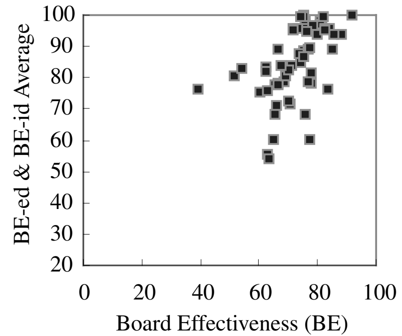


Table 11

Distribution of Firm Performance and Corporate Governance Scores [1]

	Lower 25%				Middle 50% (Median)				Higher 25%				Mean	Standard Deviation			
	THA	**KOR**	**INO**	**MAL**	**THA**	**KOR**	**INO**	**MAL**	**THA**	**KOR**	**INO**	**MAL**	**All**	**THA**	**KOR**	**INO**	**MAL**[2]
Tobin's q	0.69	0.49	0.57	0.70	0.97	0.78	0.99	1.05	1.57	1.18	2.66	2.01	1.05	0.38	0.27	1.05	0.64
ROA (2000-02)	-5.8	-0.9	-17.4	-6.9	5.4	5.7	3.3	4.0	14.3	12.3	17.9	11.5	5.9	9.3	5.6	18.1	8.6
CGS	48	38	42	64	59	49	52	74	70	64	64	82	58	7.2	10.4	7.1	7.2
CGSw	36	31	29		50	44	38		63	63	53		45 [3]	10.5	12.5	9.3	
SHR	57	53	57	65	67	64	66	76	77	75	77	85	68	7.8	8.8	8.0	7.7
EP	64	56	51	61	73	70	64	80	83	83	82	94	72	7.5	10.6	11.9	13.2
OR	49	46	57	62	68	64	74	77	82	79	87	90	69	13.1	12.7	12.3	11.0
DT	46	41	45	62	61	58	62	72	75	76	73	82	62	11.8	14.1	10.8	8.1
BE	39	21	28	59	51	34	38	73	64	56	51	83	48	9.7	14.3	9.3	9.7
CI	49	33	32	50	65	47	51	65	78	63	72	80	55	11.7	11.6	15.3	12.1
BF	39	15	31	65	59	29	49	81	76	60	64	91	52	14.1	18.5	12.5	10.2
IS	9	7	2	43	32	27	14	73	55	56	38	96	36	17.9	20.2	14.7	20.7
BE-ed	60	47	54	67	75	65	71	88	90	83	88	98	73	11.8	14.4	13.2	12.9
BE-id	52	37	53	67	72	63	70	85	91	82	86	98	71	15.0	17.5	13.1	12.5

Notes: 1. Based on the 307 sample firms for CGS, 286 firms for BE-ed, and 310 firms for BE-id.

2. THA, KOR, INO, and MAL indicates Thailand, Korea, Indonesia and Malaysia, respectively.

3. Excluding Malaysia.

Table 12
Correlation Coefficients among Major Variables

Thailand (n=54)

	Tobin's q	ROA	CGS	CGSw	SHR	BE	BE-ed	BE-id	SG	SIZE
ROA	0.25									
CGS	0.06	-0.20								
CGSw	0.06	-0.21	0.69							
SHR	-0.00	-0.11	0.80	0.44						
BE	0.10	-0.22	0.86	0.76	0.39					
BE-ed	0.14	0.11	-0.01	-0.14	0.11	-0.11				
BE-id	0.26	0.35	0.08	-0.15	0.15	-0.00	0.36			
SG	0.07	0.30	-0.08	-0.05	-0.13	-0.01	-0.01	0.11		
SIZE	0.09	-0.06	0.20	-0.02	0.26	0.09	0.20	0.26	0.29	
DEBT	0.04	-0.48	0.12	0.17	0.07	0.13	0.09	-0.18	-0.05	0.14

Korea (n=98)

	Tobin's q	ROA	CGS	CGSw	SHR	BE	BE-ed	BE-id	SG	SIZE
ROA	0.09									
CGS	0.31	0.19								
CGSw	0.31	0.36	0.87							
SHR	0.24	0.15	0.83	0.69						
BE	0.30	0.19	0.94	0.87	0.60					
BE-ed	0.15	0.08	0.59	0.51	0.50	0.54				
BE-id	0.31	0.18	0.61	0.52	0.53	0.56	0.68			
SG	0.06	0.27	0.14	0.14	0.15	0.11	0.07	0.20		
SIZE	0.15	0.21	0.72	0.60	0.53	0.72	0.31	0.32	0.21	
DEBT	0.46	-0.29	0.10	0.03	0.04	0.12	0.03	0.18	-0.13	0.03

Indonesia (n=54)

	Tobin's q	ROA	CGS	CGSw	SHR	BE	SG	SIZE
ROA	0.23							
CGS	0.26	0.29						
CGSw	0.36	0.23	0.74					
SHR	0.16	0.02	0.79	0.57				
BE	0.27	0.42	0.85	0.70	0.34			
SG	0.25	0.31	0.19	0.21	-0.05	0.33		
SIZE	-0.14	-0.03	0.28	0.26	0.16	0.29	0.35	
DEBT	-0.06	-0.28	0.16	0.30	0.20	0.08	0.24	0.54

Malaysia (n=51)

	Tobin's q	ROA	CGS	SHR	BE	BE-ed	BE-id	SG	SIZE
ROA	0.43								
CGS	-0.02	-0.07							
SHR	-0.12	-0.02	0.78						
BE	0.07	-0.09	0.87	0.36					
BE-ed	0.10	-0.06	0.36	0.22	0.36				
BE-id	0.12	-0.08	0.52	0.29	0.54	0.62			
SG	0.16	0.16	0.02	-0.02	0.05	-0.01	-0.05		
SIZE	0.07	-0.30	-0.06	-0.17	0.05	0.16	0.27	0.09	
DEBT	-0.02	-0.54	-0.01	-0.20	0.15	0.05	0.13	-0.05	0.53

Tobin's q	Tobin's q (at the end of 2002)
ROA	Return on assets (2000-2002 three year average, %)
CGS	Overall corporate governance score = SHR+BE
CGSw	Overall corporate governance score = 0.22 EP + 0.19 DT + 0.10 CI + 0.49 IS
SHR	Score for shareholder rights
BE	Score for board effectiveness
BE-ed	Score for the opinion of executive directors
BE-id	Score for the opinion of independent directors
SG	Sales growth over the 1997-2002 period: ln (2002 sales / 1997 sales)
SIZE	Size of the firm: ln (total assets)
DEBT	Debt ratio (total liability / total assets)

Note: Sample firms with debt ratio over one excluded from the analysis: Thailand 1, Korea 2, Indonesia 12, Malaysia 2.

Tobin's q is around 1.0 for all the countries except for Korea, where the median is less than 0.8. In terms of ROA, the Korean firms score better than the firms in other three countries. This seems to indicate that the Korean firms are relatively undervalued, probably due at least in part to poor corporate governance. Corporate performance varies the least for the Korean firms and the most for the Indonesian firms.

Table 12 shows correlation coefficients among variables representing firm performance, corporate governance scores, and firm characteristics. The correlation coefficients between firm performance variables (Tobin's q and ROA) and corporate governance scores are always positive for the Indonesian and Korean firms, but not for the Malaysian and Thai firms. For the Thai firms, the highest correlation with performance variables is observed for the board score based on the opinions of independent directors (BE-id). Larger

firms tend to have better corporate scores for all the countries except Malaysia. In Thailand, larger firms are associated with higher scores for SHR, but this association is somewhat weak for BE. In both Indonesia and Korea, larger firms are more closely associated with better scores for BE. As expected, SHR and BE are positively correlated in all four countries, but most strongly for the Korean firms. The correlation between board effectiveness scores based on factual information (BE) and director opinions (BE-ed or BE-id) is high and positive for the Korean and Malaysian firms, but not for the Thai firms.

Table 13 and Figure 4 show corporate governance scores by ownership and CEO type. Though statistically insignificant (except for Korea), firms with diffuse ownership, that is, without controlling owners, tend to have better corporate governance. Korean and Malaysian firms belonging to business groups or holding companies have higher corporate governance scores than stand-alone companies. Firms substantially owned by foreigners have much higher corporate governance scores in Korea and, to a lesser extent, in Malaysia and Thailand. Finally, firms with a CEO who is a professional manager, that is, a CEO who is not a member of the controlling family, have much higher scores in Korea and, to a lesser extent, in Indonesia and Thailand, but not in Malaysia.

Table 14 shows the average values of key variables for sample firms by industry and country. For specific industries, industry characteristics often seem to be quite different across the sample countries. Table 15 presents average Tobin's q for a group of firms whose CGS scores fall within a certain range. A clear positive association between corporate governance scores and Tobin's q is apparent for both Indonesia and Korea, but not for Malaysia and Thailand. For a more formal investigation of the association between corporate governance and firm performance, multiple regressions need to be estimated with some other variables that might affect firm performance.

Table 13

Corporate Governance Scores (CGS) by Ownership and CEO Type

	Thailand	**Korea**	**Indonesia**	**Malaysia**
Firms with Controlling Owners	(38) 58.1	(103) 49.2	(46) 54.2	(49) 73.8
[Firms controlled by a single domestic owner] [1]	(29) 57.5*	(95) 48.5*	(31) 53.6*	(37) 73.0
Firms with Diffuse Ownership or Collective Control	(22) 58.4	(8) 52.4	(17) 54.5	(20) 73.9
Stand-alone Firms	(33) 58.4	(74) 47.2**	(31) 54.4	(24) 71.9
Part of Business Groups or Holding Companies	(28) 58.3	(36) 53.8**	(35) 54.8	(45) 74.8
Substantially owned by foreigners	(23) 60.0	(35) 56.6**	(20) 55.0	(12) 77.2*
Others	(38) 57.4	(76) 46.2**	(46) 54.4	(57) 73.1*
CEO being a Controlling Family Member	(29) 57.4	(68) 46.5**	(40) 53.9	(25) 74.2
CEO being a Professional Manager	(32) 59.0	(43) 54.1**	(26) 55.6	(44) 73.6

Notes: 1. Firms with a single controlling owner but not controlled either by the government or foreigners.

2. Figures in parentheses are number of firms in the sample.

3. **, and * indicate that the difference in scores between the two groups of firms compared is statistically significant at a 5%, and 10% level, respectively.

Figure 4
Corporate Governance Scores by Ownership and Control Pattern

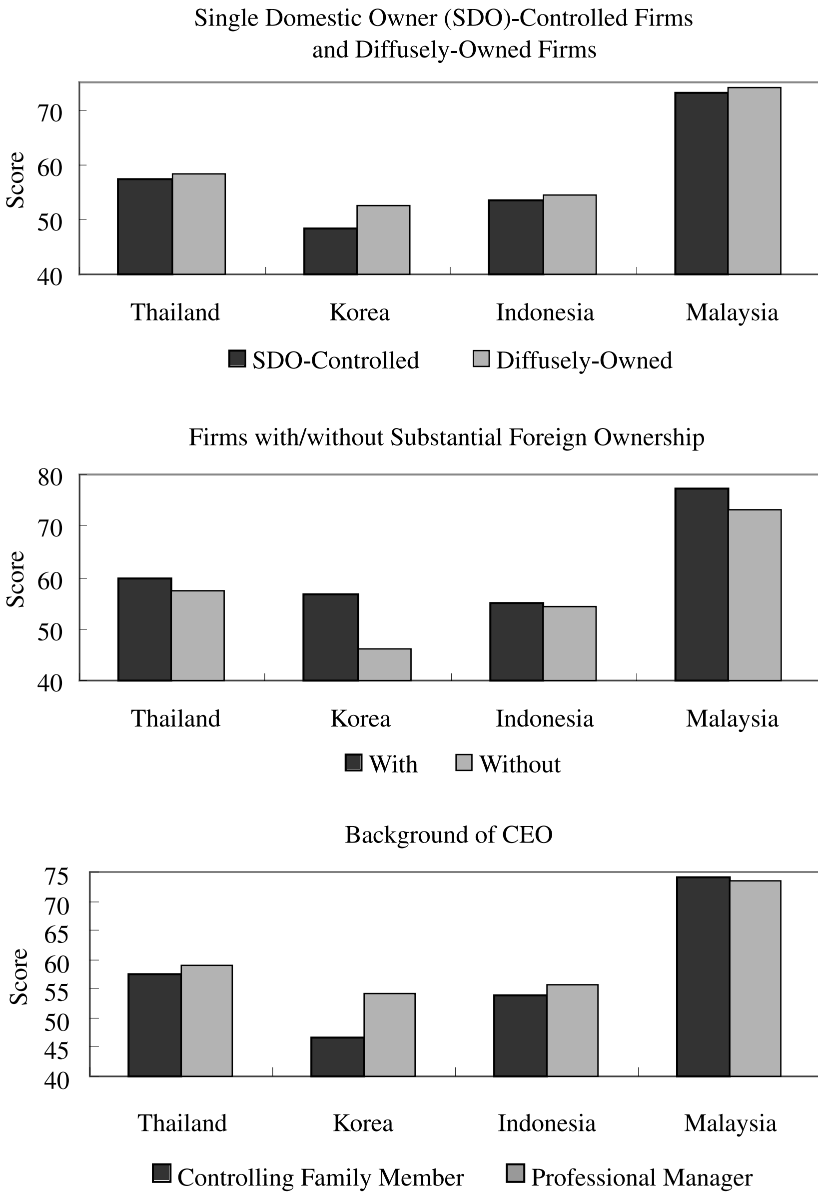


Table 14
Average Values of Key Variables by Country and Industry[1]

	Total	Food	Text	Chem	Iron	Elec	Trans	Dist
Tobin's q								
Thailand	1.05	1.10	0.81	1.08	1.18	0.99	1.20	0.93
Korea	0.81	0.79	0.66	0.86	0.74	0.95	0.84	0.80
Indonesia	1.30	1.87	1.60	0.95	0.89	0.96	1.27	1.05
Malaysia	1.35	1.67	1.04	1.69	1.53	1.03	1.09	0.85
ROA (%, average over the 2000-02 period)								
Thailand	4.9	6.3	4.2	-0.1	2.6	3.1	5.3	5.2
Korea	5.7	5.2	7.2	6.2	6.8	3.6	4.1	7.1
Indonesia	1.8	-5.3	-2.5	7.1	18.4	-3.2	5.5	2.8
Malaysia	4.2	9.5	3.1	14.2	0.3	-0.4	3.6	-2.4
CGS (Overall corporate governance score)								
Thailand	59	60	53	61	59	59	57	62
Korea	50	49	46	53	48	51	51	52
Indonesia	53	52	52	48	56	50	57	52
Malaysia	74	79	73	72	72	73	64	75
SHR (Score for shareholder rights)								
Thailand	67	66	62	72	67	64	64	70
Korea	64	61	59	68	63	66	64	64
Indonesia	66	65	65	64	72	63	70	65
Malaysia	77	84	77	70	76	78	68	80
BE (Score for board effectiveness)								
Thailand	51	53	45	51	51	53	51	53
Korea	37	36	32	39	32	36	39	40
Indonesia	39	39	39	32	39	36	44	39
Malaysia	70	75	68	74	69	69	61	69
SG (sales growth: % increase over the 1997-2002 period) [2]								
Thailand	54.2	53.7	16.6	56.1	50.5	95.0	77.6	43.8
Korea	110.4	79.7	26.8	135.7	121.5	102.1	156.4	135.9
Indonesia	25.4	55.7	13.4	21.3	57.2	-6.2	42.1	10.3
Malaysia	158.9	212.4	16.2	85.2	155.4	-15.9	63.5	362.1
Size (Total assets in USD million)								
Thailand	202	125	97	250	432	89	72	198
Korea	837	640	153	647	1,356	899	1,555	583
Indonesia	188	227	148	103	38	44	550	107
Malaysia	612	189	234	196	581	386	2,620	564

Table 14 cont.

	Total	Food	Text	Chem	Iron	Elec	Trans	Dist
Debt (total liability / total assets)								
Thailand	0.48	0.44	0.48	0.51	0.52	0.49	0.41	0.47
Korea	0.51	0.45	0.50	0.49	0.42	0.53	0.60	0.54
Indonesia	0.80	0.78	0.92	0.41	0.78	0.75	0.55	0.77
Malaysia	0.54	0.33	0.54	0.29	0.83	0.70	0.49	0.59
KS (fixed capital / total sales)								
Thailand	0.59 [3]	0.65	0.25	1.27	0.85 [3]	0.41	0.20	0.49
Korea	0.49	0.45	0.48	0.72	0.58	0.34	0.41	0.30
Indonesia	0.62	0.70	0.92	0.60	0.49	0.82	0.49	0.29
Malaysia	0.87	0.39	0.94	0.68	1.83	0.54	0.94	0.85

Notes: 1. Food (food and beverages), Text (textiles and clothes), Chem (chemicals), Iron (iron and metal products), Elec (electrical and electronics products), Trans (transport equipment), Dist (distribution and trade).

2. 15 firms established in or after 1995 were excluded in the calculation of SG (Thailand 1, Korea 8, Indonesia 3, Malaysia 3) as they distort the averages.

3. One outlier sample firm excluded.

Table 15

Corporate Governance Score (CGS) and Tobin's q

<table>
<tr><th></th><th colspan="4">Average Tobin's q</th></tr>
<tr><th>Overall Score</th><th>Thailand</th><th>Korea</th><th>Indonesia</th><th>Malaysia</th></tr>
<tr><td>80-100</td><td rowspan="2">(6) 1.175</td><td rowspan="3">(18) 0.990</td><td rowspan="3">(7) 2.111</td><td>(14) 1.239</td></tr>
<tr><td>70-80</td><td>(34) 1.203</td></tr>
<tr><td>60-70</td><td>(20) 0.997</td><td rowspan="4">(21) 1.166</td></tr>
<tr><td>50-60</td><td rowspan="3">(35) 1.051</td><td>(38) 0.829</td><td>(35) 1.269</td></tr>
<tr><td>40-50</td><td rowspan="2">(55) 0.744</td><td rowspan="2">(24) 1.095</td></tr>
<tr><td>Less than 40</td></tr>
<tr><td>Upper 30%</td><td>(18) 1.085</td><td>(33) 0.890</td><td>(20) 1.453</td><td>(21) 1.165</td></tr>
<tr><td>Middle 40%</td><td>(25) 0.974</td><td>(45) 0.809</td><td>(26) 1.297</td><td>(27) 1.252</td></tr>
<tr><td>Lower 30%</td><td>(18) 1.106</td><td>(33) 0.742</td><td>(20) 1.122</td><td>(21) 1.166</td></tr>
</table>

Note: Figures in the parentheses are number of firms in the sample.

Analytical Framework

Firm-level corporate governance practices may be viewed as endogenous. Those in control of a firm may make deliberate choices in such a way as to maximize their objectives. If their primary goal is to maximize their personal or family wealth and this goal is relatively easily achievable given the regulatory and legal environment in which they find themselves, they have no reason to introduce good governance practices that will tie their hands and will try to take advantage of the weak laws and regulations and of their poor enforcement. At the same time, other firms not aiming at expropriation may find themselves constrained or discouraged by weak legal and judicial systems in their efforts to adopt better governance practices. As Klapper and Love (2002) find, the quality of firm-level corporate governance is likely to be lower in countries with a weak legal environment.

Corporate governance practices may be determined by the scope and nature of associated agency problems (agency characteristics) of firms, that is, their need to attract external investment or external investors' difficulties in monitoring the firms. As La Porta and others (1998) argue, good corporate governance is needed for better access to external financing at lower cost. This indicates that firms in need of a good deal of external financing, such as rapidly growing firms, have an incentive to improve their corporate governance. In addition, as Himmelberg, Hubbard, and Palia (1999) argue, firms facing large information asymmetry because of other characteristics of their firms may signal to the market their intent to protect investors better by adopting good corporate governance policies. This might be the case for large firms, young firms, or firms with relatively large intangible assets.

