Asian Corporate Governance Association (ACGA)

"Asian Governance Challenges: New Opportunities For Investors"

Presentation by:

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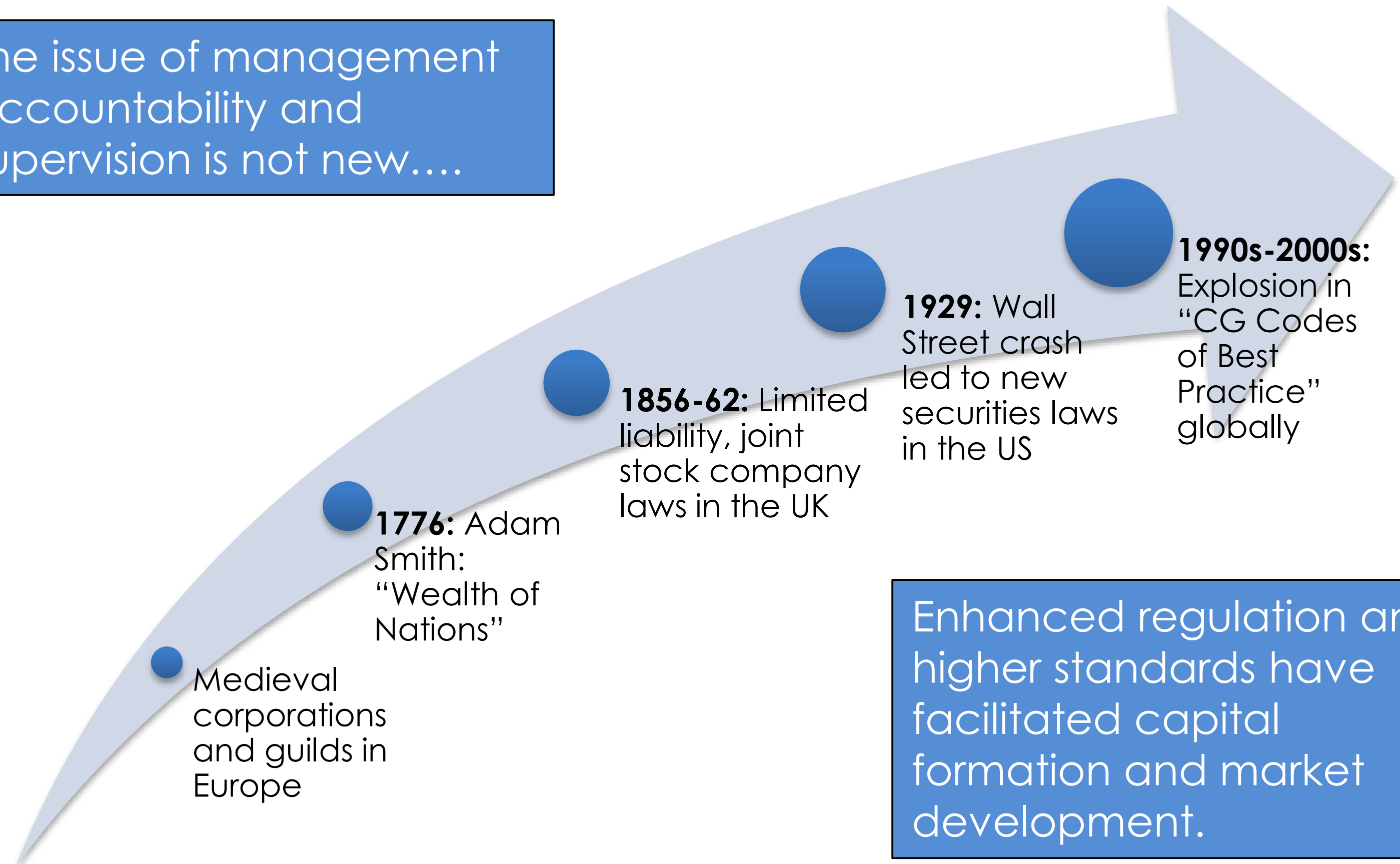
Agenda

1. A brief history of corporate governance
2. CG and ESG: Mutually reinforcing
3. Governance challenges for investors in Asia
4. Opportunities for investors in Asia
5. Seeing patterns / Proper risk analysis

1. The long history of corporate governance

The issue of management accountability and supervision is not new….



