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# Corporate Governance and East Asia: Korea, Indonesia, Malaysia, Thailand

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# CORPORATE GOVERNANCE AND EAST ASIA

by

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## Abstract

This paper explores the role of corporate governance in the Asian crisis countries: Korea, Indonesia, Malaysia and Thailand. It argues that the focus in an analysis of corporate governance should be on the provision of external equity finance -- the position of outside minority shareholders. The proportion of equity finance in the capital structure of firms is highly correlated with the status of corporate governance. In economies with extensive and concentrated family ownership of publicly traded companies, the mechanisms of corporate governance are likely to be weak. These propositions are examined in a review of the four countries. The paper concludes by recommending that strengthening of the effective limits on conflict of interest transactions by those in control of the firm would be of more immediate benefit than efforts to create managerial monitoring through development of a market for corporate control.

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In a broader perspective, of course, corporate governance is only one element in the East Asian crisis of the last two years. An explanation of the origins and development of the crisis in the region involves a complicated interplay among numerous economic and social factors, as displayed in recent reports by the World Bank<sup>1</sup> and the International Monetary Fund<sup>2</sup>. But a pattern that runs through many accounts is a mounting volume of short term, foreign currency denominated borrowings by large and already highly leveraged domestic firms and banks, even as the country drew near a collapse in investor confidence, foreign currency reserves and exchange rates. That behavior requires some examination from the point of view of both the borrowers and the lenders, and corporate governance has a part to play. Indeed, one study concludes that

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corporate governance was more important than macroeconomic conditions or policy responses in determining the extent of exchange rate depreciation and stock market performance in 1997-98 across the emerging market countries.<sup>3</sup> Likewise, the recovery and reform programs being pursued base the search for a restoration of investor confidence and foreign capital inflows in these countries in part on changes in their corporate governance institutions.

But obviously corporate governance is impinging on some much larger policy issues – such as whether the government tries to direct the economy and capital investment along certain lines, by directing bank loans or government guarantees to chosen industries or firms. If those ventures prove ill-advised, the next step often becomes a government bailout of the affected banks and corporations, to the benefit of their creditors and perhaps their stockholders as well (but not the taxpayers). The anticipation of bailouts in turn creates a misallocation of resources and perverse incentives for all concerned.<sup>4</sup> The institutions of corporate governance cannot by themselves prevent such government policies, but they are important if banks and corporations are to be run to maximize the value of the firm instead of as arms of government ministries.

In its most comprehensive sense, "corporate governance" includes every force that bears on the decision-making of the firm. That would encompass not only the control rights of stockholders, but also the contractual covenants and insolvency powers of debt holders, the commitments entered into with employees and customers and suppliers, the regulations issued by governmental agencies, and the statutes enacted by parliamentary bodies. In addition, the firm's decisions are powerfully affected by competitive conditions in the various markets in which it operates. One could go still further, to bring in the social and cultural norms of the society. All

are relevant, but the analysis would become so diffuse that it risks becoming unhelpful as well as unbounded.

I wish to go in the opposite direction, and focus on a narrow and precise part of total corporate governance: the provision of external equity finance to the firm. That may require some justification--what is different or central about external equity finance? To go one step further, what is special about equity at all, as compared to debt finance for example?

For those who desire an explanation, or justification, for giving such prominence to external equity, Part I of the paper tries to provide some answers. It reviews what is unique, and crucial, about the position of external equity in the financial structure of the firm. In particular, I want to examine the distinctly different institutions that define and protect the status of minority shareholders in public firms and private firms, drawing in part on the experience of the highly developed economies. Those who agree with this approach, or who need no review of the the argument, can skip Part I and go directly to Part II, which applies the analysis to the factual setting of the four East Asian countries. Part III concludes with some observations and recommendations as to the most important steps that might be taken to improve corporate governance, under the conditions prevailing in these countries.

## I

The special role of equity owners is that they are the residual risk-bearers of the firm. Their claim is only to whatever is left after all prior claims are paid--lenders' principal or employees' salaries, suppliers' bills, government taxes. Their investment in the firm is critical; it provides a degree of assurance that those fixed or prior claims will be paid in

accordance with their terms, and enables the firm to contract on more favorable terms with others for inputs to production. But the claim of shareholders not only comes last, but necessarily in no fixed amount, and shareholder funds are often invested in firm-specific assets of reduced value in any other use.

If the equity owners are not the managers of the firm and their claims are highly imprecise, what gives them reason to believe that they will get much of anything? Why shouldn't the managers, who are the makers of firm decisions, award themselves highly generous shares of the profits, beyond what their services could command on the labor market (while leaving the losses for the shareholders)? What keeps these "managerial rents" (which the economists often label "agency costs") under some degree of control?

To begin, why do equity owners (whom we will call shareholders, regardless of the particular legal form of the firm) have any basis to believe they will get a return on their investment, assuming they are not themselves the managers of the firm? As noted, their contract with the firm is highly incomplete, specifying neither a date for repayment of principal nor a rate of dividend payout. They "own" the residual equity but not the means of getting hold of it, and that residual itself is a function of what the controlling managers take for themselves.

One answer is that the managers have a stake in their own reputation, if they contemplate having to return to the capital markets to raise more equity to support expansion of the firm. If they appropriate "too much" for themselves, obtaining additional equity may be difficult or possible only on onerous terms, so there is an implied contract that is self-enforcing. It is also vague--what is "too much" depends on the success of the firm, the behavior of other

managers, and the expectations the shareholders had going in. And it has been often observed that many large firms rely more on retained earnings than on new equity offerings. Reputation is no doubt a constraint, but an uncertain one.

A second answer is that, under most legal systems, the shareholders have the power to elect a governing board, which in turn selects the managers who make the actual operating decisions, including decisions as to salaries and dividend payments. Thus managers who reward themselves excessively or perform incompetently are subject to replacement by the shareholders, in theory. In practice, it will depend on whether the shareholders are able to take effective collective action, and that in turn depends on a host of considerations to which we shall return.

A third answer is that a set of legal rules may limit the ability of managers to act in ways that benefit themselves and harm shareholders. An example is the provisions in US corporation codes and decisions that impose on managers and directors a fiduciary "duty of loyalty" to act in the best interests of shareholders. This general duty finds application in many different contexts--executive compensation is one, but self-dealing transactions between a controlling insider and the firm is another and more far reaching category. The consequence of the legal rule is to subject conflict of interest transactions by insiders to the possibility of outside review by a court; the value of that possibility likewise depends on a number of other factors, to which we shall return.

These answers to the pervasive problem of agency costs are not mutually exclusive but potentially complementary. They are developed, and relied upon, to different degrees in

different countries. I shall not comment further on the reputational factor; it is hard to know how much importance to accord it, and in any event it is not very amenable to change by reform efforts. My focus, therefore, will be on the role of shareholder voting power and conflict of interest law in corporate governance.

