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Private Profit or Public Purpose? Corporate Governance Convergence and the Asian State

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Is capital market integration causing East Asian countries to converge on a single model of corporate governance – the so-called Anglo-American model of minority investor protections? What explains the variation in the rate and pattern of institutional convergence among countries? Do investors and firms interacting in anonymous markets converge, or do states play a role? Does convergence on the Anglo-American model signal the victory of markets over the “developmental state”?

Evidence from a sample of six Asian and six European countries between 1989 and 1999 indicates a process of shallow rather than deep convergence on the Anglo-American model.¹ Foreign portfolio investors assign a good governance premium to shares in countries that adopt minority investor protections. The pattern of institutional change in response to this price incentive is uneven; the Asian countries have a higher average level of conformance, and more variation in conformance levels, than the European countries in this sample.

Strikingly, the state has been the prime mover behind corporate governance change in both the Asian and European countries in this sample, rather than private shareholders or employee-managers. Variation among states is explained by the degree to which minority investor protections offer states a solution to the fiscal costs imposed by poor corporate governance. In sum, shallow convergence has been driven by public purpose rather than private profit.

The commanding role of the state in corporate governance change belies the conventional wisdom that profit-maximizing private shareholders and enlightened professional managers are the drivers of global convergence towards a single “best practice” of corporate governance. Close scrutiny of the behavior of private shareholders (“blockholders” in governance *parlance*) who control many of the firms this twelve country sample reveals that they have done little to support governance changes towards the Anglo-American model, and have actively resisted such changes in many cases. By the same token, professional employee-managers in these twelve countries have systematically resisted most governance reforms.

Instead, process tracing of regulatory changes points to the state as the prime mover of governance changes. The state’s motives for supporting the Anglo-American model include income from the privatization of previously state-owned enterprises, moral hazard losses from poor governance (especially in the financial sector), and the funding of state pension plans. The state in these countries pushed through most of the changes in accounting, audit, disclosure, and oversight that resulted in shallow convergence.

¹ This sample includes six European (Belgium, France, Germany, Italy, the Netherlands, and Spain) and six Asian countries (China, Japan, Korea, Malaysia, Singapore, and Taiwan), which together account for 42% of the MSCI Global Market Index weighted by GDP, 27% of the total MSCI market capitalization in current dollars, and over 75% of the non-U.S. and non-U.K. MSCI market value.

Although these findings conclude that corporate governance convergence does not constitute a “triumph of private markets over the state”, they also suggest that something more complicated is going on, more subtle than the simple dichotomy of markets and states would suggest. The minority investor protections traced in this paper require more regulation by the state, not less supervision: this is not the race-to-the-bottom of competitive deregulation. But these governance changes are not mere *re-regulation*, as some have suggested, the old developmental state in new bottles.² It is regulation of a qualitatively different kind, based on arm’s length supervision through the neutral, quasi-independent agencies that set accounting standards, impose disclosure requirements, and punish insider-trading abuses.³

What’s New Here?

This paper operationalizes corporate governance as the dependent variable with objective criteria, providing a cross-country comparisons for a twelve country sample to explain what causes governance institutions to change over time. Most work in the economics of corporate governance measures the impact of different governance institutions on macro or micro outcomes, but the institutions themselves are usually taken as a given, and rarely examined as the dependent variable.

Once the governance institutions had been benchmarked, changes in governance institutions were process-traced back to a causal actor in each country, based on field interviews by the author. The sample countries were selected to represent a large percentage of stock markets outside the U.S. and the U.K. In an earlier professional incarnation, the author incorporated or managed a firm in 9 of the 12 countries in the sample, and had access to a network of managers, bankers, attorneys, accountants, and search firms with whom to verify institutional practices.

The following section of this paper analyzes foreign portfolio equity investment (the independent variable) and explores the conformance of governance institutions in the twelve country sample (the dependent variable). The paper then introduces the intermediate variable of ownership type, and examines each of three ownership types – private blockholders, employee-managers, and the state – for evidence that each ownership type supported or resisted governance changes in these countries. A concluding section recaps the findings and briefly summarizes their theoretical and public policy implications.

