

Development of Capital Markets and the Reform of Corporate Governance in Asia

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1. Increasing Need to Develop Capital Markets and Improve Corporate Governance in Asia

- Toward a greater role for capital markets from a bank-centered financial system
- From an insider to an outsider model of corporate governance

1) Starting from a Bank-centered Financial System

- Under-developed capital markets
 - Historical background and a characteristic of developing economies
- Particularly underdeveloped bond markets
- Inefficiency of financial institutions under strong government intervention and protected environment risk
- Integrated with an insider corporate governance system
- Dominance of conglomerates

Legacy of the Asian-style Insider Corporate Governance Model

- Founder Family/State Model (Nester & Thompson)
 - Strong control by founder families
 - State control of banks
- Dependence on the monitoring function of banks
 - Weak system for preventing insider self-transactions
- Potential to undermine interests of non-controlling investors and lack of transparency
 - Impeding the development of capital markets

Disparities in the Performance of Corporate Governance

- Two tiers
 - Relatively Good: Hong Kong and Singapore
 - Middling: Malaysia and Taiwan
 - Relatively Poor: Korea, Indonesia, the Philippines, Thailand
- Concentration of ownership and control is common

Corporate Governance Performance Ratings (1)

Rights and Responsibilities of Shareholders ⁽¹⁾		Corporate Boards ⁽²⁾		Inside Trading ⁽³⁾	
	Rating		Rating		スコア
(2) US	8.65	(3) Singapore	7.15	(4) Singapore	7.74
(9) Singapore	7.83	(7) US	6.60	(8) UK	7.00
(11) UK	7.75	(11) HK	6.33	(9) Germany	6.92
(13) Germany	7.35	(14) Taiwan	6.18	(11) US	6.69
(19) HK	6.98	(18) Malaysia	5.97	(15) HK	6.47
(25) Malaysia	6.56	(19) UK	5.94	(18) Japan	6.36
(28) France	6.32	(26) Germany	5.60	(22) Malaysia	5.58
(29) Taiwan	6.24	(29) RP	5.37	(23) France	5.55
(32) RP	5.71	(32) France	5.23	(31) Taiwan	5.03
(36) Thailand	6.24	(33) Thailand	5.19	(36) Korea	4.69
(40) Korea	5.49	(34) China	5.19	(39) Thailand	4.46
(45) Indonesia	4.83	(41) Korea	4.76	(43) China	4.03
(46) China	4.79	(45) Japan	4.44	(48) RP	3.39
(49) Japan	4.09	(47) Indonesia	4.39	(49) Indonesia	3.11

(出所) IMD World Competitiveness Yearbook 2002

Corporate Governance Performance Ratings (2)

Financial Institutions'		Shareholder Value	
Transparency	Rating		Rating
(4) US	8.06	(2) US	7.44
(9) HK	7.57	(6) Singapore	7.02
(10) Singapore	7.53	(8) UK	6.72
(14) Germany	7.22	(13) HK	6.33
(17) UK	6.89	(18) Germany	5.98
(25) France	6.1	(20) Taiwan	5.82
(28) Malaysia	5.89	(21) Malaysia	5.75
(31) Taiwan	5.58	(30) France	5.16
(32) Thailand	5.52	(31) RP	5.05
(36) Korea	5.05	(32) Thailand	5.04
(40) RP	4.73	(36) China	4.85
(45) China	3.6	(39) Korea	4.62
(46) Indonesia	3.48	(48) Indonesia	3.91
(47) Japan	3.44	(49) Japan	3.55

(出所) IMD World Competitiveness Yearbook 2002

A Survey of Corporate Governance Performance

	Total	Priority to Corporate Governance	Disclosure & Transparency	Management Responsibility	Independence of Boards	Protection of Minority Shareholders	Treatment of Shareholders	Corporate Ethics
HK	5.3	5.7	5.3	5.3	5.2	5.0	5.4	5.2
China	3.9	4.8	3.4	3.4	4.0	3.4	2.8	4.4
Singapore	6.2	6.0	5.8	5.8	5.9	6.3	6.0	7.0
Korea	5.9	6.0	5.3	5.3	6.4	6.2	5.9	5.3

