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# The Concept of Corporate Governance and Its Evolution in Asia

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**Abstract**
Corporate governance is one of the most imperative research topics all over the world for its contribution to the corporations and the global economy. Besides, Asian economy is currently the major contributor of the world economy. Laws and regulations in the Asian region have been enacted extensively and different standards have been developed during the last decade. This descriptive study attempts to summarize these developments in Asia along with the discussion of core concept of corporate governance for the new researchers in this field and other concern parties.
**Keywords:** Corporate Governance, Evolution, Asia

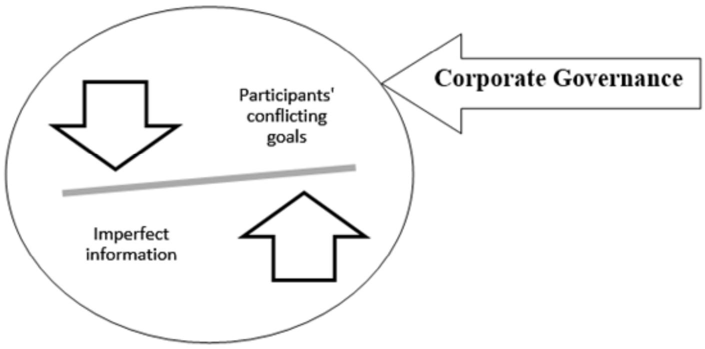
## 1 Introduction
The guidelines and methods through which corporations are governed is corporate governance. It helps to resolve the potential conflicts of interest amongst the stakeholders (shareholders, management, public administration, personnel dependent, consumers, etc.) in one corporate structure. More accountability and transparency to the investors is ensured through corporate governance. Therefore, a sound corporate governance supports companies to operate more competently, diminish risk, provide protection against mismanagement and ensure smooth access to capital which will support the growth of the companies. By means of better access to capital, corporate governance encourages new investments, enhances economic development and delivers employment opportunities. The main objective of corporate governance is to maximize and enhance shareholder's value and guard the interest of other stake holders of the community. Therefore, corporate governance became a key issue to the concern policymakers after the Asian financial crisis of 1997.
This study attempts to explore the evolution of corporate governance in the Asian region in connection with the clarification of the core concept. Thus, this research will help the apprentice researchers in the field of corporate governance by providing solid start point for further detailed specific research, along with the scholars, policymakers and other concerning bodies by giving an insight regarding the evaluation of corporate governance of Asia.

## 2 Objectives
- To depict the concept of corporate governance.
- To investigate the evolution of corporate governance in Asia.

## 3 Methodology
This study is a secondary data based descriptive research. Different articles from journals and other published reports from different financial organizations had been used in this research. The first objective of describing the corporate governance concept is achieved through the study of earlier literatures. Evolution of corporate governance, the second objective, is investigated through the reports of concern financial institutions and with the help of information in relevant websites.

## 4 Theoretical Framework:
Scholars discussed the concept "Corporate Governance" from different perspectives. According to Magdi and Nadereh (2002), corporate governance is about ensuring that the business is run well and investors receive a fair return. Organization for Economic Co-operation and Development (OECD; 1999) offers a wider definition of corporate governance. OECD defines corporate governance as the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation such as, the board, managers, shareholders and other stakeholders. It also defines the rules and procedures for taking decisions on corporate matters. Uche (2004) and Wolfensohn (1999) also discussed corporate governance in similar perspective. They argued that corporate governance is the mechanism through which the company's goals are set, the ways of achieving those goals are defined and it will monitor performance accordingly.

Potential conflicts of interest among participants (stakeholders) in the corporate structure create the need for corporate governance in a corporate setting. Imam and Malik (2007) identified two major causes behind this




conflict. Firstly, difference in the participants' preferences and goals. Secondly, lack of perfect information among participants about each other's knowledge, actions and preferences.

Jensen and Meckling (1976) addressed these conflicts by examining the separation of corporate ownership from corporate management. They claims that this separation provides executives with the ability to act in their own self-interest rather than in the interests of shareholders in absence of other corporate governance mechanisms.

Bostan and Grosu (2010) mentioned the objectives of the systems of governance in a slightly different manner. According to them, the objectives are to provide integrity management and guidance to maximize the created value for shareholders and to provide a transparent and timely communication system. The transparent communication system is the key instrument that can prevent accounting frauds. The link between information and frauds prevention is independent of the mode of corporate governance adopted by the organization structure and the control mechanism.

Corporate governance can be constituted through different indexes in an organization. Kajola (2008) discussed some of these critical factors briefly. Four key mechanisms discussed in his study are briefly presented here.