² Steven Vogel, *Freer Markets, More Rules: Regulatory Reform in Advanced Industrial Countries*, 1996.

³ For a theory explaining the trend towards arm’s length regulation by statutory agencies, see Giandomenico Majore, *Regulating Europe*, 1996

2. The FPI *Tsunami* in Asia

A flood of foreign portfolio investment (FPI) has swept all the countries in the sample, including the six Asian states. Foreign ownership as a percentage of market capitalization in the twelve countries in the sample doubled from 11.2 in 1989 to 21.2 in 1999. Foreigners' share of the Asian market capitalization trebled, from 4.2% to 13%.⁴

Table 1: Foreign Equity Ownership⁵

<u>Country</u>	<u>1989 (%)</u>	<u>1999 (%)</u>	<u>Growth (%)</u>
China	2.3	4	17
Japan	3.9	16	41
Korea	2.1	21.1	100
Malaysia	10	19.6	20
Singapore	5	10	20
Taiwan	2	7.2	36
Asian Mean	4.2	13	
European Mean	18.2	29.3	
Sample Mean	11.2	21.2	

The growth and change in foreigners' share is particularly dramatic for Japan and Korea, increasing by four times in Japan and ten times in Korea over this decade.

U.S. and U.K.-based investors (hence the "Anglo-American" *sobriquet*) acquired the lion's share of this increased foreign ownership, including the Asian markets. Table 2 shows that these U.S. and U.K. investors account for three-quarters of the financial asset pool and 87% of all equity holdings among the "Big Five" economies.

Table 2: Institutional Investor Size, 1999 (\$ billions)⁶

<u>Country</u>	<u>Total Assets</u>	<u>% in Equity</u>	<u>Share of Total Equity</u>
U.S.	\$15,800	.45	.72
U.K.	\$2,200	.67	.15

⁴ FPI is the fastest-growing component of international capital flows, far outpacing bank lending and running a close second to foreign direct investment (FDI). IMF, *International Capital Markets: Developments, Prospects, and Key Policy Issues*, 1999, page 52. Although the term FPI usually includes fixed income instruments as well, in this paper the term FPI refers only to equity assets.

⁵ Federation Internationale des Bourses de Valeurs, *fibv.com*; various country stock exchanges; author's calculations.

⁶ Carolyn Brancato, "International Patterns of Institutional Investment," *The Conference Board Institutional Investment Report*, April 2000, page 9. For the United States alone, largely institutional holdings of foreign equities grew from \$200 billion in 1989 to \$600 billion in 1994 to \$2 trillion in 1999. www.bea.doc.gov/bea/di/invpos.htm.

Japan	\$3,200	.19	.06
France	\$1,200	.30	.04
Germany	\$1,200	.19	.02

Money-managers in New York and London became minority shareholders with, on average, a fifth of the control rights over all traded firms in these sample countries, and almost 15% of the Asian control rights, in a relatively short period of time. Given the stable, concentrated holdings that characterize all of these markets, this 15% holding represented a majority of the traded “float” in most of these countries.

In parallel with this influx of foreign capital, the value of stock markets in these countries soared during this period. For all six Asian countries, the total value increased from \$3.3 trillion to \$5.6 trillion in current dollar equivalents. Setting aside Japan, which dominates the Asian sample in size, the other five countries grew dramatically, from \$350 billion to \$1.2 trillion, a growth of 3.4 times.

Table 3: Growth in Equity Markets⁷

<u>Country</u>	<u>1989 (\$bn)</u>	<u>1999 (\$bn)</u>	<u>Growth (%)</u>
China	57	158	176
Japan	2928	4455	52
Korea	110	306	177
Malaysia	48	139	382
Singapore	35	198	478
Taiwan	99	376	279
Asian Sample	3277	5632	
Belgium	65	184	183
France	311	1502	382
Germany	355	1432	303
Italy	148	728	389
Netherlands	120	695	480
Spain	111	431	287
Total	4387	10604	298

3. Institutional Roots of the “Governance Premium”

When Anglo-American investors participated in this international equity boom, drawn by potential gains from both income growth and portfolio diversification, they sailed into uncharted territory, into countries that traditionally paid little heed to the interests of minority investors – particularly in Asia. They were exposed to both *agency costs* by entrenched managers, with profits sacrificed to managerial

⁷ IMF Emerging Markets Data, various country stock exchanges, author’s calculations.

autonomy, full employment, or other “stakeholders,” and *expropriation costs* by majority shareholders, with profits diverted by a private blockholder or the state.

