cutting through complexity

Event Summary

Corporate Governance: A Delicate Balancing Act

A new study by ACCA and KPMG assesses the clarity and completeness of CG rules across 25 markets

Panel members at the report launch. From left to right: Chiew Chun Wee, Paul Yuen, Elizabeth Kong, Prof. Lawrence Loh and Irving Low.

What defines a good set of corporate governance rules? How can we be sure they will have the intended effect? And when is it right to enforce them? These are a few of the questions that emerged from a recent panel discussion at the November launch of a joint study by the Singapore Association of Chartered Certified Accountants (ACCA) and KPMG, analysing corporate governance requirements and degrees of enforceability across 25 global markets.

Titled 'Balancing Rules and Flexibility', the report assessed four pillars of corporate governance: leadership and culture, strategy and performance, compliance and oversight, and stakeholder engagement.

Hosted by Chiew Chun Wee, Head of Policy, Asia Pacific, ACCA, the panel also included the report's author, Irving Low, Head of Risk Consulting, KPMG in Singapore; Paul Yuen, Executive Director, Market Conduct Department, Monetary Authority of Singapore (MAS); Elizabeth Kong, Director, Stamford Law Corporation; and Lawrence Loh, Associate Professor, Centre for Governance, Institutions and Organisations, National University of Singapore.

Singapore's approach to governance

The ACCA–KPMG report looked at an average of 72 separate corporate governance requirements across the 25 countries, evaluating each market in terms of clarity, enforceability, and the number and type of governance instruments used. Singapore ranked first in the Asia-Pacific region and third overall behind the US and UK, with Malaysia and India equal in fourth place. Hong Kong and Taiwan both featured in the top 10. Of the markets surveyed, only three – Myanmar, Brunei and Laos – did not have a corporate governance code in place.

The report found that corporate governance benefits from careful calibration within a marketplace, and having 'intelligent rules' drawn up to suit each specific environment.

"A premise of our study was that the more comprehensive and clear a market's rules, the higher that market's ranking would be," said KPMG's Mr Low.

But having more rules, more Codes, more requirements doesn't necessarily make market outcomes better, cautioned NUS' Assoc. Prof. Lawrence Loh. Instead, what is needed is a "calibrated approach."

Agreeing, Mr Low observed that a good corporate governance framework should not simply focus on having more requirements. It should attempt to achieve a balance between rules and flexibility.

Irving Low of KPMG presenting the research study.

The entire point of having rules, he says, is to safeguard the interests of stakeholders, and to this end, the rules in a corporate governance framework should be purposeful and decided. But at the same time, the framework must allow for some flexibility, taking into consideration that different companies would face different circumstances. Subjecting companies to too many prescriptive requirements would be counter-productive, he says, as it would make doing business difficult and a 'compliance culture' of doing the bare minimum may result.

Indeed, as Mr Low observed, one of the factors that helped Singapore come out on top is the delicate balance it strikes between rules and flexibility, and its regular review of its corporate governance codes. The MAS focuses on three key areas: discouraging poor governance practices; fostering good behaviour by presenting awards and recognising best practice; and aligning the interests of the company with its stakeholders.

"[In Singapore,] we don't address issues only when there is a crisis. Instead, we review on an ongoing basis to achieve the intended objectives." said MAS' Mr Yuen.

Part of that calibration involves deciding how far to make CG requirements mandatory through the force of law. In Singapore, as with several other jurisdictions such as the UK and Australia, CG requirements are mostly kept as principles within the CG Code to allow corporations sufficient flexibility to respond to the expectations of their specific markets. Principles have the added advantage of having the market set benchmarks and foster discipline.

Still, would not all the emphasis on CG rules simply place "too much legal liability on directors, taking their focus away from business strategy and performance," asked a member of the audience.

No, countered KPMG's Mr Low. He argued that in comply-or-explain regimes, only the most crucial rules are set as Listing Rules, and the others are organised as principles in the CG Code. These principles are industry best practices that set out investors' expectations. Companies that meet these expectations would naturally attract more market interest.

He added that in such principles-based frameworks, companies can simply adopt what is most relevant to them. For now, all we need to do is to pause, let the market digest the framework, and let it manifest itself in companies' behaviour and outcomes.

New challenges, new threats

Corporate collapses at Enron in 2001 and WorldCom in 2002 brought corporate governance to the fore in the US. The 2008 global financial crisis moved the regulatory needle forwards again as the US, UK and Australian governments revised corporate governance codes in a bid to ensure that these types of scandals couldn't happen again.

