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The Suitability of Corporate Governance Models in Developing Asian Economies

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Abstract: This paper provides a consideration of the suitability of western models of corporate governance for implementation in developing Asian economies such as Thailand. The paper adopts a literature review as the research method. Definitions of corporate governance and the history and the nature of corporate governance around the world are summarised. The evidence from previous studies on the effects of the 1997 Asian financial crisis and the relationship with corporate governance is considered. International models of corporate governance, agency theory and stakeholder theory are also reviewed. Lastly, the relevance of ownership structure and corporate governance are addressed. Overall, the review in this paper suggests that the Asian financial crisis of 1997 forced companies to improve corporate governance. Recommendations include that variables identified in the literature such as the roles of the board of directors, audit committee, shareholder rights, and disclosure and transparency should be monitored and controlled by regulation to achieve a satisfactory standard or benchmark for corporate governance when compared with western models.

Key terms: Western models of corporate governance; Developing economies; Thailand; 1997 Asian financial crisis; Agency theory; Stakeholder theory.

Introduction and background

Thailand faced a financial crisis in 1997 and the crisis has been attributed to poor corporate governance. The criticisms of corporate governance in Thailand are mainly in respect of the high concentration of ownership, excessive government intervention, an under-developed capital market and a weak legal and regulatory framework for investor protection. Alba, Claessens and Djankov (1998) indicate that bank, finance and securities companies were not sufficiently cautious about their lending. The Bank of Thailand and the Securities Exchange of Thailand (SET) did not have measures on financial performance; and furthermore, auditors did not announce real information about the financial performance of businesses.

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The Asian financial crisis in 1997 was a big event forcing Thai companies to improve their corporate governance practices. In Asia, corporate governance has gained greater distinction since the Asian financial crisis in 1997. It is claimed that better governance may result from improved internal corporate governance mechanisms and enhanced accounting, disclosure, and auditing standards (Limpaphayom & Connelly, 2004; Nam & Lum, 2005). In addition, these studies show that corporate governance benefits companies with respect to increased long-term investment and increased credibility.

Thailand, like many other Asian countries, had poor corporate governance systems prior to the financial crisis in 1997, as its financial institutions and companies had previously been effectively protected from the operation of market discipline. Its corporate governance practices were characterised by ineffective boards of directors, weak internal controls, unreliable financial reporting, inadequate protection of minority shareholder rights, lack of adequate disclosure, poor audits, a general lack of enforcement to ensure regulatory compliance, and the dominance of family control over business operations was prevalent.

Western style principles and models of corporate governance, developed by the World Bank, the International Monetary Fund (IMF) and the Organization for Economic Cooperation and Development (OECD) have been proposed as preferred theoretical reporting models for Thailand. Some researchers have suggested a mixture of corporate governance models is appropriate for developing countries such as Thailand (Alba, Clasessens & Djankov, 1998; Keong, 2002; Khan, 2004). The SET and the Thai Securities and Exchange Commission (SEC) have adopted several measures to improve the accountability of management to shareholders, to enhance transparency and disclosure, and to ensure fairness to all shareholders. They studied corporate governance practices in several developed markets and adopted the practices deemed suitable to the Thai culture. As a result, western models of corporate governance mechanisms have been applied in Thailand after the Asian financial crisis.

On the grounds that Thailand is an Asian country with characteristics such as culture and styles of business operation that differ from western countries, variables affecting the successful implementation of corporate governance in Thailand may not be the same as those in western countries. In addition, Letza et al., (2004) indicate that corporate governance is completely changeable and transformable and there is no permanent or universal principle which covers all societies, cultures and business situations. Although there are many corporate governance models, researchers have concluded that each system has its own weaknesses; no perfect system exists that can be applied to all countries.

