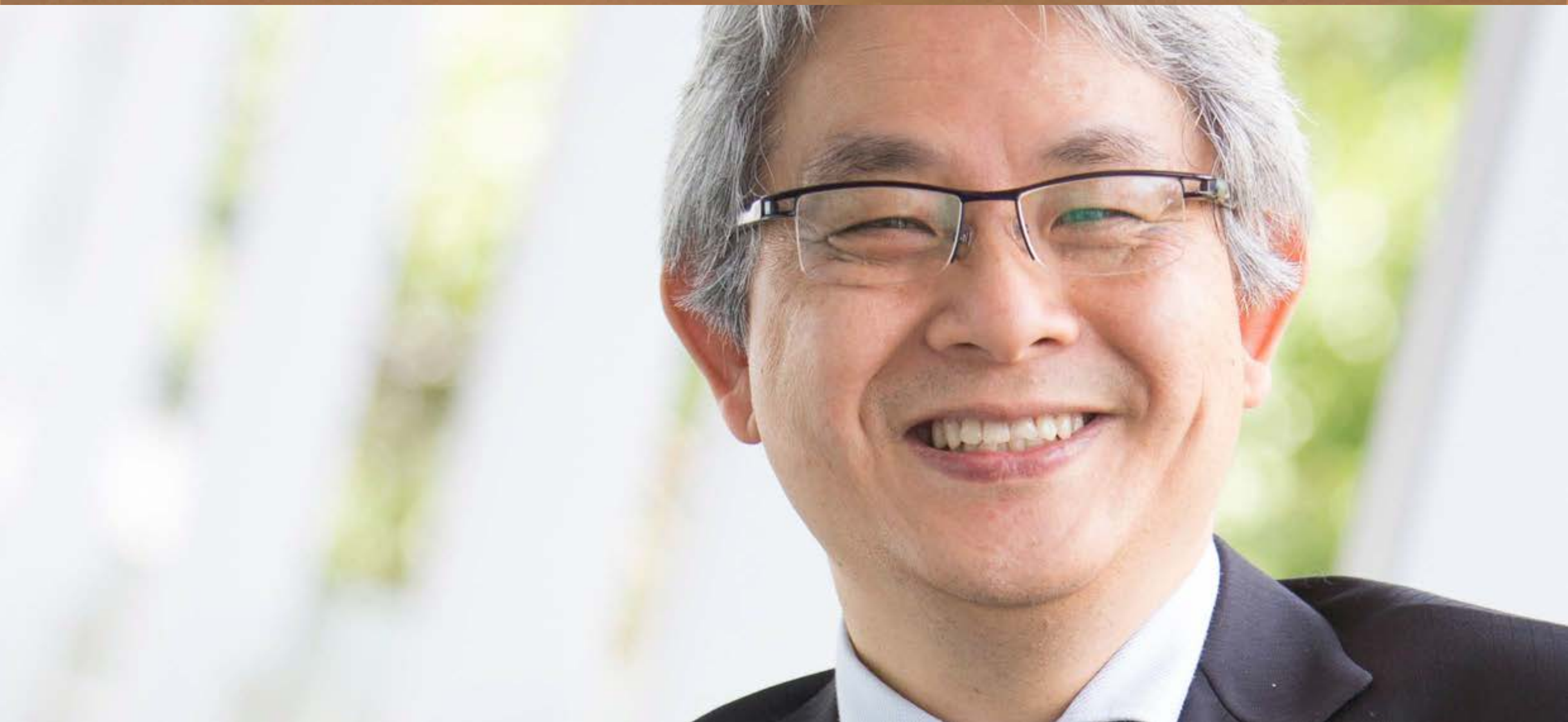
# FUTURE OF CORPORATE GOVERNANCE



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Despite extensive reform efforts and increased awareness of corporate governance over the last two decades or more, there are no apparent signs of governance lapses becoming less common. Often, history seems to be repeating itself.

Consider the cases of unauthorised trading in banks. In 1995, there was the Barings Bank scandal involving unauthorised trading in futures contracts in Singapore that brought down the bank. This was followed by losses of A$360 million from foreign currency derivatives at National Australia Bank in 2004; €4.9 billion from European stock index futures at Societe Generale in 2008; US$2.3 billion from exchange-traded funds at UBS in 2011; and US$2 billion from credit derivatives at JPMorgan in 2012.

Non-bank companies were not spared either. In 2005, China Aviation Oil, which was listed in Singapore, lost US$550 million from betting on oil derivatives; and in 2008, Citic Pacific in Hong Kong lost US$2 billion through foreign exchange derivatives.

In my view, there are three key factors that impose a continuing and increasing stress on the corporate governance of companies and markets: weak corporate cultures, cross-border differences, and complexity of organisations.

Let’s start with corporate culture. The recently released publication by the United Kingdom Financial Reporting Council (FRC) titled “Corporate Culture and the Role of Boards” defines corporate culture as “a combination of the values, attitudes and behaviours manifested by a company in its operations and relations with its stakeholders”. While corporate governance codes and rules have increased compliance and adoption of corporate governance “best practices”, they have been far less successful in improving corporate cultures.