These investors could protect themselves to some degree against both agency and expropriation costs by means of corporate governance institutions that protect the interests of minority investors.⁸ For example, detailed financial disclosure using standard accounting practices and third-party audit reduces the monitoring risk. Independent boards of directors with a fiduciary liability to minority shareholders can protect the investors from entrenched managers and blockholders. Rules for contests of control can discipline entrenched managers or private blockholders and force them to share the takeover premium with minority shareholders. Managerial incentives such as stock options can align the interests of managers with those of shareholders.

These institutional protections are reflected in share prices. Statistical, survey, and anecdotal evidence suggest that foreign portfolio investors assign a significant price discount to shares they purchase in firms whose governance practices do not protect the interests of minority shareholders against agency and expropriation costs.⁹ A McKinsey survey of two hundred investors found the average good governance premium for a sample of twenty-two countries to be 21.6%, with a low of 17.9% and a high of 27.6%.¹⁰ Mitton analyzed a sample of four hundred firms in Korea, Malaysia, the Philippines and Thailand before and after the Asian Financial Crisis of 1997-98 and found statistical evidence for a 12% premium valuation on firms that had adopted superior information institutions; moreover, firms that followed these two information practices came through the perturbations of the Asian Financial Crisis trading at a 58% premium over those Asian firms that did not follow these practices.¹¹

In the face of this “good governance premium”, the rate of change and pattern of conformance is remarkably varied. The three charts in Table 4 operationalize seven corporate governance institutions in terms of their conformance to the

⁸ Following the distinction drawn by North, institutions are the *rules* of the game, and business firms are the *players*: “Institutions, together with the standard constraints of economic theory, determine the opportunities in a society. Organizations are created to take advantage of those opportunities.” Douglass North, *Institutions, Institutional Change, and Economic Performance*, page 7.

⁹ Stephen Davis, “Leading Corporate Governance Indicators: An International Comparison,” November 1999, www.dga.com; Sang Yong Park, “Value of Governance of Korean Companies: International Investors Survey,” manuscript, April 1999.

¹⁰ Robert Felton, Alec Hudnut, and Jennifer van Heeckeren, “Putting a value on Board Governance,” *The McKinsey Quarterly*, No. 4 (1996); McKinsey Investor Opinion Survey, June 2000, www.gcgf.org. In this survey, “good governance” was defined as a majority of outside directors, extensive disclosure, and use of stock options for directors – a rather narrow range of governance institutions.

¹¹ Todd Mitton, “A Cross-Firm Analysis of the Impact of Corporate Governance on the East Asian Financial Crisis,” MIT manuscript, 3/15/2000. In these tests of the effects of information institutions, Mitton controlled for firm size and financial leverage, and included both country and industry dummy variables, with a sample size of 384 firms based on Worldscope data.

Anglo-American governance model in a series of “snapshots” taken in 1989, 1994, and 1999. Shaded boxes indicate protection for minority investors in line with the expectations of Anglo-American investors, and white boxes indicate little or no such protection.¹² Institutional detail for each country is summarized in Appendix 1.

[Table 4. - See page 44]

The Asian countries range from a low of 1 for China, to a high of 6 for both Malaysia and Singapore, displaying wider variation than the European countries in the sample. The average conformance level for the Asian countries in 1999 (50%) is higher than the average of the European countries (45%), with higher scores for both oversight and control institutions, and lower scores for management incentives. The overall rate of change for the twelve country sample is dramatic, more than doubling from an average conformance ratio of 19% in 1989 to 48% in 1999. Most of the change for the European countries occurred in the five years between 1989-199, whereas most of the change for the Asian countries took place later, between 1994-99.

