

A ROAD MAP FOR CORPORATE GOVERNANCE IN EAST ASIA

*Chee Keong Low**

I: INTRODUCTION

Recent academic research suggests that there is a systematic difference between countries in terms of the legal protection accorded to minority shareholders. Two distinct trends have emerged, namely, that the least protection for investors is provided in countries in which ownership of corporations is the most concentrated,¹ and secondly, expropriation of outside shareholders arises most significantly where a company is affiliated with a group of companies, all of which are controlled by the same shareholder.² The evidence discussed suggests that the common law system provides more protection for investors, as the transfer of assets and profits out of firms for the benefit of their controlling shareholders is more prevalent in civil law jurisdictions.³ This new scholarship is significant for two reasons, specifically, its emphasis on the centrality of legal protection for minority shareholders, and the assertion that legal regulation can outperform private contracting. In short, both strong legal regulation and effective enforcement are critical to sound and effective corporate governance.

These findings have significant policy implications, as good corporate

* Associate Professor in Corporate Law, The Chinese University of Hong Kong. Telephone: (852) 2609-7891; Facsimile: (852) 2603-5114; E-mail: cklow@cuhk.edu.hk

¹ See, e.g., Rafael La Porta et al., *Law and Finance*, 106 J. POL. ECON. 1113 (1998); Andrei Shleifer & Robert W. Vishny, *A Survey of Corporate Governance*, 52 J. FIN. 737 (1997).

² See, e.g., Mara Faccio et al., *Dividends and Expropriation*, 90 AMER. ECON. REV. 54 (2001).

³ See, e.g., Rafael La Porta et al., *Investor Protection and Corporate Valuation*, 57 J. OF FIN. 1147 (2002); Simon Johnson et al., *Tunnelling*, 90 AMER. ECON. REV. 22 (2001); Simon Johnson et al., *Corporate Governance in the Asian Financial Crisis*, 58 J. FIN. ECON. 141 (2000).

governance practices contribute towards the overall well-being of a financial system. Strong legal regulation and effective enforcement will assume increasing importance with the current deflationary pressures threatening a global economic slowdown, which would provide motive and opportunity for the expropriation of minority shareholders and creditors. However, while this line of research highlights the implications of weak or ineffective corporate governance regimes, it does not propose concrete legal or regulatory solutions thereto.

The Asian financial crisis brought to the foreground the common conditions of weak corporate governance that has allowed companies to engage in excessive over-leveraging, some of which was aided by implicit state guarantees. The concepts of transparency, disclosure and accountability were largely ignored in the lead-up to the crisis, as investors assumed short-term outlooks to derive increasing profits from the steadily rising regional financial markets. Companies across the region were equally guilty of neglecting the principles of good corporate governance, the difference being perhaps only in the degree of neglect. This is evident from instances of corporate abuse through related-party transactions, incidence of capricious decision-making, shifting of assets within the corporate group, undertaking of transactions without proper disclosure and poor financial management by directors.

The importance of corporate governance as a critical means to sustaining regional economic growth is evident in the organization of five annual meetings of the Asian Roundtable on Corporate Governance by the Organization for Economic Cooperation and Development ("OECD") under a mandate from the G-8.⁴ The *White Paper on Corporate Governance in Asia* ("White Paper") identified six key areas as priorities for reform, namely, raising the appreciation of good governance, improving the standard of enforcement, the adoption of international standards and practices, improving the performance of boards of directors, the protection of minority shareholders and the improvement of bank governance.⁵

Having released the White Paper, the next stage comprises practical

⁴ The Asian Roundtable on Corporate Governance serves as a regional forum for structured dialogue between senior policy-makers, regulators and representatives from stock exchanges, private-sector bodies, multilateral organizations and non-governmental institutions. The five meetings carried different themes and were held between 1999 and 2003. The first Asian Roundtable was held in the Republic of Korea with the theme '*Corporate Governance in Asia: A Comparative Perspective*' in 1999. This was followed by meetings in Hong Kong ('*Role of Disclosure in Strengthening Corporate Governance*,' 2000), Singapore ('*Role of Boards and Stakeholders in Corporate Governance*,' 2001), India ('*Shareholder Rights and the Equitable Treatment of Shareholders*,' 2002) and Malaysia ('*Enforcement and Finalization of the White Paper*,' 2003).

⁵ WORLD BANK, WHITE PAPER, CORPORATE GOVERNANCE IN ASIA 5-7 (2003), available at <http://www.oecd.org/dataoecd/48/55/25778905.pdf> (last visited Oct. 8, 2004).

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implementation and effective enforcement of the six key areas thereby moving the thrust from conformance to performance. Although its title is admittedly somewhat ambitious, this paper follows the 'law matters' thesis to address the issues of board performance and minority shareholder protection in East Asia.⁶ Its principal focus is on three countries, namely Hong Kong, Malaysia and Singapore, whose corporate governance practices will be adopted as proxies for the region. The choice of these three jurisdictions is premised on their sharing a common legal system which was inherited from the United Kingdom,⁷ and for the relative maturity and easy accessibility of their capital markets within the East Asian region.⁸ By adopting a 'top down' approach, this paper reviews the powers and responsibilities of directors and shareholders to highlight the deficiencies within the existing framework. It concludes with a discussion of proposals, the object of which is to actively cultivate the spirit of entrepreneurship amongst the new generation of directors, shareholders and regulators. This in turn will maximize investment returns of East Asian companies within a prudential system of sound corporate governance practices.

II. AN OVERVIEW OF THE ROLE AND DUTIES OF DIRECTORS

The company is an artificial legal entity, created and recognized by law for over a century.⁹ It comprises two principal organs namely, its board

⁶ The issues of board performance and protection of minority shareholders are respectively Priority 4 and Priority 5 in the agenda for reform set out in the White Paper. *Id.* at 6-7.

⁷ Malaysia gained independence from the United Kingdom in 1957 while the Republic of Singapore attained independence in 1965 when it seceded from Malaysia. The Hong Kong Special Administrative Region was established on July 1, 1997 under the terms of the Joint Declaration of the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the People's Republic of China on the Question of Hong Kong, following some 157 years as a colony of the United Kingdom. The stock markets of Hong Kong, Malaysia and Singapore are consistently rated as being the most liquid amongst regional East Asian bourses.

⁸ For the purposes of this paper the term "East Asia" is defined to include Brunei, Cambodia, Hong Kong, Indonesia, Japan, Laos, Malaysia, Myanmar, the People's Republic of China, the Philippines, the Republic of Korea, Singapore, Taiwan, Thailand and Vietnam. The People's Republic of China, Republic of Korea and Taiwan draw upon German civil law systems and, despite their relative size, they impose a number of legal and/or administrative constraints on non-citizens participating in their capital markets. There are a number of significant ways in which Japan differs in its institutional features from the rest of East Asia, as documented in TAKEO HOSHI & ANIL KASHYAP, CORPORATE FINANCING AND GOVERNANCE IN JAPAN (2001).

⁹ The genesis of modern company law can be traced to the decision of the English House of Lords in *Saloman v. Saloman & Co. Ltd.* 1897 A.C. 22 (Eng. H.L.), which enunciated the principle of the separate legal entity. This decision has since been statutorily enacted in corporate legislation across the Commonwealth. *See, e.g.*, Companies Ordinance of Hong

of directors and its shareholders in general meeting, both of which are regarded as its agents. The ability of either of these organs to bind the company depends on the extent of the authority bestowed upon it by legislation or by the articles of associations of the company. The latter usually confers broad powers of management regarding the affairs of the company to its board of directors. The directors act as agents of the company rather than the members in general meetings. Directors therefore assume an important function in the management of companies. However, directors are neither the agents of, nor subservient to, the general meeting of members in matters pertaining to the management of the company provided that they act within the legal limits as circumscribed by its objects and articles.¹⁰

However, there appears to be a perception, perhaps even a benign resignation, that directorships of East Asian companies are somehow appropriate 'rewards' in recognition of years of loyal and subservient service, or of friendship. This is because it is not uncommon for senior retired civil servants to be appointed to the boards of government-linked companies in Malaysia and Singapore, while the dominance of the family-shareholder effectively means only persons who are 'acceptable' to the controlling shareholder will have a realistic chance of being elected to the boards of companies in Hong Kong. By and of themselves, such practices are not necessarily bad, for there are persons of calibre who have exemplary records in public service and the private sector. However, this perception marginalizes the importance of the office of a director. Rather than being viewed as an ornament, a director must be treated and appreciated as a vital functionary of effective corporate governance.

Their common ancestry means that Hong Kong, Malaysia and Singapore share the same inheritance of English law with respect to the duty and standard of care of company directors.¹¹ Although some degree of

Kong (Chapter 32 of the Laws of Hong Kong) [hereinafter the "HKCO"]; section 16(5) of the Companies Act 1965 of Malaysia, Companies Act, Act 125 of 1965, 165 (Golden's Federal Statutes (Laws of Malaysia) 1996) [hereinafter the "MCA"]; and Companies Act of Singapore, Act 42 of 1967, ch. 50, section 19(5), sched. 8 (1988 ed., revised ed. 1990) [hereinafter the "SCA"].

¹⁰ See *Automatic Self-Cleansing Filter Syndicate Co. v. Cunningham*, 1906 2 Ch 34 (Eng. C.A.). The Articles of Association would usually provide that the "business of the company shall be managed by the directors;" see, e.g., Art. 82 of Table A of the First Schedule to the HKCO, *supra* note 9; Art. 73 of Table A of the Fourth Schedule to the MCA, *supra* note 9; and Art. 73 of Table A of the Fourth Schedule to the SCA.

¹¹ See Vanessa Finch, *Company Directors: Who Cares About Skill and Care?*, 55 MOD. L. REV. 179 (1992). See generally, A.S. Sievers, *Farewell to the Sleeping Director – The Modern Judicial and Legislative Approach to Directors' Duties of Care, Skill and Diligence – Further Developments*, 21 AUS. BUS. L. REV. 111 (1993) (overview of the comparable provisions in English and Australian law upon which the judicial pronouncements in Hong Kong, Malaysia and Singapore have been premised).

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divergence has begun to set in between the three jurisdictions in view of the differing pace of their respective socio-economic and political developments, there are nonetheless many striking similarities between them as regards the issue of company directors. Both Malaysia and Singapore share identical statutory provisions outlining the duty of directors, requiring that he “at all times act honestly and use reasonable diligence in the discharge of the duties of his office.”¹² The legislation also makes it explicit that the foregoing “is in addition to and not in derogation of any other written law or rule of law relating to the duty or liability of directors or officers of a company.”¹³ While Hong Kong does not have an equivalent statutory provision, it nonetheless shares the same common law position¹⁴ with Malaysia and Singapore, thereby making its regulatory framework broadly similar to its regional counterparts.

To ensure that directors do not abuse the powers conferred upon them, they are required to fulfill fiduciary duties of good faith to the company. A fiduciary relationship is one that exists between a person in a position of trust, namely, the fiduciary, and a person for whose benefit the fiduciary acts, the beneficiary. As fiduciaries control property in which others have an interest and exercise powers on behalf of those who are in a position of dependence, the common law imposes upon them a duty to act loyally in good faith and to avoid conflicts of interest. In the context of company law, such fiduciary duties relate to the integrity of the decisions and actions undertaken by directors who have a duty to act *bona fide* in the interests of the company, exercise the powers for their proper purpose, retain their discretionary power, avoid conflicts of interest, and exercise due care, diligence and skill.

The common law governing the standard of care required of directors has to be discerned from a large morass of complex case law, a significant amount of which was decided at a time when there were relatively few companies and when boards were usually comprised of part-time, non-executive directors who were treated more as figureheads. It remains an anomaly that while directors have almost unfettered control of the affairs of the company, they are not subject to any statutory provisions with respect to

¹² Section 132(1) of the MCA and section 157(1) of the SCA, *supra* note 9. These sections were adopted *in toto* from section 124 of the Australian Uniform Companies Act 1961-62, which was derived from Section 107 of the Companies Act 1958 of the State of Victoria. The phrase “to act honestly” has been defined as meaning “acting *bona fide* in the interests of the company in the performance of the functions attaching to the office of director.” *Marchesi v. Barnes & Keogh*, [1970] VLR 434, 438 (S.C. Victoria).

¹³ See section 132(4) of the MCA and section 157(4) of the SCA, *supra* note 9.