This paper provides a consideration of the theoretical underpinning for amendments made to the western models of corporate governance for implementation in developing Asian nations such as Thailand. The structure of this paper proceeds as follows. In the next section the research method applied in this paper is outlined. Definitions of corporate governance and the history and the nature of corporate governance around the world such as in the United States (US), the United Kingdom (UK), and Australia are summarised in the following section. The evidence from previous studies on the effects of the 1997 Asian financial crisis and the relationship with corporate governance is then considered. International models of corporate governance, agency theory and stakeholder theory are also reviewed Then the relevance of
ownership structure and corporate governance are addressed. A summary is provided in the final section.
2.0 Research method

The research approach adopted in this paper is a literature review. It commences with a thorough international search of pertinent literature. The reason for this is that numerous international studies have investigated various aspects of the implementation of corporate governance whereas there are only a small number of studies of corporate governance in Thailand where corporate governance is a relatively new phenomenon. The review in this paper draws on the knowledge base from several disciplines to build a view of the influences on corporate governance.

3.0 Literature review

The primary purpose in this section is to review the literature related to corporate governance. Good corporate governance is a source of competitive advantage and critical to economic and social progress (Iskander & Chamlou, 2000). This section consists of seven parts. First, definition of corporate governance; second, corporate governance around the world; third, corporate governance and the Asian financial crisis; fourth, international models; fifth, agency theory; sixth, stakeholder theory; and seventh, ownership structure.

3.1 Definitions

There is no universally agreed definition for what the term corporate governance means, although numerous definitions have been offered (Anandarajah, 2004). Several perspectives of corporate governance follow.

Jensen and Meckling (1976) developed a theory of the ownership structure of a firm. The basis for their analysis is the perspective that a corporation is:

‘a legal fiction which serves as a nexus for contracting relationships and which is also characterised by the existence of divisible residual claims on the assets and cash-flows of the organization which can generally be sold without the permission of the other contracting individuals’ (Jensen & Meckling, 1976, p.61).

The central point in corporate governance of the firm was laid out by Berle and Means (1932). They observed that a consequence of the separation of ownership and management was ownership dispersion and that such dispersion made subsequent monitoring and discipline of management difficult. More recently Demb and Neubauer (1992) described corporate governance as the process by which corporations are made responsive to the rights and wishes of stakeholders. Monks and Minow (1996) defined corporate governance as the relationship among various participants in determining the direction and performance of corporations. Neubauer and Lank (1998) defined corporate governance as a system of structure and processes to direct and control corporations and to account for them.

Corporate governance describes all the influences affecting the institutional processes, including those for appointing the controllers and regulators, involved in organising the production and sale of goods and services (Turnbull, 1997). Sir Adrian Cadbury stated that corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals (Iskander & Chamlou, 2000). The Asian Development Bank (ADB) defined corporate governance as the manner in which power is exercised in the management of a country’s social and economic resources for development (Wescott, 2000).
Iskander and Chamlou (2000) stated that corporate governance is important not only to attract long-term patient foreign capital, but more especially to broaden and deepen local capital markets by attracting local investors-individual and institutional. Nielsen (2000) stated that corporate governance is the system of rights, structures and control mechanisms established internally and externally over the management of a listed public limited liability company, with the objective of protecting the interests of the various stakeholders. Kidd and Richter (2003) argued that corporate governance is an indirect mechanism in reducing agency costs and transaction costs imposed by managers acting in their own interests at the expense of companies and shareholders. Solomon and Solomon (2004) suggested that corporate governance is the system of checks and balances, both internal and external to companies, which ensures that companies discharge their accountability to all their stakeholders and act in a socially responsible way in all areas of their business activity.

The OECD defined corporate governance as the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs (Clarke, 2004).

In Thailand, the National Corporate Governance Committee (NCGC) defined corporate governance as a system having a corporate control structure combining strong leadership and operations monitoring. Its purpose is to establish a transparent working environment and enhance the company's competitiveness. It also strives to preserve capital and increase shareholders' long-term value with the consideration of the business of ethics, stakeholders and social concerns factors, throughout the process (NCGC, 2005).