Enhanced regulation and higher standards have facilitated capital formation and market development.

A short history of corporate governance

CG reform picked up speed following corporate crises in the US and UK in the 1970s and 80s….

1970s: Audit committees and independent directors(US)

1980s: Greenmail sparked pension activism (US)

1992: Cadbury Report (UK)

1997/8: Asian Financial Crisis

2002: Enron

CG is a continuously evolving phenomenon. We learn by doing.

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The first decade in China

Following the re-creation of stock markets in the 1990s, China began CG reform in earnest in the early 2000s…

- **2001:** CSRC INED guidelines (before Hong Kong!)
- **2002:** CG Code of best practice.
- **2003:** Quarterly reporting
- **2005:** CBRC bank CG guidelines
- **2007:** Convergence of accounting standards with IAS/IFRS

CG is evolving in China with local as well as international characteristics. A new CG Code is in the works.

2. CG & ESG: Mutually reinforcing

CG and ESG overlap and are mutually reinforcing. But please note that the "G" in ESG does not cover all that is "CG"!

Corporate Governance

- Corporate disclosure
- Board composition
- Director duties and accountability
- Internal controls and risk management
- Accounting / auditing
- Shareholder rights
- Stakeholder relations
- AGMs and proxy voting
- Capital raising, takeovers

Environmental, Social, Governance (ESG)

- Environmental management and data collection; the climate change dimension
- Social impact of company and employee health/safety
- Governance of sustainability, including board leadership
- Disclosure and risk management of E+S
- New business opportunities?

3. Governance challenges for investors in Asia

Despite a general improvement over the past decade, governance challenges for investors in Asia remain numerous:

Disclosure, rights

- Financial reporting that varies in quality and integrity, including slow or no disclosure of "material" (price-sensitive) events
- Boilerplate "non-financial reporting" (CG reporting worse than ESG)
- Varying degrees of investor protection (ie, minority protection)
- Dilutive and unfair capital raising
- Opaque and inefficient shareholder meetings; votes not properly counted

Organisational

- Concentrated ownership (state and private)
- Related-party transactions
- Boards lacking independence and balance; weak director duties
- Executive compensation out of alignment with performance
- Dialogue with directors and senior executives a challenge

4. Opportunities for investors in Asia

A focus on CG assists in highlighting danger signs:

- **Financial reporting**: What is the company not telling you? Is it paying its auditor properly?
- **CG reporting**: Numerous "red flags" in what is said and not said (eg, who is on the audit committee and when does it meet?)
- **ESG reporting**: Puts material risks in a broader and longer term context.
- **Risk management/internal controls**: Can you understand what the company is doing? Is it believable or just "consultant-speak"?

The emergence of "investor stewardship" opens a new door:

- **Enhanced company engagement**: Meeting with directors and more senior managers increases investor influence, provides a platform for constructive suggestions to companies.
- **Learning by doing:** Governance analysis and engagement provides insights into companies that otherwise would be hard to see.

5. Seeing patterns

The late Alastair Ross Goobey, Former CEO, Hermes Pensions:

"Institutional investors are often ridiculed as potential agents of change. How can we know better than the professional managers how a pharmaceutical company or an engineering firm should be run? ….

"I would point out one very important input we can make that is unavailable to most company managements. In the UK equity market alone, we invest in about 900 companies, and we meet with perhaps one-third of those every year. ….

"<u>While we probably cannot bring any specific insight into how to make money, we certainly can and do warn of patterns that seem doomed to destroy shareholder value over the long-term</u>."

"The Responsible Owner in Action",
Corporate Governance International (CGI 2, 1999), p115-118

Proper risk analysis

The need for responsible investment
“PGGM and its clients have a clear view of the importance of responsible investment. Pension funds have an obligation to generate good returns to ensure that sufficient resources are available to pay the pensions of the funds’ participants both now and in the future.….

“Responsible investment requires a proper risk analysis that also takes account of environmental, social and corporate governance factors. It also requires active engagement not only with companies but also with supervisory and regulatory bodies. We take these factors into account in a large proportion of our investment decisions. We pursue good corporate governance and make use of our voting rights whenever possible.

PGGM, *Annual Responsible Investment Report 2008, p4*

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