¹⁴ This may be broadly divided into two distinct categories, namely the fiduciary duty of loyalty and good faith to act in the best interests of the company, and the duty to exercise due care and skill in managing the affairs of the company. See *Re City Equitable Fire Ins. Co. Ltd.*, 1925 Ch. 407 (C.A.), *aff’d* 1925 Ch. 501.

standards of conduct. These must instead be discerned from a large volume of case law, the genesis of which is derived from the early English decisions in *Re Cardiff Bank; Marquis of Bute's Case*¹⁵ and *Re City Equitable Fire Insurance Co. Ltd.*¹⁶ In essence, a director is obliged to exercise such care as an ordinary person might be expected to use in the circumstances on his or her own behalf, subject to the following three principal qualifications: that he or she

- Need not exhibit, in the performance of his or her duties, a greater degree of skill than may reasonably be expected from a person of his or her knowledge and experience;
- Is not bound to give continuous attention to the affairs of the company as his or her duties are of an intermittent nature to be performed at periodic board meetings; and
- May, in the absence of grounds of suspicion and having regard for the exigencies of business, be justified in trusting a person to whom a duty has been delegated, to perform such duties honestly.

Thus, so low is the standard that directors would only be held to breach their duty of care to the company where gross negligence can be established.¹⁷ This approach favors the less than competent director, for he or she is more likely to be relieved of liability on grounds of his or her lack of knowledge and experience.¹⁸ With this as the contemporary standard, it is indeed cold comfort for shareholders to know that there is a steady stream of marginally competent and qualified people available to manage their investments. The common law appears to endorse the view that if a company appoints a director who is not competent, or does not possess the requisite level of knowledge or experience, the company and its shareholders should bear the consequences of their own actions. That this is so despite the significant losses caused by corporate oversights at Barings in Singapore, Perwaja Steel and Renong in Malaysia, and Euro-Asia Agriculture and Peregrine Investments in Hong Kong highlights the degree to which the law with respect to the standard of care expected of directors is

¹⁵ 1892 2 Ch 100.

¹⁶ See *Re City Equitable Fire Insurance Co. Ltd.*, *supra* note 14.

¹⁷ See *e.g.*, *Overend & Gurney & Co. v. Gibb*, 1822 LR 56 (HL 480), where the court opined that directors would only breach the standard if “they were cognizant of circumstances of such a character, so plain, so manifest, and so simple of appreciation, that no men with any ordinary degree of prudence, acting on their own behalf, would have entered into such a transaction as they entered into.”

¹⁸ While some recent cases indicate a preference for a higher standard, this cannot be definitively stated as courts do not normally question decisions which are made by directors of companies. In the author’s opinion, the courts have correctly exercised judicial restraint by not substituting their opinions for that of a board. See, *e.g.*, *Howard Smith Ltd. v. Ampol Petroleum Ltd.*, 1974 AC 821; *Norman v. Theodore Goddard*, 1991 BCLC 1028; *Daniels v. Anderson*, 1995 ACSR 607.

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out of sync with commercial realities.

Unfortunately, this relatively low common law standard has been perpetuated by the handful of reported cases dealing with breaches of directors' duties of care, skill and diligence.¹⁹ A likely reason for this is the existing legal framework with respect to directors' duties, which makes it difficult for legal proceedings to be initiated. Directors are unlikely to cause the company to commence a claim in negligence against its own board members for breach of duty, while shareholders are quite often restricted by the rule in *Foss v. Harbottle*²⁰ that lays a number of legal impediments in their path. In practice, it is more common for liquidators of companies to commence legal actions against directors who breach their duties. However, such cases are usually few and far between, given the propensity of the liquidator to preserve the assets of the company for distribution as dividends to its creditors.

While one would reasonably expect comparatively higher standards for publicly listed companies, this is not the case. The low common law standards are simply perpetuated by a restatement of the same. The rules of the stock exchanges in Hong Kong, Malaysia and Singapore provide that the directors are expected to fulfill their fiduciary duties and duties of skill, care and diligence to a standard "at least commensurate with the standard established by law."²¹ They further provide that directors must "act

¹⁹ Although the courts in England and Australia have been more willing to adapt to the changing attitudes and expectations of modern society, their counterparts in Hong Kong, Malaysia and Singapore have been relatively conservative in advocating change. Compare the English decisions of *Theodore Goddard*, *supra* note 18; *In re D'Jan of London Ltd.* [1994] BCLC 561; *Permanent Building Society v. Wheeler* (1994) 12 ACLC 674 (Austl. decisions); *Mistmorn Pty Ltd v. Yasseen* (1996) 14 ACLC 1387. This approach has yet to be definitively adopted in either Malaysia or Singapore, while the courts in Hong Kong have made tentative steps towards embracing this formulation by holding there to be no difference regarding the duties and responsibilities between executive directors and non-executive directors of companies. See *In re Baldwin Construction Co Ltd.* [2001] 3 HKLRD 430. That said, it is worth noting that the Standing Committee on Company Law Reform in Hong Kong expressed the opinion that the existing standards of care and skill expected of company directors were "generally acceptable" and therefore did not warrant any legislative change. See Standing Committee on Company Law Reform in Hong Kong, CORPORATE GOVERNANCE REVIEW: A CONSULTATION PAPER ON PROPOSALS MADE IN PHASE I OF THE REVIEW, ¶ 6.13 (2001) available at <http://www.info.gov.hk/cr/scclr/index.htm> (last visited Oct. 8, 2004). Nonetheless, in its subsequent follow-up report in June 2003, the Standing Committee directed the Companies Registry to outline the fundamental but non-exhaustive requirements which the latter has since published. See Companies Registry of Hong Kong, *Non-Statutory Guidelines on Directors' Duties*, 1-4 (2003), available at http://www.info.gov.hk/cr/download/list/director_guide_e.pdf (last visited Oct. 8, 2004).

²⁰ (1843) 2 Hare 461; 67 ER 189

²¹ See ¶ 3.08 of the *Listing Rules of the Stock Exchange of Hong Kong*, available at <http://www.hkex.com.hk/rule/index/rulesandguidelines.htm>. See *Listing Requirements of Bursa Malaysia Securities Berhad (for Main Board and Second Board)* ¶ 15.09, available at

honestly and in good faith in the interests of the company as a whole” without stating how this may be achieved.²² With this as the benchmark it should not be surprising to note that the exchanges have rarely taken actions against directors of publicly listed companies save where instances of fraud are established.

As is the common practice with their counterparts around the world, the exchanges in Hong Kong, Malaysia and Singapore are empowered, with the approval of the statutory regulator, to establish and implement rules that pertain to transactions that are effected on or through its facilities. However, the stock exchanges in Hong Kong, Malaysia and Singapore are unique, for they are, or will soon be, publicly listed for-profit entities.²³ This poses a fundamental conflict of interest problem for the exercise of their regulatory functions of the stock market, and of the activities of the listed companies, may not be fully compatible with the profit motive of a listed entity. The inherent conflict of interest raises the potential for an undesirable compromise of the standard of regulations and possibly the enforcement thereof, which might in turn result in the exchanges being ‘soft’ with the imposition of sanctions against defaulting directors. Under the circumstances, it would be more appropriate to divest the exchanges of their front-line regulatory functions and to have these transferred to the statutory regulator.²⁴ However, while important, this issue nonetheless

http://www.klse.com.my/website/listing/listingreqs_mbsb.htm. While this paragraph requires each director to undergo “continuous training to equip himself to effectively discharge his duties as a director,” the standard required is nonetheless similar to that in Hong Kong and in Singapore.

²² The phrase “in the interest of the company” has been taken to mean that directors must act in the interests of shareholders as a collective group. *See Greenhalgh v. Ardenne Cinemas* [1951] Ch 286. However, this does not mean that directors owe duties to particular shareholders of the company unless special circumstances such as the need for full disclosure arise. *See Percival v. Wright* [1902] 2 Ch 421 and *Coleman v. Myers* [1977] 2 NZLR 225. *See also Hogg v. Cramphorn Ltd.* [1967] Ch 254; *Regal (Hastings) Ltd. v. Gulliver* [1967] 2 AC 134; *Harlowe’s Nominees Pty Ltd v. Woodside (Lake Entrance) Oil Co NL* (1968) 121 CLR 483; *Teck Corp., Ltd. v. Millar* (1973) 33 DLR (3d) 288; and *Howard Smith v. Ampol Petroleum, Ltd.* [1974] AC 821. For a more detailed treatment, see Robert Langton & Lindsay Trotman, *Defining the “Best Interests of the Corporation:” Some Australian Reform Proposals*, 3 FLINDERS J. L. REFORM 163 (1999).

²³ The parent companies of the Stock Exchanges of Singapore and Hong Kong were listed on their own subsidiaries in the year 2000. The Kuala Lumpur Stock Exchange has been reconstituted as the demutualised Bursa Malaysia Securities Berhad as a prelude to the planned listing of its parent company by early 2005. Currently, the only other stock exchanges that are publicly listed are the Stockholm Exchange in Sweden, the Australian Stock Exchange, and the London Stock Exchange.

²⁴ The statutory regulators in the jurisdictions in question are the Securities and Futures Commission in Hong Kong (<http://www.hksfc.org.hk>); the Securities Commission in Malaysia (<http://www.sc.com.my>); and the Monetary Authority of Singapore in Singapore (<http://www.mas.gov.sg>).

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remains outside the scope of this paper.²⁵

III. AN OVERVIEW OF THE RIGHTS OF SHAREHOLDERS

As providers of capital that facilitate the profitability of the company, shareholders enjoy certain rights, including the right to vote, the right to a dividend, if declared, and the right to a return of capital and a right to be treated fairly. These rights are personal to each individual shareholder and cannot be interfered with by either the company or another shareholder.²⁶ To ensure that the shareholder is kept apprised of the development of the company, he or she has the right to inspect registers that are kept by the company.²⁷ He or she is also entitled to receive copies of the interim accounting statements, audited profit and loss statements, balance sheets, and reports by the auditors and the directors of the company.

However, despite the rights accorded to shareholders, they are not as extensive as they may appear at first glance. One grave omission of the law is that shareholders are not provided with the right of access to the accounting records of the company. These documents are only available to the directors and auditors of the company. In short, shareholders are often oblivious to the precise financial affairs of the company and are generally at the mercy of management in so far as it pertains to the flow of information.²⁸

The will of the shareholders is reflected in resolutions that are passed during a properly convened general meeting of the company. An important element of control that the shareholders exercise, at least in theory, is the right to vote in the person of their choice as directors of the company. However, this exists only in theory, especially in East Asia given the strong

²⁵ See Chee Keong Low, *A Framework for the Delisting of Penny Stocks in Hong Kong*, 30 N.C. J. INT'L. L. & COM. REG. (forthcoming 2004) available at <http://www.ssrn.com/author=332882> (last visited Oct. 8, 2004). See also *Report of the Expert Group to Review the Operation of the Securities Futures Market Regulatory Structure* (2003), available at <http://www.info.gov.hk/info/expert/expertreport-e.htm> (last visited Oct. 8, 2004) (discussing these issues in the context of Hong Kong). The government of the HKSAR has since reviewed the general regulatory framework with respect to the listing of companies on the SEHK published *Consultation Conclusions on Proposals to Enhance the Regulation of Listings* (2004), available at <http://www.info.gov.hk/fstb/fsb/ppr/consult/doc/erlcon-ed.pdf> (last visited Oct. 8, 2004), which essentially maintains the status quo, albeit with the introduction of limited statutory backing for the Listing Rules.

²⁶ See, e.g., *Edwards v. Halliwell* [1950] 2 All E. R. 1064 (Eng. C.A.).

²⁷ These include the registers of members, directors, substantial shareholders, debenture holders, charges and holders of participatory interests. There is usually no charge for inspection during prescribed periods although a nominal charge is normally imposed for making copies.

²⁸ The cases of Enron, WorldCom and Global Crossing in the United States have provided clear demonstration that this does not, by and of itself, guarantee the accuracy of the financial information.

dominance of families and/or the state in the ownership structure of companies. Clear evidence of this has been documented in a recent study that found the top ten families in selected East Asian countries controlled between 18% and 58% of the total listed corporate assets.²⁹ The degree of control by these shareholders is such that the concepts of ‘equality’ and ‘level playing fields’ are often aspirations rather than reality, especially in the election of directors, since usually only those favored by the family will be able to secure a seat on the board of the company. This has important implications because the board of directors, as a collective unit, exercises almost unfettered powers of management over the company.

Another area of concern is the ostensible right of shareholders to be treated fairly. This right was intended to ensure that the interests of minority shareholders would not be prejudiced by the actions of the majority shareholder. Although this principle is oft times referred to as “nebulous” given the disparate strands of judicial pronouncements,³⁰ its foundation is perhaps aptly summarized by Lord Wilberforce as follows:

A limited company is more than a mere legal entity . . . [it is composed of] individuals with rights, expectations and obligations inter se which are not necessarily submerged in the company structure.³¹

The law ostensibly protects shareholders by allowing them to attend requisition general meetings or to apply for the winding-up of companies on just and equitable ground. However, one must ask how effective these options are in practice. The former requires the participation of shareholders who collectively hold at least 10% of the issued capital of the company,³² while the latter involves considerable risk to the shareholder

²⁹ See Stijn Claessens et al., *Separation of Ownership from Control of East Asian Firms*, 58 J. FIN. ECON. 81 (2000). This study, which covers the Republic of Korea, Hong Kong, Taiwan, Indonesia, the Philippines, Thailand, Malaysia and Singapore, expands on the earlier findings of Rafael La Porta et al., *Corporate Ownership Around the World*, 54 J. FIN. 471 (1999).