*Board Size*

Kajola (2008) suggested that the board size should be within a limit considering the firm's width of operation. Though the larger board size helps in monitoring, but it also increases the chance of poor communication and delayed decision making. His empirical research on board size provided this conclusion that board size and firm value are negatively related. Large boards are less effective and those are easier for the CEOs to control (Lipton and Lorsch, 1992). It becomes difficult to coordinate and for it to process and tackle strategic problems of the organization when board size becomes bigger. Yermack (1996) also finds the negative correlation between board size and profitability when conducted study on Finland. Other researchers also find the similar outcome: small sized boards are positively related to high firm performance (Mak and Kusnadi, 2005; Eisenberg, Sundgren and Wells, 1998). Sanda et al (2003) reported that firm performance is positively correlated with small, as opposed to large boards in a study conducted in Nigeria.

*Board Composition*

Board composition is another key consideration which constitute the corporate governance. Young (2003) argued that enhanced director independence is inevitably attractive. According to the proponents of agency theory, corporate governance should lead to higher stock prices or better long-term performance, because managers are better supervised and agency costs are decreased. But the findings from the empirical studies of the effect of board membership and structure on firm value or performance dramatically show either mixed results or opposite to what would be expected from the arguments of agency cost. Even some studies reveals better performances in the firms dominated by the outsiders (John and Senbet, 1998; Mehran, 1995; Resenstein and Wyatt, 1990; Weiback 1988). On the contrary, Pinteris (2002) found no such relationship in terms of profitability or firm value. Forsberg (1989) found no such relationship between the proportion of outside directors and different performance measures. Similarly, studies of Bhagat and Black (2002) and Hermalin and Weisbach (1991) also found that poorly performing firms were more likely to increase the independence of their boards. Some other group of researchers found that firm performance is not significantly linked to a higher proportion of the board members from outside (Klein, 1998; Baysinger and Butler, 1985; Mac Avoy, Dana, Cantor and Peck, 1983). Therefore, it can be concluded that the impact of the proportion of outside directors on the firm performance is mixed.

*Audit Committee*
Of the limited literatures on audit committee, Klein (2002) found that the earnings management and audit committee are negatively correlated. Few other researchers reported that entirely independent audit committees tend to have lower debt financing costs (Anderson, Mansi and Reeb, 2004).

*CEO Status*
When the same person holds the two critical positions of CEO and chairman, agency problems are expected to be higher. Several studies examined the separation of CEO and chairman of the board. . Experimenting on a sample of 452 firms of USA, Yermack (1996) confirmed that firms where the CEO and the board chairman are different persons, are more valuable.

**5 Corporate Governance in Asia**
The year 1997 with the Asian Financial Crisis, can be marked as a buzz for the Asian policy makers and companies. The crisis uncovered many institutional and policy weaknesses in this region and urged multiple reforms. Corporate governance concept and practices moved widely in this region since 1999. Number of rules, laws and regulation had been enacted, standards improved and enforcement strengthened.
Here, in this study, experiences from Organization for Economic Co-operation and Development (OECD), some key observations of OECD-Asian Corporate Governance Roundtable in 2014 and corporate governance success stories of some Asian countries through IFC had been presented.

**5.1 The OECD Experience**
The OECD Principles of Corporate Governance are highly praised and practiced in the Asian region. Practically, the OECD Principles of Corporate Governance and outputs of the Asian Roundtable are being used by all Asian economies as references in the development of their corporate governance codes, regulations, scorecards, listing rules and even in academic works. In the countries like Malaysia, Indonesia, the Philippines, Singapore, Viet Nam and Thailand, the ASEAN Corporate Governance Scorecard incorporates the OECD Principles of Corporate Governance as a major benchmark to evaluate the listed companies. Notably, the promise by Asian authorities to improve their corporate governance situations across the region is even greater.
Since its inception, Asian region made number of achievements with OECD in the last 15 years. Key accomplishments are:

- The commencement of a corporate governance structure
- Extensive enactment of the global standards under the OECD Principles of Corporate Governance
- Higher level of responsiveness and practice of the OECD Principles as a best practice benchmark

The Fidelity analysts' survey covering 1000 stocks through the Asia-Pacific found that 21% of the companies within Asia are following a global corporate governance standard in their internal or external operations. This survey concludes that the application of corporate governance is on the rise in Asia. Continuous improvement in the corporate governance practices is observed among Asian companies since the Asian financial crisis.

