Asia-Pacific Office of the CFA Institute Centre for Financial Market Integrity

Independent Non-Executive Directors

A Search for True Independence in Asia

CFA Institute
Centre for Financial Market Integrity

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A note on the use of this report:

Terminology: This report uses the term 'independent non-executive directors' (INEDs) interchangeably with the term 'independent directors'. Minority shareholders are defined as all 'non-controlling shareholders'.

Case citations: The actual cases describing the practices of independent directors were gathered from published reports in major English-language newspapers and on websites, company announcements from the stock exchanges and company websites, and securities commission websites. Each case source is attributed in the footnotes; we have not contacted the companies involved in these cases.

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SECTION 1: Summary and Recommendations

The CFA Institute Centre for Financial Market Integrity believes that board composition and independence are fundamental issues in corporate governance, especially in Asia.

Concentrated ownership structures and weak legal protection in Asia increase the importance of independent non-executive directors on corporate boards. In Asia, companies commonly have controlling shareholders who have the ability to control the nomination and election of directors to the board. Investors should be wary in investing in these companies because so-called independent directors are often essentially figureheads, serving the controlling shareholder rather than representing all shareholders equally. Independent non-executive directors should have high ethical standards with the ability to act objectively on all board matters. Most importantly, they need to be independent not only from management but also from controlling shareholders because such independence is the best way to ensure that minority shareholders' rights are not expropriated.

Given the importance of truly independent directors in Asia, this study examined ways to ensure that so-called independent directors are, in fact, *independent*.

A review of key academic research in the Asian region shows that in the presence of controlling shareholders, strong corporate governance practices have a positive effect on firm value. The literature provides evidence that strong corporate governance practices and the appointment and presence of independent non-executive directors on the board can increase firm value and decrease the cost of capital, thereby reducing financing costs. On a country level, the evidence is that these practices can also increase foreign investment in local companies and, therefore, help the development of capital markets.

Our study includes a comparative analysis of the regulations and codes of corporate governance in Hong Kong, Singapore, India, and the Philippines. These countries were chosen because of their concentrated ownership structures in the listed equity markets and because their corporate governance regulations are at various stages of development and implementation. We identify four key areas for discussion and improvement: director nomination and appointment, the concept of independence, director training and qualification, and the number of independent directors on the board.

Our key findings together with our recommendations are summarised in the following subsections.

NOMINATION AND APPOINTMENT OF INDEPENDENT DIRECTORS

The independence of the nomination committee and the nomination/appointment process are questionable.

The directors sitting on the nomination committee are often nominated and appointed by the controlling shareholder, which presents a potential conflict of interests between the controlling and minority shareholders. The controlling shareholder has the power to nominate friends, former colleagues, or relatives to the board regardless of their experience or qualifications. Directors appointed in this way often have a sense of loyalty to the controlling shareholder, potentially rubber-stamping proposals and disregarding minority shareholder interests. Therefore, the nomination committee, if present, is often controlled by the majority shareholder, which turns the process of nomination and appointment into a mere formality.

We believe one of the main obstacles to obtaining truly independent directors is the current process for nominating and appointing directors.

The quality of disclosures in directors' biographical details at the time of elections/re-elections is low.

The current level of transparency in the background of candidates up for election does not help shareholders properly assess whether or not a candidate is independent; therefore, shareholders cannot make fully informed decisions before they vote.

Recommendations

1. **Minority shareholders should be given sufficient influence over the nomination and election of directors to have an impact.** Controlling shareholders effectively have the ability to control the nomination and election of all directors. The current process can be improved by, first, allowing minority shareholders that own a minimum threshold percentage of shares to directly nominate candidates for election and by, second, introducing cumulative voting.

   Cumulative voting, which is not commonly practiced in Asia, allows shareholders to cast all of their votes for one board candidate. For example, if a shareholder owns one million shares, each share is allowed one vote. So, if 10 board members are up for election, that shareholder is able to cast 10 million votes for one director instead of a million votes for each individual director.

   Cumulative voting improves the chances of a minority shareholder naming a representative to the board. It can be effective in contested board elections and is also useful in uncontested elections because it can be used to increase the number of 'no' votes for a nominee. This recommendation is intended to give minority shareholders a greater voice than they currently have and will enhance the current nomination and election process for directors in Asia.

2. **Companies need to provide shareholders with full biographical details on all the directors/nominees up for election/re-election in the Notice of the Annual General Meeting or other relevant shareholder circulars in advance of meetings for shareholders to read the information.** The disclosures should include academic and professional qualifications, all previous and current directorships, all relevant experience, and the nature of any relationships of the person that could affect his or her ability to act objectively. Only by providing shareholders with all the relevant information in a timely manner can they make informed decisions when it comes time to vote for, or against, the appointment of a director. Increasing transparency and the quality of information disclosed to shareholders sufficiently in advance of the meeting improves the chances that truly independent directors will be appointed.

THE CONCEPT OF INDEPENDENCE

The definition of independence is subjective.

Many corporate governance codes give considerable discretion to the nomination committee and board as to whether a director is independent or not. This variability presents several challenges, particularly if the nomination committee is biased and/or the committee does not have an appropriate definition of independence. A further complication is that in Hong Kong and Singapore, a director can be deemed independent despite failing to meet the independence requirements outlined in the relevant rules or codes.

Separation of the chairman and CEO does not equal independence.

Code provisions may allow for the physical separation of the two roles, but they do not specify that the role of the chairman should be separate from management (other than the CEO) or controlling shareholders. In many circumstances, the chairman is part of the executive management team or is related to the CEO or the controlling shareholder. Given that many companies in Asia are controlled by founding families, having a chairman who is not independent from the CEO can exacerbate the problems that are already present concerning the board, such as lack of objectivity and accountability.

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Recommendations

1. **A thorough definition of independence that insists on objectivity and independence in relation to both management and controlling shareholders is very important because of the ownership structure in Asian companies.** The definition should include both positive and negative attributes. We believe positive attributes should emphasise independent and objective judgment and negative attributes should highlight the potential conflicts of interest that could arise. A thorough definition will help to guide the nomination committee in its search for independent directors, which will increase the probability that the committee will make informed recommendations to the board and shareholders.
2. **Independent exemptions should not be allowed.** Giving companies the opportunity to allow a director to be deemed independent when he or she fails to meet the defined guidelines can create problems. Providing the company with a way out encourages them to use this option rather than find another candidate who is more appropriate and meets the required guidelines. We appreciate that the guidelines are not exhaustive, but giving companies an opportunity to opt out does not promote compliance with the spirit of the code, nor does it ensure that shareholders are adequately protected.
3. **The chairman should be an independent director.** In Asia, separating the role of chairman and CEO is not enough to ensure the effectiveness of the board of directors. Although the chairman and CEO are two different people, they can still be related to each other and/or to the controlling shareholder. This situation decreases accountability and oversight and gives great power to the controlling family. Given a thorough definition of independence, the chairman should be an independent director. This step will help ensure that the board maintains its objectivity and an appropriate balance of power.

DIRECTOR TRAINING AND QUALIFICATIONS

With no requirement or encouragement for formal training for directors, the nomination committee, shareholders, and other stakeholders have little knowledge about a director's suitability for the role. The lack of a minimum level of training or qualification, such as a certification programme, makes identifying qualified candidates hard and thus makes the nomination process more difficult for the board.

Recommendations

1. **An induction course to introduce new directors to the company, its operations, and strategy and to the applicable legal and regulatory framework is the absolute minimum level of training that should be required.**
2. **A regional director certification programme should be established to develop director education and improve the effectiveness of independent directors and the director community in general.** Currently, no well-established regional director qualification system exists in Asia. Such a system would be a good way to build a strong, educated supply base of directors for nomination committees to choose from. Its development should be a long-term goal for the region. Having formal certification should not be mandatory for individuals but should be seen as best practice. The qualification will be viewed as more important if it is something people believe they should obtain for their credibility rather than being viewed as a license that every director needs.

BOARD COMPOSITION

Prescribing an absolute number of independent directors is difficult because of varying board sizes, numbers of committees, and the underlying issue of concentrated ownership.

In countries that essentially have unlimited board sizes, setting a minimum percentage of independent non-executive directors is more effective than setting a minimum absolute number because a percentage does not give companies the option to stack the board with executive directors.

Boards in Asia traditionally have few independent directors, which may limit their ability to effectively exercise independent and objective judgment. When less than a majority of directors are independent (that is, boards are not majority independent), the collective voice of the incumbent independent non-executive directors is diminished, as is their value on the board. The directors are also more likely to be stretched for time because fewer independent members are available to share the committee workload.

Recommendations

Majority-independent boards should be considered best practice. Majority-independent boards are recommended in the United Kingdom, United States, and Australia, and in Asia, they are already required in India when the chairman is either an executive or promoter of the company. Majority-independent boards should be even more important in Asia than in Europe or North America because of the high concentration of ownership in Asian companies. Majority-independent boards will ensure that there are enough independent directors on the board to exercise collective independence and to share the committee workload. However, if the independent directors are not truly independent, having a board dominated by them will be effective only on paper.

In conclusion, the CFA Institute Centre believes several issues need to be addressed before independent directors are truly independent. This report uses the countries of Hong Kong, Singapore, India, and the Philippines to identify and describe the main issues affecting director independence. Our findings have a wider application, however, because these issues are likely to arise in controlled companies in other countries with poor investor protection. This report is intended to create further discussion among investors, regulators, and all stakeholders with the ultimate goal of improving the effectiveness of independent directors throughout Asia.

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SECTION 2: Introduction

An independent board is an essential element of good corporate governance at any company. The ability of the board to demonstrate independent and objective judgement helps to proactively identify and prevent conflicts and to effectively monitor managerial performance.

Company boards normally have a mixture of executive, non-executive, and independent non-executive directors (INEDs). Traditionally, the difference between INEDs and the rest of the board is their ability to act objectively and independently from management. In Asia, however, independence from the controlling shareholder is just as important, if not more important, than independence from management.

Many Asian companies have concentrated ownership structures in which the majority of shares are concentrated in the hands of a single group of shareholders, typically the company's founding family or in the case of state-owned enterprises, a government agency. Families often control companies through complex ownership structures, such as pyramids, which effectively allow the family to exert considerable voting power with little ownership rights. In these cases, there is separation of ownership and control. It is not uncommon for Asian companies to have free floats as low as 10–20 percent, nor is it rare for listed companies to remain 40–60 percent owned by their founding chairman. Among these companies, it is not unusual to have the controlling shareholders as senior executives and members of the board of directors, including the positions of chairman and CEO, which are often not separated.

This situation inherently raises the possibility that these owner-managers will make strategic decisions about the company's business on the basis of, or in pursuit of, their own interests and will disregard the interests of minority shareholders. The situation also exposes the company and its minority shareholders to risks of expropriation if controlling shareholders divert value of the listed entity to outside business interests for their personal benefit.

In Asia, INEDs play a necessary and critical role. They act as a counterweight to controlling shareholders on the board because they are appointed to make sure that decisions are made in the best interest of the company for the long term and that decisions are fair and beneficial to all shareholders. Where there is no separation of ownership and control, a company's independent directors serve as the mechanism for preventing transactions or business decisions that unfairly or improperly benefit controlling shareholders and disadvantage the minority. This monitoring role is particularly important in countries where minority shareholder rights are low, which is the case in many Asian countries.

In the years after the Asian financial crisis of 1997, regulators began to understand the significance of INEDs. They addressed the issue by highlighting the role of INEDs in various newly developed codes of corporate governance and by setting a minimum number or proportion of INEDs for corporate boards. Despite these efforts, the issue of independence remains a problem.

The lack of truly independent directors on corporate boards is a major issue throughout Asia. This problem originates in the substantial power a controlling shareholder has to influence director nomination and appointment. The controlling shareholder, who may also serve as an executive chairman/CEO, can essentially appoint an individual with whom he or she has a connection, thereby effectively controlling the board. In such circumstances, the so-called independent directors nominated and appointed by controlling shareholders are not truly independent.

Because this practice is not uncommon in many companies in Asia, the important question to answer is: How can we improve the effectiveness of independent directors?

In this report, we try to answer this question and provide practical solutions for upholding true independence on the boards of listed companies in Asia. Section 3 demonstrates the importance of corporate governance and INEDs in Asia by using academic literature, and

Section 4 illustrates INED and board practices with real-life cases. Section 5 identifies the key concerns limiting the effectiveness of independent directors in four jurisdictions: Hong Kong, Singapore, India, and the Philippines. Finally, Section 6 reviews these issues in light of global practices and concludes with a set of recommendations.

Note that this report focuses on board composition and lack of truly independent directors in companies with controlling shareholders, specifically family-controlled companies. Other impediments to good governance include weak legal protection for minority shareholders, weak enforcement of rules and regulations, and insufficient statutory backing of laws.[1]

[1] For more information on shareholder rights, please refer to the 'Shareowner Rights across the Markets: A Manual for Investors' published by the CFA Institute Centre for Financial Market Integrity (www.cfapubs.org/doi/abs/10.2469/ccb.v2009.n2.1).

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SECTION 3: Why INEDs Are Important in Asia

From the standpoint of good governance, independent non-executive directors are an important element of any corporate board. INEDs are even more significant in Asia because of the high ownership concentration among companies and the weak shareholder rights regimes that prevail in the region.

Evidence suggests that strong corporate governance practices and the appointment and presence of INEDs on the board can somewhat counteract the ability of controlling shareholders to expropriate minority shareholders. According to various studies, corporate governance practices and INEDs are particularly important for companies in Asia because these elements can

- increase share price performance/firm value,
- decrease the cost of capital—and consequently, financing costs—and
- increase foreign investment in local companies.

In this section, we provide a literature review of these issues that is focused on the Asian countries of Hong Kong, Singapore, India, and the Philippines but includes other countries in the South East and East Asia regions.

SEPARATION OF OWNERSHIP AND CONTROL IS KEY

As first described by Berle and Means (1932), the typical UK/US (that is, Western) company exhibits separation of ownership and control. Western companies are generally widely held, meaning they have a diffuse ownership base, and they are ultimately controlled by managers who have little to no equity ownership. A principal–agent conflict arises in these companies because of the misalignment of interests between managers (agents) and shareholders (principals) and because managers are in a position to abuse their powers.