³⁰ See, e.g., *In re: Kong Thai Sawmill (Miri) Sdn Bhd*, [1978] 2 MLJ 227 (Eng. H.L.); *Ebrahimi v. Westbourne Galleries, Ltd.* [1973] AC 360 (Eng. H.L.); *In re: Holders Inv. Trust, Ltd.* [1971] 2 All ER 289 (Eng. Ch.D.); *Scottish Co-operative Wholesale Soc’y Ltd. v. Meyer* [1959] AC 324 (Eng. H.L.); and *Cook v. Deeks* [1916] 1 AC 55 (Austl. P.C.).

³¹ *Ebrahimi*, *supra* note 30, at 379.

³² See section 145(1) of the MCA and section 177(1) of the SCA, *supra* note 9. The threshold for Hong Kong was reduced to five percent effective July 1, 2000. See section 113 of the HKCO, *supra* note 9. Directors of companies are required to convene such meetings within 21 days from the deposit of the requisition notwithstanding anything to the contrary in its articles of association. Failure to comply will allow the requisitionists to convene the general meeting within three months of the date of the requisition, with all reasonable expense to be born by the defaulting directors from the fees or other remuneration due to them by company. See section 113(5) of the HKCO, *supra* note 9; section 144(4) of the MCA, *supra* note 9; section 176(4) of the SCA, *supra* note 9.

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who is responsible for the legal fees for taking the matter to court. In addition, while shareholders are empowered to request that law enforcement authorities conduct an investigation into the affairs of the company, this is uncommon save for cases that involve a large section of the community in view of the costs involved. Aggrieved shareholders also face a number of obstacles in their attempts to take directors of the company to court, the most evident being the restriction on their access to the books and records of the company. In short, none of the existing remedies available to shareholders appears realistic where they are up against an uncooperative board of directors, which is presumably almost always the case.

The foregoing limitations on shareholder rights have assumed increased significance as regional capital markets move towards the disclosure-based system of regulation (“DBR”), a model founded on the efficient market hypothesis. DBR places emphasis on full and accurate disclosure of all material information, working on the positive correlation between the efficacy of securities prices and the availability of information. Regional markets still practice a hybrid of DBR and the merit-based system of regulation (“MBR”). The latter is a model in which the regulator assumes the important role of protecting investors. This is generally achieved by ensuring that only offerings of securities that are judged to be “fair, reasonable and equitable” be allowed to proceed. The moral hazard of investing is therefore higher under the MBR, which is widely acknowledged to work best in emerging markets with high proportions of retail investors who lack financial sophistication. Taking cognizance of the fact that capital markets only achieve their full potential when they are allowed to operate unhindered, Hong Kong, Singapore and Malaysia have all announced their migration towards a robust DBR. In such an environment, investors will not only have to assume responsibility for their investment decisions but they will also have to be more vigilant in monitoring the performance of their companies and the actions of the directors.

The discussion in the preceding paragraphs alludes to the further policy issues of how the apparently competing objectives of ensuring that the rights of the minority shareholders are adequately protected can be reconciled with their assumption of a corresponding amount of risk to minimize the moral hazard of rigid regulation.

IV. PROPOSALS FOR REFORM

To be fair, the rules of the stock exchanges in Hong Kong, Malaysia and Singapore do provide some degree of protection to minority shareholders. The continuing obligations imposed upon publicly listed companies and their directors require that they provide sufficient information about transactions such that shareholders may make informed

decisions. This is particularly so for transactions that are not conducted at arm's length, e.g., between the company and related parties. In the context of such a "connected transaction," not only must the details of the transaction be provided, but the parties who are 'connected' are generally required to abstain from voting at the general meeting of members during which approval for the same is sought.

In addition, regulators within the East Asian region have begun to appreciate the complexities of case law and have begun to respond, albeit conservatively and cautiously, to some of the criticisms of the widening perception gap that exists. One example is the proposal by the Standing Committee on Company Law Reform in Hong Kong³³ to introduce a set of draft guidelines on directors' duties, with the objective of outlining general principles for directors' exercise of their powers. The proposal was subsequently adopted by the Companies Registry.³⁴ These principles restate the common law and are intended to provide guidance to directors with respect to their duties under eleven separate headings, which include the duty to act in good faith, to use powers for a proper purpose and to avoid conflicts of interest.

A. The Roles and Duties of Directors

The developments described above do not, by themselves, raise the standards expected of directors and they may not adequately protect minority shareholders in cases where nominees are used, particularly if the latter operates from an international offshore financial center. The ensuing paragraphs crystallize some of the legal issues that pertain to the office of directors and put forward some proposals for reform thereto with the objective of enhancing the standard against which directors ought to be benchmarked.

It is established law that the relationship between a director and the company is one that is based on fiduciary duties. The duties owed by directors to companies on whose boards they sit require them to act *bona*

³³ This committee was established in 1984 to advise the Financial Secretary on amendments to the Companies Ordinance and other related legislation. The primary duty of the Financial Secretary is to oversee the policy formulation and implementation in financial, monetary, economic and employment matters. The Financial Secretary is the Chairman of the Exchange Fund Advisory Committee, the governing body of the Hong Kong Monetary Authority, which has oversight of the financial system in Hong Kong.

³⁴ Corporate Governance Review by the Standing Committee on Company Law Reform: A Consultation Paper on Proposals made in Phase II of the Review, ¶ 7.03-7.12 (2003), available at <http://www.info.gov.hk/cr/scclr/index.htm> (last visited Oct. 8, 2004) [hereinafter Governance Review]. In response to this, the Companies Registry outlined the fundamental but non-exhaustive requirements which it published as the COMPANIES REGISTRY OF HONG KONG, NON-STATUTORY GUIDELINES ON DIRECTORS' DUTIES, 1-4 (2003), available at http://www.info.gov.hk/cr/download/list/director_guide_e.pdf (last visited Oct. 8, 2004).

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fide in the best interests of the company as a whole. In short, directors must exercise their powers on behalf, and for the benefit of all shareholders rather than the majority on whose vote they are ostensibly appointed to the board.

Unfortunately, it is often conveniently forgotten that whilst the powers of management are conferred on the board of directors as a collective unit, the directors' fiduciary obligations to the company is assessed on an individual basis. It is therefore not surprising that many are perplexed by the nature of the fiduciary duty owed by directors to companies, more so when the directors are classified into groups such as executive directors, non-executive directors, independent non-executive directors and nominee directors. In principle, these official titles or designations ought not matter, for substance should always precede form such that the duty owed by directors, regardless of their classification, is premised upon fiduciary relations.

Due consideration should also be paid to the proper role of directors. Are they to manage, to oversee general policy and to assume entrepreneurial risks? Should their principal function be to comply or to perform? Must they be tasked with providing the requisite vision to take the company to the next level or are they best constrained to doing what the company has done since its incorporation? These are important policy issues which responses will imply alternative regulatory frameworks upon which the duties of directors are couched.

Of equal importance is the need to ensure that the board of directors will be able to exercise objective judgment on corporate affairs, independent from undue influence by management and/or controlling or substantial shareholders. The simplest means of achieving this objective is to require that the board of directors represent the interest of all shareholders. While this may seem both obvious and logical, the current process for the election of directors is heavily biased in favor of the controlling shareholder. Not only is he or she able to exert considerable voting power at the general meeting, he or she will also be able to gain advantages through a restrictive nomination procedure and staggered board terms.

It is settled law that effective corporate governance is premised on the two cornerstones of independence and accountability. How then should boards of directors be composed to facilitate the attainment of these objectives? The two-tier board structure used in Indonesia provides insight into the impact of board structure. Indonesian companies empower boards of commissioners, which are the functional equivalent of the board of supervisors in Germany and France. The commissioners are all independent, non-executive directors. The board typically convenes separate meetings before holding joint meetings with the board of directors. A high degree of independence results from this structure and carries the

additional benefit of allowing the commissioners to focus on policy and strategy: implementation remains largely the responsibility of the directors.

While there is no need for Hong Kong, Malaysia or Singapore to adopt this structure, the hard question nonetheless must be answered: How do we promote and thereafter sustain genuine independence of directors? Unfortunately, reality is such that the question may itself defy any answer given the lack of a universal and clear consensus as to the meaning of "independence." For example, the Australian and Malaysian Codes of Corporate Governance expressly provide that a substantial shareholder of a company cannot be regarded as an independent director, while the British and Singaporean statutes are silent on this issue. The latter suggests that while substantial shareholders may not be the best independent directors, they ought not be automatically excluded solely on that basis.³⁵

A possible solution, although one that is unlikely to gain universal appeal, would be the implementation of a framework that not only requires directors to be independent in mind and judgment, but also requires that they be independently elected at the general meeting of shareholders. To this end, the regulations could be amended to require that the majority of the board members are independent, non-executive directors ("INEDs"). In addition, at least two of these INEDs should be voted in by the independent shareholders of the company.³⁶ Thus, if the board of a company consists of seven directors, a majority of four of them would be INEDs. Of these four INEDs, two should be representatives of the independent minority shareholders as it would be upon their votes that these directors be elected to the board. This proposal will, in effect, disenfranchise the majority and substantial shareholders, together with their associates, as they will not be allowed to cast their votes insofar as the election of INEDs are concerned.

The foregoing proposal was rejected by the Standing Committee on

³⁵ Compare R. Sivanithy, *Buying A Rival's Shares is Poor Judgment*, SINGAPORE BUS. TIMES, 13 June 2003, at 8; Kala Anandarajah, *When Appearances Can Stultify Independence*, SINGAPORE BUS. TIMES, 13 June 2003 (illustrating the scope and complexity of this debate). This follows an initial report by Gary Chang, *SingTel Chairman's Investment in Rival Raises Ire*, BLOOMBERG NEWS, (June 9, 2003) (noting that the non-executive Chairman of Singapore Telecom had invested some US\$180,000 in the shares of its rival MobileOne, making him the company's 19th largest shareholder as of Mar. 3, 2003). Although the shares were subsequently disposed, the debate over potential conflicts of interest has continued.

³⁶ The term "independent shareholders" refers to shareholders who do not have a significant personal or professional relationship with the company or its directors, their families and associates. As such, it would exclude most majority and substantial shareholders. To enhance the perception of independence, it is proposed that relationships for the period of two years preceding the general meeting of shareholders at which the vote is to take place be assessed. Shareholders will be deemed not to be independent and therefore precluded from the vote where a material professional relationship within this period is established.

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Company Law Reform in Hong Kong. The Committee feared the proposal would lead to a number of significant conceptual and practical problems, including tensions amongst board members due to “totally unnecessary and negative institutionalized confrontation.”³⁷ This author believes that the Standing Committee erred on the side of status quo, since the individual directors would be required to discharge his or her fiduciary duty in the interests of the company as a whole, rather than to the minority shareholders alone.³⁸ Furthermore, in conjunction with a heightened standard of care, the risk of these woes coming to fruition would be minimized.³⁹

The ritual of the general meeting where all persons nominated by the board of the company for directorships are voted in by the shareholders every year on the assumption that their votes do not count must be dispensed with. No longer should the independent shareholders have to contend with just two choices namely, to withhold their votes as an ineffectual sign of protest or to dispose of their shares in the company at a price that often does not reflect the true value. The foregoing proposals will empower independent shareholders and will be the prelude to the introduction of boardroom democracy, which currently forms part of a broad review of the proxy process by the Securities and Exchange Commission of the United States of America.⁴⁰

As a further safeguard, it is proposed that candidates for the office of INED be selected at random from a register of qualified persons which may be maintained by the Companies Registry of each jurisdiction. Persons are deemed qualified only if they meet certain requirements including independence from the company, whether in terms of shareholding or having a personal or business relationship, and being duly accredited.⁴¹ These guidelines must strike a fine balance. On the one hand, they should be sufficiently broad to provide for a large enough pool and avoid micro-

³⁷ See Governance Review, *supra* note 34. The Committee expands upon its reservations as regards the practical issues in ¶¶ 14.28-14.43 before proceeding to propose that there be at least three INEDs, with the longer-term objective being their comprising at least one third of the boards of publicly listed companies.

³⁸ *Id.* ¶¶ 14.22. The Committee did allude to this point, but opined that “there can be no guarantee that [INEDs] elected by minority shareholders will act altruistically in the interests of the company as a whole.” There is an equally great danger that INEDs will model their self-interested actions after those of majority shareholders.