Let me now try to develop further the significance of corporate governance, in terms of the significance of external equity finance in an economy. What are the alternatives for financing production? First, there could be greater reliance on debt, and even in theory a firm financed entirely by debt. Debt is by definition a fixed claim, and if the firm cannot meet its payment terms, the firm is insolvent. In an uncertain world, frequent recourse to bankruptcy and reorganization would impose a set of costs that are reduced by the inclusion of a layer of equity finance. What determines the optimal mix of debt and equity for a firm is the subject of a large amount of economic literature, both theoretical and empirical.<sup>1</sup> But observation verifies the conclusion that a significant amount of equity contributes to the efficiency of the firm.

The equity in a firm could be provided by the individuals or group who formed the company and are actively operating it. That would of course limit the amount to their financial resources, and thereby ultimately limit the growth of the firm. But it would also limit the firm in choice of investment projects, to that level of riskiness that was acceptable to the small group of owners. This would constitute another restriction on the growth of the firm.

But if the equity is provided by outside investors, who can hold investments in many companies and need not be active in their management, there are three great advantage.



(1) Outside investors can diversify their investments and thereby eliminate some of the risk. Putting it the other way, the firm can raise equity capital from them at a lower cost. (2) The outside investors can set their own level of risk by the way they form their portfolio; they are not concerned to limit the riskiness of the individual firm's investment choices to conform to their own preferences. (3) The supply of equity capital is enlarged far beyond the resources of the founders.

The extent to which those advantages are realized is a function of the share of external equity in the capital structure of the firm. It may help to identify four contrasting possibilities. First, there may be broad public ownership of most of the firm's voting equity. That implies an active secondary trading market (a subject outside the scope of this paper), in which the performance of the firm and its management is constantly being evaluated. But that also implies dispersed ownership among many small holders, who will find it difficult to act in coordination. The advantage of their being able to hold diversified investment portfolios--an elimination of idiosyncratic risk for them, a lower cost of capital for the company--is attainable, but the reduction of agency costs is more problematic. This is where corporate governance in the sense of institutions facilitating the exercise of collective voting power becomes important.

Second, there may be a majority, or at least controlling, equity blockholder, such as a founder and his family or associates, coupled with outsider ownership of the remainder of the shares. The outsiders can still diversify their holdings, but it is likely that the controlling insider is not well diversified. That means that the insider's risk tolerance will determine the firm's investment policy; there will not be the degree of separation (and value-maximization) possible for the public firm. The result may be to lead the owner to diversify within the firm, whether

economically efficient or not. The public investors cannot in practice use voting power, even ignoring all collective action problems, to discipline the controlling owner. That opens the door to a higher level of managerial rent-taking. The price at which the shares are purchased or traded will be discounted to reflect their vulnerability, resulting in a higher cost of capital to the firm. This is where corporate governance in the sense of legal rules bounding managerial rents becomes important.

Third, the firm might have no external equity. That would be true if it were 100% owned and operated by its founder. All of the advantages of external equity would be absent, but so would its disadvantages. There would be no agency costs, and no incentive problems, as between owner and manager. At a small scale of operations, the advantages are likely to dominate, but expansion to a larger scale becomes increasingly difficult.

Fourth, the firm might be government owned, in which case the taxpayer becomes the residual risk-bearer but has almost no ability to alter its operations. "Corporate governance" is at its most indirect and ineffectual, and the firm is very unlikely to be profit-maximizing. But the worst of all worlds is when the firm is privately owned but the government in fact bears most of the equity risk, as when it explicitly or implicitly guarantees creditor claims on the firm. A "bailout" policy gives the owner the gains from good outcomes and the taxpayer the losses from bad outcomes, which in turn leads the owner to have the firm be thinly capitalized and take high risks. The price for such a one-sided bargain is likely to be a corrupt relationship between the favored firms and government officials.

The first and second of these possibilities--the public firm and the founder firm--are the most germane to my present topic, and are the ones I want to explore further. They play prominent roles in the East Asian economies and their current crises. What are the conditions for their effective functioning?

The institutions that support an efficient system of broad public ownership of firms in developed countries have been much studied in recent years. With dispersed shareholder ownership, how can management be monitored and controlled or replaced? How do owners remote from the firm know what is going on or exercise their dormant voting power?

The first requisite is to have reliable information about both firm performance and managerial rents. The professional participants in the secondary market seek such information to make trading and investment profits, but where do they find it and what is its quality? Disclosure rules bear on the first, and accounting rules bear on the second.

Disclosure is an amalgam of what companies find it in their own interest to disclose and what government bodies require them to disclose. There has been a long-standing debate over just how much the second adds to the first, but in the United States the SEC disclosure regime has become quite extensive--at least in so far as it is directed at operating performance. It has never been focused on disclosure of managerial rents, but nonetheless it does generate some relevant information.

Accounting and auditing standards help determine the value and reliability of the information and reports that companies put out. They vary significantly from country to country

in the flexibility they give management to manipulate reported results. Since they are the product of a tug-of-war among managements, accountants and regulatory bodies, a lack of consistency is not surprising.

Given a certain quantity and quality of information, what can shareholders do with it? Individually, in a widely held firm, they have neither the capacity nor the incentive to do much. For monitoring to work, there must be some way to aggregate the fragmented voting power in the public firm. This occurs in developed countries like the US, Germany and Japan, but typically in markedly different ways.

In the US, the aggregation of voting power takes place in the "market for corporate control" represented by the hostile takeover bid or proxy fight. The "raider" (never underestimate the power of a pejorative label) assembles for the occasion a new control block, which can oust a poorly performing incumbent management. Of course, this overstates the present reality. Management and its counsel, with help from courts and legislatures, have devised barriers (such as poison pills and staggered boards) to takeovers which have greatly reduced their prospects for success. Still, to the degree a threat remains, it constitutes a source of discipline on management to have regard for shareholder value.

In Germany, banks can not only own stock in public companies but also vote the shares deposited with them by their account holders or owned by the investment funds they operate. The result is that a small group of banks vote a majority of the shares at the annual meetings of the largest corporations. Clearly, banks are in a position to monitor the incumbent managers, although somewhat awkwardly due to Germany's two-tier board structure, but on

whose behalf? Shareholders in general, or their own lending business with the firm? Still, management of the large public companies is not in a position of autonomy.

In Japan also, banks are thought to play an important monitoring role in their "keiretsu"--groups of firms bound together by stable cross-shareholding and often by customer-supplier relationships. The main bank has power, not from its own stockholding in the member firms (which may not exceed 5%), but from its position as a lender and as the delegated administrator on behalf of the group. Public shareholders outside the group may hold a substantial fraction of the stock, but are traditionally completely passive.