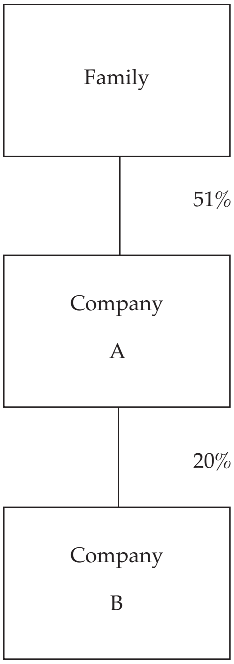
Western ownership structures are very different from the common ownership models in Asia. An ownership structure in which the majority or a high proportion of shares are concentrated in the hands of a single group of shareholders, typically the company's founding family, is common throughout Asia. Families often secure control of companies via complicated ownership structures, such as pyramids or cross-holdings. Pyramid structures are a common feature in Hong Kong and Singapore; they allow the founding family to exert a lot of control for little ownership. When ownership is defined as cash flow rights and control as voting rights, control of voting rights clearly outweighs cash flow rights.

Pyramid structures are illustrated in **Figure 1**.

One of the fundamental differences between companies with a controlling shareholder and those without is the identity of the insider, or the group that outside investors need protection from (Bebchuk and Hamdani 2009). In companies with a controlling shareholder, the principal–agent conflict is between controlling shareholders and minority shareholders; in addition, the executive management staff and the board often consist of members of the controlling family.[2] Controlling shareholders should be in a good position to monitor management because their financial interests are somewhat aligned with outside shareholders. Where separation of ownership and control exists, however, controlling shareholders often have interests that do not overlap with those of minority shareholders and they can use their power to exert control and advance their own interests. In these situations, controlling shareholders have the power to expropriate from the minority shareholders (Jensen and Meckling 1976; La Porta, Lopez-de-Silanes, and Shleifer, 1999).

[2]La Porta, Lopez-de-Silanes, and Shleifer (1999) found in their sample of more than 600 companies that at least 69 percent of the time, the controlling family was also part of management.

Figure 1. Pyramid Ownership Structure



Source: Adapted from Claessens, Djankov, and Lang (2000).

For example, assume that a family owns 51% of Company A, which owns 20% of Company B.

The family owns 10% (51% × 20%) of the cash flow rights and controls 20% of the voting rights of Company B.

Assuming, firms A and B are listed, there are no cross-holdings and there are no deviations from one-share-one-vote.

Corporate managers do not always act in the best interests of shareholders. The typical agency problems affecting companies are as follows:

- *Entrenchment*: Managers can entrench themselves in the business to secure their positions and make themselves costly to replace (Shleifer and Vishny 1989).
- *Hubris*: Managers may exhibit hubris—that is, be overconfident in their abilities— which leads to managers engaging in unprofitable and extravagant projects. This phenomenon, also called 'empire building', is a way in which managers increase their control (Jensen 1986).
- *Perquisite consumption*: Managers increase their private benefits through the consumption of 'perks' (Jensen and Meckling 1976). These perks may include extravagant gifts, holidays, use of private corporate jets, and even fraud and embezzlement.

Agency costs in the typical widely held company are often reduced because managers tend to be effectively monitored through regulations, shareholder protection, an active board, high levels of disclosure and transparency, and an active and competitive market for corporate control. In Asia, however, many of these mechanisms to reduce agency costs are not prevalent, making companies there more susceptible to abuse from controlling shareholders/management.

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The major principal–agent issue in Asia is expropriation of minority shareholders' wealth by reducing the value of the firm. The complex ownership structures, such as pyramids, are a good example of manager entrenchment and empire building. The structure enhances the owner-manager's control and is often a strong takeover defence because a hostile takeover would be costly to achieve. Often, those in control also have significant outside business interests, which are either part of the pyramid structure or part of separate business groups. These outside business interests provide another avenue to divert firm value. For example, a common abuse of minority shareholder rights is the misuse of related-party transactions (RPTs). These transactions, depending on the type, may be examples of any of the agency costs listed here, but they are most often used to help empire building; the RPT is a mechanism to transfer wealth to the future generation.[3]

RELATIONSHIP BETWEEN OWNERSHIP STRUCTURE AND FIRM VALUE

The effects of corporate ownership structures on firm value have been extensively studied. A negative relationship has been found between concentrated ownership and firm value, indicating that firms with controlling shareholders have lower values than firms that are more widely held.

To study this relationship, Lins (2003) focused on companies from 18 emerging markets—including Hong Kong, the Philippines, and Singapore. The key finding is that when a management group is the largest blockholder of shares and has controlling rights that exceed cash flow rights, as in a pyramid structure, firm value is lower than otherwise. Lemmon and Lins (2003) found similar results in their study of East Asian companies during the 1997 financial crisis.

Interestingly, Lins (2003) also found evidence that large non-management blockholders have a *positive* effect on firm value and can effectively reduce the valuation discount associated with management blockholders. Unfortunately, the study by La Porta et al (1999) of companies from 27 wealthy economies—including Hong Kong, Singapore, Japan, and South Korea—found that controlling shareholders are usually not monitored by other large shareholders.[4]

According to Claessans, Djankov, Fan, and Lang (2002), family control has a significant adverse effect on firm value. Their study of companies in eight East Asian markets suggests that the separation of ownership and control is associated with lower firm values.[5] The study also showed, however, that as the cash flow rights of the controlling shareholder increase, so does firm value. The reason is that the ability and incentive of the controlling shareholders to monitor management increases as their financial interests become aligned with other shareholders. Lei and Song (2008) and Lemmon and Lins (2003) found similar results.

WEAK LEGAL PROTECTION EXACERBATES THE ISSUE

Another major problem in Asia is weak legal protection for minority shareholders. Given the high concentration of family ownership and the incentives for expropriation of funds, the protection of minority shareholders' rights is essential. Many of the studies of ownership structure and corporate governance in Asia have also examined the level of investor protection and the legal environment in the countries. Investor protection is usually defined as the efficiency of the legal system (ie, enforcement), the level of shareholder rights and activism, and legal origin (ie, the background of the legal system, whether English, French, or socialist).

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[3]For a detailed study of RPTs in Asia, see CFA Institute (2009).
[4]The study found that in 71 percent of cases, family controlling shareholders do not share power with another large shareholder.
[5]The markets were Hong Kong, Indonesia, South Korea, Malaysia, the Philippines, Singapore, Taiwan, and Thailand.

La Porta et al (1999) suggested that high ownership concentration may be a reflection of poor shareholder protection because they found a strong negative relationship between concentration of ownership and quality of legal protection in a country. The authors also argued that family-controlled companies are more common in countries with poor shareholder protection. This finding is important because it indicates that minority shareholders' rights are lowest in the countries that need them the most. The concentration of control may also have damaging effects on the evolution of the countries' legal systems. Part of the reason may be that having control of the corporate sector in the hands of a few families gives these families the ability and incentive to lobby governments for preferential treatment (Claessens et al 2000).

The effect of weak legal protection exacerbates the negative relationship between controlling shareholders and firm value. According to Lins (2003), companies with controlling shareholders have significantly lower firm value when they are in countries with few shareholder protections. If the controlling shareholder is not part of the management team, however, the shareholder is perceived as a substitute for external corporate governance measures, so in low-protection countries, non-management controlling shareholders are more positively related to firm value.

GOOD CORPORATE GOVERNANCE EQUALS HIGHER FIRM VALUE

The need for good corporate governance is particularly important when controlling shareholders have the ability to expropriate and legal protection is weak. In a study of companies in 14 emerging economies—including Hong Kong, India, Singapore, and the Philippines—Klapper and Love (2004) found a strong positive relationship between good corporate governance practices and firm value/operating performance. They also found that the relationship is strongest in countries with weak legal systems. Therefore, corporate governance is important for companies in countries with weak investor protection.

Cheung, Connelly, Limpaphayom, and Zhou (2005) examined the corporate governance practices in the 168 largest companies in the Hong Kong market and, like Klapper and Love (2004), found a positive relationship between firm value and corporate governance practices. Balasubramanian, Black, and Khanna's 2009 study of 296 companies in India also supports this key finding.

Other studies have found that good corporate governance can improve firm value by reducing the cost of capital. Chen, Chen, and Wei (2003) studied the effect of disclosure and non-disclosure corporate governance mechanisms on the cost of capital. They defined disclosure mechanisms as the abilities of outsiders to assess the true position of the company and non-disclosure mechanisms as management discipline, board independence, accountability of management to the board, board effectiveness, and fairness towards minority shareholders. The authors used data from nine emerging markets in Asia.[6] The results showed that as companies improved their non-disclosure corporate governance (for example, as board independence and accountability increased), their costs of capital decreased. This relationship was stronger than the relationship between disclosure practices and the cost of capital. The findings suggest that good corporate governance—in particular, board practices—has the ability to lower a firm's cost of capital, thereby lowering its external financing costs and improving its value. Essentially, investors are willing to pay a premium for companies with good corporate governance in emerging markets where the chance of expropriation by insiders is great.

Good corporate governance can not only increase the performance of companies but can also raise foreign investment in a country. Foreign investors experience higher information costs when investing in companies in countries with poor shareholder protection and low disclosure and transparency. In a recent study, Leuz, Lins and Warnock (2009) found that U.S. investors have lower ownership in foreign companies with poor corporate governance, such as high family ownership, few shareholder protection rights, and little disclosure.

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[6]The markets were Hong Kong, India, Indonesia, South Korea, Malaysia, the Philippines, Singapore, Taiwan, and Thailand.

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THE PRESENCE OF INEDS EQUALS HIGHER FIRM VALUE

Given the evidence supporting the financial benefits of strong corporate governance practices, the next question is: Does the presence of INEDs on corporate boards add value? Growing empirical evidence suggests that the appointment and presence of INEDs on a board of directors is strongly related to greater firm value. The appointment of INEDs on boards in Asia should thus increase investor confidence and signal to shareholders that dominant shareholders are being monitored. Mak, Sequeira, and Yeo (2003) focused on stock market reactions to board appointments and found that the appointment of non-executive directors is viewed favourably by the market. Their study of the listed equity market in Singapore also found overwhelming evidence that the appointment of family-related directors is viewed negatively by the stock market. Black, Jang, and Kim (2006) analysed the South Korean equity market to determine whether corporate governance was able to predict firm value. Like other researchers, these authors found a strong correlation between board composition and firm value. Specifically, they found that South Korean companies with 50 percent outside directors have higher firm value.

Nowland (2008) also found evidence to support the importance of INEDs on corporate boards in his study of seven East Asian countries.[7] His research indicates that board independence is positively related to profitability but negatively related to family ownership and to the separation of ownership and control. These results suggest that family-controlled companies or companies controlled through pyramid structures tend to have fewer INEDs. Lei and Song (2008) researched corporate governance, board independence, and firm value. They found that firm value is positively related to board independence. They also found a strong positive effect on firm value if no family members were on the board. This key finding suggests that an independent board increases firm value in firms with concentrated shareholdings. Therefore, even if companies have a blockholder, an independent board assumes the monitoring role necessary to help ensure that managers and large shareholders are acting in the best interests of all shareholders.

Research by Dahya, Dimitrov, and McConnell (2006) uncovered a similar relationship between INEDs and firm value. This study of board independence in companies with a dominant shareholder in 22 countries found a positive relationship between the two variables and also found that the relationship is stronger in countries where shareholder protection is weak.[8] As mentioned earlier, in countries where legal rights are weak, appointing INEDs to a board is a way to help assure minority shareholders that their rights are being looked after. Dahya et al also found evidence that the occurrence of RPTs decreases as the number of INEDs on the board increases. Therefore, greater independent monitoring by INEDs should reduce the abusive use of RPTs.

In summary, corporate governance factors such as board independence are important for monitoring management and controlling shareholders because good corporate governance minimises opportunities to expropriate minority shareholders' wealth. In particular, the presence of INEDs gives shareholders confidence in the board and its ability to monitor management.

[7] Hong Kong, Indonesia, Malaysia, Singapore, South Korea, Taiwan, and Thailand.
[8] The study included the Asian markets of Hong Kong, India, Japan, and Malaysia.

SECTION 4: Cases

This section contains cases from Singapore, Hong Kong, and India that illustrate real boardroom practices. These real-life situations show independent non-executive directors acting with independent and objective judgement. In some cases, their efforts are overruled by the controlling shareholder, but in other situations, the INEDs do not protect minority shareholder rights but, apparently, succumb to pressure from the controlling shareholder.

We examine four areas:

1. removal of INEDs by minority shareholders,
2. removal of INEDs by a substantial minority shareholder,
3. INED resignations, and
4. questionable performance of corporate boards.

1. REMOVAL OF INEDS BY MINORITY SHAREHOLDERS

Isetan Singapore Limited
(listed in Singapore)

On 29 November 2006, 43 minority shareholders asked the board of Singaporean retailer Isetan for an extraordinary general meeting (EGM). The minority shareholders holding more than 10 percent of issued capital wanted the opportunity to vote on the removal of incumbent INEDs and replace them with shareholder-nominated INEDs.[9]

Over the years, minority shareholders had raised several concerns at annual general meetings (AGMs), but these concerns were never fully addressed. The major concern was the company's reluctance to use the S$60 million tax credit balance that was due to expire in December 2007. At the current corporate tax rate, the tax credit balance translated to S$305 million in franked dividends (dividends with no tax attached to them) to shareholders.

Isetan is controlled by Isetan Japan, which holds 61 percent of the company. Market watchers believed that the company had not used the tax credits because Isetan Japan was never in favour of doing so. Japan has a higher tax rate than Singapore, and a large franked dividend payment would have disadvantaged the major shareholder because of its large tax bill.

The minority shareholders had the view that the INEDs were aligned with management and were not thinking about the interests of the other shareholders. They were also concerned because two of the three INEDs were brothers, had been on the board since Isetan listed in 1981, and had family ties to the founders of Isetan (Shyan 2007a).

Unfortunately for the minority shareholders, the resolutions to remove the directors were voted down at the EGM on 10 January 2007. The company did state, however, that it was committed to addressing the tax credit issue at the next AGM in April (Shyan 2007b).

On 7 February 2007, the company announced it was working with advisers to find a solution, and on 27 February, it announced a S$1.50 dividend per share that included a 7.5 cent final dividend and a $1.42 special dividend (Buenas 2007). Shareholders were not happy with the amount because it was considerably less than what the company could have paid.

[9] 'Isetan Confirms Call . . .' (2006).

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Issues

This case illustrates how investors have the ability to take action if they believe directors are not acting in their best interests. Here, the shareholders lost the battle to remove the directors but the company did use the tax credits, which is ultimately what the shareholders wanted. Another benefit of the investor activism is that over the period of engagement, the Isetan share price increased 41 percent—from S$4.72 to S$6.65 per share (Butler 2007).