Conformance for accounting and audit practices increased from 20% to 67%, in a similar pattern of change in both Asia and Europe. Conformance oversight grew more modestly, although still doubling over the period. Although there was considerable change in control voting rules, there was zero change in takeover rules, reflecting a blanket refusal to adopt the institution of market-based contests for control, *a.k.a.* hostile takeovers, in both the Asian and European sample.

Can this variation in conformance among countries and between institutions be explained simply in terms of firms’ response to the FPI good governance premium, or are there other variables at work?

¹² Accounting systems are coded 1 (black box) if a majority of the listed firms use GAAP or IAS in their reporting, or if the deviations of the country’s domestic accounting systems from IAS are minor. The former datum is taken from the reports of country stock exchanges or survey agencies; the latter is based on the opinions of professional Big Five auditors interviewed by the author. Audit is coded 1 if third-party audit is a listing requirement. Oversight is assigned using the mean percentage of non-executive directors on the boards of listed firms; where NED’s are a majority, oversight is coded 1 (except for Germany and the Netherlands, which are exceptions discussed further below). Fiduciary duty is coded 1 if directors’ liability to minority shareholders has been enforced in the courts on the basis of derivative or class-action suits. Voting rights is coded 1 if the principle of “one share one vote” is observed in practice, in terms of statutory rights and procedures. If more than 50% of the listed firms employ significant anti-takeover provisions, the box is coded 0. Incentive is coded 1 if the sum of performance bonus and stock options exceeds 10% of total pay, based on a Towers & Perrin survey. These conformance rankings are consistent with those of Davis Global Advisors and similar to those performed by Déminor, with a few exceptions. For a discussion of the pitfalls of governance rankings, see Eric Coppieters, “The Governance Scorecard” and “Governance Ratings in Europe”, *Corporate Governance International*, March 2001.

4. Agency Costs, Expropriation Costs and Insider Control

Except for the United States and United Kingdom, insider systems are the rule, not the exception, around the world. Shareholdings are concentrated, not fragmented, in both Europe and Asia.¹³ In systems of insider governance, expropriation costs become as important as agency costs from the standpoint of minority investors.

Insider governance can be further subdivided into three ownership types, each exhibiting a different response to the governance premia offered by foreign portfolio investors.

- o In the first ownership type, private blockholders control the firm, usually the founder or a founding family. A minority of the shares (or a minority of the control rights) are publicly traded, with the blockholder retaining control directly *via* mechanisms such as two-class voting rights, “preference shares”, “golden shares” or indirectly through a chain of pyramids or intermediary holdings. The private blockholder monitors managers to keep agency costs under control, and compensates himself by expropriating minority shareholders through private benefits of control.
- o In the second ownership type the state is the blockholder. The government (usually the Ministry of Finance) holds a controlling share directly, or indirectly via so-called “golden shares”, granting the state a veto over control decisions. The state may or may not monitor managers to control agency costs, and may also expropriate minority shareholders.
- o In the third ownership type, voting control is widely diffused among fragmented shareholders or concentrated in a financial institution or other corporation that is in turn widely held. Absent a mechanism for disciplining the firm *via* contests for control, ownership is effectively in the hands of employee-managers – the ultimate insiders. Employee-managers may or may not monitor each other, and they may be indifferent to agency costs.

Table 5 provides an estimate of the percentages of the weighted value of traded equity held by the three ownership types for the countries in this sample, drawing on recent research that traces ultimate control by blockholders back through pyramids and indirect holding mechanisms.

¹³ Colin Mayer, "Financial Systems, Corporate Finance, and Economic Development", 307-332; Marco Becht and Ailsa Roell, "Blockholdings in Europe: An International Comparison," *European Economic Review*, Vol. 43 (1999): 1049-1056; Rafael La Porta, Florencio Lopez-de-Silanes, and Andrei Shleifer, "Corporate Ownership Around the World", 1998; Stijn Claessens, Simeon Djankov, and Larry H. P. Lang, "Who Controls East Asian Corporations?" The World Bank, Washington, D.C.