The common element is that there has to be some mechanism (or mix of them) for recombining the otherwise meaningless voting power of shareholders in publicly-held corporations. That mechanism is provided mainly through the market in the US, and through banks in Germany and Japan. None of those mechanisms seems particularly efficient. In the US, the control market has been hobbled by the courts and legislatures. In Germany and Japan, the banks appear to have the voting strength, but their incentives to exercise it for shareholder value maximization are obscure at best. Each could easily improve its own system, and borrow from the other; they are not mutually exclusive. But in none is management left completely unfettered and secure in its tenure, short of creditor intervention and bankruptcy.

When we turn to the founder-operated firm, that is precisely management's control position. Backed by ownership or control of a majority of the stock, outright or through pyramiding or a network of cross-shareholdings, or of a block sufficiently close to a majority to be practically unchallengeable, the founder and his nominees cannot be ousted in the market. The

voting rights of minority shares are largely irrelevant, unless and until the firm shifts to publicly-held status. And a wide divergence between the dominant insider's control rights and his cash flow rights creates strong incentives to enhance the private benefits of control.

In consequence, the protection of the value of minority shares rests upon legal rules. In the US, management's "fiduciary duty" is usually broken into two parts: the duty of care and the duty of loyalty. The duty of care can be thought of as addressed to the issue of managerial competence and performance, and it provides minimal protection. The duty is typically phrased as requiring "ordinary" diligence, care and skill, and in practice affords a ground for imposing liability for gross negligence, which is rarely adjudged. The market for control mechanism, on the other hand, offers in theory a way to replace management whenever its performance shortfall is greater than the costs of takeover (including the bid premium). But in the privately controlled firm, there is not much the minority shareholder can do about poor performance, either at law or through voting.

The duty of loyalty, however, is concerned with managerial rents and conflict of interest transactions, and it is easy to underestimate its importance. It applies to public corporations as well as privately controlled ones, and in the public corporation would likewise come under whatever discipline is exerted by the market as well as by banks or institutional investors. But in the privately controlled firm, the only discipline comes from the law; if the legal constraints are weak, the amount of expropriation from outside shareholders can be very great.

The duty of loyalty is a principle, in Anglo-American law, not a precise proscription. In general, it requires those in control of the firm's decisions to put the shareholders' interests above their own, when the two are in conflict. To quote a summary I wrote elsewhere:

“One can postulate a continuum of situations involving conflicts of interest between managers and owners, with the conflict becoming less sharp (and perhaps the legal rules less essential). At one extreme would be outright theft, embezzlement, and misappropriation; without effective legal sanctions in these cases, only the gullible would part with their money. A somewhat less transparent form of achieving the same end is the self-dealing transaction between the manager and his firm. By buying too low or selling too high, the controlling party transfers wealth from the firm to himself, but the picture can be confused by intricate transactions in non-standard assets or subject to varying degrees of price unfairness. Enforcement becomes more difficult, but still seems essential if agency costs are to have any bound. The appropriation of corporate opportunities, excessive compensation, and consumption of managerial perks can be still more judgmental, and probably the legal rules are less effective, but the order of magnitude is also less. And when one reaches conflicts highly intertwined with the regular operation of the business, such as excessive diversification or self-retention by less competent managers, the fiduciary duty of loyalty probably offers little protection.”<sup>6</sup>

Despite its limitations, the duty of loyalty or some equivalent seems to me to be a critical element in a country's corporate governance system. How well developed a set of rules there is to deal with managerial behavior in conflict of interest transactions has an important bearing on the risk borne by outside shareholders and the terms on which they will be willing to invest.

Of course, a set of legal rules is not self-enforcing. There also has to be some mechanism for enforcement, so the existence of legal causes of action and of a fair and reliable judicial system is essential. Enforcement requires information, so here too disclosure and reporting obligations are a necessary predicate for action. Large-scale deprivations may be hard

to conceal, but a systematic reporting requirement for conflict of interest transactions would greatly facilitate enforcement.

Even in the founders-controlled firm, the number of outside shareholders and their limited stakes may make collective action to enforce legal duties difficult to undertake. In the US, shareholder class actions or derivative suits are one response, in which an attorney seeking a contingent fee bears the brunt of organizing and pursuing the legal remedy. Without some form of representative action, the conflict of interest rules are likely to be paper tigers with little effect.

It may be noted that to this point I have made no mention of the role of the board of directors in corporate governance, for either the public or the founder firm. A managing board with outside members, in whatever exact form, may serve several functions. It may be in technical legal terms the origin of agency authority within the firm--the formal decision-maker that empowers officers and employees to act for and bind the firm. It may be a consultative body for management, to draw on experience and perspective beyond their own. But outside directors in my view cannot be typically expected to be more than a modest constraint on the behavior of those who put and keep them in office. For a firm in financial trouble, the board may sometimes be a device for managerial replacement short of bankruptcy proceedings. But neither the power nor the incentives of outside directors make them in general effective agents for minority shareholders, and imposing liability cannot fully compensate for the deficiency.

## II

We can now try to distill from the foregoing analysis some criteria for measuring and evaluating the state of corporate governance and possible reforms in different countries.



1) What is the proportion of external equity finance in the capital structure of firms for which reported data are available? What share of GDP do those firms represent?

My argument would be that these are highly correlated with the status of corporate governance in a particular country. Of course, other factors will play a role in determining the actual numbers--the tax treatment of returns to capital, the domestic savings rate, restrictions on foreign investment, exchange controls, and many other variables affecting the local economy. But the importance of external equity finance is an important indicator of the effectiveness of corporate governance. High bank-debt-to-equity ratios, and low ratios of external to inside equity, suggest corporate governance inadequacies.

A breakdown of GDP share between public-held companies and privately-controlled companies provides further insight. A large portion in public companies suggests the presence of institutions supporting the monitoring of management by shareholders, in some manner. Dominance of privately-controlled companies suggests problems with those monitoring institutions.

2) For publicly-held firms, the search for possible improvements in corporate governance should focus on enhancing the disclosure of reliable information and reducing the costs of shareholder collective action, either through the market or by large blockholders such as banks or other institutions.

Each can be broken down into a number of more specific elements. As to financial information: the extent and scope of disclosure requirements, the level of accounting and auditing

standards, the degree of enforcement, and so on. As to collective action: the presence of (or barriers to) takeover bids and proxy contests, restrictions on institutional holdings, the activism permitted pension and mutual funds, and so on.

3) For privately-controlled firms, the focus should be on the effectiveness of legal rules constraining conflict of interest behavior by the dominant insiders. Voting power and market institutions are not the primary concern, if control is firmly in the hands of the founding group and their friends and associates, who rely on personal bonds and other relationships instead. How large or small the average fraction of truly outside ownership in such firms is, gives an indication of the effectiveness of conflict law.