Given the endogenous nature of corporate governance practices, the relationship between the quality of governance and firm performance may be analyzed better in a simultaneous system than separately. Along the line of Klapper and Love (2002), the quality of corporate governance (CG) may be estimated as follows as a function of the firm's agency characteristics (ACs) using other firm characteristics (FCs) as control variables and country dummy variables (Dc) that presumably represent the degree of investor protection:[44]

$$CG = f\,(ACs, FCs, Dc).$$

44. Country-level scores for investor protection may include those for enforceability of contracts (Business Environment Risk Intelligence – Business Risk Service; and DRI Country

Firm performance (FP) may be estimated as a function of CG, Dc, Acs, and FCs:

FP = f (CG, Dc, ACs, FCs).

However, as Klapper and Love (2002) find, the effect of CG on firm performance may vary depending on the country-specific level of investor protection. More specifically, firms with relatively good governance practices are likely to be more highly valued by investors in countries where investor protection is generally poor. Extending this argument, we may also expect the market to assess the same CG differently depending on corporations' ownership and control structure. For instance, if the market suspects that controlling owners can find ways to maximize their interests at the expense of other shareholders however good their firms' corporate governance practices may appear, then the market is likely to discount the value of measured CG. The following interaction terms of CG with Dc or corporate ownership and control structure variables (Do) will indicate the extent to which any positive effect of good governance on firm performance is dependent on these county or firm characteristics:

FP = f (CG*Dc, Dc, ACs, FCs) or

FP = f (CG*Do, Dc, ACs, FCs),

where ACs represents the agency characteristics of a firm that may be measured as the firm's growth potential (sales growth) and fixed or human capital intensity (fixed capital/sales); FCs represents control variables for firm characteristics, such as total assets or sales, the firm's age, and an industry dummy (following Black, Jang, and Kim 2003; Gompers, Ishii, and Metrick 2001; Shin and Stulz 2000); Dc represents country dummy variables for the strength of legal and judicial systems for investor protection and other county effects; Do represents dummy variables for different ownership and control structures; and FP represents firm performance measured by Tobin'q or ROA. Tobin's q—the ratio of the value of a firm to the replacement value/cost of the

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Risk Review), transparency and fairness of the legal system (Economic Intelligence Unit – Country Risk Service), and law and order (Political Risk Services – International Country Risk Guide; and World Bank – 1997 World Development Report). However, country dummy variables are used instead of an investor protection variable given that only few countries are included in the survey and the difficulty of providing quantitative scores for investor protection. See footnote 50 for some of these sources, whose information was used to interpret the coefficients of the country dummy variables.

firm's assets—is approximated by the ratio of market value to book value of a firm (where the market value of a firm is measured by the sum of market value of equity and book value of debt).

Regression Results

On the basis of the analytical framework described above, regression results are presented and evaluated on the determinants of corporate governance quality and the relationship between corporate governance quality and firm performance.

What Determines Corporate Governance Quality?

Table 16 presents regression results showing what factors determine the quality of corporate governance. The Malaysian firms are excluded from this analysis because 41 of the 69 sample firms are outside the seven designated industries.[45] Independent variables included in this and the following tables are as follows:

- Ln (sales02/97) = ln (2002 sales/1997 sales)
- D (single domestic owner) or D (SDO): a dummy variable for firms controlled by a single domestic owner (other than the government, foreigners, or a nonfamily group); D (non-SDO): a dummy variable for other firms
- D (nonfamily group): firms belonging to a business group or holding company not controlled by families
- D (diffusely owned), D (group affiliated), D (substantially foreign owned), and D (professional management): dummy variables for relevant ownership and management characteristics
- D (new firms): a dummy variable for firms established after 1997

45. The 41 firms include 10 firms in diversified industries and 31 companies outside the designated 7 industries. The 31 companies largely represent services industries: 8 in property development or construction, 5 in banking and finance, 4 in telecommunications, 3 in printing and publications, 3 in gaming, 2 in electricity and power, and 6 in other industries. These 41 sample firms, particularly the 10 firms in diversified industries, exhibit much poorer performance in terms of Tobin's q or ROA compared with the 28 firms in the designated industries; however, the average quality of corporate governance differs little between these groups of sample firms. The average size of the 31 firms is 6.1 times larger (2.2 times larger in the case of the 10 firms in diversified industries) than that of the 28 firms in the 7 designated industries. The average fixed capital/sales ratio for the 31 firms is also much higher than for the 28 firms in the designated 7 industries. Even with the Malaysian firms included, the regression results do not change much, and actually show improvements in some of the equations in terms of the overall fit and the significance of explanatory variables.

Table 16

Regression Results for Corporate Governance Score (CGS) – Indonesia, Korea and Thailand [1]

	(1)	(2)	(3)	(4)	(5)	(6)
CG ScoreUsed	Shareholder Rights (SHR)	Board Effectiveness (BE)	CGS (Average of SHR and BE)	CGSw	ED Opinion (BE-ed)	ID Opinion (BE-id)
Constant	19.95**	-25.59**	-2.82	0.89	22.74	20.14
Debt/Assets	0.40	3.07	1.73	3.82	0.11	-4.60
Ln (assets)	2.29***	2.89***	2.59***	1.97***	1.98**	2.09**
Ln (sales02/97)	-0.67	0.83	0.08	0.47	2.13	3.05
Fixed Capital / Sales	-0.20	-1.11*	-0.65	-0.94*	0.89	-0.59
D (diffusely owned)	2.31	3.96	3.13*	2.89	9.97***	15.36***
D (group affiliated)	0.58	1.99	1.29	2.41*	3.51*	0.77
D (substantially foreign owned)	-0.05	5.15***	2.55**	2.98**	-1.11	-2.51
D (professional management)	-0.05	5.74***	2.84***	2.02	2.03	4.02*
D (new firms)	-0.08	8.66**	4.29	2.48	5.17	8.27
D (Thailand)	4.75***	17.11***	10.93***	5.83***	12.87***	13.65***
D (Indonesia)	5.19***	6.77***	5.98***	4.95***	10.76***	13.72***
R^2	0.172	0.532	0.450	0.258	0.282	0.259
# Observation [2]	222	222	222	222	193	196

Notes: 1. ***, **, and * indicate being statistically significant at a 1%, 5%, and 10% level, respectively.

2. Sample firms with a negative book value of equity are excluded from the total sample.

- D (industry): industry dummy variables
- D (country): country dummy variables.

Various corporate governance scores were tried as dependent variables, including scores for SHR, for BE, for the simple and weighted average of SHR and BE, and for scores based on corporate directors. The results show that firm size is significantly positively associated with corporate governance quality. This indicates that formal governance mechanisms are typically called for when firms get larger, thereby making the problem of information asymmetry substantial. Fixed capital intensity (negatively) and group affiliation (positively) also turn out to be significant in some equations. Information asymmetry is likely to be more serious where a firm's assets are largely nonfixed assets or the firm is affiliated with a business group. As a way to mitigate this, the firm may put better corporate governance mechanisms in place.

Firms with substantial foreign ownership and a professional manager as CEO are strongly associated with the effectiveness of the board of directors (based on factual information). Foreign owners will generally demand a higher quality of corporate governance, while professional managers might be less resistant to introducing better corporate governance than family managers. Corporate governance scores based on the opinions of corporate directors tend to be high for firms with diffuse ownership without a controlling owner, which also seems to indicate that controlling owners in the countries surveyed constrain better corporate governance. Debt dependence and the growth rate of sales do not have any effect on corporate governance. Finally, significantly positive country dummies for Indonesia and Thailand indicate that, other things considered in the equations being equal, Korean firms have relatively weaker corporate governance.

Does Corporate Governance Matter?

Tables 17-20 present regression results for Tobin's q with different corporate governance scores as the major independent variable.[46] Again, the Malaysian

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46. Some may question the relevance of using Tobin's q as a firm performance variable. One criticism is that it is affected by inflation: when inflation is high, the market value of fixed assets tends to be higher than their book value, raising Tobin's q. Even though the book value of equity is also adjusted through asset revaluation, higher profits, and other channels, it may be only partial and take place with some time lag. Producer and wholesale prices rose 24% in both Korea and Thailand between 1995 and 2002 and rose 73% in Indonesia. Thus the country dummy variable for Indonesia in Tobin's q equations may partially reflect higher inflation than in Korea and Thailand.

Table 17

Regression for Tobin's q: Basic Equations – Indonesia, Korea and Thailand

	(1)		(2)		(3)		(4)		(5)	
Constant	1.097	(2.33)	1.549	(3.25)	1.339	(2.90)	0.831	(1.81)	0.690	(1.95)
Debt/Assets	0.282	(1.89)	0.269	(1.82)	0.271	(1.84)	0.316	(2.09)	0.241	(2.17)
Ln (assets)	-0.043	(-1.61)	-0.060	(-2.16)	-0.063	(-2.23)	-0.029	(-1.18)	-0.005	(-0.28)
Ln (sales02/97)	0.175	(2.82)	0.167	(2.72)	0.172	(2.80)	0.174	(2.86)	0.065	(1.34)
D (single domestic owner)[1]	-0.202	(-2.53)	-0.148	(-1.80)	-0.164	(-2.03)	-0.131	(-1.64)	-0.122	(-2.05)
D (non-family group)	-0.296	(-2.87)	-0.289	(-2.83)	-0.289	(-2.83)	-0.258	(-2.50)	-0.205	(-2.54)
D (new firms)	0.343	(2.11)	0.282	(1.73)	0.302	(1.87)	0.293	(1.88)	0.200	(1.49)
D (Thailand)	0.199	(2.23)	0.094	(0.92)	0.110	(1.12)	0.154	(1.72)	0.200	(2.93)
D (Indonesia)	0.265	(2.75)	0.252	(2.64)	0.238	(2.47)	0.359	(3.08)	0.174	(2.27)
CG Score/100	**0.702**	**(1.69)**	**0.826**	**(2.58)**	**1.137**	**(2.63)**	**0.580**	**(2.34)**	**0.247**	**(1.54)**
CG Score Used	**Shareholder Rights (SHR)**		**Board Effectiveness (BE)**		**CGS (SHR+BE)**		**ED Opinion (BE-ed)**		**ID Opinion (BE-id)**	
R^2	0.162		0.176		0.177		0.185		0.155	
# Observation	223		223		223		204		219	

Note: 1. Firms controlled by a single shareholder other than the government, a foreigner, or a non-family group.

firms are not included in the analyses. The estimated equations based on the pooled three-country samples strongly indicate that corporate governance matters for the valuation of firms in the market, even though shareholders' rights alone do not have a strong influence on firm value.[47]

Table 17 shows that the rate of growth of sales has a positive impact on Tobin's q. Even though high sales growth may mean high growth potential with attendant information asymmetry, its significance as a performance indicator seems to be more important. Firm size and dummy variables for firms controlled by a single, domestic owner or belonging to a nonfamily group tend to be negatively associated with Tobin's q. This indicates that the market calls for a higher level of corporate governance for larger firms and for those controlled by a single, domestic owner or belonging to a nonfamily group. The market does not seem to view nonfamily business groups or holding companies favorably, probably because of the typical agency problem. Debt dependence is not very significant, but has a consistently positive impact. New firms established after 1997 tend to have better corporate governance. Country dummy variables for Indonesia and Thailand are generally positive, particularly for Indonesia.[48]

Looking more closely at the effect of corporate governance on Tobin's q, the coefficients for the scores of SHR and BE range from 0.70 to 0.83. This indicates that, given the distribution of corporate governance scores of the sample firms, improving the BE scores from the median to the highest 25% means a 13-14% increase in firm value. Enhancing the overall corporate governance scores (CGS) from the median to the highest 25% is associated with about a 15% increase in firm value. Indeed, corporate governance seems to have a substantial impact on the market value of firms. There is little evidence that the estimated ordinary least squares equations are not consistent because of simultaneous equation bias.[49]

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47. Even with the Malaysian sample firms included, the results change little: the measures of corporate governance quality largely remain significant in explaining Tobin's q or ROA.

48. Industry dummy variables were not included in the equations (other than those for ROA and individual countries), because none of the industry dummy variables turned out to be significant in any of the equations. This may be due to the lack of clear-cut differences in characteristics among industries across the countries. As Table 14 indicates, the characteristics of an industry often differ significantly from country to country because of differences in industrial development or international competitiveness.

49. Attempts were made to check for any simultaneous equation bias for equations in Table 17. When residuals from equations in Table 16 are included in relevant equations in

Table 18

Regression for Tobin's q

With Weighted Average Overall Corporate Governance Scores – Indonesia, Korea and Thailand

	(1)			(2)			(3)		
Constant		1.036	(2.17)		1.425	(3.08)		1.317	(2.87)
Debt/Assets		0.285	(1.92)		0.245	(1.66)		0.245	(1.67)
Ln (assets)		-0.042	(-1.60)		-0.048	(-1.88)		-0.056	(-2.13)
Ln (sales02/97)		0.174	(2.81)		0.165	(2.70)		0.167	(2.74)
D (single domestic owner)		-0.202	(-2.53)		-0.167	(-2.09)		-0.170	(-2.13)
D (non-family group)		-0.297	(-2.88)		-0.278	(-2.73)		-0.280	(-2.75)
D (new firms)		0.341	(2.09)		0.326	(2.03)		0.327	(2.04)
D (Thailand)		0.198	(2.21)		0.175	(1.98)		0.165	(1.87)
D (Indonesia)		0.279	(2.94)		0.246	(2.60)		0.245	(2.59)
CG Score/100 [1]	**SHRw**	**0.760**	**(1.77)**	**BEw**	**0.742**	**(2.91)**	**CGSw**	**1.100**	**(3.10)**
R^2	0.163			0.183			0.187		
# Observation	223			223			223		

Note: 1. SHRw, BEw, and CGSw are weighted averages of the components of SHR, and BE, and CGS, respectively, where the weights were derived from the relative magnitudes of the coefficients when the equations were estimated with these components. Where the coefficients turned out to be negative, the equations were re-estimated excluding these variables.
SHRw = 0.50 EP + 0.20 OR + 0.30 DT
BEw = 0.22 CI +0.78 IS
CGSw = 0.22 EP + 0.19 DT + 0.10 CI + 0.49 IS.

Table 18 shows the results of an attempt to ascertain the relative importance of the various components of corporate governance practices. When each of the individual components of SHR (EP, OR, and DT) and of board effectiveness (CI, BF, and IS) were included separately in the Tobin's q equation, the coefficient turned out to be positive for all the components, but not statistically significant except for IS. Note that on average, except for Malaysia, the sample firms score worst on IS.

- When the three components of SHR were included as a set in the equation, all of them still had a positive coefficient, and the relative magnitudes of the coefficients gave weights of 0.50, 0.20, and 0.30 to EP, OR, and DT, respectively, to derive a weighted average score for SHRw.
- When the three components of BE were included as a set, the weights turned out to be 0.22 for CI and 0.78 for IS (negligible for BF), from which a weighted average score for board effectiveness (BEw) was obtained.
- When the same process was continued with all six component scores, it finally excluded OR because of a negative coefficient and BF because of too small a weight. The resultant weights for EP (0.22), DT (0.19), CI (0.10), and IS (0.49) were used to derive a weighted average overall corporate governance score (CGSw).

The estimated equations with these weighted average scores as the quality of corporate governance show higher significance levels for these variables, although SHRw is still statistically only marginally significant.

A corporate governance score variable may be divided into scores for firms controlled by a single, domestic owner (SDO) and scores for other firms (Non-SDO), including those with diffuse ownership and those controlled by more than one major shareholder or by the government or foreigners. Table 19 shows that the impact of the corporate governance score on Tobin's q is about 30% lower for SDO firms than for non-SDO firms. This implies that the market discounts the measured quality of corporate governance by about 30% for firms controlled by a single, domestic owner (who has a strong incentive, as

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Table 17, these residuals turn out to be insignificant. Also the Hausman test was conducted to see whether there is any significant difference between the ordinary least squares and two-stage estimates with instrumented CG variables. The difference turns out to be insignificant as well (although the two-stage regressions are generally poorly estimated).

Table 19

Regression for Tobin's q – Indonesia, Korea and Thailand

With Separate Corporate Governance Scores for Firms Controlled by a Single Domestic Owner and Other Firms

	(1)		(2)		(3)		(4)	
Constant	0.980	(2.10)	1.421	(2.99)	1.221	(2.67)	1.186	(2.63)
Debt/Assets	0.285	(1.91)	0.270	(1.83)	0.273	(1.85)	0.250	(1.70)
Ln (assets)	-0.043	(-1.60)	-0.059	(-2.10)	-0.062	(-2.20)	-0.054	(-2.07)
Ln (sales02/97)	0.174	(2.82)	0.164	(2.67)	0.170	(2.78)	0.166	(2.73)
D (non-family group)	-0.298	(-2.89)	-0.289	(-2.85)	-0.292	(-2.87)	-0.290	(-2.88)
D (new firms)	0.340	(2.09)	0.290	(1.78)	0.306	(1.89)	0.330	(2.06)
D (Thailand)	0.201	(2.26)	0.091	(0.89)	0.109	(1.11)	0.161	(1.83)
D (Indonesia)	0.269	(2.80)	0.260	(2.75)	0.242	(2.53)	0.243	(2.59)
CG Score x D (SDO)/100 [1]	**0.558**	**(1.33)**	**0.700**	**(2.04)**	**1.006**	**(2.25)**	**0.925**	**(2.51)**
CG Score x D (non-SDO)/100 [1]	**0.868**	**(2.08)**	**1.037**	**(3.34)**	**1.313**	**(3.10)**	**1.335**	**(3.77)**
CG Score Used	**Shareholder Rights (SHR)**		**Board Effectiveness (BE)**		**CGS (SHR+BE)**		**CGSw**	
R^2	0.163		0.177		0.178		0.193	
# Observation[1]	223		223		223		223	

Note: 1. D (SDO) is D (single domestic owner), and D (non-SDO) is a dummy variable for other firms with diffused ownership or controlled by the government, a foreigner, or a non-family business group.

Table 20

Regression for Tobin's q

With Country-Specific Corporate Governance Scores – Indonesia, Korea and Thailand

	(1)		(2)		(3)		(4)	
Constant	1.511	(3.19)	1.588	(3.37)	1.285	(2.85)	1.454	(3.27)
Debt/Assets	0.261	(1.78)	0.282	(1.93)	0.223	(1.52)	0.195	(1.35)
Ln (assets)	-0.056	(-1.97)	-0.059	(-2.07)	-0.049	(-1.85)	-0.054	(-2.05)
Ln (sales02/97)	0.163	(2.71)	0.142	(2.33)	0.171	(2.84)	0.148	(2.50)
D (single domestic owner)	-0.141	(-1.73)	-0.155	(-1.91)	-0.168	(-2.14)	-0.171	(-2.22)
D (non-family group)	-0.310	(-3.04)	-0.343	(-3.34)	-0.295	(-2.91)	-0.314	(-3.15)
D (new firms)	0.297	(1.83)	0.300	(1.85)	0.341	(2.14)	0.356	(2.29)
D (Thailand)			0.514	(1.44)			0.681	(1.72)
D (Indonesia)			-0.509	(-1.65)			-1.029	(-2.67)
CG Score x D (Thailand)/100	**0.915**	**(3.41)**	**-0.093**	**(-0.14)**	**1.237**	**(3.57)**	**-0.267**	**(-0.37)**
CG Score x D (Korea)/100	**0.707**	**(2.01)**	**0.674**	**(1.75)**	**0.884**	**(2.35)**	**0.780**	**(1.74)**
CG Score x D (Indonesia)/100	**1.457**	**(4.21)**	**2.624**	**(3.69)**	**1.545**	**(4.29)**	**3.588**	**(4.88)**
CG Score Used	**BE**		**BE**		**CGSw**		**CGSw**	
R^2	0.189		0.210		0.198		0.245	
# Observation	223		223		223		223	

well as the capacity, to expropriate minority shareholders). This discount, statistically significant at a 5% level for equations (1) and (4) and at a 10% level for equations (2) and (3), is observed consistently in estimated equations with different corporate governance scores.