³⁹ See *infra*, Part IV.B.

⁴⁰ See Louis Lavelle, *A Fighting Chance for Boardroom Democracy*, BUS. WEEK (Asian Ed.), June 9, 2003, at 50-51.

⁴¹ The latter may involve the undertaking of a program akin to the Mandatory Accreditation Program of Bursa, Malaysia before a person becomes eligible to be a director of a public listed company. Program available at <http://www.bursamalaysia.com> (last visited Oct. 9, 2004).

management that may turn away talented individuals from assuming the office of INED. On the other hand, they should be sufficiently rigorous not only to ensure that those eligible are independent, but also professionally qualified to manage shareholder investments prudently and to attain a rate of return that is commensurate with the risks undertaken.

It must be acknowledged that a strict application of the registration method may not always be appropriate or in the interests of the company. To alleviate the potential burdens companies should have some degree of flexibility in finding suitable directorial candidates. One means of providing flexibility is to delegate the selection of candidates to a nomination committee, whose membership should be comprised exclusively of INEDs. To ensure their acceptance, nominees must be free of any real or perceived conflicts of interest that may affect the discharge of their duties to the company. Save for *de minimis* exceptions, any person who has had a professional or personal relationship with the company, its directors or its controlling shareholders over the past two years should be automatically disqualified from being nominated.

However, that said, boards of directors must include executive directors as they serve a vital function in ensuring effective communication between the board and the senior management of the company. The substantial shareholders must then be allowed to cast votes to elect qualified persons, other than the two INEDs who are elected on the vote of the minority shareholders, to the board of directors. Given the different functions they serve, the offices of the Chairman and the Chief Executive Officer should be effectively separated as a matter of good corporate governance practice.⁴² Companies should be required to implement a formal orientation program, details of which should be documented and

⁴² The Standing Committee on Company Law Reform in Hong Kong has not recommended the mandatory separation of the roles and functions of the Chairman and CEO although it is a "best practice" for listed companies. Governance Review, *supra* note 34, ¶¶ 11.01-11.06. The Hong Kong Exchanges and Clearing Limited ("HKEx") has since suggested separating the offices. EXPOSURE OF DRAFT CODE ON CORPORATE GOVERNANCE PRACTICES AND CORPORATE GOVERNANCE REPORT at A.2 (Jan. 2004) at <http://www.hkex.com.hk/consul/paper/edc-e.PDF> (last visited Oct. 9, 2004). This approach is consistent with that of the Code of Corporate Governance in both Malaysia and Singapore implemented in 2002. The principal difficulty with implementing this proposal stems from the form-over-substance debate. On the one hand, it is not uncommon for the non-executive Chairman of East Asian companies to either be the patriarch of the family that has a substantial shareholding or a person appointed by the government to oversee its investment. Such status provides them with greater executive powers than would normally be associated with the office. On the other hand, although the Chairman is supposed to lead the board, he or she runs the meetings off an agenda prepared and written by management. Furthermore, it is usually the CEO who responds to questions during these meetings. This conflict has not been adequately addressed in either the Malaysian or Singaporean codes, which simply prescribes a separation of the offices without effective monitoring.

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independently reviewed for rigor and relevance to enhance the effectiveness of their newly appointed directors. This program should, at an absolute minimum, include introducing the director to the various aspects of the business of the company as well as its financial reporting systems and key personnel.

Given the important functions that they serve, directors of companies should also be required to undergo a program of continuing education similar to those required of accountants and lawyers. Ongoing education will ensure that directors are apprised of developments in the business world and maintain their leadership competency. These programs can be varied to best suit the requirements of individual directors with the ultimate objectives being to enhance their oversight role and to enhance the overall standard of accountability to which boards must be held. The onus would be on the directors themselves to ensure that they are continually updated, particularly with respect to the regulatory framework, and are sufficiently knowledgeable in the area of information technology given the increasing importance of electronic commerce. Thus, the thrust should not be simply upon the accumulation of 'points' within a rigid framework but rather to gravitate towards a system that encourages, and perpetuates, self-improvement.

Another critical issue will arise under this proposal is that the remuneration to INEDs will have to increase to compensate for their greater exposure to liability resulting from a heightened duty of care, now similar to that of the executive directors. Unless they are commensurately compensated for the increased risks that they have assumed, two practical difficulties are likely to arise. First, the pool of suitably qualified persons might dwindle to the extent that it would be difficult, if not impossible, to find candidates of the requisite caliber for the job especially if a limit is imposed on the number of directorships that a person can be allowed to hold at any one time. Secondly, once appointed, INEDs may not devote sufficient attention to part-time positions. The recommendations of the Higg's Committee in the United Kingdom are apt:

The level of remuneration appropriate for any particular non-executive director role should reflect the likely workload, the scale and complexity of the business and the responsibility involved . . . non-executive directors' fees should be more clearly built up from an annual fee, meeting attendance fees (to include board committee meetings) and an additional fee for the chairmanship of committees (typically a multiple of the attendance fee) or role as a senior independent director.⁴³

⁴³ David Higgs et al., United Kingdom Department of Trade and Industry, Review of the Role and Effectiveness of Non-executive Directors, ¶ 12.24 (Jan. 2003), at

However, the mere implementation of a framework that emphasizes the independence of directors from the majority or controlling shareholder, and self-improvement of directors, is of itself insufficient. It remains an anomaly that while directors are given great control over the affairs of the company, their duties are not statutorily prescribed. The introduction of legislative changes is both more effective and expedient than waiting for definitive judicial pronouncements to be made. Given the fact-specific nature of corporate governance, it would be extremely difficult, as well as inadvisable from an equity standpoint, to formulate a uniform test to assess the performance of directors. Imposing differing standards upon executive and non-executive directors might run the risk of over-simplifying the issue at hand, and could result in a diminishing pool of entrepreneurial talent if the fear of being sued prevents individuals from accepting the office of director.

B. Modernizing the Standard of Care for Directors

The law must respond to the needs of a constantly changing business environment. An expectation gap has arisen between the common law standard of care and the public demand for increasing levels of accountability in corporate governance. This issue has been partly deflected in the past by placing ever-increasing reliance on the external auditors to structure their audits so as to incorporate procedures to detect any shortcomings with the internal controls of the company. While the importance of maintaining high standards in the carrying out of their contractual and statutory obligations by the auditors can never be overemphasised, this should not be a license for directors to abdicate their responsibilities to the company. There has to be a clear and appropriate division of responsibility between the auditor and the directors.

Any initiative for reform must be formulated to accomplish two primary goals: protecting the investing public and not generating risk-averse directors through the imposition of onerous standards. In short, the law should allow the director sufficient latitude to undertake bold and risky entrepreneurial decisions, provided that he or she does his or her homework to ensure that the judgement is exercised in a reasonably honest and

http://www.dti.gov.uk/cld/non_exec_review/pdfs/higgsreport.pdf (last visited Oct. 9, 2004) [hereinafter "Higgs Report"]. Although the Higgs Report considered it undesirable to remunerate INEDs with share options given the risk of their over-emphasizing short-term share price performance, this option should not be automatically dismissed. Stock awards may align the interests of the INED with the longer-term interests of shareholders. *See also* Governance Review, *supra* note 34, ¶¶ 14.37-14.39. However, in the author's opinion, neither report adequately analyzed the practical difficulties associated with the term "independence," which may be minimized under a system of "self-certification." *See generally*, Chee Keong Low, *Self-Certification of Independence by Directors: Some Preliminary Thoughts*, 7 CORP. GOV. INT'L 30 (2004).

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unbiased manner. In view of the complexity of evolving case law, and the difficulties that will arise with attempts at codification, the logical approach would appear to be the establishment of a new statutory framework for East Asia. Such a system must strike a fine balance between the competing needs of more effective corporate governance, on the one hand, and the recognition of the inherent risks associated with any commercial decision, on the other.

To this end, a two-step statutory regime is proposed. First, the variable, subjective standard of care laid down in *Re City Equitable Fire Ins. Co. Ltd.* must be replaced by an objective standard.⁴⁴ While it would be unrealistic to set a single uniform standard for the hypothetical reasonably competent company director, such a statutory objective standard of care would nonetheless allow the courts to judge the directors by the functions they perform, rather than by their level of knowledge and experience. Under this framework, the performance of the directors will be objectively benchmarked against that of their contemporaries in similar industries and against companies of similar sizes. This approach offers the dual advantage of allowing courts to take into account the variations in the roles performed by directors of different companies together with the procedural aspects of their decision making, while at the same time distancing the judge from being embroiled with the merits of such business decisions.

To this end, a general statement of directors' duties is preferred to a complex morass of legal rules. The implementation of such a provision would be relatively simple, with the experience drawn from corporate law reforms developed and undergone by Australia in the 1990s. The current statutory duty of care requires directors of Australian companies to exercise their power and discharge their duties with the degree of care and diligence that a reasonable person would exercise if they were a director of a corporation in the corporation's circumstances, and occupied the office held by, and had the same responsibilities within the corporation as the director. Unlike the approach adopted by Justice Romer in *Re City Equitable Fire Ins. Co. Ltd.*, this objective "reasonable person" standard does not provide for evaluations of the qualifications, skills or experience as it judges the performance of the director in light of the circumstances of the corporation. This requires consideration of such matters as the size and nature of the business of the corporation, the composition of its board as well as the state of its financial health.⁴⁵

In addition, directors in Australia are required by statute to exercise their powers and discharge their duties in good faith, in the best interests of

⁴⁴ See *Re City Equitable Fire Ins. Co. Ltd.*, 1925 Ch. 407 (C.A.), *aff'd* 1925 Ch. 501., *supra* note 14.

⁴⁵ § 180 Corporations Act 2001.

the corporation, and for a proper purpose.⁴⁶ This makes it explicitly clear that the duty to act in good faith and for a proper purpose is objective in nature, and that it may be contravened even if directors believe that they were acting in the best interests of the company.

Secondly, a statutory business judgement rule should be introduced. The principal aim of this provision would be to afford protection to directors who make properly informed and rational business decisions in good faith. This rule originated as a result of judicial concern that persons of reason, intellect and integrity not be dissuaded from serving as directors by laws requiring of them a degree of prescience not possessed by people of ordinary knowledge.⁴⁷ It recognizes the fallibility of directors. Its implementation would also serve to promote informed risk taking which rests at the heart of every entrepreneurial decision: the directors would be aware of the statutory protections against litigation by disgruntled shareholders. Again, the equivalent Australian provision may be adopted as a model for East Asia. It provides that a director will not be liable in respect of a business judgment⁴⁸ if he or she can establish the following elements:

- i. The judgment was made in good faith and for a proper purpose;
- ii. There was no material personal interest in the subject matter of the judgment;
- iii. He or she informed himself or herself about the subject matter of the judgment to the extent he or she reasonably believed to be appropriate; and
- iv. The judgment was rationally believed to be in the best interest of the corporation.⁴⁹

In the plain language of the rule, a clear distinction is made between the standard of care and skill, and the exercise of a business judgment. Thus, courts may determine whether the procedures adopted by the director meet with the required standard before proceeding to evaluate the issues arising out of the business decision. Any director who has breached his or her duty of care to the company will be deprived of the benefit of this rule

⁴⁶ *Id.* at § 181.

⁴⁷ See, e.g. Deborah DeMott, *Directors' Duty of Care and the Business Judgment Rule: American Precedents and Australian Choices*, 4 BOND L. REV. 133 (1992); Vicky Priskich, *A Statutory Business Judgment Rule in Australia: Proposals and Policy*, 27 AUSTL. BUS. L. REV. 38 (1999); Andrew Clarke, *The Business Judgment Rule – Good Corporate Governance or Not?*, 12 AUSTL. J. OF CORP. L. 85 (2000); Douglas Branson, and Chee Keong Low, *Balancing the Scales: A Statutory Business Judgment Rule for Hong Kong?* 34 HONG KONG L. J., available at <http://www.ssrn.com/author=332882> (last visited Oct. 9, 2004).

⁴⁸ This is defined to mean any decision to take or not to take action in respect of a matter relevant to the business operations of the corporation. § 180(3) Corporations Act (2001).

⁴⁹ *Id.*

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and will accordingly be held personally liable for the losses suffered by the company. This practice has the dual benefits of enhancing the performance of competent directors while simultaneously keeping the marginal candidates away from the office.

C. Modernizing Shareholders' Rights

The foregoing proposals move toward a full disclosure-based system of regulation, and they call for considerable change in the roles of both directors and shareholders in Hong Kong, Malaysia and Singapore, especially due to East Asia's entrenched corporate culture and passive acceptance of the family-owned company. Evidence for this is apparent in the disregard of minority shareholders' rights by directors, despite the requirement that directors act in the best interests of the company as a whole, and the regulators' responsibility to minimize the threat of directorial abuse.