Whether we are talking about trading, financial, corruption, environmental or safety-related scandals, they often occur in organisations with corporate cultures that put financial imperatives ahead of ethics, safety or environmental considerations. BP’s Deepwater Horizon environmental disaster, Takata’s airbag failure, Tepco’s nuclear power plant disaster, General Motors’ ignition switch failure, Olympus’s and Toshiba’s accounting scandals, Volkwagen’s emissions scandal, and GlaxoSmithKline’s (GSK) and Leighton Holdings’ bribery scandals would not have occurred with the right corporate culture. When Mary Barra took over as CEO of General Motors, she said that one of her immediate priorities was to change the corporate culture.

Boards have a key role to play in building a strong corporate culture. However, regulators can also play their part by holding companies, boards and senior

management more accountable for actions of their employees. When things go badly wrong, regulators should determine if boards and senior management have done enough to ensure that things go right rather than allowing them to just blame what went wrong on "rogue employees" – a popular excuse used by companies.

Regulators can also facilitate the development of a robust "challenge function" within boards. In countries like the U.S. where ownership in companies is generally dispersed, management have often become so powerful that they control the board. However, improved proxy access has allowed shareholders more influence over board appointments.

In most other countries around the world where there is concentrated ownership, independent directors are generally appointed by controlling shareholders and are often beholden to these shareholders. Not surprisingly, they have often failed to do their part in challenging decisions that are not necessarily in the interests of the company and all shareholders. Regulators need to take bolder steps in allowing minority shareholders more say in the appointment of independent directors. Otherwise, I can foresee the concept of independent directors falling into disrepute and disappearing as a credible mechanism for ensuring good corporate governance. In fact, serious doubts about the value of independent directors are already being expressed in many countries.

Next is cross-border differences, be they cultural norms, business practices, or laws and regulations. The bribery scandals involving GSK in China, Leighton in Iraq and Walmart in Mexico have to do with a failure of companies to appreciate (or choosing to ignore) cross-border differences.

Some other examples are HSBC's money-laundering scandal in Mexico, Caterpillar's troubled acquisition of a Chinese company, OSI's tainted-meat scandal in its China operations, Nathaniel Rothschild's dispute with the Indonesian Bakrie family in Bumi Plc, BP's joint venture in Russia through TNK-BP, and Shell's highly questionable dealings in its oil venture in Nigeria.

There are also many companies listing overseas that have created problems for local directors, regulators, investors and other stakeholders. In Singapore, we have many cases of Chinese companies - called S-chips – listing on the local exchange which have been engulfed in scandals. In these S-chip scandals, regulators and shareholders have generally been powerless to take action against directors and senior management. However, Singapore is not alone in this regard. Elsewhere, we have cases like Boshiwa and Hanergy in Hong Kong, Rino in the US, and Sino-Forest in Canada which have posed considerable challenges for regulatory and private enforcement.

In Singapore, a big debate has erupted over a proposal to allow companies to list with ordinary shares having different voting rights – so-called dual class shares (DCS). To me, the fundamental issue is the mistaken belief of some that we can somehow transplant into Singapore something like DCS that is allowed in countries like U.S. without recognizing the legal and institutional environments that help mitigate risk of abuse which do not exist in Singapore. These differences may include contingency-fee class action litigation, fiduciary duties of controlling shareholders, and the regulatory approach to corporate governance.

However, this is symptomatic of a wider issue. When reforming corporate governance codes, rules and regulations, there is a tendency to adopt practices from other developed markets without a good appreciation of the wider context within which those practices exist. In fact, the widespread adoption of the "comply or explain" approach to improving corporate governance without sufficiently considering the state of market development and investor activism is a case in point.

It is important for companies to gaining a deep understanding of cross-border differences before they enter new markets. For regulators, it is equally important that they have a good understanding of differences in legal and institutional environments when formulating their corporate governance rules.

The third factor has to do with complexity of the corporate structure, specifically the proliferation of group entities such as subsidiaries, associates, joint ventures and special-purpose entities, often layered one on top of another. Boards of directors of group entities below the parent often have a very limited governance role, and at the same time, these entities are far from the line of sight of the group board and senior management. Today, the conversation about corporate governance should include group corporate governance.

Corporate scandals often start from a group entity, sometimes several layers below the parent company. The BP environmental disaster is a good example. More recently, OW Bunker, a company listed on the stock exchange in Denmark, collapsed due to risk management failure and unauthorised transactions in its wholly-owned Singapore subsidiary.

Beyond the governance of the group entities, governance and management of other companies in the supply chain (or supply chain governance) is also important. The OSI tainted-meat scandal, the Takata airbag failure scandal and the OW Bunker collapse, for example, show how problems in one company in a supply chain can have devastating effect on other companies in that chain.

There is a need for companies and regulators to focus on group governance issues and to consider the governance and management of business partners in the supply chain.

In conclusion, in my view, the future of corporate governance revolves around the 3 C's of culture, cross-border issues and complexity.