# THAI CORPORATE GOVERNANCE: FROM CRISIS TO RECOVERY

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## ABSTRACT

The fall of the East Asian economies has been ascribed to "bad corporate governance" in addition to cronyism, corruption, and nepotism. Since little attention was paid to the issue of governance before the crisis, one cannot help but wonder whether weak governance is a trumped up explanation for the unexpected collapse of once-dynamic economies or whether there it is in fact a serious defect that was exposed by the crisis. This paper shows that there are significant flaws in Thai corporate governance, and that conventional prescriptions for strengthening governance may not work.

The two most serious governance problems among Thai corporations are connected lending and siphoning of a public company's funds through privately owned companies. Prior to the economic crisis, most commercial banks were run by families that used the banks as a convenient source of financing for their business empires. Most commercial banks own an array of unlisted businesses that are not subject to either ownership restrictions or the regulatory scrutiny of the SET (Stock Exchange of Thailand) and the SEC (Stock Exchange Commission).

The funds of public corporations in Thailand are commonly siphoned off to unlisted entities. With weak audits and little monitoring by minority shareholders, large shareholders and insiders can easily carry out transfer pricing in order to divert funds from the public company to their own, privately held companies.

The path towards building good corporate governance is arduous. Although the crisis has exposed the inherent weaknesses in the governance of the Thai corporate sector, it offers no clear directions about how to proceed. Policy prescriptions drawn from the experiences of developed countries are of limited applicability as they are based on different assumptions regarding the institutional and legal framework, the underlying corporate ownership and control structure, and the local culture. Conventional prescriptions for building good governance include strengthening minority shareholder rights, appointing independent board members, promoting corporate monitoring through institutional investors, and improving disclosure requirements.

Strengthening minority shareholders' rights will improve corporate monitoring only if shareholders are already well aware of their rights and duties as corporate owners so that they will exercise their new rights. But in a country like Thailand, individual investors are still unacquainted with the content of the law, and they are unlikely to take advantage of any additional rights they are granted. At this stage, it would be better to concentrate on educating individual investors about their rights and duties as corporate owners and promoting shareholder activism.

The appointment of independent board members is a common requirement of corporate codes of conduct. But the independence clause can only exclude managers, executives, other employees, and their relatives; it cannot rule out those with other personal connections. In a country where cronyism runs deep, the rule of law is unlikely to ensure the independence of board members. However, board members may become more accountable for their actions if their fiduciary duty is spelled out more explicitly and the penalties for neglecting such duty are made more severe.

The promotion of institutional investors should be undertaken with much caution in the case of Thailand. As the 1997 crisis revealed, institutional investors themselves—banks, finance companies, securities companies, and mutual funds—lack good corporate governance. For example, four executives of a reputable mutual fund were recently charged with "conflict-of-interest" in businesses in which they invest. One cannot rely on such institutions to raise the

standard of corporate governance.

With little monitoring by minority shareholders and board members and in the absence of institutional investors that exert pressure for good governance, large shareholders and Thai corporate insiders have had a free reins on the management of the resources of public companies. There is no easy solution to bad corporate governance.

Information is at the heart of establishing good governance. Thus, disclosure is very important, for without adequate and accurate data, we cannot penetrate the corporate veil. At the initial stage emphasis should be placed on the *quality* rather than the *quantity* of information disclosed. Inaccurate information is just as bad as, or worse than, no information. Hence, accounting should be the very first target for reform. Most literature advocates self-regulation of the accounting profession since the choice between good or bad accounting is a question of economics not ethics. Gresham's Law of the bad chasing out the good applies to accounting as well as to money. When one company can get away with manipulating or falsifying financial reports, then there is no incentive for any company to submit a valid report that may make it look worse than the competition. Bad accounting must be penalized so that it pays for companies to adopt good accounting practices. Regulatory supervision must be strengthened and penalties made much harsher for professional liability.

Once good accounting systems are in place, inappropriate insider behavior will be easier to detect. The next step is to ensure that abusers are held accountable for their crimes or misconduct. At this point, the content and the enforcement of laws covering insider trading, public companies, and money laundering must be strengthened to deter corporate malfeasance. The efficiency of the judiciary process is also of utmost importance. Cumbersome court procedures can undermine law enforcement, as is the case in Thailand.

The numerous other important measures to promote good corporate governance, such as board independence, rights of the shareholders, development of long-term equity markets, are secondary to these two steps. Once Thailand gets its accounting system right and can take legal action against abusive behavior by corporate insiders, bad corporate governance will no longer pay.