Improvements in conflict-bounding legal rules should be directed toward such issues as the scope of the rules, access to corporate information, reporting of conflict transactions (whether or not “material”), procedural barriers, and enforcement mechanisms that are viable for relatively small outside shareholders.

With the foregoing analysis as a framework, I will now turn to the four East Asian countries: Korea, Indonesia, Malaysia and Thailand. The discussion will be preliminary and tentative, reflecting limited data and understanding, but it may at a minimum suggest areas where further inquiry would be useful. The recent study by Claessens, Djankov and Lang (1998) (“CDL”) has been a most valuable source of empirical data.<sup>7</sup>

#### A. Korea

The Korean economy is usually characterized as being dominated by the government-fostered "chaebol" system—a conglomerate group of firms, linked by indirect cross-shareholdings and a common founder-chairman in the core companies. The top 30 chaebol control nearly 52% of the economy.<sup>8</sup> The founder and his family on average own about 10%, and through cross-holdings control another 30% to 40%, of the group member firms in the top 30 chaebol.<sup>9</sup> The controlling shareholder is usually also the CEO and Chairman of the Board, whose other members are executives he has selected.<sup>10</sup>

In 1996 there were 760 companies listed on the Korea Stock Exchange, with a market capitalization of \$139 billion. A study of the control pattern of 345 companies (representing 76% of the total market capitalization) with the necessary data available showed 14% to be widely held and 68% to be family controlled, if a holder with more than 10% is used as the dividing line; if a 30% holding is made the cutoff line, then 76% fall into the widely held category and 20% are family controlled.<sup>11</sup> When the size of the company is taken into account, the proportion under family control rises as size declines; using the same 30% cutoff line, the number goes from 10% of the top 20 firms to 80% of the smallest 50 firms in the sample.<sup>12</sup>

Korea, therefore, has both a significant publicly-held sector and a large number of privately-controlled firms in its public trading market, with the exact shares depending on where the control dividing line is drawn. One would expect some support for both in its legal institutions of corporate governance.

First, what is the position of small shareholders in the widely held firm? For all KSE firms in 1997, individuals owned 40% of the shares, financial institutions 22%, and other

companies 23%.<sup>13</sup> Listing on the first tier of the KSE now requires that small shareholders (<1%) own at least 40% of total shares and the principal owner/family own no more than 51%.<sup>14</sup>

Rahman (1998) made a study of the accounting practices and disclosure in East Asian countries, in comparison to selected International Accounting Standards.<sup>15</sup> For Korea, he summarized the findings for a sample of 11 of the largest banks and chaebols as follows:

“Our survey results show that none of the sample companies disclosed the amount of related party lending and borrowing. The financial statements of a little less than one-half of the sample companies made reference to existence of related party lending and borrowing but without disclosure of the amount. While all the sample companies reported foreign currency debt in the local currency, none disclosed the amount of foreign debt in the currency of repayment, and not a single corporation or bank follows IASs in accounting and reporting for foreign currency translation gains and losses. Although a vast majority of the sample companies reported the amount of the issuance of derivative financial instruments, only a tiny portion complied with other disclosure requirements set by the relevant IASs. Almost total non-compliance with IASs was found in the case of segment information. While all the sample companies disclosed the amount of contingent liability, none disclosed any information on commitments for off-balance sheet financing activities. Except in the case of a few items of disclosure, overall disclosures in the financial statements of almost all the sample banks lacked compliance with the specific disclosure requirements for bank set by IASs.”

Rahman chose to examine those accounting standards most relevant to the financial crises, as they bore on disclosures of short-term foreign currency denominated debt, contingent exposures, loan delinquencies, and the like. His conclusions do suggest, however, room for substantial improvement in financial statement disclosure in general. The Korean government has promised enhanced disclosure, through consolidated balance sheets for the conglomerates and enforcement of accounting standards in line with GAAP. It remains to be seen how the promise is fulfilled; in the past, disclosure laws have not been enforced.<sup>16</sup>

Likewise auditing, which for large companies and banks is usually performed by local member firms of the Big 5 international accounting giants, is conducted throughout the region in accordance with local auditing standards and practices.<sup>17</sup> The differences from international standards are not described in the audit opinion, which would seem a minimum step forward. Korea has the institution of a shareholder-elected internal auditor (usually a retired executive), whose potential effectiveness is similar to that of an outside director; under normal conditions, management usually chooses both. Under a 1998 law, the top 30 chaebol are to form auditor selection committees composed of internal auditors, outside directors, large creditors and large non-control shareholders.<sup>18</sup>

As noted, there is a significant portion of publicly-traded firms in Korea in which there is no controlling shareholder with a position impregnable to challenge in the market. But there was also until recently an effective set of barriers to hostile tender offers, ruling out discipline from a market for control. In 1998 legal amendments permitted even foreigners to purchase any percentage of shares without a board approval restriction.<sup>19</sup> In theory, a control market may now develop, but the US experience suggests that management will be assiduous in finding ways to thwart it.

The other avenue for shareholder discipline through voting power lies in action by significant blockholders, such as institutional investors. If foreign owners are added to Korean financial institutions, they own 31% of total market shares,<sup>20</sup> but that overstates their potential. A number of the insurance companies, securities companies and banks are controlled by a chaebol, and thus neutralized as to any monitoring of their parent. Individually, their holding in a single company is restricted, to a maximum of 20% for an investment trust company, 10% (raised

to 15% in 1998) for a bank or insurance company, and 8% for a securities company.<sup>21</sup> The investment trust funds, with the most liberal limit, have been the fastest growing institutional investor, going from 0.76% of total market shares in 1986 to 6.26% in 1995,<sup>22</sup> but they could not vote independently; they were required to shadow the voting of other shareholders. The mutual fund as a pooling of the voting power of numerous small investors simply did not exist in Korea; it may now become possible, with the removal of the shadow voting requirement in 1998.<sup>23</sup> To this point, banks and other institutional investors have been passive, and have not constituted a source of monitoring discipline on management.

The possibility of a proxy contest as another voice for small shareholder voting power should be mentioned, though only in passing. As in the US, management is in control of the proxy solicitation machinery and the annual meeting agenda, and solicits "blanket" (discretionary) proxies to obtain a quorum. A shareholders meeting may be called by holders of at least 3% of the shares.<sup>24</sup> Cumulative voting is permitted but not mandatory. A proxy fight against an incumbent management owning a block of shares has poor prospects of success, and has never been attempted.<sup>25</sup> The experience in the US would suggest that a proxy contest is of value primarily as a adjunct to a hostile takeover bid.