Table 5 Ownership Pattern (%)¹⁴

<u>Country</u>	<u>Private Blockholder</u>	<u>State</u>	<u>Employee-Manager</u>
China	0	100	0
Japan	8	2	90
Korea	68	5	27
Malaysia	60	25	15
Singapore	60	30	10
Taiwan	65	5	30
Asian Sample	43.5	27.8	28.6
European Sample	45	17	31
Total Sample	44	23	33

The Asian sample has more variation than the European sample, as it contains four countries with high private blockholder ratios and two countries, China and Japan, on the extremes of the state and employee-manager control. Compared to the mean value of the sample, stock markets in Korea and Taiwan are clearly dominated by private blockholders. Many of the Korean corporate groups, or *chaebol*, show small nominal ownership percentages by the controlling family, as do many industrial groups in Taiwan, but when the veil of indirect control is pierced, the underlying pattern of concentrated family control is revealed – two-thirds of the market value is in the hands of a few families.¹⁵ Singapore and Malaysia also have high private blockholder concentrations, mostly in the hands of a small number of Overseas Chinese (*hua qiao*) families, coexisting with a larger state-controlled sector. In China the state dominates as the ownership type, while Japan is dominated by manager-controlled firms. In Japanese manager-controlled firms there is ultimately no private blockholder with a motive or means to maximize shareholder value.¹⁶

¹⁴ European cases are based on data collected by Christoph van der Elst, "The Equity Markets, Ownership Structures and Control: Towards International Harmonization?" Universiteit Gent Working Paper 2000-04, 9/2000; European Corporate Governance Network, www.ecgn.org; Marco Becht and Colin Mayer, *The Control of Corporate Europe*, forthcoming; and Becht and Boehmer, *op. cit.* The Asian cases are based on data collected by Claessens *op. cit.* plus papers from the OECD Forum on Corporate Governance in Asia and the author's own calculations.

¹⁵ The *chaebol* founder-blockholders include Chung Ju Yung of Hyundai, Lee Byung Chul of Samsung, Koo In Hwoi of LG, and Kim Woo Choong of Daewoo (now a fugitive).

¹⁶ "Cross-shareholdings have altered the concept of the stock company in Japan. They have freed management substantially from the influence of shareholders. Stable shareholders are selected by and are dependent on management, and cannot therefore play a disciplinary role on corporate management....This leaves the main source of disciplinary pressure coming from the need to satisfy employees." Seiichi Masuyama, "The Role of Japanese Capital Markets" in N. Dimsdale and M. Prevezer, editors, *Capital Markets and Corporate Governance*, page 334. See also Masahiko Aoki and Hugh Patrick, *The Japanese Main Bank System*, 1994; Paul Sheard, "Interlocking Shareholdings and Corporate Governance in Japan, in M. Aoki and R. Dore (eds.), *The Japanese Firm*, 1994; W. Karl Kester, "Industrial Groups as Systems of Contractual Governance", *Oxford Review of Economic Policy*, Vol. 9 No. 3; Jun-Koo Kang and Rene M. Stulz, "Is Bank-centered Corporate Governance Worth It? A Cross-sectional Analysis of the Performance of Japanese Firms during the Asset Price Deflation", unpublished manuscript, 1997;

Each ownership type reacts differently to the governance premium offered by foreign portfolio investors, as each ownership type faces a different set of benefits and costs if the governance institutions change to protect minority investors from both agency and expropriation costs. The next three sections of this paper examine the role of the dominant ownership type in each country with regard to changes in minority shareholder protections.

5. The Puzzle of Passive Blockholders

The conventional private-actors-and-markets argument for convergence looks to private profit as the key to governance changes. In this story, private blockholders react to the prospect of changes in corporate governance institutions by weighing the potential gains from higher valuation of their equity holdings against the loss of their private benefits of control.¹⁷

If this calculus favors accepting the “good governance deal” from FPI, then private blockholders should first unilaterally adopt good governance practices to the extent they can do so informally without regulatory change, such as a third-party auditor, extensive disclosure, independent directors, and a one-share-one-vote capital structure. They should then press for regulatory changes in those areas beyond their unilateral control, such as the accounting system, directors’ fiduciary responsibility to minority shareholders, takeover rules protecting minority shareholders, and the use of stock options for managers, on a collective basis through their federation of industry. Finally, they should liquidate their concentrated blockholdings to “cash in” on the good governance premium extended to them by FPI.