(注) 野村証券金融研究所による①香港42社、②シンガポール29社、③韓国12社、④中国23社の7項目に関する定量評価(1:最低、10:最高)

(出所)野村証券金融研究所「アジア企業のコーポレートガバナンス」(2002年9月6日)

Source: Nomura Securities

2) Increasing Need to Develop Capital Markets and Improve Corporate Governance

- (1) Lessons from the Asian economic crisis
- (2) Facilitation of privatization and promotion of the private sector
- (3) Global trend of deregulation and liberalization of the financial service sector
- (4) Adaptation to a knowledge-based economy

(1) Lessons from the Asian Economic Crisis

- Vulnerability of the bank-centered financial system to economic globalization
 - Term and currency mismatches
- Excessive dependence on foreign portfolio investment
- Mal-functioning of corporate governance under the Insider Model

(2) Facilitating Privatization and Promotion of the Private Sector: China, in particular

- Inefficiency of SOEs and the accumulation of bad debts in the banking sector
 - Serious corporate governance problems of SOEs
 - Increasing need for privatization and promotion of the private sector
- Need to develop capital markets to finance privatized enterprises and emerging private enterprises

(4) Adaptation to a Knowledge-based Economy

- Need to evaluate intangible assets (future cash flows) of start-up high-tech firms
 - Unsuitable for Collateral-based Commercial Banking
 - Unsuitable for Regular Stock Markets Mostly for Large Enterprises
- Increasing roles for venture capitals and new equity markets
- Need to change the corporate governance mechanism in response to the increasing contribution of “knowledge” capital (workers) vis-à-vis “financial” capital

Need to Transform to an Outsider Corporate Governance Model

- Need for financing in the global capital market
 - High-tech firms, in particular
- Weakening of the corporate governance function of banks in the more competitive environment under deregulation and liberalization
- Challenge of the American model of corporate governance in corporate efficiency
 - Corporate governance as a factor in the competitive position of a firm and a location

Objectives of an Outsider Corporate Governance Model

- Maximization of shareholders' interests including that of minority shareholders
 - Disclosure of information (Control of information asymmetry)
 - Protection of minority shareholders from insider transactions
 - Provision of funds to well-managed corporations and reduction and termination of funds to poorly managed corporations

Components of an Outsider Corporate Governance Model

- Laws and regulations (securities law, accounting rules, corporate law, etc.)
- Development of relevant institutions and professionals (securities commission, accountants, lawyers, board of directors, mass media, etc.) with their sophistication, independence and governance
- Reputable financial intermediaries with their capabilities and governance
- Adequate penalties and enforcement as deterrents
- Discipline by markets for corporate control (M&A) and insolvency

Importance of Preventing Direct Insider Self-Dealing

- More damaging than direct self-dealing
- Likely to happen under Asian-type insider governance system
- Measures to prevent direct insider dealing:
 - Extensive disclosure of stock ownership and self-transactions
 - Independence of regulatory institutions, accountants, mass media, etc.
 - Capability and independence of outside directors
 - Penalties and enforcement abilities

2. Developments in Capital Market Promotion in Asia

- 1) Impact of Asian Financial Crisis
- 2) Policy Developments in Capital Market Promotion
- 3) Finance of High-tech Start-up Firms
- 4) Emergence of Capital Markets in China

1) Impact of the Asian Financial Crisis

- Recognition of the importance of corporate governance
- IMF-led reforms in the crisis-hit economies
- Entry of foreign firms in the financial as well as non-financial sectors
- Disparities in performance as a result of the varying speed of reform

2) Developments in Capital Market Promotion

- (1) Promotion of Bond Markets
- (2) Improved Competitiveness of Securities Exchanges
- (3) Development of Domestic Investors, Especially Institutional Investors
- (4) Liberalization and Improved Competitiveness of the Financial Service Sector
- (5) Improvement of Access by SMEs
- (6) Reform of the Regulatory Mechanism

3) Financing of High-tech Start-up Firms

- Spread and adaptation of the American model to the local environment
- Venture capital
 - Development in Taiwan
- New equity markets
 - Rapid expansion of KOSDAQ