The shareholders had a right to be concerned about the independence and objectivity of the INEDs. One has to question how independent the brothers were after serving 25 years on the board and having a family relationship with Isetan. As of 31 December 2008, the brothers and Chan Pengee were still listed by the company as INEDs serving on the Isetan board.

2. REMOVAL OF INEDS BY A SUBSTANTIAL MINORITY SHAREHOLDER

Kian Ho Bearings Limited
(listed in Singapore)

On 6 March 2009, the managing director of Kian Ho Bearings Ltd, Teo Teng Beng, told independent director Tan Lye Huat that at a recent executive committee meeting, the committee decided that it wanted to bring a 'lawyer-independent director' onto the board and that Tan Lye Huat should resign as soon as possible.[10]

On 11 March 2009, Tan Lye Huat sent a letter to the chairman of the board stating '. . . in light of my fiduciary responsibilities and duties as a shareholder-elected and -appointed independent director, I regret that I am unable, in all good conscience, to accede to your request to submit my resignation. . . . '

According to Tan Lye Huat, several meetings followed in which managers, the chairman, and the other independent directors attempted to persuade him to resign. Tan Lye Huat did not accede to their persuasion, which eventually led to Teo Xian-Hui, the managing director's daughter and a substantial shareholder of Kian Ho, advising the company that she wanted to remove Tan Lye Huat as a director.[11] In the letter, dated 16 March 2009, she said that the board needed legal expertise and, essentially, that Tan Lye Huat was not adding as much value as the other two independent directors on the board.

On 13 March 2009, Tan Lye Huat wrote to the board seeking clarification of several issues regarding the request for his resignation and detailing his reasons for not acceding to the request for resignation. Tan Lye Huat specifically requested that the letter be released to the Singapore Stock Exchange (SGX) and shareholders before 17 April 2009 to give the public time to review the information before the AGM on 27 April 2009.

After several attempts by Tan Lye Huat, the SGX, and the Accounting and Corporate Regulatory Authority (ACRA) of Singapore to ensure that the letter was made available to shareholders in good time, the letter was not released until late Friday, 25 April 2009, two days before the scheduled AGM on Monday.

At the AGM, Tan Lye Huat was voted off the board of Kian Ho Bearings; majority shareholders representing about 50.5 million shares voted for the resolution for his removal, and only 1.45 million voted against. The majority shareholder Tat Hong Holdings, with an approximately 30.2 percent stake, abstained from the vote because it wanted the minority shareholders to have their voice heard (Huiwen 2009).

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[10]Tan Lye Huat sits on the boards of a number of public/listed companies as well as not-for-profit organisations in Singapore. He is a member of the Institute of Directors (IoD, UK), the International Policy Governance Association, and the Australian Institute of Company Directors. Tan Lye Huat has also been accorded the title of Chartered Director of the IoD (UK) and is a founding member of the Policy Governance Association of the United Kingdom. He contributes to the corporate governance initiatives of a number of other prominent bodies (www.himgovernance.com.sg/about_people8.html).

[11]Teo Xian-Hui's shareholdings represented 13.32 percent of share capital of Kian Ho Bearings at the time.

Even though he was voted out, Tan Lye Huat was quoted saying, 'The end game is not whether I'll be in or out. The end game is whether I've fully discharged my fiduciary duties as an independent director, and I'm happy I have done so' (Huiwen 2009).

Issues

Given that the formal request to remove Tan Lye Huat was made by a shareholder with more than 5 percent at an AGM, and the resolution was voted favourably by a majority of the votes at the meeting, the company did nothing wrong legally. From the standpoint of the treatment of INEDs and the rights of minority shareholders, however, several issues are notable.

Tan Lye Huat was one of three independent directors on the board, and although the other two INEDs were due for retirement at the upcoming AGM, he was not. Moreover, Tan Lye Huat never received any verbal or written communication about any misconduct, misbehaviour, or lack of contribution on his part.

According to Tan Lye Huat, 'Several subsequent attempts by the managing director and independent director, Lee Joo Hai, were made to pressure me to resign. . . .'[12]

Tan Lye Huat acted in the best interests of all shareholders by not bowing down to the request of the majority shareholders, corporate managers, and the board. Instead, he fought to keep shareholders informed of his situation and his concerns, thereby leaving the choice in their hands.

3. INED RESIGNATIONS

Automated Touchstone Machine Limited
(delisted from SGX in September 2008)

The resignations of independent directors were a regular occurrence at Automated Touchstone Machine (ATM), a maker of automatic teller machines, during 2007 and 2008. INEDs Wong Joo Wan, the chairman of the audit committee, and Goh Sze Hui, a member of the audit committee, announced their intention to resign in September 2007. The two directors issued a joint statement that they had been unable to review the effectiveness of the company's internal controls because no internal audit had been carried out. Neither director was able to confirm the consolidated financial statements. In this letter, they recommended the appointment of a qualified chief financial officer and other finance personnel as well as the immediate outsourcing of the internal audit duties.[13] Goh Sze Hui and Wong Joo Wan were appointed INEDs on 20 April 2007 and resigned on 15 October 2008.

Problems with internal audits had been an issue at ATM from before Goh Sze Hui and Wong Joo Wan's time on the board. In fact, these men were appointed after two other INEDs, Tan Hong Huat and U Kean Seng, resigned for similar reasons on 18 April 2007. Tan Hong Huat and U Kean Seng were slated for removal as directors (together with another director) at an EGM on 20 April, but they resigned before the meeting. The third non-executive director was ousted at the EGM.

Tan Hong Huat and U Kean Seng received notice on 19 March 2007 from Wang Jia, the CEO and chairman of ATM, acting on behalf of the controlling shareholder Advent Time Ltd.[14] The notice called for their 'voluntary resignation' with threat of forced removal'.[15] The directors' joint resignation letter stated that management made false allegations about their ability to discharge their duties as INEDs, accusations they both denied.

[12]Tan Lye Huat, letter to board of directors, Kian Ho Bearings, 'Re: Request for resignation by the Exco and proposed removal as director' (25 March 2009).
[13]Wong Joo Wan and Goh Sze Hui, letter to shareholders, 'Statement by Independent Directors' (14 September 2007).
[14]Wang Jia is the founder and also the controlling shareholder of ATM; he had a deemed interest of 50.1 percent in ATM through Advent Time Ltd as of 30 August 2007.
[15]Tan Hong Huat and U Kean Seng, letter to shareholders, 'Joint Statement of Independent Directors' (20 April 2007).

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The directors went on to explain in the letter their views on why management asked for their removal. They believed the incumbent management was not happy with the recommendation of the audit committee (which they were both members of) to appoint special auditors to review significant internal control and audit issues. This recommendation was ultimately vetoed by management. The management later disagreed with the directors' views because the audit committee meeting in question took place more than one week after 19 March.[16]

Tan Hong Huat and U Kean Seng brought the issue to the SGX in early April, and the exchange directed the company under the listing rules to appoint special auditors.

Issues

Tan Hong Huat and U Kean Seng discharged their duties as INEDs by not submitting to pressure from the CEO or the controlling shareholder. They made the governing stock exchange aware of the problems with the internal audit process in the company and then, in their resignation letter, alerted minority shareholders to the situation.

Similarly, Wong Joo Wan and Goh Sze Hui, when they decided they could not effectively discharge their duties as INEDs on the audit committee, also resigned.

In both situations, the INEDs gave reasons for their resignations, thereby bringing the problems in the company to the attention of minority shareholders.

China Aviation Oil (Singapore) Corporation Limited
(listed in Singapore)

After serving on the board of China Aviation Oil (Singapore) Corporation (CAO) for more than two years, Mrs Lee Suet Fern suddenly resigned as an INED on the CAO board in April 2008. Mrs Lee Suet Fern stated in her resignation letter, which was immediately released to the public, that 'as a result of the company's approach to information flow and the management of decision-making, review, and oversight, [it is] increasingly difficult for me to properly discharge my duties as an independent director of the company'.[17]

It later became apparent that Mrs Lee Suet Fern had been thinking about resigning from the board for some time. She questioned the independence of certain board members, and she felt as though she was alone in discharging her duties as an INED, although two other supposedly independent directors were on the board. These were chairman Lim Jit Poh and Liu Fuchun, who was based in China (Quah 2008).

Part of Mrs Lee Suet Fern's concern was Lim Jit Poh's remuneration, which was over and above the director's fee. After a near collapse of Civil Aviation Oil in late 2004, the CEO was suspended and in the absence of a suitable replacement, Lim Jit Poh took over the management function of the CEO. At this time, the company introduced a special corporate governance committee to improve and advise on corporate governance, management structure, and systems. Mrs Lee Suet Fern was an active member of this committee.

Issue

As in the case of ATM, Mrs Lee Suet Fern believed she was no longer able to discharge her duties as an INED. She had been on the board for more than two years, and she had been involved in reviewing many of CAO's corporate governance practices. Her departure and the statement she made in her resignation letter signalled to shareholders that she had concerns about the company's corporate governance and internal board practices.

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[16]Wang Jia, letter to shareholders of ATM, 'Automated Touchstone Machines Limited—Joint Statement of the Executive Directors in Response to the Independent Directors' (20 April 2007).
[17]Resignation letter to chairman and vice-chairman of China Aviation Oil (Singapore) Corporation, 23 April 2008.

Swissco International Limited
(listed in Singapore)

In March 2008, two INEDs resigned from Swissco International, a marine service provider listed in Singapore. Both were former Members of Parliament. Chiang Hai Ding (also a former ambassador) and Rohan Kamis (an accountant) wrote separate resignation letters stating that they resigned because they were unable to discharge their responsibilities as INEDs.

Their decisions came after a board meeting on 27 February 2008 at which the executive chairman, Yeo Chong Lin, who is also the majority shareholder and founder, said he wanted all INEDs to serve one-year terms with renewal at the discretion of the chairman.[18]

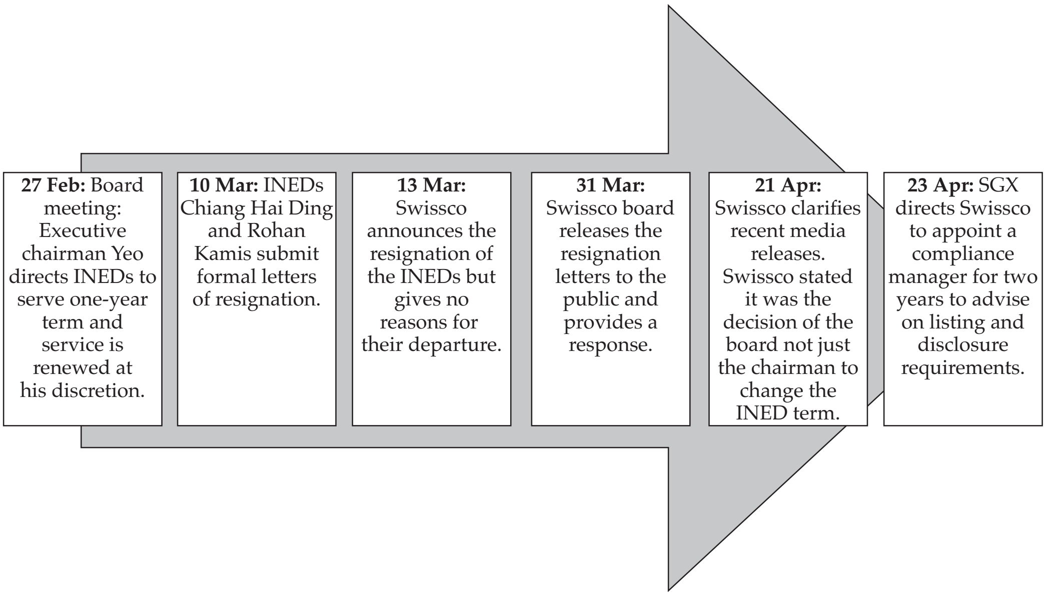
Both INEDs were shocked that the board tenure was being revised because the new terms were not in line with the three years stipulated in the company's Memorandum and Articles of Association. The company adopted a new board renewal process in 2006 that was to be implemented in 2008 whereby 'the tenure of each director should not be less than two years and not more than five years'. Exceptions were allowable 'only under special circumstances' (Loh 2008). The convention for board tenure in Singapore is that directors are elected for a term of three years (except for directors over the age of 70, for which the term is one year).[19] Rohan Kamis also highlighted in his letter that he was not happy with the structure of the bonus payments made to the chairman and the CEO (the chairman's son). **Figure 2** provides a timeline of the events in February–April 2008 related to the change in INED tenure and subsequent events.

Issues

This case illustrates several corporate governance problems:

- No conditions should be put on directors regarding their election or re-election that could affect their independence. Conditions would compromise their independence

Figure 2. Timeline of Events from February 2008 to April 2008



Source: CFA Institute.

[18]Yeo Chong Lin and his son Yeo Kian Alex (who was also CEO of the company) had a deemed interest of 54.91 percent of Swissco International through Yeo Holdings Private Ltd as of 18 March 2008.
[19]Companies Act, Chapter 50, s153, Singapore.

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and put minority shareholders at risk. As stated by Chiang Hai Ding in his resignation letter, 'Requiring independent directors to serve one-year terms, with continuation at the discretion of the company chairman, undermined their independence'.[20]

- Re-election should be assessed by the nomination committee, not the chairman alone. The directors should not be accountable to company management nor the majority shareholder but to all shareholders.
- Swissco did not make the letters public until 31 March 2008 'in response to a request to clarify an earlier announcement,'[21] despite the fact that the company announced the INEDs' resignations on March 13 and both INEDs asked for the letters to be released to the public as soon as possible.

The INEDs followed good corporate governance practices:

- They both wrote resignation letters and gave reasons for resigning in accordance with the requirement set out in the listing rules. They also asked for the letters to be made public.
- The directors chose to resign rather than continue on the board. In this way, they sent a message to investors and the public about the state of corporate governance practices at Swissco. The INEDs chose to 'rock the boat' at the risk of not being elected on to other corporate boards.