Let me now turn to the position of a minority investor in an insider-controlled firm, and the issue of conflict of interest law. The chaebol structure, a web of partially insider-owned firms with substantial outside shareholdings and cross-payment guarantees, is inherently riddled with potential self-dealing and abuse of control, problems that become more acute as firms near insolvency. Despite that, few cases have been brought,<sup>26</sup> and the resulting modest fines have been levied on the firms, not the controlling shareholders.<sup>27</sup> I have insufficient information to

characterize the content of Korean conflict of interest laws, beyond noting that the Commercial Code was amended at the end of 1998 to impose on directors an explicit fiduciary duty of loyalty to the company.

The one broad attempt to survey shareholder and creditor protection law across 49 countries is by LaPorta, Lopez-de-Silanes, Shleifer and Vishny (1998)("LLSV").<sup>28</sup> They create an index for legal protection of shareholders by looking to a set of particular provisions: one share/one vote, voting by mail, share deposit to vote, cumulative voting, some avenue of challenge to directors' decisions, preemptive purchase rights, shareholder percent to call a special meeting (and mandatory dividends as a separate category). The middle six are equally weighted, and their presence added to give a rating. For what it is worth, Korea gets a 2 (the US has a 5) and the mean for all 49 is a 3.<sup>29</sup> Unfortunately for my purpose here, their index is both crude and largely directed to matters of shareholder voting, not conflict of interest standards.

There has been since 1982 a provision whereby a dissenting shareholder from a corporate decision to sell or merge the business can require the company to purchase his shares, at a price to be determined by negotiation, prior transaction prices, the SEC or a court. This dissenters' appraisal remedy has been invoked rather frequently (almost 30% of the time) by the big investment trust companies.<sup>30</sup> What is its value is another matter. As a remedy for minority shareholders in self-dealing acquisitions by those in control, it can be simple and effective. But in arm's-length transactions with outside companies, where manager and shareholder interest is mostly aligned, it just purports to give knowledgeable shareholders a free put option if there is a price decline compared to the 60-day period prior to the board action. The provision in Korea (as in the US) makes no distinction.

The enforcement of shareholder rights is of course also an important consideration. We can begin for KSE-listed and KOSDAQ-registered firms with access to company information, such as accounting books and documents, which is limited to a shareholder owning at least 1% (0.5% for companies over 100 billion won in capital) of the stock, if he can prove the request is reasonable.<sup>31</sup> In other words, the shareholder can gain the information only by going to court.

Shareholders in KSE-listed companies can maintain derivative actions, if they own at least 0.01% of the stock.<sup>32</sup> I do not know if Korea has had the misfortune to pick up from the US all the arcane distinctions between class actions and derivative suits, or all the procedural obstacles placed on the latter. For whatever reason, the derivative suit has rarely been used; the victory for the minority shareholders in the Korea First Bank case in 1997 is apparently a first.<sup>33</sup> Class actions are supposed to be authorized in 2000. For either to work well, the essential requirement is that there be attorneys who are prepared to bear the litigation costs on behalf of nominal shareholder plaintiffs, in order to collect a substantial fee if successful; the Supreme Court regulation of legal fees makes this problematic.<sup>34</sup> Otherwise, collective action problems and costs will continue to be usually insurmountable.

LLSV (1998) also tried to rank on a scale of 1 to 10 the systems of legal enforcement in their 49 country study, using country risk ratings produced by several commercial agencies for three variables pertinent here: efficiency of the judicial system, rule of law, and corruption. Korea received a 6.00, 5.35 and 5.30--compared to 10, 10 and 8.63 for the US (or straight 10's for New Zealand, the Netherlands, Switzerland and the Scandinavian countries).



To sum up, Korea appears to have acquired at least the beginnings of the institutions necessary to support managerial monitoring and the operation of firms to maximize total shareholder value--which lead to reduced agency cost and lower cost of capital. It is considering requiring more outside directors and audit committees, and has revised its financial accounting standards toward international norms.

#### B. Indonesia

About Indonesia I have too little current information, quantitative or qualitative, to justify firm conclusions. At the end of 1996 there were 253 companies listed on the Jakarta Stock Exchange, with a market capitalization of \$91 billion. The CDL (1998) study of a sample of 178 showed that, at the 10% cutoff line, only 1% were widely held and 67% were family controlled, while at the 30% dividing line 25% were widely held and 59% family controlled. The top 10 families controlled (20% line) an incredible 58% of total market cap, through a complex web of interlinked conglomerates.<sup>35</sup> By the end of 1998, the number of listed companies had grown to 288, but more than half were on a watchlist for possible delisting due to lack of profitability; some 250 of them are majority-owned by their founders.<sup>36</sup> From July 1997 to August 1998, the market capitalization of JSX stocks had fallen from \$101 billion to \$10 billion.<sup>37</sup> The category of the widely-held public company in Indonesia appears to be rather insignificant. Hostile takeovers of a public company are in theory permitted, through a regulated tender offer, but run up against the reality of founder control.<sup>38</sup>

Rahman's study of the accounting practices of a sample of 7 large firms in Indonesia gave the following summary:

“More than half of the sample companies disclosed information on related party lending and borrowing. The amount of foreign currency debt was disclosed in both local and foreign currencies by a vast majority of the sample companies. Most of the sample companies did not comply with IASs in the case of accounting and reporting for foreign currency gains and losses. Disclosure on foreign currency risk management policy was not found in any of the financial statements. The local currency as-well-as foreign currency amounts of derivative financial instruments were disclosed by a majority of the sample companies and some additional sample companies mentioned the existence of these instruments without specific disclosure of the amount. Most of the sample companies did not disclose any information on the interests and losses relating to derivative financial instruments, and terms, conditions and accounting policies regarding such instruments. No one disclosed the extent of risk associated with the issuance of derivative financial instruments. Majority of the sample companies did not disclose segment information as per requirements of IASs. A vast majority of the sample companies disclosed the nature and amount of contingent liabilities without disclosure of the amount of contingent liabilities. The amount of guarantees given was separately disclosed by a vast majority of the sample companies. As in the case of other countries in the region, no one disclosed any information on commitments in support of off-balance sheet financing. The financial statements of none of the sample banks completely complied with the specific disclosure requirements for bank set by IASs.”