### 3.2 Corporate governance around the world

The first well-documented failure of governance was the *South Sea Bubble* in the 1700s, which revolutionised business laws and practices in England. In the US there was the stock market crash of 1929. There were other crises, such as the secondary banking crisis of the 1970s in the UK and the US savings and loan debacle of the 1980s. In addition to crises, the history of corporate governance has also been punctuated by a series of well-known company failures: the Maxwell Group of newspapers; the collapse of the Bank of Credit and Commerce International (BCCI); and Barings Bank. As a result, regulators have moved to improve the elements of corporate governance (Iskander & Chamlou, 2000). In the early 1990s, research on corporate governance in countries other than the US began to appear. At first, the research focused on other major world economies, primarily Japan, Germany, and the UK (Denis & McConnell, 2002).

**United States of America**

In 1929, the Wall Street stock market crash occurred in the US. The stock market collapse revealed market manipulation, insider trading, general mismanagement and a reckless trampling of shareholder rights. As a result, the US Congress enacted the Securities Act 1933 and the Securities and Exchange Act 1934 to address some of these abuses, primarily through the regulation of corporate financial disclosure to improve transparency.

In the late 1980s, the response to governance failure in the US was similar to the response noted in the 1930s. The most recent round of reforms began as a result of takeovers and
constituency statutes enacted under state laws. The major performance problems became evident in many of the largest corporations where reform began to focus more on the quality of corporate boards and their independence. An active group of institutional investors began to emerge (Iskander & Chamlou, 2000).

In the US in 2001, corporate crises occurred at Enron, WorldCom, Tyco International, Adelphia Communications, Global Crossing, Quest Communications, Computer Associates, and Arthur Andersen. The collapse of Enron, at that time the largest bankruptcy in US history, led to thousands of employees losing their life savings tied up in the energy company’s stock. This proved to be an unprecedented display of accounting fraud, regulatory failure, executive excess and avoidable bankruptcy, with resulting widespread disastrous losses incurred by employees’ pension funds and investors. As a result, the US Congress enacted the Sarbanes-Oxley Act (2002). This is a broad–based reform act centred on the creation of a public company accounting oversight board and the establishment of strict rules regarding auditor independence, corporate responsibility, financial disclosures, financial controls, analyst conflict of interest, white collar crime and corporate fraud (Banks, 2004).

Denis and McConnell (2002) suggested that the ownership of publicly traded firms is significantly more concentrated in other countries than it is in the US. Private ownership concentration appears to have a positive effect on firm value. There are significant private benefits of control and they are more significant in most other countries than they are for the US. Structures that allow for control rights in excess of cash flow rights are common, and generally value-reducing.

Solomon and Solomon’s (2004) study of the case of Enron’s downfall illustrates the importance of good corporate governance. They say that all the checks and balances within the corporate governance system have the ultimate aim of controlling and monitoring company management. Corporate governance mechanisms cannot prevent unethical activity by top management, but they can act as a means of detecting such activity.

United Kingdom

One of the earliest governance crises was the bursting of the South Sea Bubble of 1720-21 which dramatically changed business habits and regulations in the UK. The UK rapidly enacted corporate statutes to protect the public from such abuses as the bubble scandal. The main elements included: shareholders’ rights to information, and the ability to appoint and remove directors and auditors (Iskander & Chamlou, 2000). In the late 1980s financial scandals leading to the collapse of several prominent companies came to light in the UK. There was a strong private response alongside the public regulatory response. The corporate sector responded to the loss of confidence in financial reporting by setting up the Cadbury Committee in 1990 to develop a code of best practice (Iskander & Chamlou, 2000).