4. QUESTIONABLE PERFORMANCE OF CORPORATE BOARDS

Satyam Computer Services Limited

(listed on the Bombay Stock Exchange, National Stock Exchange of India, and as American Depositary Receipts on the NYSE)

Satyam Computer Services Ltd, one of India's largest providers of software services, had an amazing fall from grace between December 2008 and April 2009, when it made an announcement that resulted in its share price falling 78 percent, the resignation of its chairman and founder, and eventually, sale of the company.[22] After being awarded a Golden Peacock by the World Council for Corporate Governance in September 2008, Satyam was thought of as a company with strong corporate governance practices. Its golden age did not last long, however, as it was stripped of the award in January 2009 (Behan 2009).

The story began when Ramalinga Raju, chairman and founder of Satyam, tried to pass an abusive, expropriating minority shareholder RPT worth US$1.6 billion as a deal that would 'deliver greater shareholder value'.[23] Satyam wanted to buy Maytas Properties Ltd and a controlling interest in Maytas Infra Ltd. Ramalinga Raju and his brother Rama Raju, CEO of Satyam, together owned more than 20 percent of Maytas Infra, and Ramalinga Raju's immediate family owned more than 35 percent of Maytas Properties.[24] It was later found that the deal, estimated to be worth only US$225 million (Fontanella-Khan 2009), was a last-ditch effort by the chairman to 'fill the fictitious assets with real ones'.[25]

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[20] Resignation letter to board of directors of Swissco (10 March 2008).
[21] Swissco board, 'Clarification on the Recent Resignation of Two of Our Independent Directors' (31 March 2008, p. 1).
[22] This is the fall in price on the NYSE from the date of the announcement to 13 April 2009 when Tech Mahindra submitted the highest takeover bid for Satyam.
[23] Bloomberg, transcript of Satyam analyst conference call in which Ramalinga Raju is quoted (16 December 2008).
[24] The Raju brothers had a deemed interest of 8.31 percent in Satyam through SRSR Holdings Private Ltd as of 31 March 2008.
[25] Ramalinga Raju's resignation letter to the board of directors (7 January 2009).

Investors knew something was not right when the company announced the deal because

- the purchase of property and infrastructure assets was completely unrelated to the current business operations;
- the board unanimously approved the deal without shareholder approval, even though it was a RPT;[26] and
- the company, which was very evasive on the conference call after the announcement, did not even release the name of the adviser to the deal.

The timeline of events is provided in **Exhibit 1**, and **Figure 3** shows the effect of the events on Satyam's stock price. As of August 2009, Ramalinga Raju and his brother were still in jail awaiting trial on fraud and other charges.

Exhibit 1. Timeline of Events from December 2008 to June 2009

2008	2009	
• **16 Dec:** Satyam board approves the purchase of 100% of Maytas Properties Ltd for US$1.3 billion and 51% of Maytas Infra Ltd for US$300 million. • **17 Dec:** Satyam share price falls 30% on the Bombay Stock Exchange as shareholders dump the stock. The deal is called off less than 12 hours after its announcement. • **26–29 Dec:** Three of the five INEDs on the Satyam board resign.	• **7 Jan:** Chairman Ramalinga Raju resigns after admitting to falsifying the financial statements to create a fictitious cash balance of more than US$1 billion. • **9 Jan:** Police arrest Ramalinga and Rama Raju on charges of forgery, cheating, and fraud. The Indian government's Company Law Board removes the remaining directors. • **16 Jan:** The Indian government appoints an independent board to oversee the company. • **24 Jan:** Police arrest the implicated PricewaterhouseCoopers auditors.	• **27 Jan:** The board announces its intention to sell Satyam. • **7 Apr:** Police file charges of cheating and forgery against former chairman Ramalinga Raju and eight others, including his brother and the auditors. • **13 Apr:** Tech Mahindra submits highest bid, at 58 rupees per share, for Satyam. • **16 Apr:** The Company Law Board approves Tech Mahindra Ltd's proposal to buy a controlling stake in Satyam. • **22 Jun:** Satyam is renamed Mahindra Satyam.

Sources: Adapted from Anand (2009); CFA Institute.

Issues

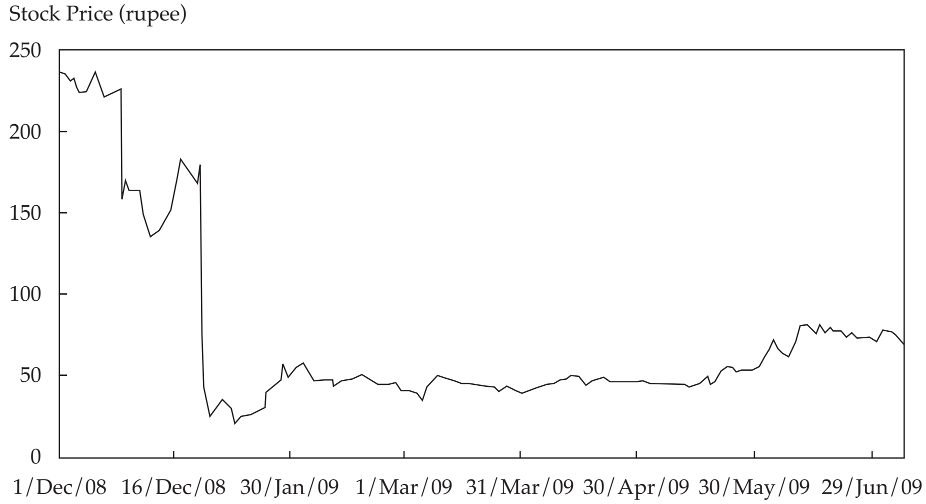
This case highlights inadequacies in corporate governance practices, especially as to the role of INEDs on company boards.

At the time of the 16 December 2008 Satyam board meeting that approved the two RPTs, five of the nine directors on the board were INEDs and the audit committee consisted of four members, all of which were INEDs.[27] Board minutes show that at least three INEDs raised questions about the motivation for the deals and the valuation of the target companies, but the end result was still unanimous approval for the two acquisitions. Three of the five INEDs subsequently, between one to two weeks after the board meeting, resigned without giving any reason.

[26] Currently, in India, the Companies Act 1956 and Clause 49 of the Listing Agreement on RPTs require only board approval; the approval of independent shareholders is not required.

[27] According to the 2008 annual report, five directors were INEDs, two were executive directors, and one was a non-executive director. The non-executive director was not classified as independent because he received a professional service fee that was over and above the director's fee.

Figure 3. Satyam's Fall from Grace



Sources: Based on data from the National Stock Exchange of India; CFA Institute.

The representation of INEDs on the Satyam board and audit committee was consistent with India's Clause 49 of the Listing Agreement on RPTs and with best practice in Asia. Nevertheless, the actions of the INEDs are questionable because they overlooked the obvious holes in the deal and gave it their full support.

Mangalam Srinivasan, an INED on the Satyam board, suggested in the meeting that board members should have been informed and involved in the process from the beginning to 'avoid the impression that the board is used as a rubber stamp to affirm the consequence or decisions already reached'.[28] This comment was timely and appropriate, but rubber stamping is effectively what Mangalam Srinivasan and the other board members did. So, the questions about the role of the INEDs on the board and whether they were acting in the best interest of shareholders remain.

CITIC Pacific
(listed in Hong Kong)

On 20 October 2008, two senior CITIC Pacific executives resigned after the company announced foreign exchange (forex) losses in excess of HK$15 billion. The finance director, Leslie Chang Li-hsien, and financial controller, Chau Chi-yin, resigned as directors of CITIC Pacific. CITIC Pacific is a Hong Kong–listed subsidiary of the Beijing-listed CITIC Group, which is China's largest state-owned investment company.[29]

The company bought forex contracts to fund an iron-ore mine in Australia. Using forex accumulator contracts, the company wanted to hedge its exposure to the rising Australian dollar (A$). Problems arose, however, when the U.S. dollar appreciated sharply against the Australian dollar.

Larry Yung, chairman of CITIC Pacific, raised the following issues in his statement released on 20 October:

- CITIC Group's hedging policies were not followed.
- Senior finance executives did not obtain the appropriate approvals before undertaking the contracts.

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[28] Satyam board minutes of 16 December 2008:4.
[29] 'Hong Kong Probes CITIC Pacific . . .' (2008).

The major problem was that the company learned about the forex exposure on 7 September 2008 but the board did not disclose the losses until six weeks later, on 20 October. This gap raised many questions from shareholders and the regulators that induced the Hong Kong Securities and Futures Commission (SFC) to launch a formal investigation into the currency transactions, including investigations into the entire board.

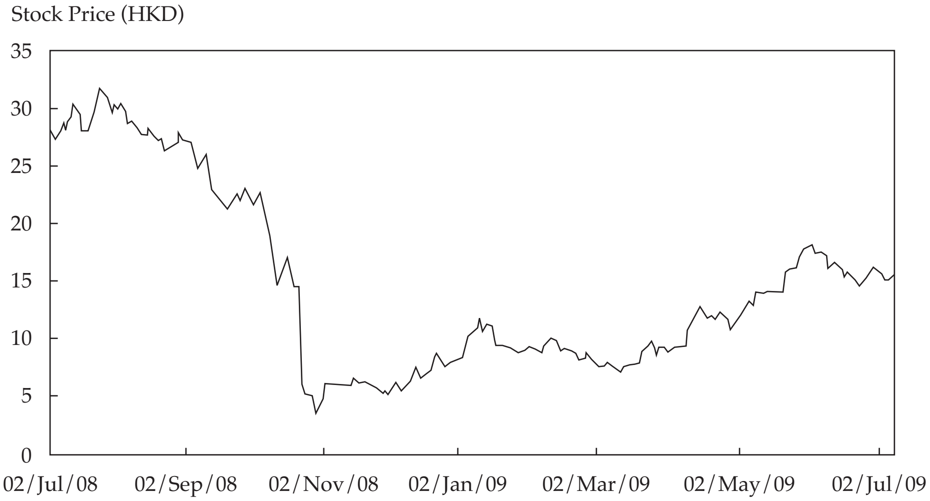
Another issue that has been raised concerns a statement in an announcement made by CITIC Pacific on 12 September 2008 in regards to an unrelated acquisition. The statement read, 'The directors are not aware of any material adverse change in the financial or trading position of the group since Dec. 31 2007'.

The company later announced that the realised and potential losses from the contracts had risen to HK$18.6 billion (US$2.38 billion). CITIC Group came to CITIC Pacific's rescue in late December 2008 when CITIC Pacific completed a deal to issue a convertible bond to its parent, thereby increasing the group's stake in CITIC Pacific from 29.4 percent to 57.6 percent in return for CITIC Pacific to have access to a HK$11.6 billion (US$1.5 billion) loan facility and transferring some of the forex liabilities to CITIC Group.[30]

After the share conversion, Larry Yung's shareholdings in CITIC Pacific were diluted to 11.5 percent from 18.4 percent and the holdings of the managing director of CITIC Pacific, Henry Fan, fell to 1.4 percent from 2.3 percent.

Larry Yung and Henry Fan resigned from their positions on 9 April 2009, a week after the Commercial Crime Bureau (CCB) of Hong Kong executed a search warrant of the company's offices. The CCB began investigating allegations of false statements by directors and/or a conspiracy to defraud, and as of August 2009, the SFC and CCB investigations continued.[31] The effect of the scandal on CITIC Pacific's share price is shown in **Figure 4**.

Figure 4. CITIC Pacific



Sources: Based on data from the Hong Kong Exchange and Clearing; CFA Institute.

Issues

The most obvious issue is the failure of the board to disclose the forex exposure to the public sooner than they did. So, the question is: When did they find out?

- The company said it became aware of the situation on 7 September 2008, but the statement made on 12 September 2008 states that the directors were not aware of 'any material adverse changes' to its financial position. Something is not right here.

[30] CITIC Pacific news release, 'CITIC Set to Move Forward with Support of CITIC Group' (12 November 2008).
[31] 'CITIC Pacific Reshuffle . . .' (2009).

- In his statement of 20 October 2008, chairman Larry Yung said that the transactions were not authorised. Therefore, the board did not know of their existence or CITIC Pacific's exposure. Several people, however, have questioned the board's ignorance. On the one hand, if the board did not know of the exposure, then the company had a lack of internal controls and risk management procedures. On the other hand, if the board *did* know, why were the forex deals not stopped?[32]
- At the time of the initial release of information, there were four INEDs on the CITIC Pacific board. Again, the questions are: When did they find out? And why did they not push for more timely disclosure?

The big problem confronting shareholders in this case is that investors who bought and sold shares in the six-week period during which the company was silent could not make fully informed decisions because they were unaware of significant, material financial information. As Figure 4 shows, over the six-week period, CITIC Pacific's share price lost 44 percent and it fell a further 55 percent when trading resumed after the announcement on 20 October. Investors who purchased CITIC Pacific shares in this period were significantly affected.

Whether the directors (including the INEDs) are liable remains to be decided.

[32]'CITIC Pacific Reshuffle . . .' (2009).

SECTION 5: Country Analyses

In this section, we provide a description and comparative analysis of the regulations regarding independent non-executive directors in Hong Kong, Singapore, India, and the Philippines, with a focus on the corporate governance codes. We have identified the following four key corporate governance areas that we believe need to be improved to increase director independence in Asia:

1. Director nomination and appointment
2. The concept of independence
3. Director training and qualification
4. The number of independent non-executive directors on a board

We open the section by providing an overview of the legal and regulatory landscape and the corporate ownership structures within these jurisdictions.

LEGAL AND REGULATORY LANDSCAPE

The legal systems in Hong Kong, Singapore, and India are all based on British common law, whereas in the Philippines, the legal system is based on French civil law. One of the main differences between these legal systems is that civil law relies on legal scholars to formulate statutes and comprehensive codes whereas common law is shaped by precedents from judicial decisions (La Porta, Lopez-de-Silanes, Shleifer, and Vishny 1998). In all these jurisdictions, a form of corporate law governs all companies and listed companies are bound by the listing rules of the exchanges.

Under corporate law, directors and senior managers are subject to civil and criminal liability. Non-statutory regulations, however, such as listing rules, represent only a contract between the exchange and the client (the issuer). Therefore, because these rules have no legal basis, non-compliance with listing rules produces only public censure and potential delisting. A related issue is that shareholders have a limited ability to seek redress under the listing rules because they are not privy to the contract.

The relevant country laws and corporate governance codes are detailed in **Exhibit 2**.

CODES OF CORPORATE GOVERNANCE

All four countries have corporate governance codes that outline best practices for matters relating to boards of directors, including board composition, independence, director qualifications, and member duties and responsibilities. The codes also describe the role of the auditors, other internal controls, and procedures for timely disclosure and transparency.