Indonesia is in the Dutch civil law tradition. Companies have a two-tier board structure: a board of commissioners, elected at a shareholders meeting for up to a five year term, is supposed to supervise the board of directors, who are executives elected by the shareholders for up to a five year term to manage the company, subject to approval by a commissioner for certain actions if specified in the articles of association. Under the 1996 Indonesian Company Law, commissioners and directors are required to "act in good faith and with a full sense of responsibility towards the company"; previously, they were not considered to be fiduciaries or to have an obligation to act in the best interests of a company's shareholders.<sup>39</sup>

A shareholder can bring a suit against a company if harmed by its "unfair and unreasonable" actions; a 10% shareholder can bring a derivative suit against a director or

commissioner whose negligence caused losses to the company. There is also a dissenters' repurchase remedy for harm from mergers or purchases or sales of the business. The Law lacks implementing regulations or judicial interpretation, so it is difficult to say what will be made of it.<sup>40</sup>

The Capital Markets Supervisory Agency ("Bapepam") administers fairly extensive disclosure requirements, but lacks enforcement authority against company management.<sup>41</sup> It also has rules which permit the disinterested shareholders of Indonesian public companies to approve or disapprove "conflict of interest" transactions, as defined, between a company and its affiliates; the definition seems to exclude a transaction between the company and a controlling shareholder!<sup>42</sup> The rules can be enforced by Bapepam and perhaps by shareholders.<sup>43</sup> It will be quite interesting to see how this provision develops over time, if it ever does. To this point, no minority shareholder oppression suits have ever been brought.<sup>44</sup>

The LLSV study gives Indonesia a score of 2 on shareholder protection, and ratings of 2.50, 3.98 and 2.15 on the legal enforcement variables (the lowest total of any country).<sup>45</sup> The judicial system is not highly regarded<sup>46</sup>. The picture is of a country in which external equity finance from small shareholders should be minimal. Any external equity is likely to be from large investors, who in effect rely on self-enforcing contractual rather than legal protections, and the financial structure of the firm is likely to use more debt and less equity.

### C. Malaysia

In Malaysia at the end of 1996 there were 621 companies listed on the Kuala Lumpur Stock Exchange, with a market cap of \$139 billion. The CDL (1998) study of a sample of 238 showed 1% widely held and 58% family controlled at the 10% cutoff line, and 41% widely held versus 46% family controlled at a 30% cutoff.<sup>47</sup> By the end of 1997, the number of listed companies (main board and second board) was up to 708 but the market cap in ringgit was down by more than half.

Listed companies have to report financial information and substantial (>2%) shareholdings to the Securities Commission and KLSE. Most have two or three outside directors, who make up a majority of the audit committee.

Rahman (1998) was able to obtain a sample of 15 of the 20 largest publicly traded corporations and banks, with the following findings as to their accounting practices in comparison to international standards:

“Although Malaysia officials adopted IASs, the mixed findings on compliance with the required accounting and reporting practices suggest the absence of appropriate enforcement efforts in that country. A vast majority of the sample companies disclosed the amounts of intercompany receivables and payables, but there was negligible disclosure on lending and borrowing activities with the associates. Most of the sample companies did not disclose the amounts of foreign debt either in local currency or in the currency of repayment. All the sample companies mentioned the use of closing rate for translation of foreign currency transactions. However, the recognition and disclosure of the amount of foreign currency translation gains and losses by almost all the sample companies was not in compliance with International Accounting Standard. None of the sample companies disclosed the accounting policy on foreign currency risk management. While more than a quarter of the sample companies disclosed the amount of derivative financial instruments, none disclosed the extent of risk associated with the issuance of derivative financial instruments and no sample company disclosed the other relevant information required by IASs. Disclosures were made on various elements of segment information by about two-thirds of the sample companies. While most of the sample companies disclosed the amount of contingent liabilities, a lesser number separately disclosed the amount of

guarantees given. There was no disclosure on commitments in support of off-balance sheet debt financing. A high degree of compliance with IASs was found in the case of some of the disclosure requirements in the financial statements of banks. However, some of the very important items of disclosure were not found in the financial statements of any one of the sample banks.”

Proxy contests are possible under Malaysian law, but with the usual advantages for incumbent management.<sup>48</sup> A shareholder group can call a special meeting only with 10% ownership. I do not have information on the extent of outside institutional shareholdings or the status of takeover contests, but institutional investors have generally been quite passive and concentrated family ownership suggests low likelihood of any success in a hostile takeover.

Turning to the position of a minority outside shareholder in a controlled corporation, LLSV (1998) give Malaysia a 4 on protecting shareholder rights against director actions, and scores of 9, 6.78 and 7.38 on the legal enforcement variables.<sup>49</sup>

Malaysia's corporate law is drawn from English sources, and thus includes the common law concept of directors as fiduciaries; there are disclosure requirements for “material” related party transactions.<sup>50</sup> Unfortunately, the shareholder approval requirement does not cover transactions with substantial owners.<sup>51</sup> Shareholders can bring both personal (contractual) and derivative actions, as well as a statutory remedy for unfair or oppressive conduct of the company's affairs.<sup>52</sup> The derivative actions have familiar procedural burdens, so the statutory remedy would seem superior, and there are in fact a few decisions in favor of plaintiff shareholders in conflict of interest situations.<sup>53</sup> Fraud, misconduct or oppression by management are also grounds for a court petition for a winding up of the company; the form of remedy would seem to make it

unsuitable except as a threat to induce compromise or settlements. On the whole, therefore, the delineation of shareholder rights is superior to their means of enforcement.

Malaysia certainly seems far more advanced than Indonesia in dealing with the conflict of interest problem--at least on paper. One would like to examine empirically the actual practice.

#### D. Thailand

There were 454 companies listed on the Stock Exchange of Thailand at the end of 1996, with a market cap of \$100 billion. A study by CDL (1998) of a sample of 167 showed 2% widely held and 51% family controlled, at the 10% cutoff line; 25% were widely held and 55% family controlled, using a 30% cutoff.<sup>54</sup> At the end of 1997, the number of listed companies had fallen to 431, and their market cap (in baht) had dropped by 56%.<sup>55</sup> SET requires listed companies to have at least two independent directors, and an approved auditor.

Rahman (1998), working with a full sample of the 20 largest corporations and banks in Thailand, described accounting practices as follows:

“Of the total number of sample companies in Thailand, exactly one-half disclosed the amount of related party lending and borrowing. The amount of foreign debt in both local and foreign currencies was disclosed in most of the financial statements.

In the case of recognition and reporting of foreign currency gains and losses, a vast majority of the sample companies did not comply with IASs, and in the case of foreign currency risk management policy there was no disclosure by any one. While only a quarter of the sample companies disclosed the amount of derivative financial instruments in both local and foreign currencies, additional one-fifth mentioned the existence of such instruments but without any disclosure of the amount. The amount of interest and losses relating to derivative financial instruments, and the terms, conditions and accounting policies regarding such instruments were disclosed by only one-fifth of the sample companies. None of the sample companies disclosed any information regarding the extent of risk associated with the issuance of derivative financial instruments. The disclosure of various elements of segment information, as per IASs, was not found in the financial statements of a vast majority of the sample companies. A vast majority of the sample companies disclosed the nature and amount of contingent liabilities and guarantees. As in the case of other countries in the region, no one disclosed any information on commitments in support of off-balance sheet financing. The financial statements of banks hardly complied with the specific disclosure requirements for bank set by IASs.”