In 1991, several large UK corporations collapsed, including Robert Maxwell MMC, BCCI and Polly Peck. As a result, one of the greatest proponents of active corporate governance, Sir Adrian Cadbury, chaired a commission and the Cadbury Report published by that commission in 1992 was to have considerable influence, not just in the UK but in many other countries around the world that adopted similar corporate governance codes of practice (Clarke, 2004). Solomon and Solomon (2004) stated that the Cadbury Report focused on the
board of directors as the most important corporate governance mechanism, requiring constant monitoring and assessment. The accounting and auditing functions were also shown to play an essential role in good corporate governance, emphasising the importance of corporate transparency with shareholders and other stakeholders. Finally, Cadbury’s focus on the importance of institutional investors as the largest and most influential group of shareholders has had a lasting impact.


Australia

The Australian corporate governance framework is characterised by a mix of legal regulation largely contained in the Corporations Act 2001 and common law principles and self-regulation most notably set out in the Australian Securities Exchange (ASX) Listing Rules, which require disclosure of corporate governance practices. Studies of the Australian corporate governance regime indicated that the share market plays an important role and that share ownership tends to be relatively widely dispersed. Shareholders are generally prepared to be mobile in their investments and the market therefore plays an important role and directors have a strong incentive to act in the interests of shareholders and to enhance shareholder value (Keong, 2002).

In Australia there were two major corporate collapses in the first decade of this century, HIH Insurance and OneTel. A round of reforms in the shape of the Australian Corporate Law Economic Reform Program (CLERP 9) in 2002 quickly published a new series of requirements for companies registered in Australia (Clarke, 2004). Corporate governance is a major focus of the changes introduced in Australia. First, the CLERP 9 Bill, incorporated into the Corporations Act, provides further law concerning auditors, the use of accounting standards and the requirements of regulatory authorities such as the Australian Prudential Regulation Authority (APRA). Second, ‘Standards Australia’ released guidance on corporate governance, ‘Good Governance Principles’ (AS 8000-2003). This standard includes comment on board structure, director independence and the skills and experience represented on the board. Third, the ASX created the ASX Corporate Governance Council in 2002.

In 2003, the Principles of Good Corporate Governance and Best Practice Recommendations (ASX guidelines) were released. The ASX guidelines were aimed at encouraging boards to think about and debate how effective corporate governance could be brought to their organisations. In 2004, the Implementation Review Group (IRG) was established to monitor the progress of companies in implementing the principles and recommendations (Kiel et al., 2004).

3.3 Corporate governance and the Asian financial crisis of 1997

It is claimed that poor corporate governance was one of the major contributing factors to the building-up of vulnerabilities in the affected countries that finally led to the Asian financial crisis in 1997 (Alba, Claessens & Djankov, 1998; Keong, 2002; Claessens, Djankov & Lang, 2000). The Asian financial crisis commenced in Thailand in 1997. Collapsing
currencies, equity and property markets in East Asia in 1997-98 exposed underlying vulnerabilities both in governance structures and values. However, an international confidence crisis was fuelled by a growing realisation of the structural weaknesses of economies often governed by crony capitalism, poor accounting and auditing systems, and too close a relationship between business and the State. Given the systemic nature of the problems of corporate governance in East Asia, only a fundamental program of reform of institutions and practices, conducted in an energetic and committed manner over a considerable period of time, was considered likely to produce results.

Khan (1999) analysed some basic issues related to reforming the corporate governance systems in post-crisis Asia. The thinness of both bond and equity markets in many Asian developing economies was identified as one problem. In addition, there are the problems of lack of, or weaknesses in, adequate regulatory structures, transparency and accountability. Johnson et al. (2000) present evidence that the weakness of legal institutions for corporate governance had an important effect on the extent of currency depreciations and stock market declines in the Asian crisis. They show that managerial agency problems can make countries with weak legal systems vulnerable to the effects of a sudden loss of investor confidence. They suggest that corporate governance, in general, and the *de facto* protection of minority shareholder rights, in particular, mattered a great deal for the extent of exchange rate depreciation and stock market decline in 1997-98.