Apathetic shareholders compound this problem, and Hong Kong, Malaysia and Singapore have no shortage of such characters. Shareholders' failure to exercise their rights has led to a dilution of their power, and with it, a degradation in standards of corporate governance. Annual general meetings are usually uneventful, as most, if not all, resolutions are passed without many debates. Shareholders seldom pose difficult questions for directors to respond to despite the fact that the annual general meeting is usually the only forum in which they are heard. This may be attributed to the dominance of the controlling shareholder, leaving the minority shareholder to think that nothing can realistically be achieved without the endorsement of the former. Another possible explanation is that lawyers and accountants, whose professional fees are borne by the company, usually accompany the directors to these meetings. It is not uncommon for questions directed to the chairman for the meeting to be referred to one of these professionals, a process that places the ordinary shareholder at a disadvantage.

A number of studies have provided evidence of a positive correlation between shareholder activism and corporate performance.⁵⁰ "Shareholder

⁵⁰ See generally MICHAEL T. JACOBS, *SHORT-TERM AMERICA: THE CAUSES AND CURSES OF OUR BUSINESS MYOPIA* (Harv. Bus. Sch. Press) (1991); Terry Campbell II & Phyllis Y. Keys, *Corporate Governance in South Korea: The Chaebol Experience*, 8 J. CORP. FIN. 373 (2002); Jonathan M. Karpoff et al., *Corporate Governance and Shareholder Initiatives: Empirical Evidence*, 42 J. FIN. ECON. 365 (1996); Andrew K. Prevost & Ramesh P. Rao, *Of What Value Are Shareholder Proposals Sponsored by Pension Funds?*, 73 J. BUS. 177 (2000); Jayati Sarkar & Subrata Sarkar, *Large Shareholder Activism in Corporate Governance in Developing Countries: Evidence from India*, 1 INT'L REV. OF FIN. 161 (2000), available at <http://www1.fee.uva.nl/fm/Conference/cifra2000/Sarkar.pdf> (last visited Oct. 9, 2004); Sunil Wahal, *Pension Fund Activism and Firm Performance*, 31 J. FIN. & QUANTITATIVE ANALYSIS 1 (1996)

activism” may be defined as the exercise and enforcement of rights by minority shareholders with the objective of enhancing shareholder value over the long term. This would include the monitoring of the actions of both the board of directors and the controlling shareholder, enhancing the transparency of the affairs of the company and engaging the management of the company in regular dialogue. On a macro level, shareholder activism would lead to participation in the further development and reform of capital markets so that growth may be sustained in tandem with protections for minority shareholders. These factors have led Professor Michael Porter of the Harvard Business School to assert that the long-term interests of companies are best served by having a smaller number of long-term or permanent shareholders, whose interests are more closely aligned with that of the company. He explains:

The long-term owners would commit to maintaining ownership for an extended period, and to becoming fully informed about the company. In return for a long-term ownership commitment, however, must come a restructuring of the role of owners in governance. Long-term owners must have insider status, full access to information, influence with management and seats on the board.⁵¹

Recent shareholders’ rights initiatives in Hong Kong, Malaysia and Singapore appear to adopt this view, although in varying degrees and different levels of success.

D. The Shareholders’ Rights Movement in Singapore, Malaysia and Hong Kong

The Securities Investors Association of Singapore (the “SIAS”), initially established as a non-profit organization to resolve the issue of the Central Limit Order Book or (“CLOB”),⁵² has developed a new agenda for educating investors and protecting shareholders’ rights. To that end, it runs courses and organizes seminars for the investing public, and assumes a monitoring role over the conduct of publicly listed companies in Singapore. The SIAS has had a number of successes with respect to its monitoring role,

⁵¹ Michael E. Porter, *Capital Choices: Changing the Way America Invests in Industry*, 5 J. APP. CORP. FIN. 2 (1992).

⁵² The CLOB was an over-the-counter exchange that was the subject of disagreements between the authorities in Malaysia and Singapore. Shareholders of companies listed on the Kuala Lumpur Stock Exchange (now reconstituted as Bursa Malaysia) were able to trade on Singapore-based CLOB, which was believed to have contributed to the volatility of the market. Trading on CLOB was suspended following the imposition of capital controls in Malaysia on Sept. 2, 1998. The suspension resulted in the freezing of the shares of some 172,000 investors worth about US\$5 billion. For an overview, see Chee Keong Low, *Financial Markets In Malaysia*, MALAYAN L.J. 462-64 (2000).

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the most visible being the attention it has drawn to misconduct by the United Overseas Bank in artificially inflating the demand of an initial public offering that was underwritten by one of its units. This resulted in a reprimand of the bank by the Singapore Stock Exchange, as well as court-imposed fine of about US\$222,000 for issuing misleading information in breach of securities laws.⁵³

The SIAS is the largest organized investor lobby group in Asia, with a membership of about 61,000 retail investors, all of who contribute an annual fee. It has received the tacit support of both the Monetary Authority of Singapore as well as the Singapore Stock Exchange, which view shareholder activism as a necessary stimulus to strengthen the city-state's claim as being the leading regional financial center. This has enabled the SIAS to secure preferential treatment for its members, which consists primarily of giving retail investors discounts on trades at some brokerages, as well as special access to initial public offerings. More importantly, the SIAS is increasingly being consulted on major corporate transactions and its active involvement in these issues bodes well for enhancing the protection of minority shareholders in Singapore.

In its report to the Finance Minister of Malaysia, the High Level Finance Committee⁵⁴ proposed formally establishing an institutionalized minority shareholder group. The *Badan Pengawas Pemegang Saham Minoriti Berhad*, or the Minority Shareholders Watchdog Group Limited ("MSWG"), was founded in August 2000. It is a not-for-profit company limited by guarantee, whose founding members are government-linked institutional investment funds. Its purpose is to monitor and research market functioning and to advise its members on issues of corporate governance, particularly those pertaining to the rights of minority shareholders. Although funded initially by capital from its founding members, the MSWG is expected to attain a self-funding status by generating income from its activities, products and services. Its corporate objectives may be grouped into three principal areas, namely:

- a. enhancing the knowledge of investors through research and effective dissemination of the results arising therefrom;

⁵³ See S. Jayasankaran, *Clobbered!*, FAR EASTERN ECON. REV., Apr. 19, 2001, at 52; J. Doebele, *Off With Their Perks*, FORBES GLOBAL, May 14, 2001.

⁵⁴ This Committee was established in 1998 to review the corporate governance practices in Malaysia. Its broad-based membership consulted extensively with the various stakeholders of the financial markets in Malaysia and its report to the Finance Minister provided the foundations that led to the publication of the Malaysian Code of Corporate Governance in 2000. This Code has since been incorporated into the revamped Listing Requirements of Bursa Malaysia Securities Berhad (for Main Board and Second Board) effective June 1, 2001. Listing Requirements of Bursa Malaysia Securities Berhad (for Main Board and Second Board) (June 2001), available at www.bursamalaysia.com/website/listing/listingreqs_mbsb.htm (last visited Oct. 9, 2004)

- b. monitoring the corporate conduct of public listed companies as well as their directors and controlling shareholders; and
- c. promoting shareholder participation by engaging in active discussions with the management of public listed companies and drafting suitable resolutions to be passed by the general meeting.

In line with its aim of becoming the platform for shareholder activism, the MSWG is a licensed investment adviser with in-house analysts to provide advice to minority shareholders. Proxy voting, a practice deviating from the norm of voting by a show of hands, is gradually gaining acceptance and effectiveness with the participation of the MSWG.⁵⁵ It has also engaged in constructive dialogue with listed companies to promote a higher standard of corporate governance practice. The MSWG views this “internal consultative” approach as preferable to bringing cases before regulatory authorities or courts, both of which involve costliness and potentially lengthy processes. With these initiatives in place, minority shareholders may not have to resign themselves to “voting with their feet” by simply selling their shares when they believe that their rights have been dishonored.

The MSWG scored its first victory as a shareholders’ rights group by mustering investor support to thwart the proposal by Maruichi Steel Tube Limited to acquire a 32.5% interest in Malaysian Merchant Marine Limited (“MMM”).⁵⁶ The MSWG opposed the transaction because the vendor was the managing director of MMM and the cash consideration represented a premium of some 310% over the last traded price when the proposed acquisition was announced. Maruichi had in fact disbursed funds in the amount of RM99.9 million, being the full amount payable for the transaction, when the vendor unexpectedly requested a rescission of the same.⁵⁷ By consenting to the rescission, Maruichi incurred no financial loss and recovered all the amounts that it had paid.⁵⁸

⁵⁵ As at June 2004, the MSWG has rendered proxy-voting services to retail and institutional investors at twenty-five different general meetings of publicly listed companies, the majority of which were for its founding members. Interview with MSWG (July 2004).

⁵⁶ Alice Chia, *Maruichi Calls Off Deal to Buy Shipping Stake*, BUS. TIMES, Dec. 17, 2002, at 1.

⁵⁷ RM is the acronym for *Ringgit Malaysia*, Malaysia’s currency. Each ringgit is divisible into 100 sen (or cents) and has been pegged at RM3.80 to US\$1 since Sept. 2, 1998. Had the deal proceeded in the manner as proposed, the managing director of Malaysian Merchant Marine, Ltd. (“MMM”) would have reaped a personal windfall profit of some US\$17.7 million. The other shareholders would have had no right of participation as no general offer would have been required under the provisions of Division 2 of the Securities Commission Act governing takeovers, mergers and compulsory acquisitions, since the requisite threshold is 33% of the issued or voting shares in a company.

⁵⁸ Unfortunately, despite its initial success, the MSWG has since floundered. This has been amplified by the departure of its Chief Executive in June 2004, and it is currently in the process of being restructured. See Errol Oh, *The Hi and Lo of Shareholder Activism*, THE

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Despite the lofty aspirations announced by its authorities,⁵⁹ Hong Kong does not yet have a formal minority shareholders' organization. The government recently refused to endorse a proposal for the establishment of the Hong Kong Minority Shareholders Association ("HAMS").⁶⁰ Rather than accept defeat, the architect of this idea, David Webb, has embarked on two related initiatives, namely, Project Poll⁶¹ and Project Vampire.⁶² The former seeks to advocate the principle of one-share-one-vote over the one-person-one-vote method, whereby resolutions are carried by a show of hands at general meetings.⁶³ Shareholder apathy, together with the holding of the vast majority of public shares within the Central Clearing and Automated Settlement System ("CCASS") in Hong Kong, has traditionally been major impediments to the request for polls. Hong Kong Securities Clearing Company Limited ("HKSCC"), a wholly owned subsidiary of Hong Kong Exchanges and Clearing Limited, operates CCASS⁶⁴ and all

STAR ONLINE, Sep. 18, 2004, at <http://biz.thestar.com.my/bizweek/story.asp?file=/2004/9/18/bizweek/8918268&sec=bizweek> (last visited Oct. 9, 2004).

⁵⁹ In his Policy Address of Jan. 8, 2003, Hon. Tung Chee-Hwa, Chief Executive of the Hong Kong Special Administrative Region, announced the government's intention to establish Hong Kong as the "premier capital formation center of China," at <http://www.info.gov.hk/ce/speech/cesp.htm> (Jan. 8, 2003), at para. 17. The Financial Services Bureau had stated its intention as early as July 1999 to establish the Hong Kong Exchanges and Clearing as the "Asian-time zone pillar of global futures and derivative markets and one of the top five equity markets in the world." See GOVERNMENT OF THE HONG KONG SPECIAL ADMINISTRATIVE REGION, HONG KONG EXCHANGES AND CLEARING LIMITED: REINFORCING HONG KONG'S POSITION AS A GLOBAL FINANCIAL CENTER, ¶ 2.3 (July 1999), available at www.info.gov.hk/fstb/fsb/topical/doc/report-e.doc (last visited Oct. 9, 2004).

⁶⁰ See generally The Hams Proposal at <http://www.webb-site.com/HAMS/default.htm> (last visited Oct. 9, 2004).

⁶¹ Project Poll Update (Apr. 5, 2004) at <http://www.webb-site.com/articles/pollsapart.htm> (last visited Oct. 9, 2004).

⁶² Webb-site.com Launches Project Vampire, (Mar. 16, 2003) at <http://www.webb-site.com/articles/vampire1.htm> (last visited Oct. 9, 2004).

⁶³ The philosophy of "one-share-one-vote" has gained wide acceptance as a fundamental principle for protecting shareholders' rights. It has been incorporated into the OECD's persuasive advisory Principles. ORGANIZATION FOR CO-OPERATION AND DEVELOPMENT, OECD PRINCIPLES OF CORPORATE GOVERNANCE, §§ I.C3 & II.A.3, available at <http://www.oecd.org/dataoecd/32/18/31557724.pdf> (last visited Oct. 9, 2004). These Principles were welcomed by the G7 leaders at their meeting in Cologne in June 1999 and have become a de facto benchmark for global best practices. While not binding, the Principles are nonetheless an important statement promoting increased transparency, integrity and the rule of law. It was adopted by the International Corporate Governance Network, whose members collectively manage assets estimated to be in excess of US\$10 trillion, at its annual meeting in Frankfurt in July 1999. See www.icgn.org/organisation/documents/cgp_statement_cg_principles_jul1999.php; www.icgn.org/organisation/mission.php (last visited Oct. 20, 2004).