**5.2 Observations of OECD-Asian Corporate Governance Roundtable; 2014**
Company law and securities law are frequently updated in all Asian Roundtable economies to incorporate new developments. Demonstrating the benefit of being able to draw on other jurisdictions' experiences, Roundtable economies have made liberal use of legislation and practices from other economies as a source of inspiration when strengthening their own systems.
Recent examples of legal reform in different countries of Asia are summarized here:

- Amendments to the Companies Act in Malaysia in 2007 and 2010 to introduce enhanced and clarified regulation of related party transactions, strengthened shareholder rights, and a better defined role of the board.
- Amendments to the Securities and Exchange Act in Thailand in 2007 to provide stronger protection for investors' interests, to enhance corporate governance of listed companies and to make key governance recommendations mandatory.
- The reform of the Companies Ordinance in Hong Kong, China was passed by the legislative council in 2012. The new Ordinance introduces enhanced accountability of directors, more shareholder engagement in the decision-making process and improved disclosure of company information.
- The Ministry of Finance in Singapore released a draft Companies Bill in May 2013, to amend the current Companies Act, based on the recommendations of the Steering Committee it had appointed in 2007. Key changes include the lessening of regulatory burdens on companies while rules and principles

ensuring transparency and accountability, including directors' duties would be strengthened.
- The 2013 Companies Act in India makes comprehensive reforms to virtually all areas affecting corporate governance. The reforms include increased requirements for independent directors, more director duties, the introduction of shareholder class action suits and the proposal of the expanded use of e-governance for various company processes.
- In case of Bangladesh, the Securities and Exchange Commission (SEC), Bangladesh Bank (BB), the Institute of Chartered Accountants of Bangladesh (ICAB), Bangladesh Enterprise Institute (BEI), the Institute of Cost and Management Accountants of Bangladesh (ICMAB) are some of the pioneer bodies working for ensuring better corporate governance in the country. Their efforts include publication of code of corporate governance for Bangladesh, different reports, organization of seminars, issuance of notification etc (Bhuiyan and Biswas, 2007).
- The Indonesian Company Law update of 2007 introduced fiduciary duties and responsibilities for commissioners and directors. The new Company Law also put the three main corporate organs in Indonesia, the general shareholder meeting, the Board of Commissioners and the Board of Directors on equal footing for the first time.
- In Chinese Taipei, updates to the Company Act between 2005 and 2012 enhanced the accountability of directors and introduced cumulative and e-voting.

**5.3 Success stories through IFC[1]**

With strong donor support, IFC continues to strengthen corporate governance programs in underserved regions, particularly in Sub-Saharan Africa, Latin America, and East Asia and the Pacific, by closely integrating its investments and advice, and focusing on capacity building of intermediaries, resulting in improved operational efficiency.

In 2013, we nearly doubled our firm-level corporate governance engagements. Thirty-one development finance institutions have now adopted the Corporate Governance Development Framework, which is based on IFC's methodology.

In Central Asia, local partners have been independently delivering corporate governance services in their markets, both in terms of training as well as consulting services. In China, we established a partnership with the Association of Public Companies to update the China Corporate Governance Guidelines for Listed Companies, develop a White Paper on Corporate Governance in China, train board directors, supervisors and senior executives of locally-listed companies, and research specific corporate governance issues.

Some of the success stories of different countries of Asia with the support of IFC have been presented here:

**Country: Indonesia**
**Client: Mitra Bisnis Keluarga Ventura (MBK)**

In 2013 IFC approved an investment (debt and equity) of $9 million for this Indonesian micro-finance company with over 300,000 micro clients, mostly women. An equity investment agreement was also signed by IFC and MBK. IFC also provided corporate governance assistance to help the company improve the structure and composition of the boards and implement good governance principles that, in turn, will help prepare the company to attract new investors. This IFC investment will enable the company to scale up its microfinance outreach, thus helping improve the quality of lives of women in Indonesia. Further, by having a sound corporate governance structure in place the company can become a standard setter for more sustainable and professionally-run microfinance institutions in the country.

*IFC corporate governance support:* Provided assistance to improve the structure and composition of the boards and implement good governance principles.

**Country: Bangladesh**
**Client: Butterfly Marketing Limited**

In FY2013, IFC invested $6.4 million in equity in Butterfly Marketing Limited, a family-owned business in Bangladesh. The company is one of the largest retail companies of refrigerators, televisions and air conditioners in the country. With a store network of 199 outlets and 340 dealers, Butterfly Marketing Limited currently has the second largest market share in the refrigerator market and the largest in the air conditioner market. IFC also provided corporate governance assistance to strengthen its governance structure offering advice on board composition, establishing an audit committee and appointment of an external auditor. The corporate governance improvements were a condition for investment, and all of the shareholders have signed on to implement the corporate governance improvement plan.

*IFC corporate governance support:* Provided assistance to strengthen the company's governance structure

[1] Investment Operations and Advisory Services Project Summaries of IFC: March 2014

offering advice on board composition, establishing an audit committee and appointment of an external auditor.