Iskander and Chamlou (2000) pointed out that the financial crisis in East Asia forced countries to take major steps to strengthen governance. Moves included closing insolvent banks, strengthening prudential regulations, opening the banking sector to foreign investors, revamping bankruptcy and takeover rules, tightening listing rules, requiring companies to appoint external directors, introducing international accounting and auditing standards, requiring conglomerates to prepare consolidated accounts, and enacting fair trade laws.

### 3.4 International models of corporate governance

The experience of the Asian crisis that revealed a systemic failure in corporate governance was a spur to the publication by the OECD of the Principles of Corporate Governance. This framework of principles was endorsed by the World Bank, the International Monetary Fund (IMF) and the ADB. This framework of corporate governance principles was intended to have universal appeal, but there was some implication that they were essentially derived from the fundamentals of the market-based system, and that they were particularly aimed at the exponents of the insider systems with relationship-based approaches, especially in the developing economies where corporate governance failure was assumed to be more likely.

The OECD initially identified five basic principles of corporate governance (Iskander & Chamlou, 2000). In April 2004, OECD governments accepted revised Principles covering six key areas of corporate governance: ensuring the basis for an effective corporate governance framework; the rights of shareholders; the equitable treatment of shareholders; the role of stakeholders in corporate governance; disclosure and transparency; and the responsibilities of the board (OECD, 2004).

Corporate governance systems vary by country. The most prominent systems of corporate governance in developed countries are the US and UK models, which focus on dispersed controls, and the German and Japanese models, which reflect a more concentrated ownership structure (Iskander & Chamlou, 2000). The ADB (2000) investigated the corporate
governance structures of the Asian crisis economies (ADB, 2000). The Bank analysed five individual countries, Indonesia, Korea, Malaysia, Thailand and the Philippines, and found that the governance structures of the crisis economies closely resembled each other. Generally, the similar elements were: high ownership concentration; bank-centric financial systems; ineffective shareholders’ rights laws; and low transparency.

There are two general models of corporate governance. The first is a shareholder or equity market-based governance model of the Anglo-American style (EMS), under which a broader range of investors plays a role through the pricing, trading and buying of the firm’s securities. The other model is a bank-led governance model (BLS), under which banks play the leading role in monitoring the firms. However, many researchers have suggested a mixture of the two models is appropriate for developing countries (Alba, Clasessens & Djankov, 1998; Keong, 2002; Khan 2004).

**Family-based corporate governance system (FBS)**

Khan (2003) studied FBS in East Asia and stated that financing can come from three different sources. First, the FBS, especially in the initial stages of development of family businesses, could be financed internally for a large part. Second, as an enterprise grows over time, the role of banks becomes more prominent. Third, at some stage—perhaps overlapping with the second, i.e., bank financing – outside equity may become the most significant source of corporate finance. However, the key difference between FBS as a governance system and BLS and EMS lies in the fact that neither the banks nor the equity markets ultimately control the family business groups. Khan (2003) also indicated the “historic mission” of the corporation as site of capital accumulation may require different types of governance structures under different historical conditions. In particular, in the East Asian context, the FBS structure has played an important role in the initial phase of capital accumulation in the East Asian countries. Indeed, its prevalence in Asian economies at all levels of development makes FBS almost a paradigmatic feature of corporate organisation and governance in Asia. Suchiro (1993; 1997) pointed out that one rationale for the FBS system is the flexibility in terms of the managerial decision-making process and efficiency in capital accumulation in the context of late-comer industrialisation. In Northeast Asia, some researchers have shown (Khan 1997; 1998) the period of catch-up growth has largely ended and global competitiveness must be increasingly based on organisational and product and technical innovations.

A competing proposal is that the transition should be towards an EMS type of corporate governance. It should be recognised that the problems here are formidable. The thinness of both bond and equity markets is one problem. In addition, there are the usual problems of lack of adequate regulatory structures, transparency and accountability. In particular, the limited expertise and other institutional resources make the implementation of such proposals (which really should be self-enforcing) problematic (Khan, 2003).