4) Emergence of Capital Markets in China

- Permitting the listing of private enterprises since the latter half of the 1990s
- Increasing share-ownership of listed SOEs by the private sector
- Increasing MBOs of SOEs
- Role of Hong Kong capital markets in Development of the capital market in China

3. Reform of Corporate Governance in Asia

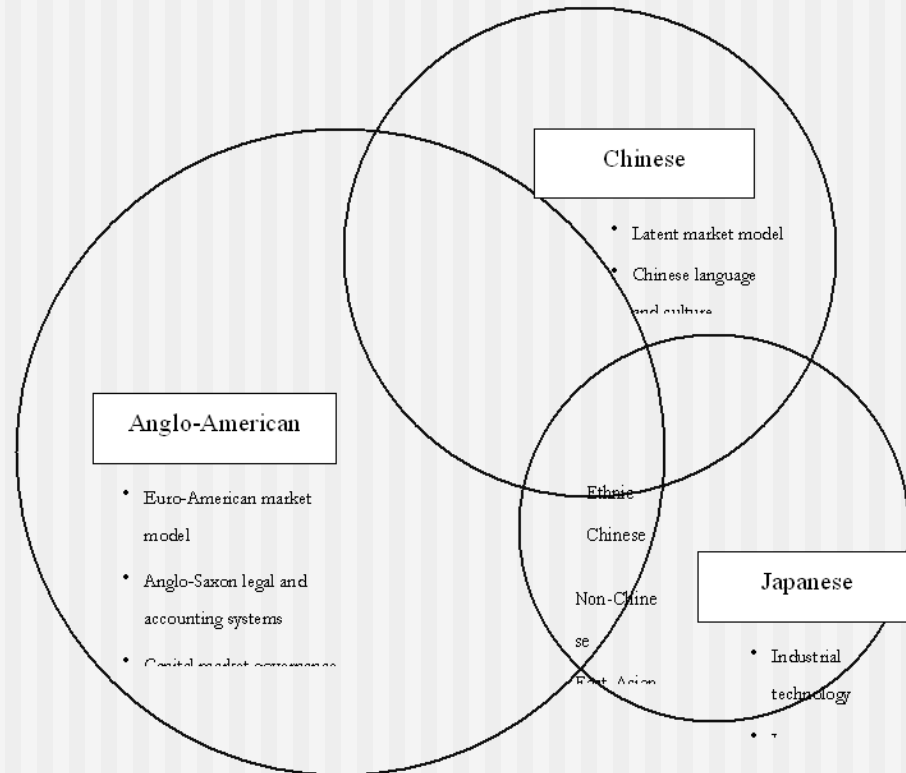
- Policy Developments for Improving Corporate Governance
 - Responses to the Asian Financial Crisis
 - Strengthening Transparency
 - Increasing Independence and Accountability of Boards of Directors
 - Regulation of Insider Self-Dealing

3. Reform of Corporate Governance in Asia (continued)

- Restrictions on Insider Self-dealing
- Rating of Corporate Governance Performance by Rating Agencies
- Listing on Stock Exchanges in Advanced Economies
 - Listing of Mainland Shares on Hong Kong Exchange

4. Spread of the American Model and Emerging Doubts about its Soundness

Image of Network Externalities



Emerging Doubts about the American Model

- Concern about the Effectiveness of its Information Disclosure System
- Doubt about the Effectiveness of the Self Regulation System
- Questioning Validity of a System Based on Maximizing Shareholders' Benefit?

5. Future Agenda

- Possibilities of diverse models of financial system and corporate governance depending on the stage of development
- Validity of accepting the American model
 - Suitability of moving to an outsider governance model
 - Necessity to adjust the sole objective of maximizing shareholders' interests
 - Role of M&As

5. Future Agenda (continued)

- Development of institutional investors and their role in corporate governance
- Other corporate governance issues
 - Securing enforcement of regulations
 - Possibility of dissolving the concentration of ownership and control?
- Opportunities for regional cooperation
 - Development of regional bond market