Other countries followed suit and implemented new guidelines of their own. But are corporate governance frameworks around the world now strong enough to prevent wrongdoing on this scale?

"It is important to get the balance right and safeguard the interests of stakeholders," said KPMG's Mr Low, acknowledging the difficulty in regulating human behaviour. "But unfortunately, the more rules you have, the more people will want to break them."

In theory, however, every new corporate scandal should make it easier to mitigate governance failures the next time around.

Panel members at the report launch. From left to right: Leong Sook Yee, Chiew Chun Wee, Paul Yuen, Elizabeth Kong, Prof. Lawrence Loh and Irving Low.

"I think the current [corporate governance] framework should mitigate the chance of another WorldCom-type scandal occurring," said Stamford Law Corp's Ms Kong. "But does that mean the current framework is good enough to avert all corporate scandals? No one can say for sure, because new challenges are being posed all the time."

As an example, Ms Kong cited the variable asset structure of the Chinese e-commerce giant, Alibaba, which accounts for about 80 per cent of all online retail sales in China. The company recently recorded the biggest-ever share price for a technology initial public offering (IPO) in the US.

"This company's assets are not even owned by shareholders and its management is virtually entrenched," Ms Kong said. "Naysayers point to these as clear signs of a [corporate governance] disaster waiting to happen. Yet it is only when the company starts to struggle that these issues will come back to haunt investors."

Promoting diversity

Board diversity ranked bottom of the overall corporate governance priorities in the 25 markets studied, and around 60 per cent of these countries had no available metrics at all – a sign that diversity is perhaps a far lower priority than in the UK and Australia, for example. In Singapore, more than 50 per cent of listed companies do not have a guidelines providing for board diversity.

"The case for board diversity has been made now, and it has been on the corporate governance agenda for some time," Ms Kong said. "Diversified boards promote more effective board decision making in the sense of avoiding 'group think."

Based on the study's findings, it seems that on average, more diverse boards chalk up higher returns on equity and assets, and make better decisions for the company's overall long-term health.

But changing the status quo appears to be the biggest challenge. Singapore has appointed a Diversity Action Committee tasked with building up the representation of woman directors on company boards. "I think we should follow the lead of those other markets where the definition of diversity is much broader," observed KPMG's Mr Low. "It should go beyond gender and include a whole host of components such as experiences and specialisation that might enrich the process of decision making."

Understanding human behaviour

The UK has revised its corporate governance codes eight times since 1992, and the US three times (twice since the financial crisis). Singapore, meanwhile, has revised its code twice since 2001, most recently in 2012. During the 19 November panel discussion event, the panellists were asked whether they felt corporate governance codes were 'proactive' enough, given the frequency of corporate scandals today.

"Obviously, we shouldn't be waiting for a crisis," said Mr Low. "Different countries have revised their codes at different times, and that reflects a state of maturity. Not every country is at the same level of maturity. The other reason why these revisions are done at different times is because they are all done incrementally."

A further question from the floor asked about the role of social psychology in shaping corporate governance guidelines, given the role of human behaviour in corporate wrongdoing.

Ms Kong said that this raised a bigger question about the philosophy behind good governance.

"In some markets – Germany, Japan and France, for example – they don't put the priority on corporate profit maximisation right at the top in the way that the Anglo Saxon model does. And this model includes Singapore," she said. "This might be one of the reasons why we have these problems, because we have put so much emphasis on maximising profits."

MAS' Mr Yuen said some government agencies in Singapore have begun considering behavioural insights as a way to guide policymaking. "It is an area we have to be mindful of, because we are trying to cultivate certain kinds of behaviours," he said.

Ultimately, the test of any good corporate governance code is how proactive shareholders are in enforcing it and holding company executives to account. In Asia, Ms Kong noted, investors are still fairly "muted" in this respect.

"That needs to change. Shareholders need to rise up and be more vocal in exercising their rights. Like democracy, corporate governance is only as effective as the ability and willingness of shareholders to speak up."

Equally important is the need for some consistency in corporate governance between jurisdictions, as we approach the ASEAN Economic Community in 2015, added Mr Low of KPMG. In this, Singapore may be in a good position to lead the region in achieving CG parity. Here too, some balance is in order. While we aim for parity in ASEAN comparable to the European Union's, an eye has to be given to context since not all countries are at the same rate of maturity.

"Revisions are normally done incrementally to accommodate the individual economy, and if policymakers are forward thinking, they would proactively take lessons from other jurisdictions to up their game in terms of transparency and accountability," Mr Low said.