

# CORPORATE GOVERNANCE: CHALLENGES AND OPPORTUNITIES IN ASIA

*ADB Headquarters, Manila*

## Remarks by Gambhir Bhatta Chief of Governance Thematic Group

**20 November 2017**

Vice President Stokes,

General Counsel Stephens,

Distinguished guests and participants from different countries,

Ladies and gentlemen.

1. On behalf of the Governance Thematic Group at ADB, I would like to welcome all of you to this event on corporate governance.
2. The subject matter of today's Program is nothing new. However, even a cursory browse of the news these days will show just how important corporate governance has now become. I'd like to recount two, of the countless many, stories that have been highlighted.

### **Cases of Snapchat and Saudi Aramco**

3. The young social media company, Snap, back in March this year, raised \$3.4 billion from investors in its initial public offering. Now there is nothing wrong with a new company generating that level of interest from eager investors. What is noteworthy though is that there are concerns about protecting shareholder rights since the company offered public shares with no voting powers. Without this, investors don't have any say

in the running of the company. Snap's recent downturn in performance has soured many investors, and some fund managers have termed this a "corporate governance nightmare".

4. On the other hand, in 2018, Saudi Aramco – the world's largest state company – will divest 5% of its almost \$2 trillion portfolio. Both the London and New York Stock Exchanges are vying for its attention. What is noteworthy in this case is that the London Stock Exchange looks set to relax some of its rules to allow for Aramco to be listed there. Needless to say, this has raised a few eyebrows.

5. Snap's experience has given rise to a concern that is described as 'passive governance'. If current trends in the corporate world are anything to go by, institutional investors have increasingly, and passively,<sup>1</sup> tended to give away control of the Board to managers and proxy advisors, and are not holding the managers to full account.<sup>2</sup> Interestingly, this generally appears to be quite the opposite in state-owned enterprises where governments – by virtue of their equity investments in the companies – have aggressively pursued their own agenda, often at odds with the core objectives of the enterprises themselves.

6. What the Snap and Aramco stories broadly point to, of course, is the importance of corporate governance. Indeed, this – and not just the strength of the balance sheet – is now an established investment criterion. It is also now recognized that weaknesses in corporate governance are almost always responsible for risky financing practices that lead to adverse effects such as non-performing loans and large-scale bankruptcies, among others.

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<sup>1</sup> "Hong Kong warns on passive governance". *Financial Times*, 20 March 2017.

<sup>2</sup> See, eg, David Smith. 2017. "Singapore risks a race to the bottom with dual-class shares". *Financial Times*, 16 March 2017, p. 18.

## Corporate Governance in the public sector

7. While good corporate governance is important in the private sector, it is equally so in the public. We need only look at the work of state-owned enterprises. The dominance of these enterprises in the global market is well documented: Price Waterhouse Coopers, for example, in 2015 estimated that they accounted for about a quarter of Global 500 companies, and their revenues rose from less than 2 trillion to almost 8 trillion dollars in the span of just ten years.

8. However, these enterprises are generally considered to be problematic. Because they normally do not have a hard budget constraint, they tend not to be cost conscious, secure in the knowledge that the government will bail them out when needed. Poor performing SOEs are also a fiscal drain as subsidies, easy credit, and market protection are continually provided. There are numerous examples where governments annually provide millions of dollars in subsidies to loss-making public enterprises, with not much really to show for them.

9. Corporate governance improvements in state-owned enterprises are critical. Earlier this year, Moody's Investor Service<sup>3</sup> warned that in many countries, including in our region, these enterprises represent a material source of financial risks for governments, including substantial risks emanating from contingent liabilities on the public budgets. Indeed, Moody's says that a risk on such liabilities for governments ranks right up there after financial sector crises and natural disasters.