**3.5 Agency theory**

It has been argued that the divorce of ownership and control has lead to the famous ‘agency problem’. Berle and Means (1932) discussed the extent to which there was a dispersion of shareholding, which consequently led to a separation of ownership and control in the US. The agency problem was explored in Ross (1973), and the first detailed theoretical exposition of
agency theory was presented by Jensen and Meckling (1976). They defined the managers of the company as the ‘agents’ and the shareholders as the ‘principals’. The problem is that the agents do not necessarily make decisions in the best interests of the principals (Solomon & Solomon, 2004).

According to Hart (1995), corporate governance issues arise in an organisation wherever two conditions are present. First, when there is a conflict of interest or agency problem, involving members of the organisation, such as owners, managers, workers or customers. The second condition is when the problem cannot be dealt with through a contract. Hart observes that there are several reasons why contracting to overcome the agency problem might not always be possible. In particular, it is not possible to contract to cover all events. In addition, there are costs associated with negotiating contracts and enforcing them.

Claessens, Djankov and Lang (2000) investigated the separation of ownership and control in 2,980 publicly traded companies in nine East Asian countries. They found that single shareholders control more than two-thirds of firms. The separation of ownership and control is most pronounced among family-controlled firms and among small firms. They found that older firms are more likely to be family controlled, as are smaller firms. Claessens and Fan (2003) found that agency problems, arising from certain ownership structures, especially large deviations between control and cash flow rights, are anticipated and priced by investors. The nature of a corporation’s ownership structure will affect the nature of the agency problems between managers and outside shareholders, and among shareholders. On the other hand, when ownership is concentrated to a degree that one owner has effective control of the firm, as is typically the case in Asia, the nature of the agency problem shifts away from manager-shareholder conflicts to conflicts between the controlling owner (who is often also the manager) and minority shareholders.

### 3.6 Stakeholder theory

Stakeholder theory has developed gradually since the 1970s. One of the first expositions of stakeholder theory was presented by Freeman (1984), who proposed a general theory of the firm, incorporating corporate accountability to a broad range of stakeholders. Stakeholders include shareholders, employees, suppliers, customers, creditors, communities in the vicinity of the company’s operations and the general public (Solomon & Solomon, 2004).

A basic issue for stakeholder theory is that companies are so large and their impact on society so pervasive that they should discharge accountability to many more sectors than solely their shareholders (Solomon & Solomon, 2004). Stakeholder theory has its origins in the social entity conception of a corporation. The modern corporation has a large scale and scope that requires distinctive professional management expertise and a great amount of capital investment. Through the stock markets, share ownership in a corporation becomes dispersed and fragmented and shareholders become more like investors than owners. Since corporations are involved in many aspects of social life and affect many people in both welfare and potential risks, a public corporation should be conscious of its social obligations such as fairness, social justice and protection of employees (Letza, Sun & Kirkbride, 2004).

Agency theory is focused on shareholder rights and the separation of ownership from control. However, stakeholder theory further extends the purpose of the corporation from maximising
shareholders’ wealth to delivering wider outputs to a range of stakeholders and emphasises corporate efficiency in a social context (Letza, Sun & Kirkbride, 2004).

3.7 Ownership structure

Hansmann (1996) defined firm owners as persons having two formal rights that included the right to control the firm and the right to appropriate the firm profits. Jensen and Meckling (1998) defined ownership as possession of a decision right along with the right to alienate that right. Ownership and control are rarely completely separated within any firm. The controllers frequently have some degree of ownership of the equity of the firms they control; while some owners, by virtue of the size of their equity positions, effectively have some control over the firms they own. Thus, ownership structure is a potentially important element of corporate governance. The relationships between ownership, control, and firm value are more complicated than that, however. Ownership by a company’s management, for example, can serve to better align managers’ interests with those of the company’s shareholders (Denis & McConnell, 2002).