⁶⁴ The Hong Kong Exchanges and Clearing Limited ("HKEX") is a holding company with a monopoly on operating the stock and futures markets, as well as their respective

shares within the system are registered in the name of HKSCC Nominees Limited.

The practical significance of this system is two-fold. First, all notices of meetings are sent to the HKSCC rather than the individual investor, due to the status of the former as the registered shareholder of the company. This means that the individual investor often will not be aware of the meetings, unless he or she has made prior arrangements with the HKSCC to forward such notices. Secondly, the HKSCC sends a representative to the meetings to vote either for or against a particular resolution, since only one vote is permitted under the “show of hands” approach. Should an individual shareholder hold an opposing view, he or she may direct the HKSCC to cast his or her votes in the manner prescribed but this would have the effect of canceling out the vote.⁶⁵ As such, the votes of a significant number of shares are not counted, thereby effectively disenfranchising shareholders of their right to vote, which Project Poll seeks to rectify.⁶⁶

Project Vampire is the acronym for “Vote Against Mandate for Placings, Issues by Rights Excepted.” Its objective is to curtail the common practice of non-pre-emptive discounted issues of shares that represent transfers of value from existing shareholders to the subscribers or places. Unlike a rights issue, which provides for an equal opportunity of participation by all shareholders, the use of placements generally dilutes the shareholdings of existing shareholders, save for those to whom the placement is made, and runs contrary to international best practices. For example, the British Pre-emption Group Guidelines⁶⁷ provide that pre-

clearinghouses in Hong Kong. It is a demutualized entity established by the merger of the then member-owned Stock Exchange of Hong Kong (“SEHK”) and the Hong Kong Futures Exchange. *See generally*, FINANCIAL MARKETS IN HONG KONG 45-67 (Chee Keong Low ed., Springer-Verlag 2000) 45-67; www.hkex.com.hk (last visited Oct. 9, 2004).

⁶⁵ Under the “show of hands” system each person has one vote at the general meeting. Hence if the HKSCC receives specific instructions it may appoint a second representative to cast the vote for the shareholders concerned. This would mean that the HKSCC would cast a vote both for and against the resolution which would have the effect of canceling each other out.

⁶⁶ While the Standing Committee on Company Law Reform in Hong Kong proposed an amendment to the Companies Ordinance to require that voting on connected transactions be affected by a poll for public companies, it nonetheless could not reach a consensus as to whether voting by show of hands ought to be discontinued. CONSULTATION PAPER, *supra* note 34, ¶¶ 17.10-17.15, 21.60-21.64. The lack of a consensus on introducing polls at general meetings may be inconsistent with the recommendation in the OECD White Paper, which seeks to promote shareholder participation by liberalizing and strengthening the voting process. WHITE PAPER, *supra* note 5, paras. 85-92.

⁶⁷ Association of British Insurers & National Association of Pension Funds, Pre-Emption Group Guidelines (1987), at http://www.avis.co.uk/pages/gdsc4_2.PDF (last visited Oct. 9, 2004). While these Guidelines are not legally binding on listed companies, they are nonetheless considered persuasive authority by the ABI and NAPF, organizations which

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emption rights may only be waived in respect to issues for cash that involve:⁶⁸

- i. A maximum of 5% of the issued capital of the company in any one year;
- ii. A maximum of 7.5% of the issued capital of the company over a rolling three-year period; and
- iii. A maximum discount of 5% to the market price.

With the approval of shareholders, which is usually obtained by an ordinary resolution at the annual general meeting, the Listing Rules of the Stock Exchange of Hong Kong allow directors of listed companies to issue up to 20% of capital to such persons, and for such purposes as they deem appropriate. Except where the company is in severe financial difficulty, the placing or subscription price must not represent a discount of more than 20% to the securities' bench-marked price of the securities and the company is required to provide notice of the agreement to place by the next business day.⁶⁹ This is similar to the situation in Singapore, although publicly listed companies in the island state may issue up to 50% if this is done on a pro-rata basis.⁷⁰ However, the Singapore Exchange is more restrictive in terms of the pricing of such placements. The Singapore discount can be no more than 10% of the weighted average price for trades done on the day that the placing agreement was signed.⁷¹ On paper, companies listed on the Bursa Malaysia are subject to the most rigid framework of the three jurisdictions with respect to share placements as they are not allowed to place more than 10 percent of their issued capital

provide proxy advisory services, whose members control more than half of the market capitalization of British equities. It is the normal practice for members of ABI and NAPF to veto any proposed transactions that go outside of the Guidelines.

⁶⁸ For non-cash issues, such as the placement of shares to facilitate an acquisition of assets by companies, the Guidelines allow for a maximum of 25% of the enlarged issued share capital over a rolling five-year period with approval usually renewed at every annual general meeting. Where the vendor places out these shares immediately after the acquisition, the Guidelines specify that these must first be offered to the existing shareholders of the company unless the issue represents less than 10% of the issued capital of the company, and the discount involved in the placement is less than 5%.

⁶⁹ Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited, (Update No. 78, Sept. 2003) *available at* <http://www.hkex.com.hk/rule/listrules/listrules.htm> (last visited Oct. 9, 2004).

⁷⁰ Singapore Exchange Securities Trading Listing Manual, R 805-06 (2004), *available at* <http://info.sgx.com/weblist.nsf/vwAppendix1?OpenView> (last visited Oct. 9, 2004). The author acknowledges with gratitude the kind assistance of Ms. Kala Anandarajah of Rajah & Tann Singapore for providing an overview of the applicable rules.

⁷¹ *Id.* at R. 811(a). This may be waived if specific shareholder approval is obtained for the issue of the shares. *See id.* R. 811(3). These rules appear to apply only to cash placements, as the Listing Manual is silent on non-cash transactions.

without shareholder approval.⁷² Issuers have discretion over the pricing of the securities to be placed except where the place is a related party, which requires that the placement must be priced at no less than the weighted average price of the shares for the five market days prior to the price-fixing date.⁷³ To further safeguard the interests of shareholders, the Securities Commission of Malaysia imposes restrictions on the issuance of securities to finance an acquisition of assets.

Given the potentially significant adverse effects that share placements can have on the interests of minority shareholders across the East Asian region,⁷⁴ it is surprising that the issue was not specifically highlighted in the White Paper. To be fair, the White Paper does raise a number of issues related to share placements; in particular, Priority 5 states that “the legal and regulatory framework should ensure that non-controlling shareholders are protected from exploitation by insiders and controlling shareholders.”⁷⁵

Although modest as compared to the HAMS proposal, Project Poll and Project Vampire have nonetheless won some successes by targeting companies that make up the Hang Seng Index in Hong Kong.⁷⁶ Voting transparency was enhanced by the demand for polls during the annual general meetings while the independent shareholders of an increasing

⁷² See Listing Requirements of Bursa Malaysia Berhad (for Main Board and Second Board), R. 6.10-6.11 (2001); Listing Requirements of KLSE for MESDAQ Market, R. 3.6.1 (2002). Although approval by shareholders must be sought for the precise terms and conditions of the issue, the rules do not impose any upper limit. This is an anomaly, particularly given the significant dilution effect that share placements can have on existing shareholders. It is also interesting to note that the Policies and Guidelines on Issue/Offer of Securities that are administered by the Securities Commission of Malaysia merely allude to the issue of warrants and not to shares. Securities Commission of Malaysia, *Policies and Guidelines on Issue/Offer of Securities*, Chapter 9 (May 1, 2003), available at <http://www.sc.com.my/html/resources/guidelines/glines-issue.pdf>. These Guidelines specify that the number of shares that can arise from all outstanding warrants should not be more than 50 percent of the issued and paid-up capital of the company at all times. See *id.* R. 9.02.

⁷³ See Securities Commission of Malaysia, *Policies and Guidelines on Issue/Offer of Securities*, ¶¶ 5.05, 10.02 (May 1, 2003), available at <http://www.sc.com.my/html/resources/guidelines/glines-issue.pdf> (last visited Oct. 8, 2004).

⁷⁴ Issuers are required to follow the *Guidelines on Asset Valuations* as prescribed by the Securities Commission and may not make up any deficiencies from internally generated funds. *Id.* ¶ 8.15.

⁷⁵ OECD, *supra* note 5, paras. 52-54.

⁷⁶ The Hang Seng Index (“HSI”) is published by HSI Services Ltd., a wholly owned subsidiary of Hang Seng Bank Ltd. See generally <http://www.hsi.com.hk> (last visited Oct. 9, 2004). It is a value-weighted index composed of thirty-three companies of combined market capitalization representing at least 75% of the total of all companies listed on the Stock Exchange of Hong Kong (“SEHK”). To qualify for inclusion to the index companies must i) have Hong Kong as its principal base of operations; ii) have been listed for at least two years; and iii) be among the top 10% of companies listed on the SEHK in terms of total market value and total turnover of its ordinary shares. The HSI has been the most widely quoted index of the Hong Kong stock market since its inception in November 1969.

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number of companies expressed their opposition to proposed mandates for placings.⁷⁷ An unexpected result has been the election of David Webb as an independent non-executive director of Hong Kong Exchanges and Clearing Limited (“HKEx”) in April 2003, despite the fact that he was not nominated by the board.⁷⁸

However, credit must be given to the HKEx for its response in initiating a series of amendments to the Listing Rules which took effect on March 31, 2004. The implementation of the rules brings the operations of the stock exchange and of its participants closer to international best practices.⁷⁹ This ongoing process of improving corporate governance practices in Hong Kong will progress to the next level on January 1, 2005, when the widely-expected introduction of the Code on Corporate Governance Practices becomes effective.⁸⁰

E. Shareholders’ Rights: Empirical Data

Shareholders’ rights groups are usually composed of retail investors and perform the important functions of enhancing the quality of understanding of capital markets and of the rights of investors within this framework. While their existence is essential, it must nonetheless be complemented by a reform of the legal and regulatory framework if the objective is to enhance corporate governance practices in East Asia. This is of particular importance given the perception of a dichotomy between the “rules on the books” and the extent of enforcement by regulators of capital markets in Hong Kong, Malaysia and Singapore. The dichotomy is illustrated in the following table, which scores the individual components

⁷⁷ These mandates were passed by the general meetings despite the opposition by independent shareholders as the dominance of family-owned and state-owned companies in Hong Kong is such that there is no realistic chance for such placements to be rejected. A study commissioned by the government of Hong Kong found that no less than 93.7% of the companies listed on the SEHK at the end of 2001 could be defined as either family-owned or state-owned. In fact, such is the dominance that only two companies could be properly defined as being “widely-held,” namely HSBC Holdings and Giordano Holdings. Larry Lang, Chee Keong Low and Raymond So, *Economic Analysis Co-Relating the Performance of Listed Companies with their Shareholders’ Profile* (Consultancy Report for the Government of Hong Kong, Companies Registry 2002), at http://www.info.gov.hk/cr/download/scclr/economics_e.pdf (last visited Oct. 10, 2004).

⁷⁸ “HKEX AGM SHAKE-UP” at <http://www.website.com/articles/HKEXAGM2003results.htm> (Apr. 16 2003).

⁷⁹ See, e.g., Press Release, Hong Kong Stock Exchange, *Amendments Relating to Corporate Governance Issues* (Jan. 30 2004), at <http://www.hkex.com.hk/news/hkexnews/0401304news.pdf> (last visited Oct. 10, 2004).