The codes in the Philippines and India are non-statutory but mandatory. In India, most items stipulated in Clause 49 are mandatory, but some, such as regular director training, are only recommended. In Hong Kong, some elements of the code have been incorporated into the listing rules and are, therefore, mandatory; an example is the criteria for independence and directors' duties.

Hong Kong and Singapore have adopted the 'comply or explain' approach to raising corporate governance standards. In this approach, companies need to *comply* with the given guidelines in the code of corporate governance or *disclose* and *explain* in the annual report why they have not complied.

Rule 3.25 of the HKEx Main Board Listing Rules describes a two-tier approach for companies in Hong Kong. The first tier includes minimum standards of board practice, and any deviation from these standards requires the company to disclose and explain it in the annual report. The second tier includes recommended best practices, and non-compliance with these recommendations does not need to be explained.

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Exhibit 2. Laws and Regulations for Hong Kong, India, the Philippines, and Singapore

Hong Kong	• **Governing corporate law**: Hong Kong Companies Ordinance ■ Regulator: Companies Registry • **Other laws**: Securities and Futures Ordinance and listing rules* ■ Regulator: Securities and Futures Commission (SFC) and Hong Kong Exchange and Clearing • ***Official corporate governance codes or guidelines****: Code of Corporate Governance (Appendix 14, HKEx Main Board Listing Rules) 2005 ('HK Code')*
India	• **Governing corporate law**: Companies Act 1956** ■ Regulator: Ministry of Corporate Affairs • **Other laws**: Securities Contract (Regulations) Act 1956 and Securities and Exchange Board of India (SEBI) Act 1992 and listing rules ■ Regulator: SEBI • ***Official corporate governance codes or guidelines****: Clause 49 of Listing Rules (revised March 2005) ('Clause 49')*
Philippines	• **Governing corporate law**: Securities Regulation Code 2000 and Corporation Code of the Philippines ■ Regulator: Securities and Exchange Commission • ***Official corporate governance codes or guidelines****: Code of Corporate Governance, Memorandum Circular No. 6, 2009 ('Philippines Code') and other circulars*
Singapore	• **Governing corporate law**: Companies Act of Singapore (Chapter 50) ■ Regulator: Accounting and Corporate Regulatory Authority (ACRA) • **Other laws**: Securities and Futures Act and listing rules ■ Regulator: Monetary Authority of Singapore (MAS) and Singapore Exchange Ltd (SGX)*** • ***Official corporate governance codes or guidelines****: Code of Corporate Governance, July 2005 ('Singapore Code')*

*The listing rules are enforced by both the HKEx and SFC.
**A new Companies Bill 2008 is tabled in the Indian Parliament; if passed, it will replace the Companies Act.
***The listing rules are enforced by both the SGX and MAS.

Source: See Appendix A.

The Singapore Code is structured as principles, guidelines, and commentaries. Rule 710 of the SGX Listing Rules requires companies to explain deviations from the guidelines. As with the second-tier recommendations in Hong Kong, the commentaries do not require explanation but serve to encourage best practice.

The benefit of having codes rather than statutes is that they are easier to change because they avoid long legislative processes. They are also less prescriptive and give more flexibility to companies. Giving companies more flexibility, however, is not always a good thing. Flexibility can result in companies complying with only what is absolutely necessary—ticking boxes—rather than complying with the spirit of the code.

A lot of discussion has focused on whether the comply or explain approach is appropriate in these markets. The non-statutory status of these guidelines reduces their effectiveness because they are harder to enforce than statutes and because shareholder redress if a company breaks a code is low. Civil claims are expensive, class actions are unavailable, and derivative suits are hardly worth shareholders' time or effort because if the plaintiff wins, financial gains go to the company, not the individual shareholders. Therefore, the comply or explain approach may work better in jurisdictions with strong shareholder activism and developed media (Coombes and Wong 2004). In those jurisdictions, companies have an incentive to comply with the guidelines because they risk public criticism and backlash from shareholders if something goes wrong.

OWNERSHIP STRUCTURE

Family ownership is common in all four jurisdictions. It is not unusual for the founding family to be the largest shareholder in many companies by owning shares directly and indirectly through pyramid structures. For family members to be actively involved in company management—from day-to-day operations to the positions of chairman and CEO—is also quite normal. Generally, shareholdings of family members are also counted and voted collectively (Ho 2003).

The founding family is often the controlling shareholder, but control is not always exercised by owning a majority of the company shares. Hong Kong and Singapore recognise that shareholders do not need more than 50 percent to effectively control a company and have incorporated this conclusion into their listing rules. In both jurisdictions, a controlling shareholder is not limited to a shareholder who owns a certain proportion of voting shares but is also a shareholder who is in a position to control the composition of the board or exercise some control over the company.[33]

As explained in Section 3, minority shareholders are at a greater risk of expropriation when there is a controlling shareholder and voting rights outweigh cash flow rights. This situation is a regular outcome of pyramid ownership structures. **Table 1**, based on Claessens et al (2002), illustrates that in 1996, family ownership was the predominant ownership type in Hong Kong (69 percent) and Singapore (53 percent) and almost predominant in the Philippines (45 percent). A recent study of companies in India shows that more than 50 percent of companies listed on the Bombay Stock Exchange (BSE) are family owned/ promoted (Saravanan 2009).[34]

Table 1. Control of East Asian Corporations by Owner Type and Economy, 1996

			Percentage of Companies with Ultimate Control*		
Economy	Number of Companies in Sample	Percentage of Companies with Dispersed Control	Family Owned	State Owned	Owned by a Widely Held Corporation or Financial Institution
Hong Kong	**225**	**8%**	**69%**	**1%**	**23%**
Indonesia	132	6	70	8	16
Malaysia	171	11	70	11	9
Philippines	**77**	**19**	**45**	**1**	**34**
Singapore	**176**	**9**	**53**	**24**	**14**
South Korea	281	41	52	0	7
Taiwan	129	29	47	1	24
Thailand	110	6	68	5	20
Total	**1,301**	**18%**	**60%**	**6%**	**16%**

*20 percent cut-off for effective control of the largest shareholder.

Source: Based on Claessens et al (2002), p. 2750.

[33]HKEx Main Board Listing Rules, Chapter 1: Interpretation; SGX Mainboard Listing Rules, Definitions and Interpretations.
[34]In India, a promoter is a person or entity that was involved in the formation of the company.

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CURRENT OBSTACLES TO INDEPENDENT BOARDS

How can INEDs help minimise the possibility of shareholder expropriation in concentrated ownership structures? In this section, we try to address this question by looking at the current rules and regulations in Hong Kong, India, the Philippines, and Singapore. For this purpose, we first reviewed the publication *Asia: Overview of Corporate Governance Frameworks in 2007* published by the Organisation for Economic Co-operation and Development and local regulations. We identified key areas in the OECD principles that we believe are important for the role of an effective INED.

OECD CORPORATE GOVERNANCE PRINCIPLES

I. Ensuring the Basis for an Effective Corporate Governance Framework
II. The Rights of Shareholders and Key Ownership Functions
III. The Equitable Treatment of Shareholders
IV. The Role of Stakeholders in Corporate Governance
V. Disclosure and Transparency
VI. The Responsibilities of the Board

Of the OECD Corporate Governance Principles, we focus on Principles II and VI.[35] The summary table in Appendix B is a comparative overview of these two key areas for the four Asian markets in our study.

We have identified four main areas that we believe are important for minimising the possibility of shareholder expropriation in Asia:

1. Director nomination and appointment
2. Concept of independence
3. Director training and qualification
4. Board composition

Information about these four areas is important for understanding the current state of regulations and the consequent effectiveness of INEDs in these markets. Each area will be discussed in detail.

1. Director nomination and appointment

All the jurisdictions in our study give shareholders the right to nominate candidates for board positions, although this right is rarely exercised by minority shareholders (see Appendix B). Differences between markets lie in the thresholds required for shareholders to be granted this entitlement and the ability shareholders have to place nominations directly on the slate.

Generally, the nomination of directors is the responsibility of the board. The concept of a nomination committee of the board is gaining acceptance in the more developed markets. These committees are widely used in the United Kingdom, United States, and Australia. The nomination committee usually has the task of reviewing the size and composition of the board, identifying suitable directors for nomination, planning for succession to the CEO and chairman positions, and assessing the independence of the INEDs.

Nomination committees are a comply or explain requirement in Singapore but only a recommended best practice in Hong Kong. They are mandatory in the Philippines, but India's Clause 49 makes no actual reference to a nomination committee at all. The only committee that is mandatory in all four jurisdictions is the audit committee.

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[35]The Principles are non-binding standards and best practices that help to guide the process for developing strong corporate governance practices within countries (OECD 2004).

If companies in Hong Kong and Singapore have a nomination committee, at least a majority of the members are required to be independent. In the case of Singapore, the chairman of the committee must be independent. In the Philippines, nomination committees need to have at least three members on the committee but only one member is required to be independent.

Disclosure of details about directors

Another concern is the quantity and quality of information disclosed about directors up for election or re-election. All jurisdictions require some level of disclosure, but some requirements are better than others because of the depth of disclosure they require. Disclosure of biographical details such as professional experience, directorships, and the presence of significant relationships with management/shareholders is of most importance to shareholders at the time of elections.

In Singapore, Appendix 7.5.1 of the SGX Mainboard Listing Rules mandates the disclosure in the announcement of the director's appointment biographical details, including academic and professional qualifications, past and present directorships, and any significant relationship with management and/or substantial shareholders. In addition, the Singapore Code recommends that the information be included in the annual report with the names of directors up for election and re-election.

In Hong Kong, listing rules mandate the inclusion of similar information in the annual report, the notice of an AGM or the accompanying circular to shareholders, and in a notice of appointment.[36] In India, Clause 49 states that shareholders must be presented with information about a director's expertise and shareholdings as well as other directorships and relationships among directors in the notice of appointment. In the Philippines, the Final List of Candidates and Information Statement prepared by the nomination committee must include background information on the nominees as required under the Securities Regulation Code.[37]

The disclosure of director information in Hong Kong is widespread, and the quality is high, as would be expected because it is a mandatory requirement under the listing rules. For the same reason, the inclusion of biographical information in the announcement of appointment for Singaporean companies is widespread. Our understanding is that the quality of disclosure (if any) in India and the Philippines is low. In some cases, the announcement of appointment made to the stock exchange consists of only one or two lines. In the Philippines, shareholders are not sent the information but need to download it themselves.

Key problems:

Independence of the nomination committee is questionable. Our first concern is the independence of the nomination committee. If the board does not have a nomination committee that is composed of at least a majority of independent directors and if there is a majority shareholder on the board, then appointing truly independent directors will be problematic. Boards in Asian companies have traditionally had few outside directors, and in those companies that do, the independence of the so-called INEDs is questionable. Typically, the majority shareholder or CEO (who is sometimes one and the same) nominates directors from his 'old boys' club' regardless of the nominees' experience or qualifications. This practice effectively builds up support for the controlling shareholder on the board. The situation contains a potential conflict of interests because the INED has been nominated and appointed by the CEO but the CEO is the person the INED was hired to monitor.

The nomination and appointment process tends to exclude minority shareholders. Our second concern is the actual nomination and appointment process. Not all jurisdictions give shareholders the ability to directly nominate candidates. For example, the process is controlled by the nomination committee in the Philippines. India has no official regulation for a nomination committee at all; therefore, the board/controlling shareholder there has total

[36]See Chapter 13 of the HKEx Main Board Listing Rules.
[37]Part IV(A) of Annex 'C' of SRC Rule 12 and SRC Rule 38 No. 8D.

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control. In countries that do give shareholders the right to directly nominate directors, such as Hong Kong and Singapore, there is no guarantee that these nominees will be appointed because controlling shareholders will always be able to out vote the minority shareholders.

The quality of disclosure of directors' biographical details at the time of election/re-election is low. The current level of disclosures highlighting the background of candidates up for election does not help shareholders assess whether or not candidates are independent. Therefore, this information does not give shareholders the opportunity to make fully informed decisions before they vote.

2. Concept of independence

The four jurisdictions have slightly different ways of defining independence. All call for an independent element of the board of directors, and they all (except India) refer to the need for INEDs to be able to 'exercise independent judgement'.

They all specify different relationships or financial interests that may inhibit a director's ability to exercise independent judgement and, as a consequence, be deemed independent. In each of the jurisdictions discussed in this report, to be considered independent a director must NOT

- be a current or past employee/director of the company or its subsidiaries,
- be connected to the management/board of the company or its subsidiaries,
- *be a substantial shareholder, be connected to, or represent a substantial shareholder,*
- be a partner, director, or employee of a professional company that currently provides or has recently provided services to the company or its subsidiaries or has a business relationship with the company/subsidiaries or a related party, or
- have received financial assistance from the company, or a related party, other than the director fee.

Singapore has the only governance code that is silent on substantial shareholders in its guidelines on independence. For the purpose of determining independence, a holding of 2 percent of voting shares is considered substantial in India and the Philippines; in Hong Kong, the defining level is an interest of 5 percent or more.[38] The remaining relationships are included in all four definitions of independence, but there are some variations on 'cooling-off periods'—that is, the time period after a relationship has ended and when a person is deemed independent again.

An example of a loosely defined guideline is the objectivity test for independence for business relationships in Singapore. Guideline 2.1(d) of the Singapore Code states, 'As a guide, payments aggregated over any financial year in excess of S$200,000 should generally be deemed significant'. The sum of S$200,000 over a year could equate to a large proportion of the company's revenue, which could significantly affect the director's ability to make independent judgements on the board. RiskMetrics Group, which provides proxy research on companies worldwide to a global client base, uses US$20,000 (about S$27,000) as a threshold. The other three jurisdictions use the word 'material' to explain when a business relationship impedes independence but do not provide a substantive definition of material.

Independence exemption

In Hong Kong and Singapore, a director can be deemed independent despite the existence of specific relationships or external factors creating ties to the company. In both jurisdictions, the nomination committee (if present) is responsible for assessing the independence of directors.

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[38]See India's Clause 49, the Philippines' SRC Rule 38 of the Amended Implementing Rules and Regulations of the Securities Regulation Code, and Rule 3.13(1) of the HKEx Main Board Listing Rules.