LaPorta et al. (1999) showed that a large fraction of public and private companies around the world are family-controlled and often follow a pyramidal ownership structure. The use of pyramidal ownership structures allows the family to exert control over a large network of companies. Family companies appear to be more prevalent in countries with weak minority shareholder protection.

The US evidence of the effects of ownership structure on corporate decisions and on firm value includes Morck, Shleifer, and Vishny (1988) and McConnell and Serves (1990) who found that the alignment effects of inside ownership dominate the entrenchment effects over some ranges of managerial ownership. Bertrand et al. (2004) found that larger families are associated with a larger number of smaller firms in the group and with somewhat deeper groups. These effects of family composition on group size and structure are stronger for groups where ultimate control has been transferred from the founder to descendants. They also found that group firms tend to overlap less along genealogical lines once the founder has left active management: different sons of the founder are less likely to jointly hold board positions in the same firm once the founder retires. They suggested that potential conflicts between family members lead to distortions in the organisation and governance of the groups once the founder has retired.

Shleifer and Vishny (1997) suggested that the benefits from concentrated ownership are relatively larger in countries that are generally less developed, where property rights are not well defined and/or not well protected by judicial systems. La Porta, Lopez-De-Silanes and Shleifer (1999) confirmed this proposition empirically as they show that the ownership stakes of the top three shareholders of the largest listed corporations in a broad sample of countries around the world are associated with weak legal and institutional environments. They also investigated the issue of ultimate control. They traced the chain of ownership to find who has the most voting rights. They suggest that ownership and control can be separated to the benefit of the large shareholders.

Claessens, Djankov and Lang (2000) found that older firms are more likely to be family controlled, as are smaller firms. In some countries a significant share of corporate assets rests in the hands of a small number of families. They also found that corporate control is typically
enhanced by pyramid structures and cross-holdings among firms in all East Asian countries. They suggested that a re-examination of the relationship between ownership structure and corporate performance is needed. In most of the developing East Asian countries, wealth is very concentrated in the hands of a few families. Wealth concentration might have negatively affected the evolution of the legal and other institutional frameworks for corporate governance and the manner in which economic activity is conducted.

Many researchers noted that owners often enhance their control rights through cross-shareholdings and pyramidal structures. The effect of the divergence between control and ownership comes at a price of reduced firm value (Claessens, Djankov, & Lang, 2000; Claessens, et al., 2002). Claessens, Djankov and Lang (2000) also found that ownership of Thai public companies, as in other East Asian countries, is highly concentrated and family dominated. Other studies in East Asia have also found that corporate governance factors affect firm valuation (Mitton, 2002; Lins, 2003; Zhuang et al., 2000).

High ownership concentration is typically both a symptom and a cause of weak corporate governance (Claessens, Djankov & Lang, 2000). Corporate governance ought to be a means for investors to monitor and control management when protection systems are weak (Alba, Claessens & Djankov, 1998). The high concentration of ownership reduces the effectiveness of some important mechanisms of shareholder protection, such as the system of the board of directors, shareholder participation through voting during shareholder meetings, transparency and disclosure.

4.0 Summary

In 1997, the Asian financial crisis occurred. This crisis led to the collapse of many companies and to the introduction of corporate governance structures in developing Asian countries like Thailand. As a result, interest in corporate governance increased. Government, business, institutional investors, professional advisers, consultants and academics have all taken a closer interest in issues like corporate ownership structure, board structure and composition, directors’ and officers’ legal duties and chief executive officer’s remuneration. Good corporate governance in listed companies is likely to increase confidence and trust in capital markets.

One of the most important characteristics of the corporate sector in Thailand is the feature of family control over business operations. At the time of the 1997 financial crisis, Thai public companies were characterised by their large family ownership with family members and related-party shareholders as the controlling shareholders. Lack of transparency and the lack of solid information regarding financial transactions as a result of this structural feature appear to have been critical factors contributing to the Thai financial crisis (Alba, Claessens & Djankov, 1998).