Table 20 presents estimated equations with country-specific corporate governance score variables. When estimated without country dummy variables, the equations show that corporate governance exerts the smallest impact on Tobin's q in Korea and the largest impact in Indonesia. The coefficients for three different countries—in equations (1) and (3)—are statistically different at a 1% significance level. This pattern seems to be consistent with the expectation that corporate governance matters more in countries with poor legal and judicial protection of investors as confirmed by Klapper and Love (2002).[50] When the equations were estimated with country dummy variables, however, the impact of corporate governance on Tobin's q is insignificantly negative for Thailand, but becomes much larger for Indonesia. This implies that for our sample firms, corporate governance does not matter in Thailand and matters much more in Indonesia than the average for all firms in the three countries.

ROA is another commonly used corporate performance variable. Table 21 presents equations estimated with ROA as the dependent variable. The average ROA for 2000-2002 is much better predicted than the ROA for 2002, because various factors can cause annual ROA to fluctuate widely. The estimated equations show that our measure of corporate governance quality is positively associated with ROA for 2000-2002, and the association is statistically significant. Also significant are debt dependence (negatively) and sales growth (positively) for 1997-2002.

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50. Korea's legal and judicial system for investor protection is measured to be a little stronger than Thailand's and substantially stronger than Indonesia's. Four published scores for 2002-2003 were considered: Political Risk Services (2003) for law and order (scored from1 to 6); Heritage Foundation/Wall Street Journal (2003) for law and order (property rights, scored from 1 to 5); Business Environment Risk Intelligence (2002) for enforcement of contracts (scored from 0 to 4); and Economist Intelligence Unit (2003) for legal and regulatory risk (scored from 0 to 100, but rescaled from 0 to 5 for the purposes of this study). The measured risk based on the average of these four scores for Thailand is 20% higher than for Korea, while that for Indonesia is twice that for Korea. These relative risks are remarkably similar to the relative magnitudes of the estimated coefficients for country-specific corporate governance scores.

Table 21

Regression for ROA – Indonesia, Korea and Thailand

	(1)		(2)		(3)		(4)	
	ROA (2002)		ROA (2002)		ROA (2000-02 Average)		ROA (2000-02 Average)	
Constant	-4.18	(-0.44)	-7.69	(-0.86)	4.62	(0.73)	2.01	(0.33)
Debt/Assets	-3.45	(-1.17)	-3.73	(-1.27)	-11.25	(-5.69)	-11.54	(-5.89)
Ln (assets)	0.24	(0.43)	0.30	(0.58)	- 0.05	(-0.15)	-0.08	(-0.22)
Ln (sales02/97)	2.13	(1.73)	2.13	(1.73)	3.45	(4.15)	3.46	(4.20)
D (new firms)	0.18	(0.06)	0.87	(0.27)	1.02	(0.46)	1.55	(0.72)
D (industry)	Dist (+)**		Dist (+)** Food (+)*		Dist (+)** Food (+)** Text (+)**		Dist (+)** Food (+)*** Text (+)**	
D (country)	Insignificant		Insignificant		Thailand (-)*		Thailand (-)*	
CG Score/100	**BE 10.80**	(1.76)	**CGSw 14.26**	(2.04)	**BE 8.88**	(2.15)	**CGSw 14.47**	(3.10)
R^2	0.086		0.091		0.252		0.269	
# Observation	223		223		223		223	

Note: ***, **, and * indicate being statistically significant at a 1%, 5%, and 10% level, respectively.

Table 22

Regression for Firm Performance by Country

	(1)	(2)	(3)	(4)	(5)	(6)
	Thailand	**Thailand**	**Korea**	**Korea**	**Indonesia**	**Indonesia**
Dependent Variables	Tobin's q	ROA (2000-02)	Tobin's q	ROA (2000-02)	Tobin's q	ROA (2000-02)
Constant	0.025 (0.03)	-8.53 (-0.65)	1.091 (3.12)	8.89 (1.19)	1.519 (0.91)	-8.55 (-0.50)
Debt/Assets	0.277 (1.23)	-9.49 (-2.69)	0.643 (5.86)	-5.14 (-2.06)	0.361 (0.56)	-13.91 (-2.12)
Ln (assets)	0.020 (0.46)	-0.05 (-0.08)	-0.055 (-2.66)	-0.56 (-1.27)	-0.190 (-1.97)	-0.26 (-0.27)
Ln (sales02/97)	-0.001 (-0.01)	3.14 (1.92)	0.008 (0.19)	2.74 (2.78)	0.339 (1.82)	5.03 (2.66)
D (single domestic owner)	-0.243 (-1.99)	0.23 (0.12)	0.027 (0.46)	-0.41 (-0.29)	-0.227 (-0.81)	-0.39 (-0.14)
D (non-family group)	-0.350 (-2.51)	-1.62 (-0.71)	-0.050 (-0.55)	-2.84 (-1.32)	-0.375 (-1.34)	6.08 (2.14)
D (substantially foreign owned)			0.210 (4.05)	3.76 (3.13)		
D (new firms)	-0.305 (-0.79)	-18.48 (-3.15)	0.061 (0.70)	2.24 (1.12)	2.171 (2.61)	7.92 (0.94)
EPP [1]					0.159 (2.08)	-0.53 (-0.68)
D (industry) [2]	Not included (all insignificant)	Dist(+)* Food(+)*	Elec (+)*** Chem (+)** Food (+)* Iron (+)*	Text (+)*** Dist (+)*	Text (+)*	Chem (+)* Food (+)**
CG Score/100	**0.906** (1.72)	**19.80** (2.40)	**0.576** (2.67)	**12.95** (2.34)	**3.206** (2.62)	**33.95** (2.73)
CG Score Used	**(BE-ed + BE-id) / 2**	**(BE-ed + BE-id) / 2**	**CGSw-k** [3]	**CGSw**	**CGSw-i** [3]	**CGSw-i** [2]
R^2	0.213	0.537	0.493	0.389	0.477	0.540
# Observation	53	53	109	109	54	54

Notes: 1. EPP is the score for employee participation practices (see footnote of Table 6-3).

2. ***, **, and * indicate being statistically significant at a 1%, 5%, and 10% level, respectively.

3. CGSw-k = 0.34 DT + 0.32 BF + 0.33 IS, and CGSw-i = 0.45 EP + 0.08 OR + 0.16 CI + 0.31 IS, where the weights were derived from the relative magnitudes of the coefficients when the equations were estimated with all the six components of CGS and re-estimated after excluding any components with a negative coefficient.

Finally, Table 22 presents some firm performance equations by country. They show a statistically significant impact of corporate governance quality on firm performance. The table attempts to provide weighted average corporate governance scores by country. Arguably, the specific components of corporate governance practices to which investors pay the most attention may differ for each country because of differences in ownership and control structures, regulatory frameworks, or relevant corporate practices.[51] The corporate governance components that appear more important in the Tobin's q equations include DT, BF, and IS for Korea and EP, OR, CI, and IS for Indonesia.

As already suggested by equations with country dummy variables in Table 20, no association between corporate governance (based on factual information) and firm performance could be found for Thailand. Thus an alternative measure of corporate governance quality is attempted, that is, board effectiveness scores based on the opinions of both executive and independent directors (average of BE-ed and BE-id), which turns out to be significant, particularly in the ROA equation.[52] Debt dependence is significant (positive) for Tobin's q in Korea, but has a negatively significant impact on ROA in both countries. For Korea, other things being equal, firms substantially owned by foreigners have a significantly higher Tobin's q, while no significant effect is found for firms controlled by a single, domestic owner, as is the case for most of the Korean sample firms.

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51. For example, certain components of corporate governance practices, for example, rules governing information disclosure and transparency or board composition, may be strictly regulated in a country so that little variation is observed among firms. In such a situation, however important the components might be, they are unlikely to be considered seriously in investors' evaluation of companies or show any significance in estimated Tobin's q equations.

52. The Thai consultant suggests that the failure to find any association might be due to the relatively small sample and the inclusion of many small firms whose shares may not be actively traded and accurately valued in the market. However, it may well be due to the relatively poor quality of corporate governance scores for the Thai firms (see footnote 43). Regression results for Malaysian firms (not shown) do not show any effects of corporate governance scores on corporate performance either. This result might be due in part to the failure to control industries for the sample firms. One possibility is that for countries where corporate governance quality is above a certain level, and with relatively little variation among companies, the analytical framework used here may not be sophisticated enough to address the issue.

6 *Potential Role of Stakeholders*†

The Anglo-American model of corporate governance may not necessarily be the most efficient model in all circumstances, and may work best under certain conditions. Those skeptical about the efficacy of the Anglo-American market-based system naturally turn to stakeholders other than shareholders in relation to their potential role. Given the underlying forces that affect institutions and people's behavior pertaining to corporate governance, this section assesses the potential role of these stakeholders and also discusses the survey results based on directors' opinions.

Underlying Forces Shaping Corporate Governance

What determines the quality of corporate governance is not simply the enactment of laws and regulations. Culture influences not only the shape that institutions take, but is also likely to affect the behavior of those participating in corporate governance mechanisms. In addition, market forces working toward the convergence of corporate governance practices, as well as other institutional factors, make fundamental changes difficult. Finally, changing technologies and types of corporate activities call for new models of corporate governance.

Role of Culture

As the corporate culture differs from firm to firm in different cultures, so may the way that corporate governance works (see, for example, Iu and Batten

† The authors appreciate Takao Kato's contribution to this section: he assisted the authors with the design of survey questions particularly on the roles of employees and joint labor-management committees (JLMCs) as well as the interpretation and analyses of the relevant survey results.

2001).[53] The most dominant value system in Asia is probably Confucianism, and its essential teachings include harmony in human relations and education as a way of training people. The emphasis on harmonious human relationships based on filial piety, respect for superiors, and care for subordinates might have been fertile soil for collectivism as opposed to individualism. As is most evident in Japan, teaching people to avoid social embarrassment and shame by meeting the expectations of others contributed to collective cooperation, minimal social deviance, and conformity in a group or organization. As a consequence, Japanese firms tend to be less concerned about supervisory chores, rely less on litigation to deal with failed expectations than the social sanction of a "shame culture," and prefer informal binding through human relationships.[54]

Given a preoccupation with harmonious human relationships, minority shareholders in Asia may not be very assertive in protecting their rights and independent directors may be far less independent in their behavior than those in Western countries. Management is generally characterized by an attitude of benevolent paternalism, which often makes board discussions about sensitive issues perfunctory. Given the views about relationships, management tends not to be very careful about related-party transactions. Iu and Batten (2001) observe that Asian culture significantly impedes the implementation of the Anglo-American model of corporate governance and view the model of family-based ownership concentration and the role of relationship-based business as representative of a cultural tendency toward familism and group affiliation.

Also pronounced in Asia is an egalitarian corporate culture, whereby decisionmaking is collective or consensus based on the basis of shared information and employee participation and the disparity of financial compensation between upper management and workers is relatively small. Certainly Asian cultural values are more in favor of a stakeholder model than the Anglo-American model based on shareholder supremacy. The implication is that strenuous efforts are required to strengthen relevant institutions and promote a culture that helps the model to function efficiently. Asian countries

53. For a discussion of social and corporate cultures with reference to People's Republic of China, Japan, and Korea, see Freeman (1998); Kim (2002); and Picken (2003).

54. According to Hitchcock (1994), East Asians value an orderly society, societal harmony, accountability of public officials, openness to new ideas, freedom of expression, and respect for authority most highly. By contrast, the most important American values include freedom of expression, personal freedom, individual rights, open debate, thinking for oneself, and accountability of public officials.

may attempt to develop their own model that is more compatible with their culture. A challenge to any such effort is how to avoid intrinsic weaknesses that are likely to result from the cultural preferences for families and relationships.

Convergence Versus Path Dependence

Many people predict a global convergence of different corporate governance systems to one that is likely to be the Anglo-American model. Increasing numbers of European and Asian firms are listed on US stock exchanges, thereby subjecting themselves to the US listing regulations and securities laws. Also many US institutional investors investing heavily in Europe and Asia are increasingly demanding adherence to certain corporate governance principles and specific standards.[55] With further globalization of international capital markets and growth of multinational corporations, the need for international harmonization of securities regulations and disclosure standards will become stronger. (For a more comprehensive list of reasons for such convergence, see Coffee 1999, 2002; Gilson 2000; Hansmann and Kraakman 2000).

The efficacy of corporate ownership and governance systems may change depending on the adequacy of the contractual infrastructure for protecting investors (La Porta and others 1997; Rajan and Zingales 1998). In the absence of adequate protection, investors tend to be preoccupied with management control, which often leads to concentrated ownership or a relationship-based system of corporate governance, particularly where capital is scarce relative to available investment opportunities to make price signals for guiding investment less important. This indicates that as an economy matures with capital accumulation and better investor protection, a market-based Anglo-American model will work better than a relationship-based model.

Despite these powerful forces, key differences in corporate governance features are likely to persist because of the path-dependent nature of corporate ownership and governance (Bebchuk and Roe 1999). Switching costs result from sunk costs, resistance by vested interest groups, and network externalities even in cases where relevant parties are aware of a more efficient system. If the entities

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55. Institutional investors hold US$24 trillion in financial assets in the world's top five markets, 76% of which are held by UK and US investors. For the 25 largest US pension funds, which account for two-thirds of all foreign equity investment by US investors, the percentage of foreign equity held in their individual portfolios rose from an average of 8% in 1993 to 18% in 2000 (Conference Board 2000).

are myopic, the evolutionary process in response to environmental changes is likely to lead to a local optimum, which will also cause path dependence. Still another important cause of path dependence is complementarity among institutions that characterize a corporate governance system in relation to structure of ownership and decision rights, financial systems, employment and human resource management systems, degree of disclosure and transparency, and internal or external mechanisms of corporate governance.

An implication is that mixing the elements of different governance systems together may not make much sense, because it will result in a loss of institutional complementarity. Unless institutions are changed simultaneously *en masse* in such a way as to ensure complementarity, an efficient shift to another system would be difficult. In this connection, Schmidt and Spindler (2000) envisage that as markets continue to be globalized, the insider control system is likely to experience a greater degree of destabilization than the Anglo-American system, because it relies more on mutually consistent and stable expectations among diverse groups of stakeholders.

The 1997 Asian financial crisis served as a powerful break from path dependence as many family-based business groups went bankrupt or underwent substantial restructuring or ownership dilution. The resulting extensive legislative and regulatory reform of corporate governance itself represents a major break from the past. The crisis has likely provided a rare opportunity to move to a new system that may be the Anglo-American model. Nevertheless, core elements of the past system remain largely intact, namely, the concentrated ownership structure and the nonseparation of ownership and management. Thus a fundamental change from the insider control model with domination by a controlling owner will be difficult.

Changing Technologies and Types of Corporate Activity

Depending on the types of technologies employed and activities undertaken, firms' organizational structure and corporate governance can differ widely. For firms whose core competence depends on workers' skills, a governance structure that ignores workers' role is likely to lead to trouble, and a failure to involve them in corporate decisionmaking would make it difficult to retain and motivate them. Also the development of technology implies that workers need more skills and requires more workers with multiple skills. This will increasingly induce corporations to involve employees in shop-floor

decisionmaking, in other practices leading to higher corporate performance, or even in formal corporate governance.

Aoki (2003) argues that the desired governance structure may differ depending on the type of organizational characteristics, especially information connectedness among all those involved. For example, employee participation in corporate governance or contingent relational governance by creditor banks in serious financial distress may complement corporatist wage setting and an information-sharing organizational architecture (where workers' inputs and cooperation are critical to corporate success). Similarly, Mayer (2000) argues that different types of corporate activities may need different ownership and control structures. For example, traditional manufacturing activities with a long gestation period may need committed large investors with control for an extended period, while many "new enterprises" may do better with dispersed owners that are less committed but more flexible.

Role of Stakeholders

When a corporation is in a serious financial distress, residual claimants include not only shareholders, but also other stakeholders. Thus creditor banks and employees are likely to have particularly strong incentives to monitor firms. Given Asian enterprises' vulnerability to abuses by controlling families, their heavy dependence on banks, and the increasing importance of "knowledge workers," the scope for other stakeholders to play a corporate governance role could be considerable. The actual or potential roles of stakeholders are likely to depend on firms' characteristics in relation to their dependency on bank loans, level and type of technology, and extent of human capital. The survey attempts to evaluate the degree to which firms pay attention to the interests and potential roles of various shareholders.

Corporate directors in the countries surveyed seem to view the roles of broader stakeholders rather positively. Banks have certainly strengthened their monitoring of their corporate clients since the Asian crisis, and companies are interested in having a close, long-term relationship with their creditor banks, particularly in Indonesia and Thailand. The survey results also show a relatively high prevalence of joint labor-management committees (JLMCs) in Indonesia and Korea, although they seem to play only a limited role as a potential governance mechanism. Nevertheless, employees are likely to play a substantial corporate governance role in the future given their fairly high level

of education and relatively long tenure along with the prevalence of various complementary mechanisms whereby employees could play an enhanced role, including shop-floor and financial participation. Corporate directors seem to believe in the rising importance of human capital for corporate success without being overly concerned about the downside of employees having a stronger voice or participating more actively.

Role of Stakeholders in General

Some people view corporate governance as dealing with mechanisms whereby the stakeholders of a corporation exercise control over corporate insiders and management in such a way that the stakeholders' interests are protected (Berglöf and von Thadden 1999; John and Senbet 1998). The single-minded pursuit of shareholders' interests with little regard paid to other stakeholders might be both unfair and inefficient.[56] In reality, most managers, even in Anglo-American enterprises, seem to believe that the relationship between stakeholders and the firm is one of the key elements of corporate success, if not the most critical factor. The role of various stakeholders may be even greater in many Asian enterprises, where a key challenge is to prevent the abuse of power by controlling owners.

Stakeholders primarily include investors, managers and employees, customers, suppliers and other business partners, and local communities. Regulatory and supervisory agencies, civil activists, and the media may play an important role in enhancing corporate governance. Securities regulatory bodies and fair trade commissions are directly involved in setting and enforcing the rules on the conduct of business by corporations for the purpose of protecting investors. Media attention can motivate politicians, bureaucrats, controlling families, and managers, who are concerned about damage to their reputations, to adopt more effective corporate governance laws, policies, and practices (Dyke and Zingales 2002a, 2002b).

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56. The OECD (1999) maintains that the "corporate governance framework should recognize the rights of stakeholders as established by law and encourage active cooperation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises." (p. 20) More specifically, the OECD says that the corporate governance framework should permit performance-enhancing mechanisms for stakeholder participation such as employee representation on boards; employee stock ownership plans, other profit-sharing mechanisms, or governance processes that consider stakeholders' viewpoints in certain key decisions; and creditor involvement in governance in the context of insolvency proceedings.

Relationships Between Banks and Businesses and Banks' Corporate Governance Role

Most large companies in the region still borrow extensively from banks, because capital markets are relatively underdeveloped. Creditor banks have a natural comparative advantage in monitoring their corporate clients, and this advantage becomes more pronounced when banks have stable, long-term relationships with their clients. At the first signs of deteriorating corporate performance, the creditor bank may intervene in corporate management to help it better handle the problems of financial distress on the basis of its accumulated information. Such action on the part of creditor banks may provide a flexible, informal alternative to the roles the market plays in corporate control or bankruptcy proceedings (Ferri, Kang, and Kim 2001; Hoshi and Patrick 2000; Sheard 1994).[57]

Is bank-based corporate governance an option for Asian economies? The capital market-based Anglo-American model requires many institutions to support the system, including legal, accounting, auditing, and credit rating systems; investment consulting; investment banking; disclosure and other fair trading rules; internal corporate governance mechanisms; and markets for corporate control. Because building such institutions takes much time and effort (Kanda 2001), Asian countries may be advised to make the best use of banks for corporate governance together with efforts to strengthen relevant capital market institutions.