In Hong Kong, a detailed definition of independence is incorporated in the HKEx listing rules. If a director fails to meet the guidelines for independence, however, he/she can still be deemed an INED if the company demonstrates to the exchange that the person is independent and gives reasons in the announcement of the director's appointment and in the next annual report. The director must also submit a written confirmation to the exchange of the factors that make the director independent and notify the exchange of any changes to his/her circumstances.[39]

In Singapore, a less prescriptive approach is taken: The definition of independence is stated only in the Code of Corporate Governance, not the listing rules. Moreover, Guideline 2.2 of the Singapore code states that the relationships are 'not intended to be exhaustive' and that 'in spite of one or more of the relationships', the director can be considered independent. Therefore, directors who would not normally be deemed independent may be considered independent at the discretion and responsibility of the company as long as the company makes appropriate disclosures and explanations.

Separation of the role of chairman and CEO

All jurisdictions recommend that the role of the chairman and the CEO be performed by different people. In both Hong Kong and Singapore, non-compliance needs to be disclosed and explained. These two jurisdictions also require the company to disclose in its annual report the nature of any relationship between the chairman and CEO. In addition, the Singapore Code states in its commentary that companies may appoint a lead independent director when the chairman and the CEO are related or when they are both executives.

In the Philippines, the separation is recommended but compliance is not mandatory. India's Clause 49 contains no specific requirement for separation, but if the chairman is an executive chairman or promoter, the number of INEDs required to be on the board increases from at least a third to at least half.

Key problems:

The definition of independence is subjective. Based on the information presented in the corporate governance codes, considerable discretion is given to the nomination committee and board as to whether a director is independent or not. This flexibility may create problems if the nomination committee is biased and/or the committee does not have an appropriate definition of independence. A board may believe that a relationship could not reasonably be perceived to interfere with a director's independent and objective judgement, but the perception of investors may be different. Giving an exemption to certain directors is not in the best interest of shareholders. The perception of independence by outsiders, such as investors and other stakeholders, is important for the company and the market. Lack of trust and confidence in the nomination process, the directors, and the board is not beneficial to the company.

The separation of chairman and CEO does not equal independence. The provisions in current codes allow for the physical separation of the two roles, but none of the codes state that the role of the chairman should be separate from management (other than the position of CEO) or controlling shareholders. In many circumstances, the chairman is part of the executive management team or is related to the CEO or the controlling shareholder. Given that many companies in Asia are controlled by founding families, having a chairman who is not independent from the CEO can exacerbate the problems that are already present within the board, such as a lack of objectivity and accountability.

[39] Rule 3.14 of HKEx Main Board Listing Rules.

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3. Training or professional requirements

With the exception of India, all jurisdictions refer to induction or orientation programmes for directors when they are first appointed to the board. Training board members about the business, the risk profile of the company, and their responsibilities and duties as directors is listed as a non-mandatory requirement in Clause 49 in India. In Singapore and Hong Kong, the codes require newly-appointed directors to undergo appropriate training in the form of a 'comprehensive, formal and tailored induction' (Hong Kong) or orientation programme (Singapore). The training is designed to ensure that directors have an understanding of the company's operations and governance as well as the applicable legal and regulatory framework. The HK Code also recommends that all directors participate in continuous professional development, but this training is not a formal requirement. The Singapore Code also encourages companies to provide training for first-time directors. The Securities and Exchange Commission of the Philippines encourages corporate directors to undergo one day of corporate governance training, whereas the Central Bank of the Philippines mandates a two-day course for directors of banking institutions.

None of the codes have any explicit requirement that attendance at director training be disclosed in annual reports.

Key problems:

With no requirement or encouragement for formal training—for example, a certificate—the nomination committee, shareholders, and other stakeholders have little knowledge about a director's suitability for the role. Identifying a pool of qualified candidates is thus difficult, which makes the nomination process more difficult for the board.

4. Board composition

The minimum number of INEDs required on a board is similar in the four jurisdictions, from two (or 20 percent) in the Philippines, a third in Singapore and India, and at least three in Hong Kong.[40] In fact, India mandates that if the chairman is an executive or a promoter, the proportion of INEDs must increase to at least 50 percent. A majority of independent directors on the board would be considered international best practice.[41] None of the countries in our sample reach this threshold.

In analysing independence of boards, board size and the number of board committees in the various jurisdictions are also important. The Philippines is the only country that sets a maximum of 15 members. India, Hong Kong, and Singapore do not limit the size of the board. Boards generally implement between one and three committees; so, with less than a majority of directors on the board independent, independent (or majority-independent) representation on each committee may be difficult to have.

Key problems:

Prescribing an absolute number of INEDs on the board as a requirement is difficult because of varying board sizes, number of committees, and the underlying issue of concentrated ownership. In countries that essentially have unlimited board sizes, setting a minimum *percentage* of independent non-executive directors is more effective than establishing a minimum absolute *number* because a prescribed percentage does not give companies the option of stacking the board with executive directors.

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[40] Rule 3.10 of the HKEx Main Board Listing Rules requires at least three independent non-executive directors on a board. In addition, the HK Code (Rule A.3.2) recommends as best practice that independent, non-executive directors represent at least one-third of the board.

[41] A majority of independent directors is required in the United States and is recommended in the UK Combined Code on Corporate Governance and the Australian Stock Exchange recommendations.

When boards are less than majority independent, the collective voice of the incumbent independent non-executive directors is diminished, as is their value on the board. The directors are also more likely to be stretched for time because fewer independent members must share the load of committee work.

WHAT IS HAPPENING IN PRACTICE

After focusing our previous discussion on the state of the current regulations and corporate governance prescriptions in all four countries, we now turn to how some of these prescriptions are being implemented. **Table 2** provides information on three of the areas mentioned in the preceding material: the nomination committee, separation of the chairman and CEO, and number of INEDs on the board.

We also examined the percentage of INEDs on corporate boards in selected countries and report our findings in **Figure 5**. On average, Singapore's corporate boards are majority independent, but all four of our countries fall below the average of the sample, which is 55 percent. One could argue that Singapore's high representation of INEDs on the board is a result of the high percentage of foreign companies listed in Singapore; such companies are competing in a global market, and international investors see majority-independent boards as the benchmark.

In summary, our review of the regulations and practices in Hong Kong, Singapore, the Philippines, and India identified areas that need to be improved. We believe improvements in the areas of director nomination/election, the concept of independence, the training and professional requirements of directors, and composition of the board are essential for improving independence of boards and strengthening investor protection. We consider ways to address these issues in the following section.

Table 2. Corporate Governance in Practice

Category	Hong Kong	India	Philippines	Singapore
Percentage of companies with a nomination committee*	51% (83% majority independent)	Not common	Common	94% (81% majority independent)
Percentage of companies where the role of chairman and CEO are separated**	75%	59%	Not available	59%
Percentage of companies complying with stated rules on number of INEDs***	69%	87%	70%	95%
Average board size	10	10	9–10	7–8

*Hong Kong: Numbers reflect companies in the HSCI for 2008; see Grant Thornton (2009). Singapore: Numbers reflect SGX Main Board companies in 2006 (see Mak 2007). Philippines: Numbers are based on comments from practitioners in the Philippines.
**Hong Kong: Numbers reflect companies in the HSCI for 2008; see Grant Thornton (2009). India: Numbers reflect companies in the BSE 200 in 2006; see Balasubramanian et al (2009). Singapore: Numbers reflect SGX Main Board companies in 2006; see Mak (2007).
***Hong Kong: Numbers reflect companies in the HSCI for 2008; see Grant Thornton (2009). India: Numbers reflect companies within the BSE 200 in 2006; see Balasubramanian et al (2009). Philippines: Numbers are from a 2003 survey by the World Bank (2006). Singapore: Numbers reflect SGX Main Board companies in 2006; see Mak (2007).

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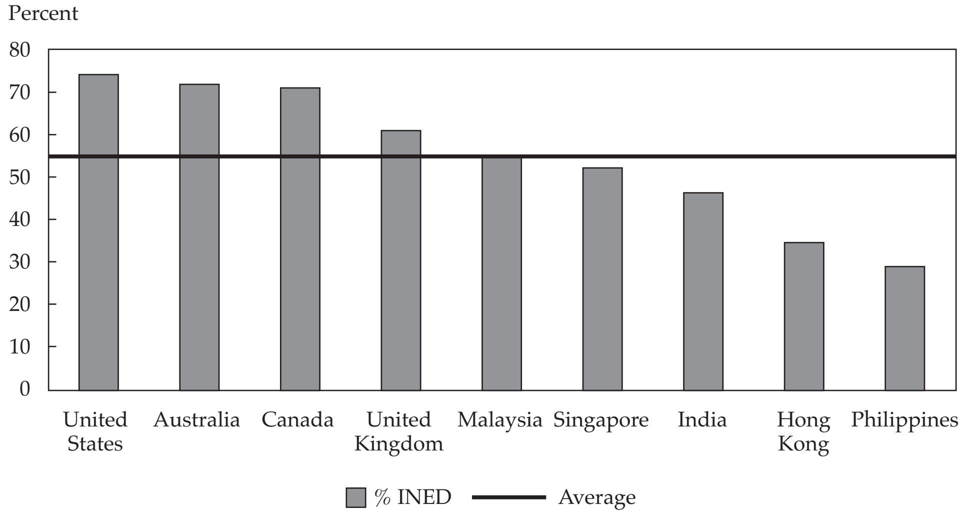
Figure 5. Average Percentage of Independent Directors on Corporate Boards in Selected Countries



Note: The average percentage of independent directors in the Philippines is based on a sample size of only four companies covered by GovernanceMetrics International (GMI).

Source: Based on GMI (June 2009).

SECTION 6: How We Can Improve the Effectiveness of INEDs

In this section, we present potential solutions and recommendations for each of the four areas of concern identified in Section 5—namely, director nomination and appointment, the concept of independence, director training and qualification, and board composition.

NOMINATION AND APPOINTMENT OF INEDs

Key areas:

- Nomination/appointment process
- Quality of information disclosed before election

Nomination and appointment process

The nomination committee is charged with the responsibility of selecting independent non-executive directors and putting together an objective slate. In an ideal situation, the nomination committee would be made up of truly independent directors who were appointed in an objective process. In the presence of a controlling shareholder, however, the actions of the nomination committee are questionable because of the following:

1. The INEDs (who usually make up the majority of the nomination committee) may not be truly independent.
2. The process the nomination committee uses may not be objective. The controlling shareholder often controls the voting process as well as who is placed on the slate.

We believe that to get truly independent directors, we first need to improve the nomination and election process. Only then can the nomination committee work in the way it was originally intended.

Monks (2006), a strong advocate of corporate governance and independent directors and the founder of Institutional Shareholder Services (acquired by RiskMetrics in 2007), encapsulated the issue of independence in three points:

1. Independent directors are essential to good governance.
2. Directors selected in a self-selecting process cannot be considered in any meaningful way to be independent.
3. Therefore, good governance requires something other than a board of self-selected directors (Monks 2006, p. 35).

In Asia, INEDs who are appointed to the board by a self-selected board are often loyal to the person who gave them the post, and they have an unstated appointment to serve that person. According to Monks (2006): 'There is always a reluctance to confront, embarrass and combat someone who has conferred a favour, there is always reluctance to join a club just to attack it, irrespective of the issues involved' (p. 34).

Discussions with independent directors also show that it is very hard for independent directors to voice an opinion that differs from the majority. To be heard, independent directors need to be strong willed and not easily influenced or bullied. In any case, the controlling shareholder has the power to appoint and dismiss INEDs at will regardless of the director's experience or skills. This, in turn, perpetuates the tendency to not rock the boat and diminishes the value of INEDs. Such a situation was clearly evident in the case of Tan Lye Huat's removal from the board of Kian Ho Bearings by a substantial minority shareholder (see Section 4).

Ultimately, the problem comes down to the power the controlling shareholder can exert in the nomination/appointment process.

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We use case studies from different countries to examine three potential mechanisms to improve the nomination and appointment process for INEDs. The cases illustrate three approaches:

A. Allowing minority shareholders to *vote* for a proportion of the INEDs
B. Giving minority shareholders the ability to *nominate* directors to the board
C. Cumulative voting

A. Allowing minority shareholders to *vote* for a proportion of the INEDs

We first examine cases of mandatory representation of minority shareholders on the board of directors in Chile and Italy.

Mandatory representation of minority shareholders on the board of directors: Chile

Chile[42]

A typical board in Chile has between seven to nine members, of which three are part of the directors committee (DC), which is essentially a typical audit committee. The current law requires that the DC be majority independent unless there are not enough independent directors on the board. Independent directors are defined solely as directors who are elected without the votes of the controlling shareholder.

Given the loose requirements for electing independent directors, Chile has put forward a new proposal that **requires all corporations with a net worth in excess of US$38 million and relevant minority shareholder interest of at least 12.5 percent to have at least one independent director.**[43] To nominate a director, shareholders are required to hold at least 1 percent of capital. To be considered independent, the candidate must be independent in judgement and have no conflict of interests with the corporation (and subsidiaries), management, or controllers. There are also some rules that assume lack of independence on the basis of the activities and ties of the candidate with the company, the management, or the controlling group within the previous 18 months.

In its original form, the bill maintained the existing rule that requires that the votes from the controller not be considered in the election of independent directors. Community opposition may result in this portion of the bill being overturned, thereby allowing the controller to participate in the vote. The bill also proposes, however, that even if only one independent director gets elected to the board, he or she will chair the board and have control over the DC. These directors will be considered independent, and once elected, they must act independently, in such a way that they do not represent the group that elected them.

The bill is currently with the Senate of Chile, and the hope is that it will be passed by year-end.