⁸⁰ Hong Kong Exchanges and Clearing, Ltd., *Exposure of Draft Code on Corporate Governance Practices and Corporate Governance Report* (Jan. 2004), at <http://www.hkex.com.hk/consul/paper/edc-e.PDF> (last visited Oct. 10, 2004).

out of a maximum of 10.⁸¹

Table 1: Comparative scores on corporate governance practices

Country	Score on regs. (2002)	Score on regs. (2003)	Score on regs. (2004)	Score on enforcement (2002)	Score on enforcement (2003)	Score on enforcement (2004)
HONG KONG	8	8	6.6	6	6.5	5.8
MALAYSIA	9	9	7.1	2.5	3.5	5.0
SINGAPORE	8	8.5	7.9	7	7.5	6.5

While Malaysia scored the highest amongst the ten countries surveyed in both 2002 and 2003 for the rules and regulations it has implemented, the perception of its enforcement of the same was abysmal.⁸² There is, however, an encouraging trend of increasingly favorable perceptions of enhanced enforcement as evidenced by the attainment of a break-even mark of five for the most recent survey. This despite the introduction of more

⁸¹ See AMAR GILL, CLSA EMERGING MARKETS, CG WATCH: CORPORATE GOVERNANCE IN ASIA (2002) [hereinafter "CG Watch 2002"]; AMAR GILL AND JAMIE ALLEN, CLSA EMERGING MARKETS AND ASIAN CORPORATE GOVERNANCE ASSOCIATION, CG WATCH: CORPORATE GOVERNANCE IN ASIA, 2003 [hereinafter "CG Watch 2003"]; and AMAR GILL AND JAMIE ALLEN, CLSA EMERGING MARKETS AND ASIAN CORPORATE GOVERNANCE ASSOCIATION, CG WATCH: CORPORATE GOVERNANCE IN ASIA, 2004 [hereinafter "CG Watch 2004"]. CLSA Emerging Markets is a part of CLSA Asia-Pacific Markets which is headquartered in Hong Kong and is widely recognized as a leader in brokerage and investment banking services; see www.clsa.com. The Asian Corporate Governance Association is an independent, non-profit organization based in Hong Kong and working on behalf of all investors and other interested parties to improve corporate governance practices in Asia; see www.acga-asia.org. These annual surveys examine the state of corporate governance across the following East Asian countries: Hong Kong, India, Indonesia, Malaysia, the People's Republic of China, the Philippines, the Republic of Korea, Singapore, Taiwan and Thailand through the ranking of five principal macro-determinants. The principles are: i) rules and regulations (15%); ii) their enforcement (25%); iii) the political and regulatory environment (20%); iv) adoption of international accounting standards (20%); and v) the institutional backdrop and corporate governance culture (20%).

⁸² Its rating of 2.5 in the year 2002 ranked it sixth amongst the countries surveyed, putting it marginally ahead of Indonesia, which has a score of 1, and the Philippines and Thailand, which each have a score of 2. Even the People's Republic of China was perceived to be a more effective enforcer with a score of 3 despite the ratings for its rules and regulations being only 4.5 as compared with the score of 9 attained by Malaysia. The findings of this study are consistent with those obtained from a survey of publicly listed companies, independent non-executive directors and institutional groups in Malaysia. Kuala Lumpur Stock Exchange and PricewaterhouseCoopers, Malaysian Corporate Governance Survey 2002, at www.pwc.com/pdf/my/eng/survrep/cgsurvey2002execsummary.pdf. (last visited Oct. 9, 2004).

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rigorous benchmarks which saw the ratings of both Hong Kong and Singapore drop substantially.⁸³ The perception of “form over substance” is also evident in both Hong Kong and Singapore albeit to a lesser degree, with the latter outperforming the former in all three years in question.⁸⁴

In a nutshell, reforms are urgently required to facilitate shareholder activism and to empower shareholders, if the capital markets in East Asia are to avoid the perception of being risky places for investment. The thrust of these reforms must be directed at the minimization and/or removal of legal impediments that prevent shareholders from the effective enforcement of their rights. This would include enhancing access to company information, removing obstacles for lawsuits⁸⁵ and allowing shareholder groups to piggy-back on findings against companies and/or their directors.⁸⁶

F. Options for Shareholder Litigation

Shareholders should be allowed to sue on instances of bad governance and the companies should be required to assist on the proviso that the rendering of such assistance does not materially compromise the interests of the company. Any action, reprimand or censure that is issued by the regulators or the stock exchanges against the company or its directors should be deemed as sufficient bona fide grounds for an action to be initiated and the onus would then fall upon the company or its directors to establish their innocence. While this may be viewed as a reversal of the

⁸³ See CG Watch 2004, *supra* note 81, at 8. The current score places Malaysia as equal fourth with the Republic of Korea in terms of enforcement behind Singapore, Hong Kong and India.

⁸⁴ Singapore had the higher country score with a rating of 7.4, compared to the 7.2 attained by Hong Kong, in 2002. Both have since improved their scores: in 2003, Singapore was 7.7, while Hong Kong was 7.3. Both countries, together with India, were pronounced to offer the best macro corporate governance environment of the countries surveyed. See CG Watch 2004, *supra* note 81.

⁸⁵ This would necessitate the statutory repeal of the decision in *Foss v. Harbottle*, 2 Hare 461, 67 ER 189 (1843). That case set forth two restrictive rules: i) the proper plaintiff rule, which holds that only the company is allowed to sue for losses suffered; and ii) the internal management rule, which refers to the reluctance of the court to interfere with internal irregularities that are capable of ratification by shareholders at general meetings. These rules have had the unintended consequence of placing a major obstacle in the way of minority shareholders as companies are unlikely to bring an action against its directors or majority shareholder for a breach of duty or acts of bad governance. See also Sandra K. Miller, *Minority Shareholder Oppression in the Private Company in the European Community*, 30 CORNELL INT'L L.J. 381, 401-02 (1997); M. Freeman Durham, *The Companies Act, 1980: Its Effect on British Corporate Law*, 4 NW. J. INT'L L. & BUS. 551, 581 (1982).

⁸⁶ See generally, Chee Keong Low, *Comments on the Securities and Futures Bill*, HONG KONG LAWYER, Apr. 2001, at 28; Chee Keong Low, *Regulating the Regulators*, 12 COMP. SECRETARY 12, Dec. 2002, at 45 (providing observations on the approach to regulatory reforms in Hong Kong). A number of these are equally applicable to Malaysia and Singapore given their historical links as members of the Commonwealth.

onus of proof, its benefits as an important signaling device should outweigh the costs.

To provide the necessary stimulus to encourage shareholder activism, particular attention may be directed at two principal areas, namely, the introduction of class actions and the elimination of the “loser pay” principle in civil litigation. Most markets in East Asia do not suffer from a dearth of rules and regulations, but rather from weak enforcement thereof. The White Paper recognizes this deficiency and recommends that “all jurisdictions should strive for effective implementation and enforcement of corporate governance laws and regulations” as a key area of reform.⁸⁷ In particular, it observed that:

The credibility – and utility – of a corporate governance framework rest on its enforceability. Securities commissions, stock exchanges and self-regulatory organizations with oversight responsibilities should therefore continue to devote their energies to implementation and enforcement of laws and regulations . . . In this regard, it is important to stress the interaction between effective market discipline and self-discipline. *The role of policy-makers is not only to enforce current laws but to promote institutions that facilitate market discipline.*⁸⁸

Empowering shareholders to take legal action will compensate for the lack of enforcement. The success of capital markets depends in part on the ability of shareholders to enforce their private rights as investors or to seek recompense should these rights not be given effect. Class action suits offer a number of advantages over derivative action suits, the latter of which appears to be the preferred option for regulatory reform in East Asia.⁸⁹

⁸⁷ See WHITE PAPER, *supra* note 5, at 13, ¶¶ 39, 40-42.

⁸⁸ *Id.* at 13, ¶ 41 (emphasis added).

⁸⁹ A derivative action refers to civil proceedings brought by minority shareholders to seek a remedy for the company with respect to a wrong done to it. Any damages awarded by the court would go to the company, instead of the members initiating the derivative action. Currently, only Singapore has a statutory provision for derivative actions by shareholders. SCA, *supra* note 9, § 216A. Hong Kong’s Legislative Council has introduced a bill to amend its *Companies Ordinance* in July 2003 to facilitate derivative actions. See Discussions of the Bills Committee, ¶¶ 104-37, available at <http://www.legco.gov.hk/lcsearch/showdoc.htm> (last visited June 18, 2004). Malaysia remains governed by its common law and its *Rules of the High Court*. Derivative actions should not be viewed as ineffective. Despite the obstacles facing it, a civil watchdog organization in the Republic of South Korea has managed to achieve some degree of success against Korea First Bank, Samsung Electronics, Hyundai Heavy Industry, SK Telecom, LG Chem, and Daewoo Auto. See People’s Solidarity for Participatory Democracy, Action Bodies: Participatory Economy Committee, at §§ 1, 2 (2004), at http://eng.peoplepower21.org/contents/actionbody_economy.html. However, the author advocates the introduction of class actions in securities litigation so that an effective regime premised on a ‘carrot-and-stick’ approach can be implemented. See also WHITE PAPER, *supra* note 5, at 29-32, ¶¶ 139-52.

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First, class actions allow shareholders to file suits against directors with the burden of proof shifted to the latter. Secondly, awards of damages are paid to the plaintiff shareholders rather than the company. Thirdly, they avoid the expense associated with multiplicity as only one lawsuit is filed and the ruling applies to all shareholders that are subject to the same case unless he or she has opted out of the same. Fourthly, they provide incentives for shareholders to sue as the burden of legal costs is shared amongst the entire group, rather than being borne by an individual. Lastly, they provide a credible and effective threat to directors to ensure that they keep on the straight and narrow with regards to affairs of the company. The establishment of the necessary legal infrastructure for class action lawsuits is not expected to be a major obstacle. For example, it may be modeled after the system that exists for securities law litigation in the United States, with such amendments as are necessary to reflect the specific requirements of the legal framework of countries in East Asia.⁹⁰

However, unlike the practice in the United States, the author does not advocate the introduction of contingency fees at this juncture given the possibility of abusive litigation and the creation of an entirely new industry of professional plaintiffs. Instead, it is proposed that the loser pay principle in civil litigation be dispensed with. This principle has been a major obstacle to the filing of shareholder suits in East Asia on two grounds. First, there is an inherent worry by individual shareholders that they would be pursued to bankruptcy if they fail in their litigation against the company or its directors. This is so because defeat in civil proceedings not only exposes the shareholder to bear his or her own legal costs, but also those of the party in whose favor the court has decided. The double or nothing approach is compounded by the fact that the case may be taken on appeal should the company or the directors lose the verdict, especially since their legal costs are usually borne either by the company itself and/or by the insurance company that has assumed the risk. Secondly, companies and directors have been successful in thwarting shareholder suits by demanding security for costs under the applicable *Rules of the High Court*. This in essence requires the plaintiff shareholder to deposit into court such sums of money or security as is deemed appropriate in the circumstances to ensure that the 'loser pay' principle may be effected. Such a requirement acts as an impediment to shareholder suits, since the shareholder may not have the financial wherewithal to post the deposit, regardless of the merits of his case at law against the defendants. Retiring the loser pay rule will contribute to leveling the playing field between the plaintiff shareholders

⁹⁰ The framework in the United States derives its foundations from three principal pieces of legislation: FED. R. CIV. P. (1938); the Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 1995 U.S.C.A.N. (109 Stat. 737); and the Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, 12 Stat. 3227 (1998).

and the defendant company and directors within the arena of securities litigation.⁹¹

V. REGULATORY REFORM

It is also timely to review the role of the regulator in promoting good corporate governance.⁹² As capital markets become increasingly complex, the regulator is at risk of being marginalized unless it adapts to these changes. Two particular challenges are presented to regulators: the need to cope with large and complex financial institutions,⁹³ which cross traditional industry sectors, and the need to adapt to the growth of cross-border business as a result of globalization. In fact, such is the trend that many regulators may well move towards a model premised on the structure of the Monetary Authority of Singapore or on the Financial Services Authority of the United Kingdom, the latter of which was itself established following the merger of ten previously separate regulators.⁹⁴ An effective regulatory framework must be proactive, with the objective being to strike an appropriate balance between the often-competing interests of protecting the investing public and allowing market forces to dictate the speed and direction of healthy competition and market innovations. In short, regulators should view their role more as navigators, as opposed to watchdogs, if they are to remain relevant in a constantly changing global environment.

The protection of shareholder interests is a common theme in regulatory reforms in East Asia. For example, the protection for whistle-

⁹¹ To safeguard the company and directors against lawsuits that are frivolous, vexatious or abusive of process, it is proposed that judges retain the discretion to impose costs on the plaintiff shareholder where the facts of the case reasonably justify such an order. Hence, while the impediment against the lawsuit is removed at the outset there nonetheless exists the threat of imposition of costs at the end of the trial under certain strict circumstances.

⁹² See generally Chee Keong Low, *Revisiting the Regulatory Framework of Capital Markets in Malaysia*, 14 COLUM. J. ASIAN L. 277 (2001) (expanding on this theme).

⁹³ The distinction between banking, insurance and securities industries is becoming increasingly blurred as a result of mergers and/or acquisitions. The rapid growth of such behemoths, whose business is both multi-functional and cross-sectoral, places the traditional structures of institutionalized regulation under strain. An example of such a financial supermarket is Citigroup which counts financial services, banking, insurance, fund management and securities dealing as amongst its core businesses.