In reality, however, banks have failed to play any meaningful corporate governance role in these economies largely because of poor corporate governance in the banks themselves. Banks were often controlled by powerful families who had corruptive ties with political elites. In cases where large businesses were prohibited from controlling banks as in Korea, the government continued to intervene in the management of private banks. In the crisis-hit Asian countries, many banks are newly in government hands. The challenges include how to strengthen corporate governance in these government banks and what ownership and governance structures to introduce when they are privatized.

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57. For other in-depth discussions of relationship banking and of the relevant literature, see Aoki (1994); Boot (2000); Nam (2004); Petersen and Rajan (1994); and Weinstein and Yafeh (1998).

An interesting undertaking would be to assess whether the relationship between business firms and their banks has undergone any changes since the Asian financial crisis. Because the major postcrisis reform efforts have been directed toward the problems of poor governance in both big businesses and banks as well as the unhealthy relationship between banks and businesses, banks might now be more serious about monitoring their client firms. More serious monitoring of corporate clients by banks may lead to banks developing an interest in promoting stable, long-term relationships with their clients.

Relationship banking has several merits from corporations' point of view. By reducing information asymmetry between firms and their banks, firms may expect easier access to credit, mitigation of liquidity constraints, risk sharing, prevention of premature liquidation, and more efficient corporate restructuring. However, relationship banking entails risks as well. Because of soft budget constraints (better chance of loan renegotiation), client firms' investment efficiency may be lower. A relationship bank may also discourage risk taking by client firms, thereby constraining it from fully realizing its corporate growth potential, and extract rents from its clients by charging higher interest rates.

Relationship banking can be cemented by having banks participate in formal corporate governance mechanisms, for example, by holding equity shares of client firms and being represented on their boards of directors. As both creditors and shareholders or directors, banks might have stronger incentives and enhanced capacity to monitor firms. Any potential conflicts of interest between creditors and equity holders may also be alleviated, and the premature liquidation of distressed client firms might be avoided. These potential benefits also come with risks. Firms may be more likely to undertake unproductive investments because of the soft budget constraints, and banks may distort corporate decisions to protect their own interests as creditors. In particular, someone from a bank who sits on the board of a client firm faces conflicts of interests between his or her fiduciary duty to the firm and to the bank.

Employee Participation in Corporate Decisionmaking

Long-term employees have often invested heavily in firm-specific human capital that is of little value outside the firm, making them extremely interested in monitoring their firms. Currently, however, employees in Asian developing countries seem to play a limited role in corporate governance.

This situation is likely to change in the future. Aside from anticipated progress in socio-political democratization, employers in more industrialized economies in the region will find that motivating employees to acquire the necessary skills and giving full reign to their initiative and creativity will become increasingly essential. Where the innovative ideas and dedication of core employees are the key source of corporate competence, as is increasingly the case in knowledge-intensive firms, these employees may be encouraged to take part in corporate decisionmaking and governance.[58] As noted earlier, Asian enterprises are characterized by a relatively small difference in status between management and workers; a corporate culture that favors collective cooperation and harmony; and a highly-educated, long-term workforce. All these characteristics increase the prospects for a system based on worker participation and cooperation in the region.[59]

The experiences of industrial countries, as well as the realities and challenges the Asian economies face, suggest that boards of directors are unlikely to become forums for management and labor to share the decisionmaking function (Hunter 1998; Stern 1998). A more promising channel for worker participation in governance may be works councils or JLMCs. JLMCs serve as a mechanism for employee participation and involvement on a large variety of issues, ranging from basic business policies to working conditions, in a less confrontational format than collective bargaining situations.[60]

58. See Blair (1996) for the protection of firm-specific human capital investment, Milgrom and Roberts (1995) and Rajan and Zingales (2000a, 2000b) for emerging governance concerns in "new enterprises," Donaldson and Preston (1995) and Freeman (1999) for a stakeholder theory of corporations, and Freeman (2000) for the emergence of "shared capitalism." See also Nam (2003).

59. However, other forces may work against this trend. As lifetime, or even long-term, employment is becoming rare and labor mobility is increasing, both employees and employers are less keen to make firm-specific or relationship-specific investments. Furthermore, "new enterprises" whose success or failure becomes apparent relatively quickly will be increasing, though the development of such enterprises seems to be slow in Asia compared with that in many industrial countries.

60. For example, many observers attribute the peaceful relations between labor and management at the enterprise level in Japanese companies to the establishment of JLMCs (Inagami 1988; Shimada 1992). According to Kato and Morishima (2002), in 1950 only about 20% (30% for manufacturing) of publicly traded firms in Japan had JLMCs. During the next two decades, JLMCs spread rapidly, and by 1970 the figure had risen to close to 60% (70% for manufacturing). Progress continued, and as of 1992, fully 80% of all firms (nearly 90% for manufacturing firms) were reported to have JLMCs. See also Rogers and Streeck (1995).

Empirical evidence suggests strong complementarity among different forms of worker participation, namely, strategic decisionmaking, equity ownership and other forms of financial participation, and decisionmaking on the shop-floor, together with conducive work organization and human resource management practices. Having many of these complements in place is necessary to effectively motivate workers (Berman and others 1999; Black and Lynch 2001; Freeman, Kleiner, and Ostroff 2000; Helper 1998; Ichniowski, Shaw, and Prennushi 1997; Kato and Morishima 2002; Michie and Sheehan 1999; Milgrom and Roberts 1995; OECD 1995, 2000). As a strategic complement, employee stock ownership programs may be seriously considered.

Economic success in East Asia has led to noticeable progress in democratization and stronger labor rights. However, economic setbacks in the wake of the financial crisis have resulted in a large increase in unemployment that might have weakened the voice of workers. At the same time, the weakening grip of families on large businesses, together with the progress toward knowledge economies, might provide a favorable environment for workers to raise their voice.

Views on the potential effects of a stronger voice for labor or enhanced labor participation in corporate decisionmaking vary widely. Some observers expect that this would help prevent abusive behavior by controlling owners, while others believe that labor's interests would be better served at the expense of shareholders. Observers also argue that labor participation can improve firm performance because of better information flows, better decisionmaking, and more effective enforcement of decisions. With heightened vigilance by workers, firms might also be more likely to adhere to workplace-related laws and regulations. Perceptions also seem to differ widely on employee involvement in shop-floor decisionmaking, for example, by means of self-directed teams, problem-solving groups, or quality circles. While some believe that such involvement is essential for enhancing productivity, others worry that it will make labor too strong. (For more in-depth discussion and empirical literature on the effects of various types of employee participation in shop-floor and governance activities, see Nam 2003).

Much of the focus of the survey is on works councils and JLMCs. In most firms without a labor union, they are the only representative form of worker participation in corporate governance; however, their mode of operation might

be quite different across firms and countries in terms of the issues discussed, the frequency of meetings, and the way in which representatives are selected. The survey is also interested in various employment practices and policies that are believed to be essential complements to effective worker participation. The degree of worker participation and the prevalence of complementary practices are likely to differ depending on such factors as firm size, employment stability, and composition of the workforce.

Survey Results

The survey of human resources (factual information) and the role of stakeholders (directors' opinions) was conducted as part of the questionnaire survey described earlier (Tables 23 and 24 present the responses). It focuses primarily on the role and priorities of broad stakeholders in corporate governance reform, the monitoring role of creditor banks, and the participation by employees in corporate decisionmaking.

Role of Broad Stakeholders and Priorities in Relation to Corporate Governance Reform

Respondents in all four countries seem to be relatively favorably disposed toward corporations pursuing the interests of all stakeholders in addition to those of shareholders (Table 23). Those strongly supporting the idea that corporations have the goal of enhancing the well-being of various stakeholders in addition to shareholders account for 52-62% of total respondents, compared with the 7-29% who strongly hold the view that the only goal is making profits for shareholders. Among the four countries, Korean directors are a little less favorably disposed to stakeholders' interests.

Independent directors are viewed as the most important in preventing abusive behavior by controlling owners by 74% of the Malaysian directors, 67% of the Indonesian commissioners, and 54% of the Thai directors, but only 25% of the Korean directors. Surprisingly, 34% of the Korean respondents (including 40% of executive directors) indicate that the most important role is played by the labor union or employees, whose role is considered the least important by the respondents in three other countries. Institutional investors (particularly in Malaysia and Thailand) and creditor financial institutions (particularly in Indonesia) are also expected to play a role in abuse prevention by controlling owners.

Table 23
Potential Role of Stakeholders in Corporate Governance
Opinion Survey

	Responses	Thailand		Korea		Indonesia		Malaysia	
		ED	ID	ED	ID	ED	ID	ED	ID
1.1 The only goal of a corporation is making profit for shareholders.	Y+	11	13	17	25	4	2	9	10
	Y	25	26	54	41	8	12	34	19
	O	5	13	26	25	7	4	3	16
	N	28	24	11	6	10	24	13	18
	N+	6	11	2	3	4	9	3	3
1.2 A company, besides making profit for shareholders, has the goal of enhancing the well-being of various stakeholders, such as employees and customers.	Y+	42	55	57	54	18	29	34	45
	Y	33	32	48	46	14	21	25	21
	O	0	1	5	1	1	1	2	0
	N	0	0	0	1	0	0	1	0
	N+	0	0	0	0	0	0	0	0
2. Whose role is most important in preventing the controlling owners from abusing their power?									
A. Minority shareholders	1	14	10	22	16	3	5	2	4
	2	17	21	15	11	11	14	19	28
	3	16	9	19	23	3	6	28	16
	4	13	23	15	19	12	11	6	11
	5	11	22	24	21	4	15	4	4
B. Institutional investors	1	9	19	14	10	3	4	10	9
	2	18	15	21	18	8	9	26	20
	3	31	29	17	17	10	13	20	31
	4	10	18	26	26	8	16	1	3
	5	4	5	18	18	4	8	2	0

C. Independent directors	1	44	42	20	26	25	31	47	51
	2	13	17	26	21	2	11	11	12
	3	9	18	20	16	4	8	2	1
	4	4	6	13	13	2	1	0	0
	5	3	4	13	16	0	0	0	1
D. Creditor financial institutions	1	4	10	15	20	2	7	1	1
	2	15	20	16	20	9	9	2	0
	3	15	19	20	20	13	15	4	11
	4	23	20	19	15	5	16	44	42
	5	14	15	20	17	4	4	8	9
E. Labor unions or employees	1	2	7	38	26	0	4	0	0
	2	7	16	14	19	3	8	1	2
	3	3	8	15	13	3	9	5	4
	4	22	18	15	17	6	7	8	7
	5	37	36	13	17	21	22	45	49
3.1 Banks screen loan applications more carefully after the Asian crisis.	Y+	31	31	21	17	10	17	10	13
	Y	35	49	69	61	23	33	38	46
	O	1	6	15	18	0	1	12	1
	N	7	2	4	1	0	0	0	3
	N+	0	1	0	1	0	0	0	0
3.2 Banks monitor the firm more closely after making loans since the Asian crisis.	Y+	19	15	17	13	11	15	5	4
	Y	40	61	70	58	22	35	39	46
	O	7	11	18	26	0	1	13	4
	N	6	1	4	1	0	0	3	8
	N+	2	1	0	1	0	0	0	0
3.3 Banks play a more active role in corporate restructuring in the event of the firm's financial distress after the Asian crisis.	Y+	15	15	13	9	10	12	7	7
	Y	34	46	43	54	17	31	25	38
	O	17	20	47	31	4	7	21	14
	N	7	6	5	4	2	1	7	3
	N+	1	1	0	1	0	0	0	0

Table 23 cont.

	Responses	Thailand		Korea		Indonesia		Malaysia	
		ED	ID	ED	ID	ED	ID	ED	ID
4. Is the firm interested in having a more stable long-term relationship with the creditor bank(s)?	Very much	49	65	45	35	23	44	42	51
	A little	15	16	57	55	7	4	17	11
	Not interested	9	7	6	10	3	3	0	0
5. Agree on the following reasons for interest in having a stable long-term relationship with bank(s)?									
5.1 Advice of banks on overall business and financial strategies	Y+	6	9	2	1	4	3	3	7
	Y	29	34	31	26	18	38	19	18
	O	10	17	36	35	6	5	12	8
	N	5	6	25	21	2	2	21	26
	N+	2	2	2	2	0	0	0	2
5.2 Better credit access and mitigation of temporary liquidity shortage	Y+	10	10	14	15	7	6	7	13
	Y	34	48	66	49	19	35	21	22
	O	4	9	14	18	4	5	22	19
	N	3	2	2	3	0	2	6	8
	N+	0	0	1	0	0	0	0	0
5.3 Avoiding premature liquidation and being better helped in the event of severe financial distress	Y+	12	8	4	3	6	4	5	8
	Y	30	43	39	37	18	33	17	19
	O	4	13	37	29	6	9	28	27
	N	5	3	14	13	0	2	5	7
	N+	0	2	2	3	0	0	0	0
6. Agree on the following reasons that make the firm reluctant to develop such a relationship?									
6.1 Decline of corporate dependence on bank loans or inadequate expertise of bank officers to meet corporate demand for diverse financial services	Y+	5	6	4	1	1	2	4	4
	Y	33	36	39	43	14	26	19	28
	O	15	32	42	38	9	16	29	22
	N	14	9	20	13	8	7	7	7
	N+	1	1	0	0	1	0	0	0

6.2 Reluctance to reveal sensitive corporate information to banks, and anticipated banks' monitoring and management intervention	Y+	4	3	7	3	0	1	6	4
	Y	30	38	42	41	11	20	17	26
	O	18	20	38	39	11	16	25	11
	N	14	18	17	11	10	12	10	20
	N+	3	4	1	0	1	2	1	0
6.3 Possibility of being stuck to a bank	Y+	5	3	5	4	0	2	4	3
	Y	28	32	43	38	16	26	19	28
	O	16	29	40	37	10	11	28	20
	N	19	17	16	16	7	10	8	9
	N+	0	2	0	0	0	1	0	2
6.4 Increased concern over potential negative impact of banks' own distress	Y+	2	3	3	1	2	1	4	3
	Y	24	26	33	29	13	27	24	27
	O	27	35	39	37	13	20	26	22
	N	14	17	29	23	5	3	3	5
	N+	1	2	0	5	0	0	2	4
7. Agree on the following effects of creditor bank's holding equity shares of your firm?									
7.1 The bank's monitoring incentives will be strengthened.	Y+	8	5	7	7	2	1	2	1
	Y	34	42	70	63	20	34	23	22
	O	19	22	25	25	8	8	23	18
	N	8	12	7	4	3	7	11	17
	N+	2	4	0	1	0	1	0	4
7.2 Conflicts of interest between the creditor bank and corporate shareholders will be lowered.	Y+	4	7	1	0	2	2	0	0
	Y	18	26	46	30	10	19	4	7
	O	26	29	46	54	12	9	26	20
	N	20	20	16	16	8	20	29	31
	N+	3	3	0	0	1	1	0	3

Table 23 cont.

	Responses	Thailand		Korea		Indonesia		Malaysia	
		ED	ID	ED	ID	ED	ID	ED	ID
7.3 Premature liquidation in times of distress will be lowered.	Y+	3	4	3	2	2	1	0	1
	Y	26	30	46	39	14	29	10	8
	O	24	33	45	46	12	14	34	30
	N	15	14	14	11	4	7	15	18
	N+	3	3	1	2	0	0	0	4
7.4 With the reduced liquidity constraints, the chance for undertaking unprofitable investments will be increased.	Y+	2	2	0	2	1	2	0	0
	Y	21	22	19	9	6	17	14	12
	O	28	40	37	43	12	14	30	26
	N	18	18	46	39	12	15	15	20
	N+	2	3	7	6	2	3	0	3
7.5 The bank will exert a stronger influence on the firm for its own interests, charging higher interest rates or favoring low-risk projects.	Y+	5	2	3	2	2	3	2	1
	Y	29	14	45	30	7	17	19	22
	O	20	37	33	45	13	16	27	23
	N	14	27	25	18	6	11	11	10
	N+	3	5	2	3	5	4	0	5
8. Agree on the following effects of creditor bank's being represented on the board of your firm?									
8.1 The firm will be better monitored by the creditor bank.	Y+	5	10	22	15	3	3	3	1
	Y	36	35	70	71	21	27	12	16
	O	15	25	11	9	7	10	30	24
	N	9	10	5	5	1	8	13	14
	N+	6	5	0	0	1	3	1	6
8.2 No particular corporate governance role is expected unless the firm is in financial distress.	Y+	5	5	6	2	1	1	1	0
	Y	14	26	27	30	21	31	7	10
	O	21	28	40	46	5	13	28	22
	N	26	22	33	19	5	5	22	23
	N+	3	3	2	2	1	1	1	6

8.3 The firm can expect favors from the bank (better access to credit, reduced liquidity constraints, risk sharing, etc.)	Y+	5	4	2	2	4	3	1	2
	Y	21	42	49	44	21	32	8	10
	O	25	25	42	37	6	8	31	26
	N	11	11	14	14	1	7	18	18
	N+	8	1	1	2	1	1	1	6
8.4 The bank will have too much influence over the firm (allowing it to pursue its own interests at the expense of the firm or other stakeholders of the firm).	Y+	8	7	10	6	4	2	7	4
	Y	20	20	45	32	12	22	17	20
	O	19	26	37	46	11	11	27	23
	N	21	29	13	15	4	15	8	10
	N+	2	1	1	1	2	1	0	4
9.1 Since the Asian crisis, the labor union has become more powerful.	Y+	1	0	9	9	5	2	0	0
	Y	1	0	26	17	12	22	14	16
	O	3	7	25	24	10	13	16	19
	N	16	10	17	14	6	10	7	5
	N+	2	4	1	1	0	0	0	3
9.2 Since the Asian crisis, employee voice/participation in corporate decision-making has increased.	Y+	3	0	5	7	1	0	1	1
	Y	11	14	29	26	12	16	13	17
	O	18	26	40	32	5	12	27	27
	N	30	35	28	31	15	23	16	12
	N+	5	4	5	1	0	0	0	3
9.3 Employee voice or participation has not increased since the crisis, but is expected to increase as the economy fully recovers.	Y+	4	3	3	3	1	1	0	0
	Y	26	30	30	25	9	11	20	29
	O	13	26	34	33	12	20	23	19
	N	21	21	24	28	8	18	14	10
	N+	2	0	5	1	3	0	0	1
10. How important are the following reasons for the (expected) increase in employee voice/participation?									
10.1 Democratic reform resulting from economic progress and growth of the educated middle class	Very important	15	24	4	4	2	9	6	17
	Somewhat important	19	25	61	48	20	19	40	38
	Not too important	8	14	13	21	0	2	2	0
	Not important at all	2	0	1	0	0	0	0	0

Table 23 cont.