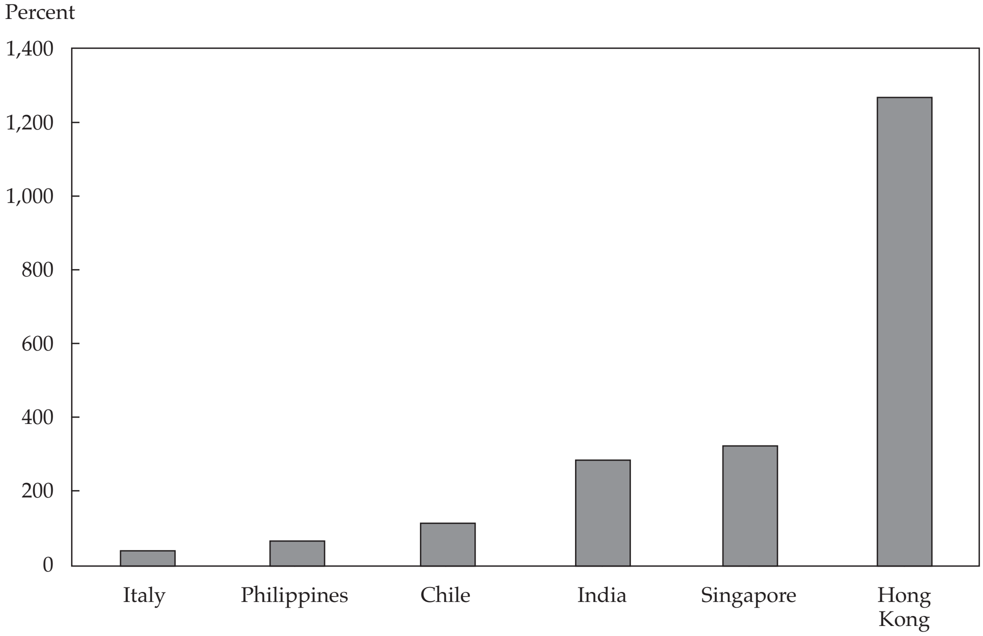
The biggest similarity between Chile and the Asian markets is the concentrated ownership structure among companies, and as in Asia, ownership through pyramid structures is also very common. Ownership concentration can be 60–70 percent or even higher for the less liquid stocks. Relative to other Latin American nations, the Chilean equity market is highly developed; **Figure 6** shows that it has a market capitalisation ratio (market capitalisation to GDP) similar to those in the more developed markets worldwide.

There is one main difference between Chile and the Asian markets: Pension funds play an important role in the growth of the stock market and the development and implementation of corporate governance practices in Chile. They are the most dominant institutional investor in the Chilean market and in 2007, represented 64 percent of GDP (see **Table 3**). According to the OECD, Chile was the second highest non-OECD nation when ranked on fund assets as a proportion of GDP, followed by Singapore (3rd), Hong Kong (5th), India (17th) and China (29th). The Chilean pension fund industry experienced significant growth from 1981, when a new pension reform mandated all workers to invest 10 percent of their income in a defined-contribution system.

[42] The source for this case is personal communications from Hector Lehuede, adviser to the Minister, Ministry of Finance, Chile (2009).

[43] If approved, this proposal will amend Law 18.046 (Corporations Law) and Law 18.045 (Securities Market Law). The legislation can be found at www.svs.cl/sitio/english/legislacion_normativa/legislacion_valores.php.

Figure 6. Market Capitalisation Ratio, 2007



Note: The Hong Kong and Singapore ratios are inflated because of the high number of foreign listings in these two markets. In Singapore, foreign listings equated to approximately 35 percent of total SGX market capitalisation in 2007, and in Hong Kong, China stocks (H and Red shares) equated to 52 percent (this figure excludes other foreign listed stocks). With these adjustments, the ratio falls to 615 percent for Hong Kong and 219 percent for Singapore.

Sources: Based on data from the World Bank, World Development Indicators Database; World Federation of Exchanges; and Blume and Alonso (2007).

Pension funds are engaged investors in Chile because for more than 20 years, they have been managing a growing pool of compulsory savings and often take a long-term view of the market. Pension funds are also engaged because provisions in pension fund legislation mandate active ownership. In Chile, institutional investors, including pension fund administrators, have the ability to elect directors of listed companies.[44] Pension funds that collectively own 12.5 percent of votes are allowed to elect one director through cumulative voting as long as the director is not related to the controlling shareholder.[45] Consequently, pension funds already have board representation on 20–25 percent of the top 200 stocks traded on the Santiago Stock Exchange.

Table 3. Pension Fund Assets for non-OECD Countries, 2007

Country	Fund Assets (US$ billions)	Fund Assets (% of GDP)
Chile	105.6	64.4%
Singapore	90.7	56.2
Hong Kong	64.6	31.2
India	63.6	5.4
China	19.2	0.6

Note: GDP measured in current U.S. dollars.

Sources: Based on data from OECD (2008); World Bank, World Development Indicators Database.

[44]Pension fund administrators are the individual(s) ultimately responsible for the operation and oversight of the pension fund (see the OECD site at http://stats.oecd.org/glossary/detail.asp?ID=5268).
[45]Pension funds are not able to own more than 7 percent, however, of any individual security. For more information, see Clarke (2007).

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Mandatory representation of minority shareholders on the board of directors: Italy

Another form of proportional voting is the electoral quotient system used in Italy.[46] This method differs from Chile's approach in that shareholders propose a slate of candidates rather than nominate a director to be included in the existing slate.

Italy[47]

Italy adopted a new method for appointing board members as part of its 2005 regulatory reform. Under this reform, the bylaws of Italian corporations must allow for the appointment of at least one representative of minority shareholders to the board of directors through a proposal of alternative lists of candidates.

The 2005 reform states that this director is to be appointed from the minority slate that obtains the highest number of votes and is not in any way related to the majority slate.

Companies have to specify the participation threshold for minority shareholders, but it is not to exceed 2.5 percent of share capital.

For example, at Telecom Italia, both the board of directors and the board of statutory auditors use the electoral quotient system in which shareholders cast votes for competing lists of nominees. Shareholders who represent 0.5 percent of the ordinary share capital can submit a slate as long it is received in the specified time frame and has all the appropriate enclosures.[48]

Without going into the details, we can describe the system as follows: a majority of the directors are elected from the slate with the majority of votes (majority slate) and the remaining directors (at least one) are chosen from the other slates (minority slates).

At least one nominee on the slate must meet the independence requirements set out in the company's bylaws. The number of independent directors to be elected depends on the size of the board. If the minimum number of independent directors is not elected, then the votes are recalculated so that the independent director with the highest vote is appointed.

As in Chile and Asia, ownership is highly concentrated in Italy. It is typical for Italian listed companies to have a blockholder owning at least 55 percent of voting shares. The separation of control and ownership through pyramids is also quite common, with 20 percent of the 20 largest companies having this structure (Enriques and Volpin 2007).

Of the countries included in Figure 6, Italy has the lowest market capitalisation ratio, smaller than both the Chilean and Philippine markets.

B. Giving minority shareholders the ability to *nominate* directors to the board

Monks (2006) proposed a process to increase minority shareholders' rights. His proposal suggested the inclusion of a new 'shareholder advisory committee' for listed companies. Shareholders who owned at least US$10 million in market value of common shares would be able to establish a committee of three people that could put together a slate of nominees for the nomination committee. He included his proposal in the proxy form for Exxon Mobil at their 1992 AGM, but it was not approved.

In May 2009, the U.S. SEC put forward another proposal to allow shareholders to nominate up to 25 percent of the board of directors, with the percentage based on the size of the company. Under this proposal, shareholders of companies with a global market share of US$700 million or greater would be eligible to nominate a director if they owned at least 1

[46]For an explanation of electoral voting, see Fremond and Capaul (2003).
[47]This section is adapted from Malberti and Sironi (2007).
[48]See 'Board of Directors: Responsibilities, Independence and Work Procedure,' Telecom Italia: www.telecomitalia.com/cgi-bin/tiportale/TIPortale/ep/browse.do?tabId=4&pageTypeId=-12695&LANG=EN&channelId=-12792&channelPage=/ep/channel/default.jsp; retrieved June 2009.

percent of the shares. The threshold would increase to 3 percent for medium-sized companies and 5 percent for small companies. Shareholders would be allowed to aggregate their holdings to meet the thresholds, but one condition is that shareholders would have to hold their shares for at least one year. They would also have to certify that they were not holding the stock simply to effect a change in control.

At the time of writing our paper, the proposal was still in consultation.

C. Cumulative voting

Cumulative voting is used in countries around the world as a method to improve the voting rights of minority shareholders. It is currently used in Chile, Italy, Russia, and the United States, as well as in Asia, the Philippines, Taiwan, South Korea, and China. The Philippines is the only country we studied where cumulative voting is allowed and practiced.

What Is Cumulative Voting?

Cumulative voting allows a shareholder to accumulate its votes for one candidate on the nomination slate, thus theoretically increasing the shareholder's chances of electing the shareholder's desired candidate.

The cumulative voting process is based on each shareholder having the ability to accumulate the shareholder's votes in such a way that the total number of votes for each shareholder equals the number of shares owned multiplied by the number of candidates up for election.

For example, suppose a shareholder owns 1 million shares. Each share is allowed one vote, so if 10 board members are up for election, this shareholder may cast 10 million votes for one director instead of 1 million votes for each individual director. Cumulative voting allows the shareholder to cast all the votes for one person or divide them between the candidates of the shareholder's choice.

The aim of cumulative voting is to increase a minority shareholder's ability to elect a director to the board. It can be an effective tool in contested board elections, but it is also useful in uncontested elections because it can be used to increase the number of 'no' votes for a nominee. Cumulative voting does not guarantee that the shareholder will be able to elect a preferred candidate, however, because of the following:

- Minority shareholders need to be able to co-ordinate their voting preferences amongst themselves for their votes to be effective. This co-ordination is difficult if the minority shareholder base is not large or cohesive. A good analogy is the organisation of football fans at home and away games. For the fans from the non-home team (minority) to make an impact and not be drowned out by the cheers of the home team (majority) fans, they need to be organised and sit together.
- Majority shareholders have the same right to accumulate their votes, and there is nothing to stop them from outvoting the minority.

Cumulative voting has been used in Chile for more than 20 years. This country's experience shows that cumulative voting does not always work in the way that it was primarily intended—that is, to protect minority shareholders. Chile has found that the controlling shareholder can accumulate shares more effectively than minorities; therefore, the controlling shareholder can still dominate the voting process. In the Philippines, the experience has been similar.

Nevertheless, cumulative voting can be a useful tool for minority shareholders if shareholder activist groups or large minority shareholders participate in cumulative voting and organise their votes to elect a preferred candidate.

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Recommendations

Minority shareholders should be given sufficient influence over the nomination and election of directors to have an impact. Controlling shareholders effectively have the ability to control the nomination and election of all directors. The current process can be improved by first allowing minority shareholders who own a minimum threshold percentage of shares to directly nominate candidates for election and second by introducing cumulative voting.

Cumulative voting, which is not commonly practiced in Asia, allows shareholders to cast all of their votes for one board candidate. For example, if a shareholder owns one million shares, each share is allowed one vote. So, if 10 board members are up for election, that shareholder is able to cast 10 million votes for one director instead of one million votes for each individual director.

Cumulative voting improves the chances of a minority shareholder naming a representative to the board. It can be effective in contested board elections and also useful in uncontested elections because it can be used to increase the number of 'no' votes for a nominee. This recommendation will give minority shareholders a greater voice and will enhance the current nomination and election process for directors in Asia.

Disclosure of a director's details in company announcements

In the four jurisdictions we examined, the quality of the disclosure of director's details in company announcements varied. It is important that shareholders have access to the right information about candidates for a directorship at the right time. Disclosure of the biographical details of nominees is mandated only in Hong Kong and the Philippines. The quality and ease of access to this information by shareholders before a meeting is greater in Hong Kong.

Recommendation

Companies should provide shareholders with full biographical details on all the directors/nominees up for election or re-election in the Notice of the Annual General Meeting or other relevant shareholder circulars sufficiently in advance of meetings for shareholders to read the information. The disclosures should include academic and professional qualifications, all previous and current directorships, all relevant experience, and the nature of any relationships that could potentially affect the person's ability to act objectively. Only by providing shareholders with all the relevant information in a timely manner can shareholders make informed decisions when it comes to vote for, or against, the appointment of directors. Increasing transparency and the quality of information disclosed to shareholders should improve the chances that an effective INED is appointed.

CONCEPT OF INDEPENDENCE

Key areas:

- Definition of independence
- Independent exemption
- Separation of the role of chairman and CEO

Definition of independence

Low (2004) asked, 'How do we promote and thereafter sustain genuine independence of directors?' and in his answer he wrote, '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"' (p. 178).

Independence is highly subjective, and the definition differs in most jurisdictions. In the four countries we studied, we found five basic relationships that need to be considered before a director is considered independent. A director should not

- be a current or past employee/director of the company or its subsidiaries,
- be connected to the management/board of the company or its subsidiaries,

- *be a substantial shareholder, be connected to, or represent a substantial shareholder,*
- be a partner, director, or employee of a professional firm that currently provides or has recently provided services to the company or its subsidiaries or has a business relationship with the company/subsidiaries or a related party, or
- have received financial assistance from the company, or a related party, other than the director fee.

The details of each relationship vary in each jurisdiction.

With the exception of Singapore, the governance codes all include a statement referring to a relationship with substantial shareholders prohibiting the label of independence. We believe any definition of independence needs to take into account not only the potential for traditional agency problems between management and shareholders but also the potential for mis-alignment between controlling shareholders and minority shareholders, which is a major concern in Asia. The OECD (2004) states in Principle VI (E) that 'independence from controlling shareholders or another controlling body will need to be emphasised, in particular if the *ex ante* rights of minority shareholders are weak and opportunities to obtain redress are limited' (p. 64).

Recommendation

A thorough definition of independence that insists on objectivity and independence in relation to both management and controlling shareholders is very important because of the ownership structure in Asian companies. The definition should include both positive and negative attributes. As described by the OECD, positive attributes can be used to complement the negative attributes often defined in codes, thereby increasing the probability of effective independence.[49]

We believe positive attributes should emphasise independent and objective judgement through:

- a high level of professionalism, integrity, and ethics,
- relevant experience and knowledge that can be shared with the board,
- good communication and interpersonal skills to facilitate board discussion, and
- the ability to ask probing questions and give constructive feedback.

Several definitions of independence include negative attributes that if present would deem a director *not* independent. As noted previously, five relationships are specified in the four jurisdictions we studied. After looking at the definitions proposed by Hermes Investment Management Ltd,[50] the UK Combined Code on Corporate Governance,[51] the corporate governance principles of the Australia Stock Exchange (ASX),[52] and CalPERS (the California Public Employees' Retirement System) in the United States,[53] we have identified the following list of relationships that could be expected to potentially affect a director's independence.

A non-executive director should NOT:

- be a current or past employee of the company or its subsidiaries,
- be connected to the management/board of the company or its subsidiaries,
- be a substantial shareholder or connected to, or represent, a substantial shareholder,
- represent other interest groups that could exert significant influence (suppliers, customers, creditors, etc),
- be an employee/partner of a professional firm that has a current or past business relationship with the company/subsidiaries or a related party,

[49] OECD (2004) Principle VI (E).
[50] Asian Development Bank (2003).
[51] Financial Reporting Council (2008).
[52] ASX Corporate Governance Council (2007).
[53] Asian Development Bank (2003).