**Country: Pakistan**
**Client: Matco Rice Processing Limited**
In 2012 IFC made a $4.9 million equity investment in Matco Rice Processing Limited, a family-owned firm and the country's leading basmati-rice exporter. The investment is part of an $18 million project that integrates rice paddy procuring and processing. The investment came about after one of the company's board members attended a corporate governance leadership training offered by the IFC-supported Pakistan Institute of Corporate Governance. Seeing value in the training, the board member invited the institute to conduct a corporate governance workshop for Matco's board to address the role, authority, and fiduciary duties of the board and its structure and composition. This enabled Matco to make necessary changes and position itself as a viable investee client.
*IFC corporate governance support:* Provided corporate governance leadership training to IFC-supported organization, which in turn provided training to the company on the role, authority, and fiduciary duties of the board and its structure and composition.

**Country: Mongolia**
**Client: Khan Bank**
In 2011, IFC committed a $20 million subordinated loan to Khan Bank, as part of a $50 million external financing from a strategic investor as a result of improved corporate governance. Khan Bank is a leading commercial bank in Mongolia with 500 branches and over 4,000 employees. It provides financial services to more than 80 percent of the households in that country. IFC provided advisory support to the bank to make improvements to its corporate governance practices to support the client's plan to go IPO in overseas stock exchanges in the next two to three years. IFC identified key risks, including unclear authority line between the board and senior executives. In 2013, IFC invested in a $40 million subordinated loan from the IFC Asset Management Company, together with $71 million in IFC syndicated and parallel loans to Khan Bank.
*IFC/corporate governance support:* Provided support to make improvements to the bank's corporate governance practices to go for an IPO. IFC identified key risks, including unclear authority line between the board and senior executives; ineffective communications between the board and management; ineffectiveness of the board committees; related party transactions issues and conflict of interest issues and proposed an improvement plan.

**Country: India**
**Client: Craftsman**
In 2011, IFC made a $13.6 million equity investment in Craftsman, a family-owned firm in India with revenues of about $120 million in fiscal year 2011. As part of IFC's $13.6 million equity investment, IFC provided advisory support to the company that helped improve its corporate governance practices, including reducing the family's representation on the board, nominating two independent directors, and hiring a chief financial officer. Craftsman also had to form an audit committee comprised solely of independent directors. The only recommendation pending is formation of the audit committee. Standard Chartered PE invested about Rs 850 million 18 months ago.
*IFC corporate governance support:* Provided support to help improve its corporate governance practices, including reducing the family's representation on the board, nominating two independent directors, and hiring a chief financial officer.

**5.4 A roadmap for improving corporate governance infrastructure**
After surveying challenges and progress, as well as engaging in an extensive consultation process among Roundtable participants, the original 2003 White Paper priorities were updated in 2011 with the publication of *Reform Priorities in Asia – Taking Corporate Governance to a Higher Level.* The 2011 report reflects the changes in the corporate governance landscape since 2003 and is intended to continue to support decision-makers and practitioners in their efforts to take corporate governance to a higher level. The updated priorities for reform are:

- All jurisdictions should strive for active, visible and effective enforcement of corporate governance laws and regulations. Regulatory, investigative and enforcement institutions should be adequately resourced, credible and accountable, and work closely and effectively with other domestic and external institutions. They should be supported by a credible and efficient judicial system.
- The quality of disclosure should be enhanced and made in a timely and transparent manner. Jurisdictions should promote the adoption of emerging good practices for non-financial disclosure. Asian Roundtable jurisdictions should continue the process of full convergence with international standards and practices for accounting and audit.

- Board performance needs to be improved by appropriate further training and board evaluations. The board nomination process should be transparent and include full disclosure about prospective board members, including their qualifications, with emphasis on the selection of qualified candidates. Boards of directors must improve their participation in strategic planning, monitoring of internal control and risk oversight systems. Boards should ensure independent reviews of transactions involving managers, directors, controlling shareholders and other insiders.
- The legal and regulatory framework should ensure that non-controlling shareholders are adequately protected from expropriation by insiders and controlling shareholders.
- Shareholder engagement should be encouraged and facilitated, in particular by institutional investors.

## 6. Conclusion

The impact of good corporate governance is being comprehended in the Asian region throughout the last decade. Public and private sector institutions should continue to make the business case for the value of good corporate governance among companies, board members, gatekeepers, shareholders and other interested parties, such as professional associations. The implementation and monitoring of audit and accounting standards should be overseen by bodies independent of the profession. Key stakeholders like external auditors, rating agencies, advisors and intermediaries should be able to inform and advise shareholders free of conflicts of interest. Accordingly, corporate governance can act as a glue of harmonization in the corporate setting.

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