	Responses	Thailand		Korea		Indonesia		Malaysia	
		ED	ID	ED	ID	ED	ID	ED	ID
10.2 The impact of the Asian crisis: weakening family control and labor's falling a victim of poor corporate governance	Very important	5	11	8	5	1	3	2	5
	Somewhat important	22	26	54	54	15	18	26	38
	Not too important	12	20	17	13	5	8	12	8
	Not important at all	5	5	0	1	0	1	8	3
10.3 Increased importance of human capital: strategic decision-making power given to core employees to encourage innovation and dedication	Very important	23	25	16	6	7	5	8	21
	Somewhat important	19	31	43	40	13	21	37	33
	Not too important	1	6	20	27	2	4	3	0
	Not important at all	1	0	0	0	0	0	0	0
10.4 Growing role of employees in shop-floor decision-making or share ownership	Very important	8	10	2	1	0	0	3	3
	Somewhat important	31	35	37	26	11	22	21	26
	Not too important	6	15	37	42	8	6	19	23
	Not important at all	0	1	3	3	3	2	5	2
11. Agree on the following statements about the expected consequences of stronger labor voice or participation in corporate decision-making?									
11.1 Abusive behavior of controlling owners will be held in check.	Y+	8	6	6	5	3	2	2	4
	Y	32	45	67	51	20	35	31	34
	O	18	24	30	37	5	6	23	16
	N	8	7	6	7	5	4	5	10
	N+	3	0	1	1	0	2	0	0
11.2 Firm performance will be improved due to improved information flow, better decisions and enforcement.	Y+	11	8	5	4	3	4	2	2
	Y	35	50	50	48	21	31	40	50
	O	18	19	37	40	5	6	18	8
	N	5	5	18	9	4	6	1	4
	N+	2	0	0	0	0	2	0	0

11.3 Workplace-related laws and regulations will be better observed.	Y+	12	14	3	2	8	6	3	3
	Y	45	60	58	48	21	34	41	53
	O	10	6	37	43	3	6	16	5
	N	3	2	12	7	1	2	1	4
	N+	1	0	0	1	0	1	0	0
11.4 Interests of labor will be better served at the expense of shareholders.	Y+	5	6	1	2	2	4	1	0
	Y	36	39	39	29	22	31	21	26
	O	18	29	41	44	6	7	29	25
	N	8	7	28	20	0	5	9	13
	N+	4	1	1	6	3	2	1	0
12. What will be the effects of employee involvement in shop-floor decision-making?									
12.1 Such activities are essential to productivity enhancement.	Y+	25	23	32	16	13	13	6	9
	Y	44	57	60	63	18	26	43	52
	O	4	2	17	14	1	6	13	5
	N	0	1	1	8	1	3	0	0
	N+	0	0	0	1	0	1	0	0
12.2 Such activities might ultimately make labor too strong.	Y+	3	3	3	4	2	3	1	2
	Y	16	23	42	28	9	15	4	10
	O	18	23	42	41	4	8	35	31
	N	26	32	20	26	13	20	22	20
	N+	10	2	3	3	5	3	0	2
12.3 Such activities help experienced employees leave the company to start his/her own business.	Y+	3	1	1	0	0	1	1	0
	Y	14	15	13	9	8	15	12	20
	O	18	34	50	41	2	5	30	22
	N	28	33	41	38	18	25	17	14
	N+	9	1	4	14	5	3	1	8

Table 23 cont.

	Responses	Thailand		Korea		Indonesia		Malaysia	
		ED	ID	ED	ID	ED	ID	ED	ID
13. Whose role is most important in improving corporate governance in the country?									
A. (Financial) press	1	6	3	12	11	0	2	2	2
	2	3	8	18	21	1	5	2	0
	3	9	11	14	14	2	4	0	0
	4	8	17	19	21	6	10	10	12
	5	18	19	27	21	10	14	15	13
	6	26	22	15	9	14	15	33	37
B. Civil (minority shareholder) activists	1	2	6	17	12	0	2	1	2
	2	8	4	11	8	7	6	3	4
	3	6	15	22	21	9	4	18	21
	4	12	13	24	20	8	10	16	14
	5	25	23	15	22	7	15	18	17
	6	17	18	16	14	2	13	6	6
C. Professional societies such as accounting and audit	1	26	22	10	11	5	5	4	4
	2	17	27	23	20	14	12	8	16
	3	15	13	23	18	5	18	24	20
	4	8	11	21	22	4	6	10	7
	5	3	5	13	15	3	8	15	17
	6	1	6	16	11	2	1	1	1
D. Financial supervisory agencies or fair trade commission	1	11	16	52	47	12	16	25	19
	2	14	19	21	22	4	11	19	27
	3	15	16	15	14	11	15	5	4
	4	21	19	8	8	2	4	4	4
	5	5	10	6	4	4	3	3	3
	6	4	1	4	3	0	1	6	7

E. The judiciary	1	16	9	4	1	2	7	16	15
	2	9	14	20	15	2	6	10	9
	3	8	9	11	6	2	5	10	14
	4	9	12	17	10	9	11	11	12
	5	9	14	21	17	6	5	3	4
	6	18	22	31	48	12	16	12	10
F. Outside directors	1	12	28	13	17	14	18	14	24
	2	19	17	12	12	5	10	20	8
	3	16	17	20	23	4	4	5	5
	4	15	7	15	16	4	8	11	15
	5	7	7	22	17	3	5	8	10
	6	2	6	22	13	3	4	4	3
14. Which of the following tasks is most effective for better corporate governance in the country?									
A. Making the internal corporate governance mechanisms work better	1	28	39	43	44	20	36	30	30
	2	13	13	25	20	4	4	13	11
	3	13	11	18	11	3	8	16	17
	4	7	4	11	7	2	2	2	3
	5	9	12	5	6	2	1	1	3
	6	1	3	4	11	2	0	0	1
B. Making the external governance mechanisms (such as hostile M&A) more effective	1	2	4	6	2	0	2	3	3
	2	8	10	14	16	10	7	4	6
	3	11	13	21	19	7	9	5	1
	4	12	11	24	24	4	7	19	24
	5	11	15	22	24	7	12	23	18
	6	25	28	19	13	5	14	8	12

Table 23 cont.

	Responses	Thailand		Korea		Indonesia		Malaysia	
		ED	**ID**	**ED**	**ID**	**ED**	**ID**	**ED**	**ID**
C. Enhancing the standards of accounting, audit and disclosure	1	27	29	26	25	8	3	14	20
	2	21	27	25	21	12	26	26	21
	3	9	15	16	18	8	7	17	17
	4	9	7	15	14	4	8	2	3
	5	3	6	14	9	0	5	3	0
	6	2	1	11	11	1	2	0	4
D. Conducting and publicizing corporate governance rating	1	2	4	2	3	0	5	12	10
	2	3	11	9	10	1	2	14	16
	3	13	16	7	10	5	7	7	10
	4	12	21	13	17	6	8	6	6
	5	25	12	35	17	6	7	7	6
	6	16	17	39	41	15	22	16	16
E. Prohibiting or tightly controlling some types of related-party transactions (like lending to directors or senior officers and cross-guarantees of repayment)	1	5	6	9	8	4	2	2	0
	2	23	10	11	13	1	6	4	9
	3	12	20	29	22	5	8	13	11
	4	18	19	29	22	9	19	21	22
	5	8	20	15	24	10	12	16	17
	6	4	7	13	9	4	4	6	5
F. Reducing ownership concentration (by tighter control of cross-shareholding or pyramid ownership structure, etc.)	1	9	6	22	17	1	3	2	3
	2	4	12	22	17	5	6	0	1
	3	14	7	16	19	5	12	4	8
	4	11	16	14	14	8	7	12	6
	5	16	18	14	18	8	13	12	20
	6	18	23	18	13	6	10	32	26

Some differences are apparent in general perceptions among the four countries as to whose role is most important in relation to improving corporate governance. Forty-nine percent of the Korean respondents and 35% of the Malaysian respondents indicate that financial supervisory agencies and fair trade commissions play the most important role, while 39% of the Indonesian respondents and 31% of the Thai respondents consider that outside directors and professional societies such as those for accounting and audit staff are most important. These differing perceptions are likely to reflect the relative roles the various parties have played in corporate governance reform in each country. Some respondents also appreciate the roles of the judiciary (particularly in Malaysia and Thailand) and of minority shareholder activists (particularly in Korea).

Of the various tasks involved in improving corporate governance, the respondents generally share the view that the top priorities are making internal governance mechanisms work better (67% for Indonesia and 42-47% for the other three countries) and enhancing the standards for accounting, auditing, and disclosure. Other priorities supported by the respondents include reducing the ownership concentration (particularly in Korea) and tightly restricting some types of related-party transactions (particularly in Thailand). The Indonesian respondents also express hope for more effective external governance mechanisms, such as hostile takeovers.

Monitoring by Banks and Relationship Banking

After the Asian crisis, banks strengthened their screening of loan applications, monitoring, and restructuring of corporate borrowers in financial distress. This change in banking behavior appears to be stronger in Indonesia and Thailand than in the other two countries. Eighty-seven to 90% of the Malaysian and Thai directors and 81% of the Korean directors agree (Y+ or Y) that banks screen loan applications more carefully. They also agree (83% for Thailand and 76-77% for Korea and Malaysia) that banks monitor firms more closely after making loans. Virtually all the Indonesian respondents agree that banks have stepped up their efforts in relation to these two aspects of monitoring. The respondents agree somewhat less on whether banks are playing a more active role in corporate restructuring in the event of a firm facing financial distress.

More than 90% of the respondents in all four countries say that their firms are interested in a stable, long-term relationship with banks, though respondents

who say they are "very much" interested accounted for 80% of respondents in Indonesia, 71-77% in Malaysia and Thailand, but only 38% in Korea. As for the reasons for this interest, the respondents generally agree that it is due to the expectation of better credit access and mitigation of temporary liquidity shortages. Expectations of avoiding premature liquidation and receiving more help in the event of severe financial distress are also strong reasons in Indonesia and Thailand. Respondents agree much less on the importance of advice from banks on overall business and financial strategies (except in Indonesia). Malaysian respondents give relatively weaker support to these reasons than those in the other three countries.[61]

Clearly some firms are not keen about maintaining a close, long-term relationship with banks, with 44-53% of the respondents in each country agreeing that this is because of decreasing dependence on bank loans or banks' inadequate expertise to meet corporate demand for diverse financial services. About the same proportion of the respondents also agree on the possibility of being stuck to a bank as a reason for being reluctant to develop such a relationship. Reluctance to reveal sensitive corporate information to banks and an anticipated increase in monitoring or management intervention by banks also seem to be a concern for Korean and Thai firms. The Indonesian commissioners and the Malaysian directors show a relatively high degree of concern about the potential negative impact of distress among banks themselves, which might in part reflect the disruption of the relationship between banks and businesses caused by the financial crisis.

As for the expected effects of banks holding corporate equity shares, about 70% of the Indonesian and Korean directors and commissioners, 57% of the Thai directors, and 40% of the Malaysian directors agree that this would strengthen banks' monitoring incentives. Except for the Malaysian directors, the respondents also tend to agree that this would help avoid premature liquidation in times of distress. Overall, the respondents tend to support the view that banks will exert a stronger influence on firms for the sake of their own interests (particularly in Korea and Malaysia). A relatively high number of Korean respondents tend to think that banks holding equity shares would

61. The stronger interest by the Indonesian firms and relatively weak interest by the Korean firms in having a stable, long-term relationship with their banks likely reflects the firms' financial capabilities, the availability of alternative financing options such as through capital markets, and the firms' experience with bank and business relationships.

mitigate conflicts of interest between creditor banks and corporate shareholders, but few Malaysian respondents think so. Few respondents think that this would increase the likelihood of undertaking unprofitable investments (particularly in Korea).

Except in Malaysia, respondents expect that having a creditor bank represented on the board of its corporate client will result in better monitoring by the bank (particularly in Indonesia and Korea). More than 70% of the Indonesian respondents also expect favors from the bank, compared with 47% for the Korean and Thai directors, but much fewer of the Malaysian directors. The view that the bank would exert too much influence over the firm also finds some positive support, particularly among the Korean and Malaysian respondents.

Role of Employees and JLMCs

Labor has clearly become weaker in Thailand, but has gained strength in the other three countries, particularly in Indonesia. In situations of widespread downsizing and rare hiring, labor tends to be weak; however, it seems to have been helped by recent progress in political democratization in Indonesia and by the weakening of family business groups that tend to suppress labor rights.

Basic Employee Characteristics

Table 24 shows that the proportion of employees with 10 or more years of tenure is at least 30% for one-third of the sample firms in Malaysia and almost half the sample firms in the other three countries. Where employees have lengthy periods of tenure with a firm, they presumably possess a considerable amount of firm-specific human capital, and thus have a significant stake in their firms.

Korean firms employ considerably more highly educated and highly skilled employees than Indonesian and Thai firms: in 60% of Korean firms, at least 30% of their labor force has a 4-year college degree, compared with 45% for the Malaysian firms and about 30% for the Indonesian and Thai firms. In terms of the readiness of the labor force to participate in corporate governance and its incentives to do so, the employee stakeholder model of corporate governance appears to be potentially more viable in Korea than in the other three countries.

Table 24
Human Resources and Employee Involvement Practices
Factual Information

	Responses	Thailand	Korea	Indonesia	Malaysia
1. Number of employees	Less than 100	1	5	5	4
	100-299	7	28	7	2
	300-499	5	23	4	4
	500-999	21	24	16	10
	1000-4999	22	22	23	23
	5000-	4	8	11	8
2.1 Share of managerial or supervisory employees	Less than 5%	9	1	4	0
	5-10%	15	4	8	0
	10-30%	28	65	46	15
	30-50%	7	27	5	34
	50% or more	0	11	3	11
2.2 Share of employees working for more than 10 years at the firm	Less than 5%	1	1	4	6
	5-10%	4	11	7	9
	10-30%	24	42	25	22
	30-50%	17	21	16	15
	50% or more	13	30	13	4
2.3 Share of employees graduated from a 4-year college or university	Less than 5%	3	0	1	8
	5-10%	10	0	8	7
	10-30%	27	41	39	17
	30-50%	11	39	11	16
	50% or more	7	25	7	10
3. Size of workforce change over the past three years	Increase	15	22	17	26
	Less than 10%	7	8	9	16
	10-30%	6	11	6	9
	30% or more	2	3	2	1
	Decrease	21	44	23	7
	Less than 10%	7	7	5	6
	10-30%	12	20	15	1
	30% or more	3	15	3	0
	Almost the same	21	45	26	25
4. Does the firm have the following employment practices or policies?					
4.1 Self-directed teams (MS)	Yes	49	95	56	54
	No	9	13	9	6
4.1 Self-directed teams (Non-MS)	Yes	32	65	36	46
	No	20	39	30	12
4.2 Problem-solving groups or quality circles (MS)	Yes	48	84	54	51
	No	9	24	11	9

4.2 Problem-solving groups or quality circles (Non-MS)	Yes No	38 17	90 16	48 18	46 12
4.3 Job rotation or cross training (MS)	Yes No	47 12	78 29	56 9	37 21
4.3 Job rotation or cross training (Non-MS)	Yes No	43 16	64 41	55 10	48 10
4.4 Employee stock ownership plans (MS)	Yes No	11 44	37 69	18 47	42 18
4.4 Employee stock ownership plans (Non-MS)	Yes No	4 48	37 68	14 51	34 24
4.5 Stock option plans (MS)	Yes No	8 48	24 82	13 52	46 14
4.5 Stock option plans (Non-MS)	Yes No	4 51	15 90	7 58	27 31
4.6 Profit sharing or performance-based incentive pay (MS)	Yes No	22 35	67 42	45 20	41 18
4.6 Profit sharing or performance-based incentive pay (Non-MS)	Yes No	19 38	64 43	45 21	39 19
5. Have a works council or joint labor-management committee (JLMC)?	Yes No	12 46	91 17	48 18	19 49
6. Year when the JLMC was introduced	2002-2003 1999-2001 1995-1998 1990-1994 Before 1990	0 3 2 2 5	2 7 13 13 57	3 5 5 10 26	1 0 2 7 9
7. Number of meetings last year	Less than 3 times 4-6 times 7 times or more	1 7 1	20 51 23	28 13 8	4 9 5
8.1 JLMC representatives chosen by the union?	All Some No	5 2 4	47 12 6	27 17 5	2 15 1
8.2 JLMC representatives chosen by employees?	All Some No	6 3 3	34 12 11	28 15 6	2 15 1
9. Are the following issues discussed at the JLMC?					
9.1 Basic business strategy	Yes No	3 9	41 52	9 39	2 17
9.2 Sales or production plans	Yes No	5 7	42 50	7 41	3 16

Table 24 cont.

	Responses	Thailand	Korea	Indonesia	Malaysia
9.3 Introduction or elimination of organizational units	Yes	4	27	19	4
	No	8	66	30	15
9.4 Introduction of new technology or equipment	Yes	4	29	25	2
	No	8	63	24	17
9.5 Hiring	Yes	4	29	20	4
	No	9	62	28	15
9.6 Transfer to different departments or subsidiaries	Yes	6	40	35	6
	No	7	54	13	13
9.7 Layoffs or downsizing	Yes	5	69	45	5
	No	8	24	4	14
9.8 Promotion/demotion, or other changes in employee status	Yes	7	35	33	5
	No	6	58	16	14
9.9 Working hours or vacations	Yes	9	88	45	18
	No	4	6	4	1
9.10 Employee health and safety	Yes	12	88	46	18
	No	1	6	3	1
9.11 Mandatory retirement	Yes	6	56	21	13
	No	6	37	27	6
9.12 Wage and bonus	Yes	9	81	35	17
	No	4	13	13	2
9.13 Severance pay and pension	Yes	8	68	41	17
	No	5	25	8	2
9.14 Training and education	Yes	9	61	37	18
	No	4	32	11	1
9.15 Fringe benefits	Yes	11	82	32	12
	No	2	11	17	7
9.16 Corporate philanthropic work	Yes	7	52	37	5
	No	6	41	12	14

JLMCs and Other Complementary Work Practices

JLMCs are prevalent in the Korean and Indonesian firms (84% and 73%, respectively, in 2003), but relatively rare in the Malaysian (28%) and Thai (21%) firms. The nature and scope of JLMCs appear to be quite different in Korea and Indonesia. Most Indonesian firms with JLMCs hold JLMC meetings less than three times a year, whereas about 80% of Korean firms hold such meetings four or more times a year. The role of unions in JLMCs is much stronger in Korea than in the other nations. Specifically, in more than 70% of the Korean firms with a labor union, the union chooses all employee representatives, compared with 55% of the Indonesian firms and an even lower percentage in the other two countries.

The corporate governance functions of JLMCs in the four Asian nations under review appear to be limited. They are more likely to discuss issues directly related to labor than business strategies and plans. In most firms with JLMCs, they rarely discuss the firms' basic business strategies and sales and production plans, the introduction or elimination of organizational units, and the introduction of new technology or equipment. For JLMCs to function well as a corporate governance mechanism, as is generally the case in many Japanese firms, management will need to share information about more business-related issues and the quality of the information shared needs to be high.

Employee participation and involvement at the grassroots level, such as self-directed teams and quality control circles, are quite popular among publicly traded Asian firms. More than 80% of all firms in the countries surveyed use self-directed teams for managerial and supervisory employees. They are also used for other employees in almost 80% of the Malaysian firms and about 60% of the firms in other three countries. Problem-solving groups and quality circles are in place in 69-85% of the firms for nonmanagerial and nonsupervisory employees and in even more firms for managerial and supervisory personnel. Job rotation and cross-training appear to be equally popular among the Asian firms: 61-85% for nonmanagerial and nonsupervisory employees and almost the same incidence for managerial and supervisory staff.

In contrast, financial participation schemes do not appear to be widespread in Asian firms. Most of the sample firms lack an employee stock ownership plan except in Malaysia. Such plans are particularly rare for nonmanagerial and nonsupervisory staff, although almost 60% of the Malaysian and 35% of the Korean firms have employee stock ownership plans for all employees.

Except in Malaysia, stock option plans are even less popular and are found in only 15-20% of firms for managers and supervisors and 7-14% of firms for other employees. In Malaysia, the shares are 77% and 47%, respectively. Of all financial participation schemes, profit-sharing plans are the most widespread among the respondent firms. They are in place for both managerial and supervisory staff and for other employees in almost 70% of the Indonesian and Malaysian firms, 60% of the Korean firms, but only about 35% of the Thai firms.

Employee Participation and Corporate Performance

In an attempt to ascertain whether employee participation has any positive association with firm performance, Table 25 shows estimated Tobin's q equations with employee participation variables. The score is based on the incidence of various participatory practices, including self-directed teams, program-solving groups or quality circles, job rotation or cross-training, employee stock ownership plans, stock option plans, and profit-sharing or performance-based group incentive pay. Employee participation practices (EPP) turn out to have a statistically significant impact on Tobin's q. This indicates that these participatory practices can lead to better operational performance or that the market evaluates these practices favorably. When country-specific EPP variables are tried, however, the impact is only statistically significant for Indonesian firms.[62]

Opinion Survey Results on the Role of Employees

While 38-51% of the Indonesian, Korean, and Malaysian directors respond that labor unions have become more powerful since the Asian crisis and only 19-23% respond negatively, as many as 73% of the Thai directors respond negatively (see Table 23). Employees' voice or participation in corporate decisionmaking seems to have changed little in Korea and Malaysia, but has decreased in Thailand, and probably in Indonesia as well.