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- participate in the company's share option or performance-related pay scheme or receive financial assistance from the company/subsidiaries or a related party,
- receive an income from the company other than directors fees,
- have conflicting cross-directorships,
- serve as a independent director for more than the specified length of time, or
- be over a certain age (Hermes Investment Management suggests 70 years of age).[54]

Compiling an exhaustive list of behaviour/characteristics to be included in a definition of independence is difficult because many conflicts of interest could arise in practice. Independence may be a state of mind, which is simply not measureable, and a person may meet all the guidelines for independence and still not act in the best interests of shareholders. We believe, however, that establishing a list that encompasses a broad range of forbidden relationships and circumstances makes it easier to decide whether a director would be able to effectively exercise objective and independent judgement. The list thus decreases the probability that the director will act improperly. A thorough definition can help to guide the nomination committee in its search for independent directors, which will increase the probability that the committee will make informed recommendations to the board.

Independent exemption

Further complicating the likelihood of having independent directors on the board are the exemptions. In both Hong Kong and Singapore, directors can be deemed independent despite the existence of specific relationships or external factors that should make them ineligible for that title. As mentioned in Section 5, Hong Kong's listing rules allow the director to be deemed independent if the issuing company can demonstrate to the satisfaction of the HKEx that the person is independent and the director submits a written confirmation to the exchange explaining his or her case. All INEDs then need to provide an annual confirmation of their independence to the issuer.

The Singapore Code states that the listed relationships are 'not intended to be exhaustive' and that 'in spite of one or more of the relationships', a director can be considered independent. Neither the issuer nor the director needs to submit any declaration to the exchange; all the issuer needs to do is explain it in the annual report.

In both these situations, the nomination committee is responsible for determining the independence of the INED nominee. So, we are led back to the previous discussion of the actual ability of the nomination committee to act objectively in companies that have a controlling shareholder.

Recommendation

Independent exemptions should not be allowed. Giving companies the ability to allow a director to be deemed independent when he/she fails to meet the defined guidelines can create problems. Providing the company with a way out encourages them to use the option rather than find another candidate who is more appropriate and meets the required guidelines. We appreciate that the guidelines are not exhaustive, but giving companies an opportunity to opt out does not promote compliance with the spirit of the code, nor does it ensure that shareholders are adequately protected.

Separation of the role of chairman and CEO

For the board to be effective, there needs to be a clear separation between the management of the board and the management of the company. If the CEO and the chairman are the same person, the accountability of the CEO to the board is limited and the board's capacity to monitor management, especially the CEO, is severely hindered.

[54] We do not believe that a person is no longer able to be independent and objective after a certain age; we included the situation in the list to provide a complete outline of the negative attributes we found.

However, although physical separation of these roles is important, separation of the chairman and CEO may not be enough to ensure the effectiveness of the board because of dominance of the board and executive management by controlling shareholders. Cases among Asian companies where the separate chairman still has a relationship with the CEO, such as a father-and-son relationship, are not unusual. In addition, the chairman is often also the controlling shareholder (remember the Swissco case in Section 4). Although the roles would be physically separate, the day-to-day functions would be blurred; the chairman/father might involve himself in the operational aspects of the company rather than focusing on managerial oversight. In such cases, it would also be difficult for the chairman to be objective about the CEO's performance, so the board's monitoring function would be impaired by the family control. Mak and Singh (2006) provided a good analogy: 'Separation in many Asian companies is analogous to two people not being legally married but co-habiting' (p. 195).

In all jurisdictions, companies in this situation would be complying with the appropriate provisions (because the role of the chairman and CEO would be separate), but this compliance would clearly be following the letter of the law, not the spirit.

Recommendation

The chairman should be an independent director. In Asia, separating the role of chairman and CEO is not enough to ensure the effectiveness of the board of directors. Although the chairman and CEO are two different people, they can still be related to each other and/or to the controlling shareholder. This situation decreases accountability and oversight and gives great power to the controlling family. Given a thorough definition of independence, the chairman should be an independent director. This step will help ensure that the board maintains its objectivity and an appropriate balance of power.

DIRECTOR TRAINING AND QUALIFICATION

Induction training

As mentioned in Section 5, with the exception of India, the codes in all the jurisdictions we studied refer to induction or orientation programmes for directors when they are first appointed to the board. Nothing else is mentioned in regard to director training or disclosure of attendance.

Recommendation

An induction course introducing new directors to the company, its operations and strategy, as well as the applicable legal and regulatory framework the organisation works in is the absolute minimum level of training that should be required.

Formal qualification for all directors

We believe increasing director training to a level at which directors can pursue a formal certification would benefit all stakeholders. Companies are finding it difficult to appoint appropriate directors; establishing a certification programme that is well recognized in the region should make it easier for them to identify a qualified pool of directors. If the programme is accepted by directors, encouraged by investors, and advocated by regulators, then over time, director education will increase and directors will gain a greater understanding of what it means to be a director. Nomination committees will then have an alternative to the old boys' club and an incentive from investors and regulators to choose qualified directors. The qualification will strengthen the ethical practices of directors and ultimately benefit investors.

Several institutes of directors (IoDs) in Asia are starting to focus on director education. The Australian Institute of Company Directors (AICD), which is affiliated with the IoD in the United Kingdom, has a well-established Company Directors Course that leads to an internationally recognized qualification. The AICD has recently helped the Thai IoD establish a similar programme. The Indonesian Institute of Corporate Directorship and the Philippine Institute of Corporate Directors are also trying to develop a programme.

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Recommendation

Establish a regional director certification programme to develop director education and improve the effectiveness of INEDs, as well as the director community in general. There is currently no well-established regional director qualification in Asia, so it would be a long-term goal for the region, and it will be a good way to build a strong, educated supply base for nomination committees to choose from. Having a formal certification should not be mandatory but, instead, seen as best practice. There is more value in the qualification if it is something people believe they should obtain to be seen as credible rather than being a license that every director needs.

BOARD COMPOSITION

What is the appropriate number of INEDs on a corporate board?

Stipulating a number of INEDs to be required on a board is difficult because of varying board sizes. Instead, the number of INEDs should be expressed as a proportion of the total board size. In determining the appropriate number of INEDs, it is important to recognise the difference between increasing the number of INEDs from 20 percent to 30 percent and increasing the number from 30 percent to more than 50 percent—that is, to a majority. For example, on a board consisting of 10 members, having 20 percent INEDs is definitely better than having 10 percent because at least the two independent directors have more power to act together if they believe shareholder rights are being compromised. However, although increasing the number from 20 percent to 30 percent or 40 percent will continue to increase the collective voice of directors on the board, this voice may never be heard until the number of INEDs reaches at least a majority.

Currently, in most of the jurisdictions we studied, the number of INEDs required on the board is probably not sufficient to meet the demand for INEDs on board committees, especially because some committees require a majority of independent directors. For example, the Singapore Code requires one-third of the board to be independent. If the board has nine members, three of these directors are required to be independent. Both the nomination committee and audit committee require at least three members and, including the remuneration committee, all the committees need to be majority independent. Therefore, the three INEDs would need to be sitting on at least two of the three committees, if not all of them. Moreover, this conclusion does not include any other committees the company might choose to put in place. These INEDs would thus have to make a large commitment to the board; they might need to attend four to six board meetings a year (unless they were retired, this commitment would be in addition to being employed).

Recommendation

Majority-independent boards should be considered best practice. Majority-independent boards are recommended in the United Kingdom, United States, and Australia. In Asia, they are already required in India when the chairman is either an executive or promoter of the company. Majority-independent boards should be even more important in Asia because of the high concentration of ownership in Asia. Majority-independent boards will also ensure there are enough independent directors to exercise collective independence on the board and to share the load of committee work. If the independent directors are not truly independent, having an independent board will be effective only on paper.

Appendix A. Sources and Resources

OFFICIAL CORPORATE GOVERNANCE CODES AND LEGISLATION

Hong Kong

- Companies Ordinance (Chapter 32): www.legislation.gov.hk/eng/home.htm
- **Exchange and Clearing**, *HKEx Main Board Listing Rules*, Appendix 14. Code of Corporate Governance 2005: www.hkex.com.hk/rule/listrules/Appendix_14.pdf
- **Exchange and Clearing**, HKEx Main Board Listing Rules, Chapter 3: Authorised Representatives and Directors 2005: www.hkex.com.hk/rule/listrules/Chapter_3.pdf

India

- **Ministry of Corporate Affairs**, The Companies Act 1956:
  www.mca.gov.in/Ministry/actsbills/pdf/Companies_Act_1956_Part_1.pdf
  www.mca.gov.in/Ministry/actsbills/pdf/Companies_Act_1956_Part_2.pdf
- **Securities and Exchange Board of India**, Clause 49 of Listing Rules 2004 (amended in April 2008); www.sebi.gov.in/circulars/2004/cfdcir0104.pdf

Philippines

- **Securities and Exchange Commission**, Securities Regulation Code (SRC):
  www.sec.gov.ph/index.htm?src/index
- **Securities and Exchange Commission**, Corporation Code of the Philippines:
  www.sec.gov.ph/laws/B.P.68/Corporation%20Code%20of%20the%20Philippines.pdf
- **Securities and Exchange Commission**, Code of Corporate Governance, Memorandum Circular No. 6, 2009: www.sec.gov.ph/circulars/cy,2009/sec-memo-06,s2009.pdf

Singapore

- **Accounting and Corporate Regulatory Authority**, Companies Act of Singapore (Chapter 50):
  http://statutes.agc.gov.sg/non_version/cgi-bin/cgi_retrieve.pl?actno= REVED-50
- **Stock Exchange**, Code of Corporate Governance, 2005:
  http://info.sgx.com/SGXRuleb.nsf/VwCPForm_LISTING_MANUAL_Download/Code%20of%20Corporate%20Governance%202005.pdf/$File/Code%20of%20Corporate%20Governance%202005.pdf

KEY REGULATORY WEBSITES

Hong Kong

- Companies Registry: www.cr.gov.hk/en/home/index.htm
- Securities and Futures Commission: www.sfc.hk/sfc/html/EN/
- Exchange and Clearing: www.hkex.com.hk/index.htm

India

- Ministry of Corporate Affairs: www.mca.gov.in/Ministry/index.html
- Securities and Exchange Board of India: www.sebi.gov.in/

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Philippines

- Securities and Exchange Commission: www.sec.gov.ph/

Singapore

- Accounting and Corporate Regulatory Authority: www.acra.gov.sg/
- Monetary Authority of Singapore: www.mas.gov.sg/index.html
- Stock Exchange: www.sgx.com/

Appendix B. Corporate Governance Frameworks: Comparative Country Overview

	Hong Kong	India	Philippines	Singapore
SHAREHOLDERS' RIGHTS & EQUITABLE TREATMENT				
Do shareholders have the right to vote on:				
• **Appointment of directors**	Yes (50%)	Yes (50%)	Yes (50%)	Yes (50%)
• **Removal of directors with cause**	Yes (50%)	Yes (50%)	Yes (67%)	Yes (50%)
• **Removal of directors without cause**	Yes (50%)	Yes (50%)	Yes (67%)	Yes (50%)
How can shareholders directly nominate directors onto the board?	A shareholder can nominate a director (through an ordinary resolution) with at least 1 weeks' notice prior to AGM, if a) member has at least 5% of total voting rights or b) at least 100 members holding shares on which there has been paid up an average sum, per member, of not less than HK$2000.	The shareholders can nominate a director (through an ordinary resolution) with at least 14 days notice before the meeting with details of the candidate including a deposit of 500 rupees (refunded if elected), if a) member has not less than 5% of voting power or b) not less than one hundred members holding shares on which there has been paid up an aggregate sum of one lakh of rupees.	Nominating shareholders submit their nominations to the nomination committee who then decide whether the candidate will be placed on the Final List of Candidates.	A shareholder can nominate a director (through an ordinary resolution) with at least 1 weeks' notice prior to AGM, if a) member has at least 5% of total voting rights or b) at least 100 members holding shares on which there has been paid up an average sum, per member, of not less than S$500.
RESPONSIBILITIES OF THE BOARD				
Cumulative voting for the election of board members permitted?	No	No	Yes	No
What are the rules and procedures for:				
• **Nominating board members**	Candidates are generally proposed by the nomination committee, but shareholders have the right to nominate candidates as well.	Candidates are generally proposed by the board, but shareholders have the right to nominate candidates as well.	Nomination committee pre-screens all nominees and prepares a Final List of Candidates.	Candidates are generally proposed by the nomination committee, but shareholders have the right to nominate candidates as well.
• **Electing board members**	Approved by shareholders.	Approved by shareholders.	Approved by shareholders.	Approved by shareholders.

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	Hong Kong	India	Philippines	Singapore
Which board committees must be established under current laws or regulations?				
• **Audit Committee**	Yes	Yes	Yes	Yes
• **Remuneration Committee**	A comply and explain requirement under the Code	Non-mandatory requirement under the Code	Non-mandatory requirement under the Code	A comply and explain requirement under the Code
• **Nomination Committee**	Recommended under the Code	No	Yes	A comply and explain requirement under the Code
Director qualifications:				
• **Minimum education and training requirements?**	Yes	No	Yes	Yes
• **Professional experience?**	Yes	No	Yes	Yes
• **Does law or regulations require continuing training for board directors?**	Recommended in the Code	No	No	No
Board Independence				
What is the minimum number of independent directors required on the board?	At least 3	Executive chairman—at least 50% of the board is independent. Non-executive chairman (non-promoter)—at least one third of the board is independent. Non-executive chairman who is a promoter, related to a promoter or person occupying a management position at the board level or one level below—at least 50% of the board is independent.	At least 2 or 20%, whichever is lesser.	At least one third

	Hong Kong	India	Philippines	Singapore
Does the definition of "Independence" exclude people who are:				
• **Related to management (by birth/ marriage)?**	Yes	Yes	Yes	Yes
• **Related to a major shareholder?**	Yes	Yes	Yes	Yes
• **Employees of affiliated companies?**	Yes	Yes	Yes	Yes
• **Representatives of companies having significant dealings with the subject company?**	Yes	Yes	Yes	Yes
Does law/regulation require the separation of chairman and CEO?	A comply and explain requirement under the Code	No	Recommended in the Corporate Governance Code but no mandatory	A comply and explain requirement under the Code

Source: Based on data from 'Asia: Overview of Corporate Governance Frameworks in 2007' (Paris, France: OECD, 2007), various regulations.

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