If an “indecent event” occurs in a company’s financial reporting, shareholders owning 20% may apply to the Ministry of Commerce for appointment of an inspector to investigate.<sup>56</sup>

The SEC Act of 1992 "protects" shareholder interests by requiring any acquirer of 5% or more of equity securities of a listed company to file a report the next day; if the acquisition reaches 25%, then the acquirer must make a tender offer to purchase 100%.<sup>57</sup> Shareholders may call special meetings if they own 10%, but removal of directors requires the vote of 3/4 of the shareholders at the meeting. I have no empirical data on the incidence or success of hostile takeover bids for public corporations, nor on the position and role of domestic or foreign institutional investors. Proxy contests do not occur.

As to the status of a minority outside shareholder in a controlled corporation, LLSV (1998) rate Thailand as a 2 on their shareholder rights protection scale, and give it scores

of 3.25, 6.25 and 5.18 on their enforcement variables.<sup>58</sup> Thai courts move at an exceedingly slow pace. A shareholder owning at least 5% may sue a director on behalf of the company for actions not "in good faith and with care to preserve the interests of the company."<sup>59</sup> A self-dealing transaction (loans excepted) is valid if approved by the board of directors, without reference to any standard of fairness,<sup>60</sup> but should be reported to SET and approved by shareholders.<sup>61</sup> A local author noted: "Directors in Thailand do not have comprehensive fiduciary duties. ... In reality, there have been very few civil or criminal cases relating to director liability in Thailand and even with the laws on the books, they have little meaning without use and enforcement."<sup>62</sup> In a country where even in the ten largest non-financial firms, the three largest shareholders own on average 44%, most outside shareholders are in family controlled firms and dependent on such legal provisions and incentives for protection of their interests.<sup>63</sup>

### III

To summarize, using a 20% holding as the defining block, the portion of publicly traded companies that is widely held is 43% in Korea, 10% in Malaysia, 7% in Thailand and 5% in Indonesia--compared to 80% in Japan. The portion family controlled is 48% in Korea, 62% in Thailand, 67% in Malaysia and 72% in Indonesia--compared to 10% in Japan.<sup>64</sup> Corporate governance in the widely held firm is an important issue for Korea, but definitely a secondary concern for the other three--or for the rest of Asia, for that matter.

A picture of the financial structure in East Asia is summarized in the following table, based on those firms in the Worldscope Database, which contains 86% of world market



capitalization. For each country, the table gives the number of firms in the sample and their percentage of total national market capitalization, and the percentage of those firms that are insider controlled (where the top five shareholders own more than 50%, which understates the actual extent of insider control). It also gives for the sample firms the amount of external equity (defined too broadly as all equity held outside the top five) and the composite debt-equity ratio.

<b>Financial Structure Table - 1996</b>							
	GDP	TNMC	No. of firms in sample	Share of TNMC	Insider Controlled	External equity	Debt/equity
Korea	\$484.6	\$138.8	272	75%	12%	70%	289%
Indonesia	\$227.4	\$91	148	90%	81%	34%	122%
Malaysia	\$99.3	\$307.2	418	68%	50%	49%	95%
Thailand	\$181.4	\$99.8	276	89%	44%	61%	170%

Source: Worldscape Database, for YE1996, with the expert assistance of Margaret Enis.  
\$ figures are U. S. Billions

If the percentage of equity that is external is taken as a rough indicator of the level of corporate governance in a country, as I have argued, the table reinforces the conclusion that at present corporate governance is most advanced in Korea and least in Indonesia.

The percentage of firms that is insider controlled, even by a top 5/50% standard, also suggests that the position of a minority shareholder in a controlled firm is an issue that should be given priority at this time in at least three of these countries. My thesis has been that the

minority outside shareholder in a controlled firm typically gets little protection from his voting power. This is of course a simplification; the world does not divide neatly into the two categories of widely held and insider owned and controlled. There are intermediate situations and complicating circumstances. But as a general proposition, improvement in the disclosure of and legal protections against conflict of interest transactions benefitting insiders would do the most to enlarge the pool of public investment capital--and lower its riskiness and cost--for most of Asia.

Though my information is incomplete, it seems that a great deal could be done to improve conflict of interest law in all four countries. Only Malaysia apparently follows the US-UK approach of imposing a general fiduciary duty on those in control of the firm; the others rely on a scattering of specific requirements which leave a lot uncovered. But beyond the content, one must pay attention to the procedures for enforcement, both in the sense of various legal impediments to maintaining an action and in the sense of mechanisms to overcome the collective action problem which paralyzes small shareholders. Without procedures that are efficient (rather than deliberately costly) and incentives that capture a major part of the gain for the party bearing the expense and risk of initiating an action against corporate insiders, the rules on the statute books remain largely irrelevant. That may well be the current situation in all four countries.

The same collective action problem pervades the category of the widely held company, but now voting power is not impotent, if it can be mobilized. Mobilizing votes through takeover bids requires a set of supporting conditions, not only legal but economic. The legal conditions in the US are far from ideal, but have not yet precluded all hostile takeovers, though

not for want of management efforts in that direction. In most of Asia, the strength of concentrated power wielded by a small number of dominant families suggests that, if their holdings in individual firms were to drop to levels vulnerable to outside takeovers, they could erect legal barriers beyond those found in the US--if they chose. And currently the economic conditions are also lacking, such as adequate and reliable disclosure, deep and well functioning secondary trading markets and ample sources of at least interim financing. They will not be developed quickly or by mere legislative enactment.

Mobilizing votes by coordination among a relatively small number of significant outside blockholders is less difficult and seems easier to attain, again if not legally impeded. If they are to serve as general shareholder monitors, institutional investors must hold significant percentages and be independent of their portfolio companies. They must also have adequate incentive to take on the task on behalf of all equity holders, which raises empirical questions in both Germany and Japan. But this mode of corporate governance seems more likely in the short run, at least, for the Asian countries.

In conclusion and summary, then, if this analysis is accepted, I would translate it into the following set of priority recommendations, for the countries concerned or for the programs of international financial institutions. There is a long list of measures and institutions that play some role in corporate governance: independent directors, audit committees, proxy proposals, nominating committees, listing and delisting exchange requirements, insider trading rules, and so on for public companies; board or shareholder approval requirements for company

transactions with directors, dissenters' appraisal remedies for mergers and acquisitions, preemptive subscription rights for shareholders, cumulative voting, and so on for privately-controlled companies. (Both rest on a foundation of legal recognition and enforcement of a shareholder's status as an owner of the firm.) One strategy would be to press ahead on all fronts. These recommendations are for a strategy of focusing on a limited number of the most salient issues.

#### A. Conflict of interest law

The potential for minority shareholder expropriation by conflict of interest transactions seems to me to be a major risk exposure in all these economies, particularly given patterns of interlocking partial ownership of companies in a group. It can be addressed in two ways, not mutually exclusive. One is the imposition of a general "fiduciary duty of loyalty," developed in its particulars over time by lawsuits and courts. The other, probably more suitable for most non-common-law countries, is a set of more specific statutory rules.