As for the reasons why employees' voice or participation might have increased, the respondents in all four countries tend to view the growing significance of human capital as important, particularly in Malaysia (97%) and least so in

62. When the Malaysian firms are included in the regression, EPP turns to be insignificant, although the country-specific EPP for Indonesia remains significant.

Table 25

Regression for Tobin's q

With Employee Participation Variables – Indonesia, Korea and Thailand

	(1)			(2)			(3)			(4)		
Constant		1.535	(3.24)		1.332	(2.93)		1.581	(3.38)		1.407	(3.13)
Debt/Assets		0.292	(1.98)		0.269	(1.84)		0.327	(2.23)		0.303	(2.08)
Ln (assets)		-0.065	(-2.33)		-0.063	(-2.40)		-0.060	(-2.19)		-0.060	(-2.30)
Ln (sales02/97)		0.158	(2.58)		0.158	(2.60)		0.157	(2.61)		0.157	(2.63)
D (single domestic owner)		-0.147	(-1.80)		-0.164	(-2.07)		-0.142	(-1.76)		-0.159	(-2.00)
D (non-family group)		-0.278	(-2.73)		-0.267	(-2.65)		-0.265	(-2.63)		-0.255	(-2.55)
D (new firms)		0.273	(1.68)		0.311	(1.96)		0.341	(2.11)		0.374	(2.36)
EPP [1]		**0.041**	**(1.97)**		**0.043**	**(2.13)**						
EPP* D (Thailand)								**0.034**	**(0.91)**		**0.039**	**(1.05)**
EPP* D (Korea)								**-0.002**	**(-0.06)**		**-0.000**	**(-0.01)**
EPP* D (Indonesia)								**0.141**	**(3.34)**		**0.140**	**(3.37)**
D (Thailand)		0.129	(1.25)		0.189	(2.14)		0.038	(0.24)		0.081	(0.54)
D (Indonesia)		0.236	(2.48)		0.225	(2.36)		-0.197	(-1.09)		-0.202	(-1.13)
CG Score/100	**BE**	**0.741**	**(2.30)**	**CGSw**	**1.053**	**(2.99)**	**BE**	**0.653**	**(2.05)**	**CGSw**	**0.967**	**(2.77)**
R^2	0.191			0.204			0.220			0.233		
# Observation	223			223			223			223		

Note: 1. EPP is the score for employee (other than managers and supervisors) participation practices calculated on the basis of survey questions on the existence of six participatory practices including self-directed teams, problem-solving groups or quality circles, job rotation or cross training, employee stock ownership plans, stock option plans, and profit sharing or performance-based group incentive pay (1if a particular practice is in use, 0 if not; the score is the sum of the scores of the six practices).

Korea (69%). Expected democratic reform is also considered important, particularly in Indonesia and Malaysia, while weakening family control and labor falling victim to poor corporate governance in the wake of the Asian crisis are the most important reasons in Korea. However, the growing role of employees in shop-floor decisionmaking or share ownership receives relatively little support except in Thailand.

Concerning the expected consequences of labor having a strong voice or participating, 79-86%) of the Indonesian, Malaysian, and Thai, respondents indicate that this will result in better observance of workplace-related laws and regulations and is also likely to hold back abusive behavior by controlling owners (most important in Indonesia and Korea) and improve firm performance. Interestingly, respondents in Korea, where labor unions are stronger, give relatively low support to the view that a stronger labor voice or participation would better serve labor's interests at the expense of shareholders.

Most of the respondents agree that employee involvement in shop-floor decisionmaking is essential for enhancing productivity. While respondents gave more positive responses than negative responses to the view that such involvement might ultimately make labor too strong in Korea, the opposite is the case in the other three countries, particularly in Malaysia. This might be understandable given that some Korean labor unions have been extremely militant and labor unrest has occasionally been a source of serious business uncertainty.

Analyses

On the basis of the questionnaire survey, this subsection evaluates the characteristics of firms that are more favorable to a potential corporate governance role by creditor banks and employees. Assuming that executive directors are in a better position than independent directors to evaluate the potential role of stakeholders, the analyses are based on the opinions of executive directors only. Of particular interest is knowing how this stakeholder role is affected by the family control of firms and by improved corporate governance along the lines of the Anglo-American model.

Specifically, two questions are addressed. First, what firms are likely to think that creditor banks represented on a corporate board have a corporate governance role even when the firm is not in financial distress? Representation on the board of directors is a typical form of participation in corporate governance. Indeed, 20% of the Thai firms in the sample and about 10% of

the Indonesian and Korean firms have former or current officers of major creditor financial institutions on their boards.

Second, what are the determinants of JLMC incidence and effectiveness (see Kato and Nam 2004 for a more detailed analysis)? JLMCs are not always a forum for corporate governance, but could function as such, and many JLMCs deal with a variety of issues that are not directly related to workers' welfare. In addition to JLMC incidence, the study attempts to ascertain what characteristics of firms make their JLMCs likely to discuss management issues.

The results show that the directors of family-controlled firms tend to view the corporate governance role of banks less favorably, but better recognize the role of employees in preventing abusive behavior by controlling owners. Firms with better corporate governance tend to favorably view neither of these roles of banks or employees, although their JLMCs tend to discuss more management issues. Directors in unionized firms seem to be more favorably disposed toward the corporate governance role of banks and their firms are more likely to have a JLMC.[63]

Potential Corporate Governance Role of Banks

Estimated equations in Table 26 show that firms with better corporate governance quality (CGS) and firms that are substantially foreign-owned or are controlled by a single, domestic, private owner tend to view the corporate governance role of creditor banks less favorably. This indicates that the Anglo-American corporate governance model (subscribed to by firms with a good corporate governance score) and the bank governance model are competing with each other at the firm level. Substantially foreign-owned firms are likely to be subscribing to the Anglo-American model. For family-controlled firms to be reluctant to accept a corporate governance role of banks in normal times is understandable.

The ratio of fixed capital to sales turns out to be negative and statistically significant in a specification of the equation. Fixed capital-intensive firms are likely to have less serious information asymmetry than human capital or knowledge-intensive firms and thus less need for bank monitoring and

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63. Given that the Malaysian sample includes diverse industries dominated by services, it is excluded from the regression equations. When the Malaysian firms are included, the results pertaining to the corporate governance role of banks become somewhat weaker, while those pertaining to JLMC incidence and the corporate governance role of employees remain much the same.

Table 26
Firms Appreciating the Corporate Governance Role of Banks
Indonesia, Korea and Thailand

	(1)	(2)	(3)	(4)
Dependent Variable	OLSQ Bank CG Role	OLSQ Bank CG Role	Probit D (bank director)	OLSQ R-Banking
Constant	-0.15	0.01	-6.05**	1.52**
Debt/Assets	0.09	0.05	3.71***	-0.03
Ln (assets)	0.11*	0.09	0.08	-0.07*
Fixed Capital / Sales	-0.08	-0.11*		-0.00
Ln (firm age)			-0.37**	
D (single domestic owner)	-0.54**	-0.43*	-0.86*	0.42***
D (non-family group)	-0.31	-0.36	-0.06	0.26
D (diffusely owned)	-0.36	-0.49*	0.52	-0.20
D (substantially foreign owned)	-0.59*	-0.64**	0.72	-0.15
D (government-owned bank)	0.29	0.31		0.02
D (own group bank)	0.38	0.44		-0.74***
D (other group bank)	0.41	0.43*		-0.26
D (foreign bank)	0.00	0.04		-0.41**
CG Score (CGS)	-0.028***	-0.029***	-0.011	0.018***
D (bank director)		0.58**		0.34**
D (union)		0.39**		
Stakeholder Interests			1.45***	
D (industry)	All insignificant	All insignificant	Food(+)** Text(+)*	Elec(+)** Chem(+)*
D (Korea)	-0.44*	-0.62**	-0.08	-0.31*
D (Indonesia)	-0.92***	-1.05***	-0.45	0.49***
Number of observations	175	171	185	166
R^2	0.161	0.237	Pseudo $R^2 = 0.385$	0.302

Notes: "Bank CG Role" is the degree of agreement-between 2 (for strong agreement) and -2 (for strong disagreement)-on the statement that the creditor bank, if represented on the board of your firm, would have a corporate governance role even when your firm is not in financial distress (rephrasing the Question 8.2, Role of Stakeholders, Opinion Survey).

"R-Banking" is the degree of interest (2 for very much interested, 1 for a little interested, and 0 for not interested) in having a more stable long-term relationship with the creditor banks (Question 4, Role of Stakeholders, Opinion Survey).

D (government-owned bank), D (own group bank), D (other group bank), and D (foreign bank) are dummy variables for firms whose biggest creditor bank is owned by the government, by its own group, by other group, and by foreigners, respectively.

D (bank director) and D (union) are, respectively, a dummy variable for companies whose boards are represented by creditor financial institution(s), and for firms with a labor union.

"Stakeholder Interests" is the degree of agreement (between 2 and -2) on the statement that a company has the goal of enhancing the well-being of various stakeholders besides making profit for shareholders (Question 1.2, Role of Stakeholders, Opinion Survey).

governance. The Thai firms are more receptive to the idea of a corporate governance role for banks than the Indonesian and Korean firms. Firms favorably disposed toward a corporate governance role for banks include those already have bank representatives on their boards, those with a labor union, and those whose major creditor financial institution belongs to a business group (other than its own). Corporate directors may be more willing to rely on a governance role by banks as a way of counterbalancing the voice of labor.

We now turn to the determinants of board representation by a major creditor financial institution. The probit analysis in Table 26 indicates three factors, all of which are statistically extremely significant. As expected, firms with a high debt ratio (many of them in financial distress) and firms whose executive directors are more favorably disposed to the interests of broad stakeholders are more likely to have a board member representing a creditor financial institution. In addition, firms controlled by a family (a single, domestic, private owner) are less likely to have directors representing their creditor financial institutions.

Responses to the question of how interested firms are in having a stable, long-term relationship with creditor banks indicate that their interest in relationship banking is far from being an interest in banks' corporate governance role. Firms with better corporate governance or controlled by a single, domestic, private owner, as well as firms belonging to a nonfamily group, express stronger interest in relationship banking. Most likely firms with good corporate governance are more willing to share corporate information with their creditor banks and accept closer monitoring by banks. Family-controlled firms may also be interested in relationship banking because they would like to rely on bank borrowing rather than financing in the capital market for fear of ownership dilution and a loss of control.

By contrast, firms whose major creditors are foreign banks or banks in their own business groups are less interested in relationship banking. Foreign banks

would generally like to have an arm's length relationship with their corporate clients. Where the major creditor bank is a group bank, the firms are likely to be well looked after by other group firms and may not be keen about relationship banking. Understandably, firms with directors representing a major creditor financial institution and smaller firms express more interest in relationship banking. Finally, the Indonesian firms show more interest in relationship banking while the Korean firms are least interested, which is probably reflects the level of financial development (the degree of dependence on bank financing).

JLMC Incidence and the Potential Governance Role of Employees

The incidence of JLMCs is analyzed using a probit model. A firm having a labor union is expected to be positively correlated with the incidence of JLMCs because of the alleged complementary role that unions play in employee participation and involvement. For example, Kato (2003) reports that unions were preventing Japanese JLMCs from becoming ineffective and dormant by retaining the strong consultative role of JLMCs during Japan's prolonged recession. Unions are often an integral part of successful employee participation, though some might argue that unions may consider participatory employment practices a substitute for unions and therefore view them as a major threat to their existence.

The size of the firm is generally expected to be positively correlated with the incidence of JLMCs, because larger companies tend to have more resources—both financial and nonfinancial—to develop elaborate work practices. However, some argue that smaller firms are less likely to be run in a top-down fashion and tend to be more flexible and agile, and are therefore more capable of innovating in relation to employment practices. Also tried in the regressions are variables representing the types of corporate ownership and management, as well as industry and country dummy variables, to control for industry-specific factors and differences in regulatory environments and legal frameworks.[64]

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64. Firms' capital intensity (ratio of fixed capital to labor) may also affect the incidence of JLMCs, positively if it represents technically more advanced firms with a relatively large skilled labor force that tends to use more advanced and elaborate work practices, and negatively if it represents more machine-paced production methods, which are likely to make participatory employment practices less effective (see, for example, Jones and Kato 1993). This variable is insignificantly negative in the estimated JLMC incidence equations (results not shown in Table 27).

The estimation results, which are presented in Table 27, show that the labor union variable has a positive and significant effect on the incidence of JLMCs at a 1% level, supporting the complementarity between unions and participatory employment practices. The estimated coefficient on firm size measured by the number of employees is also positive and significant at a 1% or 5% level. Thus the data support the view that larger companies tend to have more resources to develop elaborate work practices over the alternative view that smaller firms tend to be less likely to employ top-down practices and to be more flexible and agile, and are therefore more capable of innovating in relation to employment practices.

The probit analysis also shows that diffusely-owned firms and substantially foreign-owned firms are less likely to have a JLMC. Perhaps these firms are more likely to subscribe to the Anglo-American shareholder model of corporate governance as opposed to the alternative model with a particular emphasis on the role of stakeholders. Among different industries, the textile industry stands out as having a significantly higher JLMC incidence. Finally, even after controlling for diverse variables, Korean firms, and Indonesian firms to a lesser extent but still significantly, are more likely to have JLMCs than Thai firms.

The study also attempts to evaluate what kinds of firms are more likely to expand the role of JLMCs to discuss not only labor issues, but also management issues. A regression of the number of management issues discussed in JLMCs on a number of firm characteristics, including our corporate governance score (CGS), indicates that the estimated coefficient on CGS is positive and statistically significant at a 5% level. Thus the evidence suggests a complementarity between corporate governance and JLMCs. In other words, improving corporate governance may lead to JLMCs starting to function as a mechanism that fosters the role of employee stakeholders in corporate governance. However, the regression result indicates that the JLMCs of unionized firms are not less likely to discuss management issues. This may be due to the complementary role of the union and the JLMC in discussing or negotiating labor issues at a relatively early stage of development of labor-management relations. Not surprisingly, JLMCs that discuss many labor-related issues also tend to discuss more management issues. Again, JLMCs in the textile industry tend to discuss more management issues than JLMCs in other industries.

The last equation in Table 27 evaluates the subjective opinions of corporate directors in relation to the importance of employees' role in preventing abusive

Table 27

JLMC Incidence and Corporate Governance Role of Employees

Indonesia, Korea and Thailand

	(1)	(2)	(3)	(4)
Dependent Variable	Probit D (JLMC)	Probit D (JLMC)	OLS Agenda M	OLSQ Role-workers
Constant	-2.93***	-3.18***	-0.72	3.90***
Ln (number of employees)	0.25***	0.25**	-0.14	-0.14
D (single domestic owner)	-0.11	-0.14	-0.87**	0.51**
D (non-family group)			-0.75*	
D (diffusely owned)	-0.96**	-1.15**	-1.50**	
D (substantially foreign owned)	-0.76**	-0.70*	-0.86*	
D (founder CEO)		0.31		
D (professional management)		-0.05		
D (union)	1.11***	1.09***	-0.59**	0.16
D (JLMC)				0.31
Agenda L			0.17***	
CG Score (CGS)		-0.004	0.038**	-0.031**
D (industry)	Text(+)**	Text(+)**	Text(+)***	All insignificant
D (Korea)	1.56***	1.66***	0.70	0.96***
D (Indonesia)	1.09***	1.14 ***	0.45	-0.45
Number of observations	221	220	145	168
R^2	Pseudo R^2 = 0.403	Pseudo R^2 = 0.416	$R^2 = 0.326$	$R^2 = 0.467$

Notes: Agenda M and Agenda L are the number of management issues and labor-related issues, respectively, discussed at a JLMC.

"Role-workers" is the opinion on the importance of the roles played by labor unions or employees in preventing the controlling owners from abusing their power among various stakeholders (1-5; where 5 is the most important, and 1 is the least important).

D (founder CEO) is a dummy variable for firms whose CEO is founder of the firm.

behavior by controlling shareholders. The regression result shows that firms with good corporate governance scores tend to place less value on this role of employees, indicating the existence of competition between the shareholder-based and the employee-based models of corporate governance. Moreover, as expected, this role of employees is more important for firms controlled by a single, domestic, private owner, where room for expropriation by the controlling owner is supposedly high. After controlling for these and other factors, Korean corporate directors seem to view this role of employees more positively than those in the other countries.

Thus firms with good corporate governance are more likely to discuss management issues at JLMCs, but probably do not have to rely on employees to prevent expropriation by controlling owners. Family-controlled firms are more likely to have a JLMC than diffusely-owned or foreign-owned firms, and employees in family-controlled firms may play an important role in preventing expropriation by the controlling owners. Finally, unionized firms are more likely to have a JLMC and such a JLMC tends to discuss more labor-related issues than management issues.

7 *Conclusion*

The questionnaire survey shows that diffused ownership is relatively rare in all the countries under study except for Malaysia. Professional managers in CEO positions are found in less than 60% of the Malaysian firms and only in 40-50% of the respondent firms in three other countries. This confirms that the major corporate governance concern in listed firms is indeed to prevent controlling owners from expropriating minority shareholders.

The surveyed firms are doing relatively well in recognizing the rights of shareholders. This may be due to the fairly elaborate laws and regulations on shareholders' rights and the operation of shareholders' meetings. Nevertheless, there is substantial room for improvement. Given the high ownership concentration in most firms, for minority shareholders to address their concerns by calling a special shareholders' meeting or putting issues on a meeting agenda seems to be difficult. Shareholders are inadequately protected with such rights as priority capital subscription, approval of major related-party transactions, and dissenters' rights. Moreover, voting by mail is largely unavailable, and minority shareholders seem to take little part in the process of selecting board members. Sample firms perform relatively poorly in relation to information disclosure and transparency, particularly for matters potentially involving self-dealing or other conflicts of interest. In Indonesia and Thailand, web sites are not yet fully utilized as a way to disclose information in a timely manner and enhance transparency.

Thai boards of directors seem to be too large with too few independent directors, while Indonesian boards are probably too small. The positions of CEO and board chairperson are separated in more than 80% of the Malaysian and Thai firms and in all Indonesian firms because of the two-tier board system. The true independence of independent directors is rather doubtful, particularly

in Korea, judging from their roles in setting board agendas and patterns of behavior during boardroom discussions. This seems to result primarily from the fact that directors are effectively selected by the CEO or controlling owner, while cultural factors such as personal relationships or behavioral norms play a relatively small role.

The functions of boards and board committees in the countries under review are generally weak, even though corporate directors tend to agree that their boards are a forum for serious discussion of significant corporate matters. In all four countries, boards seem to be somewhat inactive in selecting, monitoring, and replacing CEOs and reviewing the remuneration of key executives and directors. They are particularly poor in evaluating and supporting directors so that they can contribute effectively as board members. Outside or independent directors are inadequately supported with necessary information, access to outside professional services, personnel assistance, education and training, stock-based incentive compensation, and insurance coverage for personal liability.

Banks have certainly strengthened their monitoring of their corporate clients since the Asian crisis, and companies are interested in having a close, long-term relationship with their creditor banks, particularly in Indonesia and Thailand. Even though the firms are aware of the potential risks of banks' influence, such risks seem to be more than offset by the expected benefits of relationship banking.

The survey results show a relatively high prevalence of JLMCs in Indonesia and Korea in contrast to Malaysia and Thailand, but JLMCs in these countries seem to play only a limited role as a potential governance mechanism. Firms' management is unwilling to share information about business-related issues, and JLMCs are largely preoccupied with labor-related issues.

Even though banks and employees play only a small role, this may not be the case in the future. Corporate directors in the countries surveyed generally view the roles of broader stakeholders favorably. About 60% of them strongly agree that a corporation has the goal of enhancing the well-being of various stakeholders in addition to making profits for its shareholders. They are generally interested in relationship banking and seem to be increasingly willing to treat employees as partners given the increasing importance of human capital. Their concerns about the downside of increased participation by these stakeholders does not seem to be serious. Other factors contributing to a favorable environment for employee participation include employees'

educational background, relatively long tenure, and the availability of complementary mechanisms such as shop-floor and financial participation that truly make employees stakeholders.