Corporate governance in Thailand is currently at a crossroads. Much of the relevant literature claims significant benefits from the implementation of corporate governance. Thus, corporate governance has received substantial interest from companies and regulators and is of concern to both the public sector and the private sector. The international corporate governance system assumes a separation of ownership and control, a questionable assumption in the Thai context. Since the Asian financial crisis, all listed companies, especially family-owned businesses, have made generally poor information disclosure about related-parties
transactions. This could be improved as part of the move to promote and enhance corporate governance. Family owners should be more interested in working with outside shareholders to maximise firm value.

Consideration should be given to the use of outside directors, a tool normally used in western cultures. The purpose is that outside directors can help monitor management and family owners. However, Thai people are non-confrontational and group-orientated. Many boards become so-called “rubber stamp” boards, not because directors are unaware or uninterested in their roles and duties but because they are being considerate and respectful of the owner’s decisions (Limpapayom et al. 2004). The use of outside board members can be a very powerful tool under a corporate governance system that recognises institutional and cultural differences.

Cultural attitude is important to identify the root cause for legal tardiness in Asian countries where legal practices are considered a foreign element that is not part of Asian culture. Actual implementation of legal processes is mostly avoided and settlement outside the court is more popular. Corruption is another factor that does not ensure justice for those who need or warrant it. However, corruption has a long history in Thai culture, stretching over many centuries. The Thai aversion to confrontation inherent in any adversarial legal system means that parties prefer amicable settlement rather than litigation.

The attitudes of directors need to improve concerning the awareness of the role of other stakeholders in the company. Independent directors are expected to take a leading role in preventing controlling owners abusing their power and pursuing their private interests. In future reforms the true independence of independent directors should be encouraged so that they can serve and protect the interests of a broader group of stakeholders.

Agency problems arise when a person, as a public sector employee or official, is influenced by personal considerations (Boadi, 2000). In Thailand family businesses, such conflicts of interest can be difficult and damaging. After the financial crisis the Thai Constitution was amended to include provisions to prevent conflicts of interest between elected officials and big business, including an unprecedented bar on politicians holding shares in companies. Such provisions were seen as necessary to avoid repetition of the corruption in previous governments that greatly contributed to Thailand’s 1997 financial collapse.

Stakeholder theory is that companies are so large and their impact on society so pervasive that they should discharge accountability to many more sectors than solely their shareholders (Solomon & Solomon, 2004). If corporate governance in Thailand is to improve, outside directors and professional societies will be expected to play the leading roles, supplemented by efforts of financial supervisory agencies and the judiciary. Better governance would also result from improved internal corporate governance mechanisms and enhanced accounting, disclosure, and auditing standards (Limpapayom & Connelly 2004).

One useful framework of corporate governance reform is the structure, process, and strategy of the corporate governance system. The structure of the governance system is important. The structure outlines the rules: disclosure standards, laws and regulations, and the organisations charged with enforcement have a major influence on the effectiveness of any governance regime. In Thailand, the structure required to build good corporate governance practices is now largely in place.
Finally, improvements to corporate governance could be initiated by many organisations, including government and educational institutions or universities. These organisations could help to improve corporate governance by strengthening rules and laws. They need to monitor enterprise management; further improve accounting practices and disclosure of information; improve enforcement of corporate governance regulations; encourage minority investors to monitor and discipline executives and protect minority investors; improve the framework for corporate governance and encourage public discussion on the issue; and, analyse data to monitor firms’ performance.

Overall, the review in this paper suggests that the Asian financial crisis forced companies to improve corporate governance. Variables identified in the literature such as the roles of the board of directors, audit committee, shareholder rights, and disclosure and transparency could be monitored and controlled by regulation to achieve a satisfactory standard or benchmark for corporate governance when compared with western models.

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