1) Scope. The law should at a minimum cover transactions, direct and indirect, between the firm and those in control of it. In terms of persons covered, the important point is not formal status as an officer or director by itself, but the possession of control over decisions of the firm. That means the top management in truly public companies, but the dominant shareholders in others, whether or not they serve as directors also.

2) Standards. One approach is a prohibition of all self-dealing transactions. That might be desirable if it is anticipated that enforcement of the law will be ineffectual. Otherwise, a less stringent rule--such as a standard of "fairness"--is probably preferable. Conflict of interest transactions can be mutually advantageous, like other contracts; it is just that the domination of one party gives no reason to presume that its interests will be served. A "fairness" standard implies a judgment by some outside party as to whether the terms resemble those that might have been arrived at in an actual arm's length bargain.

3) Enforcement. Who is the outside party who determines whether that standard was observed? One finds a variety of answers in different legal codes.

a) "Disinterested" directors. Some statutes validate self-dealing transactions if they have been disclosed to and approved by directors on the board who did not have a personal stake in the matter. Unfortunately, "disinterested" does not mean "independent." If directors have been in reality selected or retained on the board by a controlling person who is a party to the transaction, their approval of the transaction should have little consequence.

b) Shareholders. If shareholders (not counting those who are interested) approve the transaction with full disclosure of terms and gains, the question turns into one of the feasibility of collective action. In a private company with a small number of shareholders who hold substantial stakes, their approval should end the matter. But in a widely-held public company, shareholder approval is likely to be a foregone formality.

c) Courts. The determination can be committed to a judge. How satisfactory a solution that will be depends primarily on two factors.

(1) Judicial system. If the judicial system is independent and impartial, or is moving in that direction, this is probably the best answer, even given the subjective nature of the judgment being called for. But that rests on a further factor--will the case ever be presented?

(2) Litigation incentives. Only in a modest fraction of cases will an individual shareholder (or small group) find it economically sensible to bear the entire risks and costs of litigation for a proportionate share of the recovery. For there to be effective enforcement, there must be some mechanism for collective action, such as derivative suits and class actions brought by attorneys in search of substantial fees if successful. This has proven a powerful enforcement mechanism in the US, as is being demonstrated in an increasing variety of contexts. But it depends on its being acceptable under social norms and bar rules, which may require a process of explanation and adoption. Otherwise, conflict of interest rules may be of little value without some different avenue of enforcement.

d) Administrative agencies. Enforcement could be committed to a government agency, charged with the task. This is definitely second best to an effective bar, for agency incentives to act are weak and often vulnerable to political pressure. But if there is no better alternative, then it is the last line of defense.

B. Market control

In the longer run, it is important to strength the prospects of managerial monitoring for public companies through facilitating the assembly of significant voting positions. Where it can be brought to bear, shareholder majorities can address not only conflict of interest expropriation but, even more significantly, the quality of managerial performance and the need for replacement. Only in Korea would such measures offer the possibility of immediate appreciable gains. To implement such an approach, several factors are worth stressing.

1) Information disclosure. Trading markets are fundamentally markets in information. Obviously, the extent and reliability of corporate financial information reported to exchanges and shareholders helps determine the depth of capital markets, the liquidity of investors' positions, and the accuracy of pricing. If the required disclosure also addresses conflict of interest transactions, it facilitates enforcement of those rules as well.

2) The role of institutional investors. Enhancing the growth and activism of institutional investors makes possible direct shareholder monitoring of management in public companies. As capital flows into pension funds, investment companies, insurance companies and the like, with the growth of these economies, it is important that they not be restricted to ineffectual holdings and passive voting in portfolio companies. The same is true for banks, whose defaulted loans are bestowing on them large equity positions.

3) Takeovers. The opportunity for hostile takeovers can be a powerful disciplinary force on the incumbent management of widely-held firms, and for that reason one fiercely resisted in the

names of "stability" and "shareholder protection." I would not be very optimistic about the development of a market for corporate control in the short run; it also requires large and liquid capital markets. If those funds are from foreign sources, it becomes easy to play on xenophobic fears as another line of defense. But looking forward, it is a mechanism worth fostering.

### C. Education and training

To the extent the institutions and concepts described above are unfamiliar, there is need for a program of explanation and consultation and training. It would certainly not do simply to propound US laws or institutions, which are themselves often inefficient in dealing with these matters. In particular, the US has, as part of the process of contention among its own interest groups, added procedural obstacles to many of these devices, which no one would be well advised to emulate.

From the standpoint of international financial institutions, it would also be worthwhile to create and maintain a set of empirical indicators of status in dealing with corporate governance, beyond the valuable but simple beginning in the LLSV (1998) study. The actual incidence of various events, such as takeover attempts or conflict of interest lawsuits, adds a great deal of understanding of the reality that lies outside the pages of statutes.



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## Endnotes

1. [30]
2. [8]
3. [10] at 49.
4. [12], [23]
5. Modigliani & Miller [20] demonstrated that it doesn't matter in a formal model, which has given rise to a vast literature seeking to explain why in actual practice it does.
6. [26]
7. [6]
8. [21] at 28.
9. [16]
10. [5] at 4.
11. [6] at 12.
12. Id. at 28, 30.
13. [5] at 13.
14. [9] at 62.
15. [25] at 30.
16. [13] at 102-3.
17. [25] at 37.
18. [5] at 9.
19. [21] at 21.
20. Id. at 14
21. [18] at 146.

22. Ibid.
23. [5] at 10.
24. [21] at 25.
25. [13] at 104.
26. [21] at 31.
27. Id. at 34.
28. [15]
29. [15] at Table 2, 1130-31.
30. [18] at 138.
31. [13] at 103-4.
32. [5] at 8.
33. [5] at 7.
34. [21] at 27.
35. [6] at 6, 12.
36. [7] at 33.
37. [2] Indonesia.
38. [7] at 45.
39. [22] at 239.
40. [22] at 240.
41. [7] at 47.
42. [2] Indonesia, App. 9.
43. [22] at 240.
44. [2] Indonesia at 29.
45. [15] at 1130, 1143.

46. [2] Indonesia at 13.
47. [6] at 6, 12.
48. [11] at 16-7.
49. [15] at 1130, 1142.
50. [2] Malaysia at 33-5.
51. Id. at 44.
52. [11] at 21.
53. Id. at 24-5.
54. [6] at 6, 12.
55. [28] at 12.
56. [2] Thailand at 36.
57. [28] at 9.
58. [15] at 1130, 1142.
59. Public Limited Companies Act B, E, 2535, Section 85.
60. Id. at Section 87.
61. [27] at 53-66.
62. [29] at 15-16.
63. [1] at 13.
64. [6] at 12.