Corporate governance practices have been scored to come up with aggregate scores that can be used to investigate the link with firm performance. The scores are based only on practices related to shareholders' rights and the effectiveness of boards. The scores are generally lower and more dispersed among the surveyed countries and firms for board effectiveness than for shareholders' rights. The highest scores are found among the Malaysian firms, followed by the Thai firms. Scores for the Korean firms are the poorest, which is consistent with their dominance by a single, large owner. Regression results show that high overall corporate governance scores are associated with larger firms and firms that are substantially foreign owned or have a professional manager as CEO.

For all the sample firms, the survey results provide strong evidence that corporate governance matters in terms of Tobin's q. Although scores for shareholders' rights alone do not have any significant association, scores for board effectiveness and overall scores are significantly associated with firm performance as measured by Tobin's q. Investigated by country, such an association is evident for Indonesia and Korea, where corporate governance is relatively poor, but such evidence is not forthcoming for Malaysian and Thai firms.

The regression results also provide some other interesting evidence. First, the market seems to discount the quality of corporate governance by about 30% in the case of firms controlled by a single, domestic owner. Second, corporate governance matters more in countries where the legal and judicial systems for protecting investors are weak. Third, the market valuation of companies is also associated with employee participatory practices, including shop-floor activities and participation in financial matters. Finally, the components of corporate governance practices that a market pays the most attention to may differ across countries.

Among the various components of corporate governance practices, what appear to be the most significant are support for and evaluation of outside directors. This is the area where the sample firms generally score most poorly. The results suggest that how adequately independent directors are supported and evaluated for their best contribution to the company is more important than

the superficial board structure, such as the share of independent directors. This finding is consistent with the respondents' view that the highest priority for having more effective boards is the timely provision of relevant information to directors.

Overall, the survey results indicate that a big gap between the regulatory framework and actual corporate governance practices probably does not exist in form, but that a substantial gap exists in substance or spirit. Understandably, larger gaps and variations exist in areas where regulations and guidelines are less demanding or enforcement is difficult, such as supporting and evaluating outside directors and the specific functions of the board or of board committees. For all the sample firms there is clear evidence that corporate governance matters in the valuation of firms and that the market seems to be smart in evaluating the quality of firms' corporate governance, in that it tends to differentiate among firms more on the basis of substance than of form.

The findings indicate that the Anglo-American corporate governance framework does work. Even though firms in the countries under review may not embrace the model wholeheartedly, the market obviously discriminates among firms according to the model's standards, suggesting that firms will move toward meeting more of these standards. However, the survey also provides evidence of a potential governance role for other stakeholders, although they are not currently much involved in playing such a role. Their enhanced role is indicated by the perceptions of corporate directors in relation to firms' objectives, their expectations for creditor banks and employees, and the characteristics of workforces in these countries. A stakeholder model appears to be less promising in firms that are substantially foreign owned or have already embraced the Anglo-American model with higher corporate governance scores. Also for firms controlled by a single family, the potential corporate governance role of employees tends to be better recognized, while that of banks is not very welcome.

For the economy as a whole, the stakeholder model is likely to be a complement to rather than an alternative to the Anglo-American shareholder model. Since the Asian crisis, the countries under review have already invested a good deal to put this model in place and no alternative models are available. The trend toward globalization in corporate direct investment and portfolio investment will also be a powerful force for convergence toward the Anglo-American model. One may also argue that the complementary institutions that need to

be built around this model will make the prospects for any other models poor; however, many of the institutions now being built, such as relevant legal, accounting, and audit systems, are likely to form the basic infrastructure for any workable models, and existing cultural norms and corporate cultures might be more favorable for a stakeholder model. Firms are likely to be able to determine their own corporate governance frameworks depending on their ownership structure and other characteristics.

A policy implication of the survey results is that the on-going corporate governance reform efforts should be continued to encourage firms to pay more attention to substance than to form. To enhance the effectiveness of boards, the provision of adequate support for outside directors seems to be the most important factor, as well as the promotion of a boardroom culture that encourages constructive criticism and alternative views. More broadly, as indicated by the respondents, priorities should be given to making internal corporate governance mechanisms work better and enhancing the standards for information disclosure, accounting, and auditing. Critically important for these tasks are the roles of regulatory agencies, independent directors, and professional societies.

Appendix A. Survey Questions

Questionnaire Survey on Corporate Governance Practices

Factual Information

To the respondents

Thank you very much for your willingness to join this survey. This survey is being conducted by the request of the Asian Development Bank Institute (Tokyo) with a view to understanding corporate governance practices across Asia at the firm level.

The survey is asking questions on the practices in your firm, regardless of the laws and regulations. Your accurate and frank response is key.

The results will be used only for research purposes and be presented only in aggregate without being revealed by individual firms.

To be answered by the company secretary or any officer in charge of governance matters (shareholder relations, public disclosure, assisting outside directors, etc.)

Please check (√) the appropriate parentheses or express the extent to which you agree or disagree on the given statement by choosing (circling) one of the following:

Y+	strongly agree
Y	agree
O	neither agree nor disagree (or no opinion)
N	disagree
N+	strongly disagree

I. General Information on the Firm and Respondent

1. ***How do you describe the ownership and control structure of the firm?***
   – The largest shareholder has a substantial voting right (say over 30-40%, including that of companies he controls) and effectively controls the firm --- (**A**)
   – The largest shareholder effectively controls the firm even though his voting right is far less than 30-40% -- (**B**)
   – Two or more large shareholders collectively control the firm -------------- (**C**)
   – Ownership is fairly diffuse with no controlling shareholder, and the management is not directly controlled by shareholders --------------------- (**D**)
   – Others --- [Please explain: **E**]

2. ***Is the firm a stand-alone company or a subsidiary of a business group or holding company?***
   – Stand-alone company -- (**A**)
   – Subsidiary of a family-based business group --------------------------------- (**B**)
   – Subsidiary of a business group not controlled by families ------------------ (**C**)
   – Part of a family-based holding company -- Parent firm (**D1**) Subsidiary (**D2**)
   – Part of a holding company not controlled by families
   -- Parent firm (**E1**) Subsidiary (**E2**)

3. ***Is the firm wholly or partially owned and controlled by the government?***
   – No --- (**A**)
   – Yes, substantially owned and controlled by the government --------------- (**B**)
   – Partially owned, but not much controlled by the government -------------- (**C**)
   – Others --- [Please explain: **D**]

4. ***Is the firm wholly or partially owned and controlled by foreigners (foreign firms)?***
   – Little owned by foreign investors -- (**A**)
   – Yes, substantially owned and controlled by foreigners (foreign firms) --- (**B**)
   – Substantially owned, but not controlled, by foreign investors -------------- (**C**)
   – Others --- [Please explain: **D**]

5. ***What relation does the CEO have with the founder or the largest shareholder?***
   – Founder him/herself (**A**)
   – Founder's family member (**B**)
   – Professional manager (**C**)
   – Others --- [Please explain: **D**]

6. ***What is the ownership/control structure of the biggest creditor bank of your firm?***
   - Mainly government-owned --- (**A**)
   - Belong to the same business group as the firm's ----------------------------- (**B**)
   - Belong to a business group not related with the firm ------------------------ (**C**)
   - Mainly owned and controlled by a foreign financial institution(s) -------- (**D**)
   - Owned by small shareholders (no controlling owner) ---------------------- (**E**)

7. ***Does your firm have a labor union(s)?*** ----------------------- Yes (**A**) No (**B**)

II. Shareholder Rights and Disclosure of Information

Shareholder Rights

1. ***Is there any deviation from the one-share one-vote rule in your company?***
   - No (**A**)
   - Yes, non-voting (preferred) stock (**B**)
   - Others [Please explain: **C**]

2. ***How easy is it for your shareholders to participate in voting at the shareholders' meeting?***

2.1 Is voting by mail allowed? ------------------------------------ Yes (**A**) No (**B**)

2.2 Can anybody serve as a proxy?
---------------------------- Yes (**A**); No [only who? **B**]

3. ***Do you agree with the following statements for your firm?***

3.1 Shareholders are provided with adequate information on the agenda items of the shareholders' meeting -------------------------------------- **(Y+, Y, 0, N, N+)**

3.2 Adequate time is given for asking questions and placing issues at the shareholders' meeting --- **(Y+, Y, 0, N, N+)**

3.3 Shareholders' priority subscription right in the issuance of shares or convertible bonds (so that they can maintain their fractional ownership) is adequately protected in the company's articles of incorporation or in the process of shareholder approval -------------------------------- **(Y+, Y, 0, N, N+)**

3.4 Related-party transactions are fully discussed with adequate information at the shareholders' meeting (with interested shareholders abstaining from voting) --- **(Y+, Y, 0, N, N+)**

3.5 It is not difficult to know how much equity ownership the major shareholders control (including the equity shares of companies they control)?
-- **(Y+, Y, 0, N, N+)**

4. What is the role of shareholders in practice in nominating candidates and electing outside directors of your firm?

4.1 Are director candidates disclosed before the shareholders' meeting?
-- Yes (**A**) No (**B**)

4.2 Can minority shareholders (holding more than a certain level of shares) nominate candidates at the shareholders' meeting or prior to the meeting (to have the company disseminate relevant information)? ---- Yes (**A**) No (**B**)

4.3 Is cumulative voting practiced in your firm?
- Introduced, and has been exercised at least once ----------------------------- (**A**)
- Introduced, but has not occurred so far --------------------------------------- (**B**)
- The firm opted out (by the articles of incorporation, etc.) ------------------ (**C**)

4.4 Would it be possible for the director candidates proposed by the management of your firm to fail to be elected at the shareholders' meeting?
------------------------------ Sometimes (**A**) Rarely (**B**) Unthinkable (**C**)

5. Information about the latest annual shareholders' meeting:

5.1 How long did the meeting last?
- Less than 30 minutes (**A**) 30-60 minutes (**B**) 1-2 hours (**C**)
  2-3 hours (**D**) Over 3 hours (**E**)

5.2 How many shareholders attended the meeting? ---------------- [ ] persons

Disclosure and Transparency

6. Does your firm disclose the following information? If yes, by what means?
<More than one choice can be made.>

Web: company's web page	**AR**: annual report
RR: report to regulatory agencies	**No**: no disclosure

6.1 Self-dealing (related-party) transactions --
-------------------------------------- Web (**A**) RR (**B**) AR (**C**) No (**D**)

6.2 Directors' selling or buying shares in their company
-------------------------------------- Web (**A**) RR (**B**) AR (**C**) No (**D**)

6.3 Resume/background of directors - Web (**A**) RR (**B**) AR (**C**) No (**D**)

6.4 Remuneration of directors --------- Web (**A**) RR (**B**) AR (**C**) No (**D**)

6.5 Fees paid to external auditors, advisors, and other related parties
-------------------------------------- Web (**A**) RR (**B**) AR (**C**) No (**D**)

6.6 Major contingent liabilities such as cross-guarantees of debt repayment
-------------------------------------- Web (**A**) RR (**B**) AR (**C**) No (**D**)

6.7 Policies on risk management ------ Web (**A**) RR (**B**) AR (**C**) No (**D**)

6.8 Significant changes in ownership Web (**A**) RR (**B**) AR (**C**) No (**D**)

6.9 Governance structures and policies (explicit corporate governance rules and vision) -------------------------------- Web (**A**) RR (**B**) AR (**C**) No (**D**)

6.10 The extent to which the firm's corporate governance practices conform to the established standards --------------- Web (**A**) RR (**B**) AR (**C**) No (**D**)

7. How timely and informative are the disclosures?

7.1 Does your firm disclose semi-annual reports? --------------- Yes (**A**) No (**B**)

7.2 Does your firm disclose quarterly financial statements? --- Yes (**A**) No (**B**)

7.3 Does your firm have a web-site? Is it also in English?

- Available and very informative both in local language and English ------- (**A**)
- Web-site informative in local language, but limited information in English --- (**B**)
- Web-site informative in local language, but no English web-site ---------- (**C**)
- Web-site available only in local language and not very informative ------ (**D**)
- No web-site yet -- (**E**)

8. How do you compare the accounting and audit standards of your firm with the relevant international standards (such as IAS and ISA)?

- Virtually the same -- (**A**)
- Some relaxation -- (**B**)
- Substantially lower --- (**C**)
- Not sure --- (**D**)

III. Effectiveness of the Board of Directors

Board Size and Structure

1. How is your board composed?

1.1 How many directors does your (supervisory) board have in total? ------- [ ]

1.2 How many outside directors does your board have? ------------------------ [ ]

1.3 How many independent directors does your board have? ------------------ [ ]

1.4 Are there any foreign nationals on your board? ------------ Yes (**A**) No (**B**)

1.5 Does the CEO of your firm also serve as board Chairman? --------------------- -- Yes (**A**) No (**B**)

2. Do you have the following person on your board now (as a director)?

2.1 Current or former officer of a major creditor financial institution -- No (**A**) Yes (**B**)

2.2 Labor representative or labor-recommended director ----- No (**A**) Yes (**B**)

2.3 Officer of an affiliated company ------------------------------ No (**A**) Yes (**B**)

2.4 Senior manager from a supplier or customer company ---- No (**A**) Yes (**B**)

2.5 Someone from a law/accounting/consulting firm that provides professional services to your firm -- No (**A**) Yes (**B**)

Independent Directors and Board Independence

3. How prevalent are the following practices?

3.1 Independent directors meeting formally or informally without management to discuss corporate matters
---------------------- Often (**A**) Sometimes (**B**) Rarely (**C**) Never (**D**)

3.2 Independent directors altering or adding the board meeting agenda set by the CEO ---------------- Often (**A**) Sometimes (**B**) Rarely (**C**) Never (**D**)

3.3 Independent directors participating actively in board discussions
---------------------- Often (**A**) Sometimes (**B**) Rarely (**C**) Never (**D**)

3.4 Agenda items disapproved at the board meetings by independent directors
---------------------- Often (**A**) Sometimes (**B**) Rarely (**C**) Never (**D**)

3.5 Individual directors' positions on board meeting agendas recorded in minutes
---------------------- Often (**A**) Sometimes (**B**) Rarely (**C**) Never (**D**)

4. What is the typical term of independent directors? -------------------- [ ] years

Functions of the Board and Board Committees

5. Does your board have the following committees? What proportion of the committee members are independent directors [50%, 2 out of 3, etc.]?

5.1 Audit Committee ------------------------ Yes (**A**) [ ], No (**B**)

5.2 Compensation Committee ------------- Yes (**A**) [ ], No (**B**)

5.3 Nomination Committee ---------------- Yes (**A**) [ ], No (**B**)

6. (If you have an audit committee) How effective and independent is your audit committee?

6.1 Does it have someone with accounting/finance expertise? Yes (**A**) No (**B**)

6.2 Is it chaired by a genuine independent director? ---------- Yes (**A**) No (**B**)

6.3 Are minutes written for each audit committee meeting? -- Yes (**A**) No (**B**)

6.4 Is each member's remuneration approved separately at the shareholders' meeting? -- Yes (**A**) No (**B**)

6.5 Are there written rules governing overall audit function? - Yes (**A**) No (**B**)

6.6 Does it autonomously select/recommend the external auditor and conduct a proper review of his work?
------------------------ Very much so (**A**) To some extent (**B**) Hardly (**C**)

6.7 Does it approve the appointment of the internal auditor and supervise him to routinely review risk exposure and accounting procedures?
----------------------- Very much so (**A**) To some extent (**B**) Hardly (**C**)

7. How is the CEO evaluated and compensated?

7.1 Does your board or compensation committee formally evaluate the CEO's performance?
--------- Yes, as a routine (**A**) Sometimes (**B**) Rarely (**C**) Never (**D**)

7.2 How about the review of CEO compensation?
--------- Yes, as a routine (**A**) Sometimes (**B**) Rarely (**C**) Never (**D**)

7.3 Is the CEO given a stock option? - Substantially (**A**) Some (**B**) None (**C**)

Board Meeting Frequency, Attendance, Etc.

8. How much time and effort did directors devote to board meetings last year?

8.1 How many board meetings were held last year?
---- 2-3 times (**A**) 4-5 times (**B**) 6-7 times (**C**) 8 times or more (**D**)

8.2 On average, how many hours did a board meeting last?
------- Not more than 1 (**A**) 1-2 (**B**) 2-3 (**C**) 3-4 (**D**) Over 4 (**E**)

8.3 What was the average attendance rate for board meetings?
90-100% (**A**) 80-90% (**B**) 70-80% (**C**) 60-70% (**D**) 50-60% (**E**)

General Support for Directors

9. Does the company provide any education or training opportunities for directors beyond what is mandatory?
------------------------------- Actively (**A**) Occasionally (**B**) Never (**C**)

10. Is a contact person designated for the support of outside directors?
-- Yes (**A**) No (**B**)

Compensation and Liability

11. Does the outside director compensation include a stock option or company shares? -- Yes (**A**) No (**B**)

12. Is there any formal mechanism for evaluating the performance of directors?
Yes, and effective (**A**) Yes, but ineffective (**B**) No formal mechanism (**C**)

13. Are directors covered (at the company's expense) by directors insurance for any personal liability? ---- None (**A**) Yes, but only partially (**B**) Yes, fully (**C**)

Thank you very much.

Now we would like to get some factual information on your firm's human resources. Please feel free to ask your secretary or whoever you deem appropriate to fill out the remainder of the survey.

Let us repeat that all responses will be kept in strict confidence.

IV. Human Resources

1. How many employees does your firm have? --------------------- [ ] persons

2. Roughly what percent of your employees belong to the following groups?

2.1 Managerial and supervisory employees ----------------------------------- [ ] %

2.2 Employees working for more than 10 years at your firm --------------- [ ] %

2.3 Employees graduated from a 4-year college or university -------------- [ ] %

3. In the past three years, by what percent has the size of your firm's workforce changed?

– Increased by [**A**:] %

– Decreased by [**B**:] %

– Almost the same (**C**)

4. Does your firm have the following employment practices/policies? Answer by managerial/supervisory employees (MS) and other employees (Non-MS).