⁹⁴ The British legislation underpinning banking, insurance and securities regulation was completely rewritten by the Financial Services and Markets Act (2000), which repealed and consolidated various statutes. See Ch. c.8 at <http://www.hms0.gov.uk/acts/acts2000/20000008.htm> (last visited Oct. 20, 2004). Upon its establishment, the Financial Services Authority assumed regulatory powers previously exercised by, amongst others, the Treasury, the Bank of England, the Friendly Societies Commission, the Registry of Friendly Societies, the Personal Investment Authority, the London Stock Exchange, and the Securities and Investment Board.

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blowers has been significantly enhanced in Malaysia with the enactment of amendments to the Securities Industry Act 1983.⁹⁵ These amendments grant indemnity against liability to auditors and key officers of publicly listed companies including the chief executive, the company secretary, the internal auditor and any officer entrusted with the responsibility for preparing financial statements, if they report breaches of securities laws or of the listing rules or any matter which may adversely affect the financial position of their companies. Auditors are obliged to report any corporate conduct which, in their professional opinion, constitutes either a breach of securities laws and/or the listing rules, or a matter that would adversely impact the financial position of the company. Should this be done in good faith and in the performance of a statutory duty, the auditors will be protected against liability that may arise from legal actions such as defamation suits. There is no mandatory requirement for key officers to report such practices to the authorities but, if done in good faith, such persons will be protected against legal liability and dismissal from their jobs.

An important area that appears to have eluded closer regulatory attention is that of the quality of disclosure, as much of the recent focus has been on the quantity of disclosure.⁹⁶ Rather than continue to inundate investors with more information, due consideration should be given to three key areas: simplifying disclosure, ensuring timeliness and improving the access to information. Simplicity in numbers can be achieved with the introduction of plain language to prospectuses and corporate announcements. Rather than focus narrowly upon the frequency of disclosure, the authorities should encourage timeliness in the dissemination of price sensitive information, which in turn requires more effective

⁹⁵ See Securities Industry (Central Depositories) (Amendment) Act 2003, §§ 99E-F (2003), available at http://www.sc.com.my/html/resources/guidelines/SICDA_AMENDED.pdf (last visited Nov. 8, 2004). The author acknowledges with gratitude the kind assistance of Datin Zarinah Anwar and Ms. Alina Tong Mei Lin of the Securities Commission of Malaysia for the provision of a succinct update on these provisions which took effect as of Jan. 5, 2004. There are presently only three other jurisdictions with similar 'whistle-blowing' legislation, namely the United Kingdom (Public Interest Disclosure Act, 1998), South Africa (Protected Disclosures Act, 2000) and the United States of America (Sarbanes-Oxley Act, 2002).

⁹⁶ See Joseph P.H. Fan & T.J. Wong, *Corporate Ownership Structure and the Informativeness of Accounting Earnings in East Asia*, 33 J. ACCT. & ECON. 401 (2002). The authors observed consistently low levels of transparency and disclosure quality in Malaysia's and Singapore's recently-adopted quarterly reporting systems for listed companies, and in the remaining system of semiannual reporting at the Stock Exchange of Hong Kong. Although these jurisdictions have relatively high accounting standards, and have adopted international accounting standards, these changes alone do not provide for the requisite level of transparency. In the author's opinion, none of these initiatives adequately address the importance of the quality of information as measured by the ease of comprehension thereof.

enforcement of the existing rules and regulation. Much of the information that is presented is either dated or of limited use to the shareholders. To rectify the problem, enhanced access to more pertinent information is necessary. Such information includes executive compensation and benchmarking; cross-shareholding structures within group affiliations, especially where a member of the group is a bank; related party transactions; and the interaction between ownership structure and corporate policies on dividends, investments and financing. A detailed discussion of these proposals remains outside of the scope of this paper because the issues warrant a more in-depth analysis than can be provided here.⁹⁷

The effectiveness and efficiency of regulatory frameworks may be further enhanced with the implementation of full functional regulation; namely, a system where capital market activities are regulated according to their functions rather than institutional form.⁹⁸ This will minimize regulatory gaps and overlaps, with the resultant 'seamless' regulatory framework reducing the scope for regulatory arbitrage. This will also provide the necessary platform from which risk-based supervision may be implemented to augment the introduction of a disclosure-based system of regulation.⁹⁹ However, regardless of the ultimate structure of the regulator, the structure must be couched upon transparency and accountability. Both elements are crucial towards promoting, and maintaining, confidence in the regulator, without which capital markets are unlikely to prosper.¹⁰⁰

⁹⁷ See, e.g., Stijn Claessens & Joseph P.H. Fan, *Corporate Governance in Asia: A Survey*, 3 INT'L. REV. FIN. 71 (2002). See also Deborah A. DeMott, *Shareholder Challenges to Executive Remuneration*, 74 AUSTL. L.J. 576; Ian M. Ramsay, *An Empirical Study of the Use of the Oppression Remedy*, 27 AUSTL. BUS. L. REV. 23 (1999); John Lessing, *Institutional Investors: Will We See Greater Cooperation Between Them Regarding Corporate Governance*, 10 BOND L. REV. 376 (1998).

⁹⁸ Hong Kong has consolidated its regulatory structure into a single piece of legislation, the Securities and Futures Ordinance. Securities and Futures Ordinance (Apr. 1, 2003), available at http://www.justice.gov.hk/blis_ind.nsf/CurAllEngDoc?OpenView&Start=568&Count=30&Expand=568#568. This is likely to be the first of a number of reforms that will culminate into a proactive statute that will meet international standards of practice. See The Securities and Futures Commission of Hong Kong at <http://www.hksfc.org.hk> (last visited Oct. 27, 2004); the Securities Commission of Malaysia at <http://www.sc.com.my> (last visited Oct. 27, 2004); the Monetary Authority of Singapore at <http://www.mas.gov.sg> (last visited Oct. 27, 2004) (providing more information about their recent reform measures).

⁹⁹ The introduction of the disclosure-based system of regulation, whose principal objective is to facilitate the establishment of a more efficient and transparent securities market, will further enhance the powers of regulators as they will assume two important roles. First, it will regulate the quality, accuracy and timeliness of material information both during the initial public offering as well as throughout the tenure of these securities. Secondly, it will assume a more active role in ensuring strict compliance with disclosure requirements through a combination of strengthened surveillance and enhanced enforcement.

¹⁰⁰ See WHITE PAPER, *supra* note 5, ¶ 208 ("All Asian countries should continue to strengthen regulatory institutions that: (i) establish high standards for disclosure and

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VI. CONCLUSION

Does corporate governance matter? To be realistic, the practice of good corporate governance, by and of itself, is unlikely to substantially influence investment decisions. Investors demand a return commensurate with the level of risks assumed for a particular investment. The key influences upon which investment decisions rest involve an assessment of the current and prospective financial performance of the company. This would include a review of its earnings record, gearing ratio, and dividend policies, and also the risk factors to which the company is exposed. It therefore logically follows that companies with the best corporate governance practices are unlikely to be attractive to investors unless they also produce a constant flow of profits.

The attention that has been accorded to corporate governance practices has been so significant that it has given rise to a new 'ratings' industry with at least two major global players, namely, Standard and Poor's ("S&P") and Governance Metrics International ("GMI").¹⁰¹ The S&P model of "corporate governance scores" focuses on what the company does. The methodology seeks to synthesize the key elements of corporate governance on a global basis as opposed to the imposition of the standards of any particular jurisdiction. The scoring is issued on a scale of 1 to 10, with the latter being best, and is based on an assessment of both the financial standing of the company as well as meetings with its senior management. The GMI "ratings" model differs in that it utilizes a series of detailed and proprietary metrics and a mathematical algorithm to evaluate the corporate governance policies and practices of companies on the basis of publicly available information. By using a standardized research template, GMI facilitates a comparison of ratings between companies regardless of domicile, industry or size, and sells this product by annual subscription.

The implementation of sound corporate governance practices does not come without a cost. At its most elementary level the changes call for enhanced accountability and transparency in various aspects of the administration of companies. These may require a change in the mindset of issuers and investors, especially in East Asia where the family or government-linked company dominates within an environment of shareholder passivism. Nonetheless, there appears to be little, if any, disagreement with the contention that effective corporate governance does

transparency; (ii) have the capacity, authority and integrity to enforce these standards actively and even-handedly; and (iii) oversee the effectiveness of self-regulatory organizations."); *see also id.* ¶¶ 209-18 (ensuing discussion).

¹⁰¹ *See* Standard & Poor's website, at <http://www.standardandpoors.com> (last visited Oct. 27, 2004) (detailing the company's governance services); Governance Metrics International's website, at <http://www.governancemetrics.com> (last visited Oct. 27, 2004) (detailing the company's governance services).

contribute positively to the development of financial markets, be it with respect to attracting capital or the retention thereof. There is increasing survey evidence that good corporate governance plays an important role in the investment decisions of major institutions and that a premium is often reflected in the price of the securities of companies that practise it.¹⁰²

The introduction of the statutory framework for directors as outlined above, in conjunction with a scheme of accreditation and continuing professional development, will rectify an antiquated anomaly common of company law throughout the East Asian region. These amendments will, in turn, enhance the accountability of directors and the transparency of their actions, leading ultimately to an improvement of the standard of corporate governance.

The empowerment of the investor has thus far not been associated with the assumption of a corresponding degree of risk. A principal reason for this is the fact that many regional capital markets remain largely regulated within a hybrid system that combines both merit and disclosure-based systems of regulation. However, this is likely to change as more East Asian markets adopt the principle of “caveat emptor,” namely, “let the buyer beware.” Doing so will shift the onus of responsibility squarely back to the investors, thereby enhancing their incentives to make use of the information to which they are privy. This will in turn necessitate a change to the flow and quality of information, with the emphasis being on timeliness and ease of comprehension. While this imposes additional responsibilities on retail investors, it nonetheless goes some way towards minimizing the moral hazard of rigid regulation. Coupled with their empowerment, these changes will enable shareholder groups to assume a vital role in enhancing corporate governance as they serve not only to protect the rights of shareholders but also to educate them on the importance of exercising these rights.

Regulators will need to be more proactive in facilitating the development of capital markets in the era of globalization. Country level evidence has been adduced to illustrate the significance of inept enforcement and of weak legal institutions in exacerbating the stock market declines during the Asian financial crisis of 1997, while relationship-based systems have been shown to contribute towards misallocation of capital.¹⁰³

¹⁰² See e.g., McKinsey & Co., *Global Investor Opinion Survey: Key Findings (2002)*, at <http://www.mckinsey.com/clientservice/organizationleadership/service/corpgovernance/pdf/GlobalInvestorOpinionSurvey2002.pdf>; McKinsey & Co., *Emerging Market Policymaker Opinion Survey: Key Findings (2002)*, at http://www.mckinsey.com/clientservice/organizationleadership/service/corpgovernance/pdf/2002_Emerging_Market_Policymaker_Opinion_Survey_Corp_Gov.pdf; the S&P Transparency and Disclosure Study (2002), available at http://www.securitization.net/pdf/sp_trans_101602.pdf; CLSA Corporate Governance Watch, *supra* note 81.

¹⁰³ See, e.g., Rajharam G. Rajan and Luigi Zingales, *Which Capitalism? Lessons from the East Asian Crisis*, 11 J. APPLIED CORP. FIN. 40 (1998); Simon Johnson et al., *Corporate*

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To prevent further deterioration, there is an urgent need to enhance both the transparency and accountability of regulators, whilst at the same time requiring them to better protect the rights of minority shareholders. Legislation will have to be redrafted to enable regulators to regulate on a functional basis rather than on the existing markets basis so as to minimize any lacuna with the regulatory framework. This will provide for a more comprehensive system within which the agenda for enhanced corporate governance may be better implemented. However, the best legislative and regulatory infrastructures will remain completely ineffectual unless they are complemented with the will to enforce the rules and regulations affirmatively, without any fear or favor.

This article raises some legal and regulatory issues within the rubric of corporate governance and proposes some possible solutions thereto. These should not be viewed as definitive but merely as a sampling of the corporate governance problems that East Asian companies must confront. The White Paper on Corporate Governance in Asia provides a sound foundation from which further research and collaboration may be undertaken and effected between academics, practitioners and regulators across the region. While corporate governance affects the entire spectrum of stakeholders who are associated with companies and capital markets, it is nonetheless not the exclusive domain of any particular segment, hence the need for a roadmap. It is a vexatious issue that requires a coordinated approach involving the active participation of all the stakeholders, commencing with an appreciation of its benefits. Needless to say, improving the standards of corporate governance in East Asia will not come without a cost, as compliance with the different rules and codes, and the enforcement thereof, will require additional investment. However, perhaps the question is better posed by asking whether East Asia can afford *not* to?

Governance in the Asian Financial Crisis, 58 J. FIN. ECON. 141 (2000); Simon Johnson and Todd V. Mitton, *Cronyism and Capital Controls: Evidence from Malaysia*, 67 J. FIN. ECON. 351 (2003).

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