10. It is thus no surprise that some governments increasingly loath to stand as guarantors of loans taken by 'strong' SOEs; they argue the strength of their balance

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<sup>3</sup> Their report "Sovereign Contingent Liabilities; Public Enterprises Represent a Material Source of Fiscal Risk to Some Sovereigns," looks at data on contingent liabilities (ie, liabilities that governments may end up paying should a SOE, for which the government has stood as guarantor, default on its loans) of nonfinancial public sector companies of 87 developed and emerging market countries for the period 2010 to 2015. It makes for somber reading. See also "Moody's: China, Dubai and Venezuela most exposed to debt from public sector enterprises", 25 January 2017, Global Credit Research.

sheet ought to suffice in tapping capital markets. Indeed, reforming SOEs has become important if they are to eventually access long-term capital from private and public debt markets. For this, of course, enhancing corporate governance is critical.

11. Recent research by ADB<sup>4</sup> on this subject in the Pacific has shown that, in the main, public companies perform best in an environment with strong corporate governance. However, as long as they remain under government control, the risks of political interference and non-commercial decision-making remain high. Which is why political will to sustain the reforms is 'a necessary and sufficient condition' for such reforms to succeed.

### **Some challenges on corporate governance**

12. I'd like to now touch briefly on some of the main challenges that have been identified in corporate governance across the board. To cite just a few: nurturing shareholder relationships and engagement, rights of minority shareholders, regulation of proxy firms, diversity on boards, risk management, and cyber security.

13. While all of these challenges should certainly occupy our minds, for the agenda on 'democratizing capital', and also for equity considerations, protecting minority shareholding rights is important. For this, 'disclosure' is critical since openness is the basis of public confidence in the corporate system. Governments must ensure rigorous provisions for such disclosure in both private and public companies.

14. In reality, both companies and governments need to do more.

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<sup>4</sup> ADB. 2016. Finding Balance 2016: Benchmarking the Performance of State-Owned Enterprises in Island Countries. Manila. The participating countries for this study from the Asia Pacific region that are developing member countries of ADB were: Fiji, Kiribati, the Marshall Islands, Papua New Guinea, Samoa, Solomon Islands, Tonga, and Vanuatu.

- a. Of companies is required a mindset change on realizing the importance of good corporate governance, including securing adequate board independence; and embracing strict accounting, auditing, and reporting norms.
- b. Of governments is required stability and predictability as evidenced in strong legislation, control on corruption, and, most important, rigor of rules and their consistent and impartial enforcement.

### **ADB's work in corporate governance**

15. ADB has, over the years, supported, and invested in, various aspects of corporate governance in its developing member countries, including in:

- a. Strengthening overall corporate governance and regulatory framework (such as in Pakistan, Vietnam, and countries in the Pacific; as well as at state level in India);
- b. Reforming capital markets and improving listing requirements, such as in Sri Lanka, Indonesia, and the Philippines;
- c. Reorganizing and corporatizing entities (such as Assam State Electricity Board), and rationalization of public enterprises in Tonga; and
- d. Enhancing the capability of governments to control for corruption, such as in Bangladesh.

16. We could – and should – do more; and this is where programs such as today's are important.

### **Benefiting from this Program**

17. We have here with us a diverse audience – government officials and regulators, commercial court judges, legal practitioners, ADB staff, and others that deal with corporate governance issues on a regular basis. By engaging globally credible experts

on this subject, the Program seeks to identify corporate governance issues that need to be addressed in the public and private sectors, and what can be learned from international good practices.

18. We also see other benefits from this Program (as indeed from the other two to be designed in 2018):

- a. First, coming together like this gives ADB an opportunity to hear from you about where, and how, it can help contribute to effective corporate governance in your countries; and
- b. Second, we hope this will help establish a knowledge network of interested practitioners that can serve as resource persons in the practice of corporate governance across the countries of the region.

19. I look forward to the discussions in this Program, and am confident we will be able to chart a meaningful way ahead for the upcoming programs to be designed.

Thank you.

***(1,448 words, without the titles; time: 7 mins and 03 seconds)***