4.1 Self-directed teams (which have some degree of responsibility and discretion over such decisions as methods of work, task schedules, assignment of members to different tasks, and feedback about group performance)
---------------- For MS: Yes (**A1**) No (**A2**); For Non-MS: Yes (**B1**) No (**B2**)

4.2 Problem-solving groups or quality circles (quality programs where employees are involved in problem solving)
---------------- For MS: Yes (**A1**) No (**A2**); For Non-MS: Yes (**B1**) No (**B2**)

4.3 Job rotation and cross training
---------------- For MS: Yes (**A1**) No (**A2**); For Non-MS: Yes (**B1**) No (**B2**)

4.4 Employee stock ownership plans
---------------- For MS: Yes (**A1**) No (**A2**); For Non-MS: Yes (**B1**) No (**B2**)

4.5 Stock option plans
---------------- For MS: Yes (**A1**) No (**A2**); For Non-MS: Yes (**B1**) No (**B2**)

4.6 Profit sharing or performance-based group incentive pay
---------------- For MS: Yes (**A1**) No (**A2**); For Non-MS: Yes (**B1**) No (**B2**)

5. ***Does your firm have a works council or Joint Labor-Management Committee (JLMC)?***
   JLMC is a standing committee where labor and management "consult each other" on business, production, labor conditions, fringe benefits, etc.
   – Yes (**A**) No (**B**) **<Skip the following questions, if you answered "No.">**

6. ***When did your firm introduce the JLMC?*** <If you have more than one JLMC, please refer to the most important JLMC.>
   – 2002-03 (**A**) 1999-2001 (**B**) 1995-98 (**C**) 1990-94 (**D**) Before 1990 (**E**)

7. ***How many times did the JLMC meet last year?*** <If you have more than one JLMC, please refer to the most important JLMC.> ------------------ [ ] times

8. ***How are employee representatives to the JLMC selected?***

8.1 Are they chosen by the union? <Answer only if your firm has a union.>
--------------------------------- Yes, all (**A**) Yes, some (**B**) No, none (**C**)

8.2 Are they elected by employees?
--------------------------------- Yes, all (**A**) Yes, some (**B**) No, none (**C**)

9. ***Are the following issues discussed at the JLMC?***

9.1 Basic business strategies --------------------------------------- Yes (**A**) No (**B**)
9.2 Sales or production plans ------------------------------------- Yes (**A**) No (**B**)
9.3 Introduction or elimination of organizational units --------- Yes (**A**) No (**B**)
9.4 Introduction of new technology or equipment --------------- Yes (**A**) No (**B**)
9.5 Hiring -- Yes (**A**) No (**B**)
9.6 Transfer of employees to different departments or subsidiaries
--- Yes (**A**) No (**B**)
9.7 Layoffs or downsizing -- Yes (**A**) No (**B**)
9.8 Promotion/demotion or other changes in employee status - Yes (**A**) No (**B**)
9.9 Working hours or vacations ----------------------------------- Yes (**A**) No (**B**)
9.10 Health and safety --- Yes (**A**) No (**B**)
9.11 Mandatory retirement --- Yes (**A**) No (**B**)
9.12 Wage and bonus --- Yes (**A**) No (**B**)
9.13 Severance pay and pension ------------------------------------ Yes (**A**) No (**B**)
9.14 Training and education -- Yes (**A**) No (**B**)
9.15 Fringe benefits --- Yes (**A**) No (**B**)
9.16 Corporate philanthropic work -------------------------------- Yes (**A**) No (**B**)

Questionnaire Survey on Corporate Governance Practices

Opinion Survey

To the respondents

Thank you very much for your willingness to join this survey. This survey is being conducted by the request of the Asian Development Bank Institute (Tokyo) with a view to understanding corporate governance practices across Asia at the firm level.

The survey is asking questions on the practices in your firm, regardless of the laws and regulations. Your accurate and frank response is key.

The results will be used only for research purposes and be presented only in aggregate without being revealed by individual firms.

To be answered by executive directors or independent directors

Please check (√) the appropriate parentheses or express the extent to which you agree or disagree on the given statement by choosing (circling) one of the following:

Y+ – strongly agree
Y – agree
O – neither agree nor disagree (or no opinion)
N – disagree
N+ – strongly disagree

I. General Information on the Firm and Respondent

1. Information on respondent:

1.1 On how many corporate boards of directors do you serve now?
--- [ ] boards

1.2 [For independent directors only] What is your major background? <Check one.>
– Business executive (**A**) – Financial institution (**B**) – Academic (**C**)
– Public servant (**D**) – Other professional (**E**) – Other (**F**)

2. How is the competitive environment of your firm (in major business activities)?

2.1 Are there many firms selling products or services that compete with your firm? ----------------------- Many firms (**A**) A few firms (**B**) No firm (**C**)

2.2 Does your firm sell products/services in international markets?
-- Yes (**A**) No (**B**)

2.3 Of the following four factors, which is the most important to the way your firm competes in its market?
– Price (**A**) – Overall quality (**B**) – Innovative products (**C**)
– Tailoring products to specific customers' needs (**D**)

3. What is your view of corporate governance in your firm compared with other Exchange-listed firms?
– Much better (**A**) – Slightly better (**B**) – About the same (**C**)
– Slightly worse (**D**) – Much worse (**E**)

4. How do you compare your firm's current corporate governance practices with those of three years ago?
– Much better (**A**) – Slightly better (**B**) – About the same (**C**) – Worse (**D**)

II. Effectiveness of the Board of Directors

Board Independence

1. Do you believe "independent directors" of your company are truly independent from the CEO or controlling shareholders? --- **(Y+, Y, 0, N, N+)**

2. What do you think about the following reasons for "independent directors" not being fully independent from the CEO or the controlling owner?

2.1 Because the CEO has effectively selected the board members
-- **(Y+, Y, 0, N, N+)**

2.2 Because of concern over personal relationships with other directors
--- (**Y+, Y, 0, N, N+**)
2.3 Because openly objecting to the management-proposed agenda is viewed as an act contrary to behavioral norm ---------------------------- (**Y+, Y, 0, N, N+**)
2.4 Because the CEO will decide the extension or termination of the directorship
--- (**Y+, Y, 0, N, N+**)
2.5 Because of the concern of possible responsibility/blame when their views turn out to be wrong in the future ----------------------------- (**Y+, Y, 0, N, N+**)
2.6 Because the CEO and management team are supposed to be better informed on most issues and have better judgment --------------------- (**Y+, Y, 0, N, N+**)

3. Who has the strongest voice in the selection and dismissal of independent directors?

– Board or nomination committee (autonomously) --------------------------- (**A**)
– CEO --- (**B**)
– Controlling owner (who is not the CEO) ------------------------------------ (**C**)

4. What do you think about the role of your board of directors?

4.1 It is a forum of serious discussion for all the significant matters of the firm
--- (**Y+, Y, 0, N, N+**)
4.2 It is rather perfunctory: the CEO dominates the board meeting, and different views of directors are not welcome --------------------------- (**Y+, Y, 0, N, N+**)

5. Do you agree that your board is active in and makes much contribution to the following tasks?

5.1 Actively involved in formulating long-term strategies ------ (**Y+, Y, 0, N, N+**)
5.2 Plays an important role in selecting, monitoring, and replacing the CEO
--- (**Y+, Y, 0, N, N+**)
5.3 Seriously reviews key executive and director remuneration (**Y+, Y, 0, N, N+**)
5.4 Effectively oversees potential conflicts of interest including related-party transactions -- (**Y+, Y, 0, N, N+**)
5.5 Ensures the integrity of the firm's financial reporting ------- (**Y+, Y, 0, N, N+**)
5.6 Ensures proper disclosure and actively communicate with shareholders and stakeholders -- (**Y+, Y, 0, N, N+**)
5.7 Ensures the effectiveness of various governance practices - (**Y+, Y, 0, N, N+**)

6. Who has the strongest voice in removing a poorly performing CEO and selecting a new CEO? <You may choose more than one.>

– It is effectively the board of directors ------------------------------------ (**A**)
– It is done by the controlling owner, but the board puts some input -------- (**B**)
– It is done by the controlling owner, but (middle and upper level) managers exert some influence (through the board or otherwise) ------------------- (**C**)

– It is done solely by the controlling owner (Chairman, government, etc) -(**D**)
– None of the above ------------ [Please specify: **E**]

Directors' Access to Information

7. How good do you think is access to information for independent directors?

7.1 Meeting/discussing with managers (who are not board members) and workers of the company ---- Often (**A**) Sometimes (**B**) Rarely (**C**) Never (**D**)
7.2 Access to business records and books of account
------ No restriction at all (**A**) Somewhat limited (**B**) Very limited (**C**)
7.3 Enough information in time to be digested before every board meeting?
---------------------------- Very much so (**A**) Not always (**B**) Rarely (**C**)
7.4 Permitted to obtain the services of outside legal, financial and other professional advisors at the company's expense?
--------------------- Yes, they are (**A**) Only exceptionally (**B**) Never (**C**)

Compensation and Liability

8. What do you think about the financial compensation for independent directors? ----------- Probably overpaid (**A**) Adequate (**B**) Inadequate (**C**)

9. How serious is your concern about potential director liability (for the breach of the duty of care)?
Very serious (**A**) Serious (**B**) Slightly concerned (**C**) Not concerned (**D**)

Priorities for a More Effective Board

10. What do you think about the following tasks for the purpose of enhancing the effectiveness of the board?

10.1 Selecting more of better qualified, truly independent directors
--- **(Y+, Y, 0, N, N+)**
10.2 Separating the CEO from the board chairman position ----- **(Y+, Y, 0, N, N+)**
10.3 Promoting boardroom culture that encourages constructive criticism and alternative views --- **(Y+, Y, 0, N, N+)**
10.4 Timely provision of relevant information to the directors - (Y+, Y, 0, N, N+)
10.5 Providing education programs and adopting codes of conduct for directors
--- **(Y+, Y, 0, N, N+)**
10.6 Formal annual evaluation of the board and directors -------- **(Y+, Y, 0, N, N+)**
10.7 Formal CEO evaluation by the board -------------------------- **(Y+, Y, 0, N, N+)**

10.8 Giving (independent) directors better compensation and making it more linked to firm performance -------------------------------------- (**Y+, Y, 0, N, N+**)
10.9 Better disclosure of board activity ------------------------------ (**Y+, Y, 0, N, N+**)

11. Do you think that the following tasks will contribute to the better performance of outside directors?
11.1 Better attendance at the board meetings ----------------------- (**Y+, Y, 0, N, N+**)
11.2 Better preparation for, and more active participation in, board discussion -- (**Y+, Y, 0, N, N+**)
11.3 Better knowledge of the business of the firm ----------------- (**Y+, Y, 0, N, N+**)
11.4 Better awareness of fiduciary duties to all shareholders, sometimes willing to speak for minority shareholders -------------------------------- (**Y+, Y, 0, N, N+**)

III. Role of Stakeholders

1. Would you agree on the following statements?
1.1 The only real goal of a corporation is making profit for shareholders --- (**Y+, Y, 0, N, N+**)
1.2 A company, besides making profit for shareholders, has the goal of attaining the well-being of various stakeholders, such as employees and customers --- (**Y+, Y, 0, N, N+**)

2. Among various stakeholders, whose role do you think is most important in preventing the controlling owners (of your firm) from abusing their power (to pursue their private interests)? <Write 1, 2, 3, 4, 5 starting from the most important.>
– Minority (non-controlling) shareholders -------------------------------------- [**A**]
– Institutional investors (investment trust companies, banks, etc.) ---------- [**B**]
– Outside directors -- [**C**]
– Creditor financial institutions -- [**D**]
– Labor unions or employees -- [**E**]

3. Would you agree on the following statements about creditor banks' efforts to monitor your firm after the Asian crisis?
3.1 Banks screen loan applications more carefully -------------- (**Y+, Y, 0, N, N+**)
3.2 Banks monitor the firm more closely after making loans --- (**Y+, Y, 0, N, N+**)
3.3 Banks play a more active role in corporate restructuring in the event of the firm's financial distress --- (**Y+, Y, 0, N, N+**)

4. ***Is your firm interested in having a more stable long-term relationship with the creditor bank(s)?***
   --- Very much interested (**A**) A little interested (**B**) Not interested (**C**)

5. ***Do you agree on the following reasons for interest in such a relationship?*** <If your firm is not interested, you may skip this question.>

5.1 Advice of the banks on overall business and financial strategies -- **(Y+, Y, 0, N, N+)**

5.2 Better credit access and mitigation of temporary liquidity shortage -- **(Y+, Y, 0, N, N+)**

5.3 Avoiding premature liquidation and being better helped in the event of severe financial distress --- **(Y+, Y, 0, N, N+)**

6. ***Do you agree on the following reasons that may make your firm reluctant to develop such a relationship?***

6.1 Declining corporate dependence on bank loans (for more creditworthy firms) and inadequate expertise of bank officers to meet corporate demand for diverse financial services -------------------------------------- **(Y+, Y, 0, N, N+)**

6.2 Reluctance to reveal sensitive corporate information to banks, and anticipated increase in banks' monitoring and management intervention -- **(Y+, Y, 0, N, N+)**

6.3 Possibility of being stuck to a bank (in the face of increasing competition among financial institutions) ---------------------------------- **(Y+, Y, 0, N, N+)**

6.4 Increased concern over potential negative impact of bank's own distress -- **(Y+, Y, 0, N, N+)**

7. ***Would you agree on the following effects of creditor bank's holding equity shares of your firm?***

7.1 The bank's monitoring incentives will be strengthened ----- **(Y+, Y, 0, N, N+)**

7.2 Conflicts of interest between the creditor bank and the corporate shareholders will be lowered -- **(Y+, Y, 0, N, N+)**

7.3 Premature liquidation in times of distress will be avoided -- **(Y+, Y, 0, N, N+)**

7.4 With the reduced liquidity constraints, the chance for undertaking unprofitable investments will be increased ------------------- **(Y+, Y, 0, N, N+)**

7.5 The bank will exert a stronger influence on the firm for its own interests, charging higher interest rates or favoring low-risk projects **(Y+, Y, 0, N, N+)**

8. ***Would you agree on the following effects of creditor bank's being represented on the board of your firm?***

8.1 The firm will be better monitored by the creditor bank ----- **(Y+, Y, 0, N, N+)**

8.2 No particular corporate governance role is expected unless the firm is in financial distress --- **(Y+, Y, 0, N, N+)**

8.3 The firm can expect favors from the bank (better access to credit, reduced liquidity constraints, risk sharing, etc.) ----------------------- **(Y+, Y, 0, N, N+)**

8.4 The bank will have too much influence over the firm (allowing it to pursue its own interests at the expense of the firm or other stakeholders of the firm) -- **(Y+, Y, 0, N, N+)**

9. Do you agree on the following statements for your firm?

9.1 Since the Asian crisis, the labor union has become more powerful <Skip this question if your firm does not have a union.> --------------- **(Y+, Y, 0, N, N+)**

9.2 Since the Asian crisis, employee voice/participation in corporate decision-making has increased--- **(Y+, Y, 0, N, N+)**

9.3 Because of the deteriorated employment situation, employee voice/participation has not increased since the crisis, but is expected to increase as the economy fully recovers------------------------------------ **(Y+, Y, O, N, N+)**

10. How important are the following reasons for the increased (or expected-to-increase) employee voice/participation? <Skip this question if your response to the previous questions (both 9.2 and 9.3) was N or N+.>

VI:	very important	**SI**:	somewhat important
NTI:	not too important	**NIA**:	not important at all

10.1 Democratic reform resulting from economic progress and growth of the educated middle class --------------- VI (**A**) SI (**B**) NTI (**C**) NIA (**D**)

10.2 Due to the impact of the Asian crisis: weakening family control and labor's falling a victim of bad corporate governance --------------------------------------- VI (**A**) SI (**B**) NTI (**C**) NIA (**D**)

10.3 Due to increased importance of human capital (or "knowledge worker"): strategic decision-making power given to core corporate members to encourage innovation and dedication ------------ VI (**A**) SI (**B**) NTI (**C**) NIA (**D**)

10.4 Due to the growing role of employees in shop-floor decision-making or share ownership ---------------------------- VI (**A**) SI (**B**) NTI (**C**) NIA (**D**)

11. Would you agree on the following statements about the expected consequences of stronger labor voice or participation in corporate decision-making?

11.1 Abusive behavior of controlling owners will be held more in check -- **(Y+, Y, 0, N, N+)**

11.2 Firm performance will be improved due to smoother information flow, better decisions and enforcement ------------------------------------- **(Y+, Y, 0, N, N+)**

11.3 Workplace-related laws and regulations will be better observed -- **(Y+, Y, 0, N, N+)**

11.4 Interests of labor will be better served at the expense of shareholders
-- (**Y+, Y, 0, N, N+**)

12. What do you think about employee involvement in shop-floor decision-making (through work teams, quality circles, and other autonomous groups)?

12.1 Such activities are essential to productivity enhancement -- (**Y+, Y, 0, N, N+**)
12.2 Such activities might ultimately make labor too strong ----- (**Y+, Y, 0, N, N+**)
12.3 Such activities help experienced employees leave the company to start his/her own business --- (**Y+, Y, 0, N, N+**)

13. Whose role do you think is most important among the following entities in improving corporate governance in your country? <Write 1, 2, ...6 starting from the most important.>

– (Financial) press -- [**A**]
– Civil (minority shareholder) activists -- [**B**]
– Professional societies such as accounting and audit ------------------------- [**C**]
– Financial supervisory agencies or fair trade commission ------------------- [**D**]
– The judiciary --- [**E**]
– Outside directors --- [**F**]

14. Which of the following tasks do you think is most effective for better corporate governance in your country? <Write 1, 2, ...6 starting from the most important.>

– Making the internal corporate governance mechanisms (such as shareholder participation and the role of the board) work better-------------------------- [**A**]
– Making the external governance mechanisms (such as hostile M&A) more effective -- [**B**]
– Enhancing the standards of accounting, audit and disclosure -------------- [**C**]
– Conducting and publicizing corporate governance ratings ----------------- [**D**]
– Prohibiting or tightly controlling some types of related-party transactions (like lending to directors or senior officers and cross-guarantees of repayment) --- [**E**]
– Reducing ownership concentration (by tighter control of cross-shareholding or pyramid ownership structure, etc.) --- [**F**]

Appendix B. Scoring Corporate Governance Practices and Opinions

Question Number	Weight (%)	Score by Response
Shareholder Rights		
Effective participation in decision-making (EP)		
1	100/4	A (100), B (50), C (0)
2.1-2.2	100/4	A (100), B (0)
3.1-3.2	100/4	Y+ (100), Y (75), O (50), N (25), N+ (0)
5.1	100/4	A (0), B (25), C (50), D (75), E (100)
5.2		Up to 25 (0), 26-100 (50), more than 100 (100)
Election of directors and other rights of shareholders (OR)		
3.3-3.5	100/2	Y+ (100), Y (75), O (50), N (25), N+ (0)
4.1-4.2	100/2	A (100), B (0)
4.3-4.4		A (100), B (50), C (0)
Disclosure and transparency (DT)		
6.1-6.10	300/6	Add [A (40), B (30), C (30)], D (0)
7.1-7.2	200/6	A (100), B (0)
7.3		A (100), B (75), C (50), D (25), E (0)
8	100/6	A (100), B (50), C (0), D (50)
Effectiveness of the Board of Directors: Factual Information		
Board composition and independence (CI)		
1.1		8-10 (100), 6-7 or 11-13 (67), 4-5 or 14-16 (33), otherwise (0)
1.2		Not scored
1.3	300/7	[#1.3 / #1.1] ≥ 0.5 (100), 0.5 > [ ] ≥ 0.25 (50), otherwise (0)
1.4		Yes (100), No (0)
1.5		Yes (0), No (100)
2.1-2.5		Not scored
3.1-3.5	300/7	A (100), B (67), C (33), D (0)
4	100/7	1-3 (100), above 3 (0)
Functions of the board and the activities of board committees (BF)		
5.1-5.3	100/4	A ≥ 0.75 (100), 0.75 > A ≥ 0.5 (70), A < 0.5 (40); B (0)
6.1-6.5	100/4	A (100), B(0)
6.6-6.7		A (100), B (50), C (0)

7.1-7.2	100/4	A (100), B (67), C (33), D (0)
8.1	100/4	A (0), B (50), C (100), D (100)
8.2		A (0), B (25), C (50), D (75), E (100)
8.3		A (100), B (75), C (50), D (25), E (0)
Access to information, general support, and director compensation and liability (IS)		
7.3	100/6	A (100), B (50), C (0)
9	100/6	A (100), B (50), C (0)
10	100/6	A (100), B (0)
11	100/6	A (100), B (0)
12	100/6	A (100), B (50), C (0)
13	100/6	A (0), B (100), C (100)
Effectiveness of the Board of Directors: Opinion Survey		
Board composition and independence (CI)		
1	100/3	Y+ (100), Y (75), O (50), N (25), N+ (0)
2.1-2.6		Not scored
3	100/3	A (100), B (0), C (0)
6	100/3	A (100), B (50), C (50), D (0); Average in case of more than one choice
Functions of the board and the activities of board committees (BF)		
4.1	100/3	Y+ (100), Y (75), O (50), N (25), N+ (0)
4.2		Y+ (0), Y (25), O (50), N (75), N+ (100)
5.1-5.7	200/3	Y+ (100), Y (75), O (50), N (25), N+ (0)
Access to information, general support, and director compensation and liability (IS)		
7.1	200/4	A (100), B (67), C (33), D (0)
7.2-7.4		A (100), B (50), C (0)
8	100/4	A (100), B (100), C (0)
9	100/4	A (100), B (100), C (50), D (0)
10.1-10.9		Not scored
11.1-11.4		Not scored

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