First, the temporal expectation that private blockholders will unilaterally adopt good governance standards for informal institutions they can control at the firm level and then lobby their governments for changes in formal institutions is not

Ulrike Schaede, Takeo Hoshi, and John McMillan, "Japanese Deregulation: What You Should Know", www.nmjc.org; Joe Peek and Eric S. Rosengren, "Determinants of the Japan Premium: Actions Speak Louder than Words", NBER Working Paper No. 7251, 1999, www.nber.org/papers/w7251; Joe Peek and Eric S. Rosengren, "The Good, the Bad, and the Ugly: The Costs and Benefits of the Japanese Main Bank System," Federal Reserve Bank of Boston working paper, 10/2000.

¹⁷ The private blockholder evaluates whether the increase in value caused by the higher valuation of the firm on a per-share basis, multiplied by the blockholders percentage ownership, minus the taxes to be paid on liquidation of that ownership, is greater or less than the net present value of the future stream of private benefits of control (PBOC), minus the costs of extracting those private benefits. More formally, is $[(\Delta P/E) * (\text{ownership}\%) * (1-t)] > [(NPV \text{ PBOC}) * (\text{costs of extracting PBOC})]$? This simple equation ignores the diversification benefit whereby the blockholder can invest his liquidated proceeds (net of tax) in a diversified portfolio, whereas he remains over-exposed to a single firm (or corporate group) as a blockholder. The “costs of extracting PBOC” are equivalent to the “cost of theft” in the blockholder’s utility function, described in La Porta *et al.*, *Investor Protection and Corporate Valuation*, NBER Working Paper 7403, October 1999, <http://www.nber.org/papers/w7403>.

borne out by the pattern of change in any of these countries individually, nor for the sample as a whole. This expectation is tested in Table 6, which ranks governance institutions by increasing formality, meaning that institutional changes require regulatory action by the state rather than unilateral innovation by firms. If blockholders did innovate informal institutions and then lobby for change in formal institutions, the conformance ranking and change should be highest at the top, i.e. for management incentives, and lowest at the bottom, i.e. for fiduciary responsibility, which is embedded in the court system. However, the conformance rankings of the Asian countries in Table 6 show no pattern of informal innovation followed by formal regulatory change, either by country or for the whole sample.

Table 6: Informal and Formal Change

<u>Institution</u>	<u>Conformance</u>	<u>Change</u>
Management Incentive	2	2
Non-executive directors	3	2
Takeover rules	0	0
Audit	5	3
Accounting system	2	2
Voting rules	5	3
Fiduciary responsibility	5	3

Secondly, there is no evidence that private blockholders lobbied for governance changes on a collective basis. For every country in this sample in which business firms engage in collective lobbying through a group such as the Federation of Korean Industry (FKI), these collective business entities have been passive or hostile with regard to corporate governance reforms, despite active lobbying across a wide range of other regulatory issues. Business federations have been most hostile to governance reforms in countries with the highest concentration of private blockholders, including Korea (68%) and Taiwan (65%).

Thirdly, as for the expectation that private blockholders should incrementally liquidate their concentrated holdings to take advantage of the FPI premium for good governance, there is no evidence of this taking place in any country in the sample. In Korea, the top thirty *chaebol* blockholders have *increased* their concentration within affiliated groups in recent years, in the face of pressure from the state and incentives from FPI to do so.¹⁸ Anecdotal evidence from Taiwan, Malaysia, and Singapore shows no signs of large private blockholders reducing their holdings in order to profit from higher FPI valuation; on the contrary, as in Korea, many owner-families have been concentrating their ownership holdings.¹⁹

¹⁸ Myeong-Hyeon Cho, "Corporate Governance in Korea", paper for UCSD Conference on Corporate Restructuring in Korea, 10/2000.

¹⁹ This conclusion is based on the author's interviews with investment bankers and fund managers in Europe and Asia in 1999 and 2000. There is little public domain information on this question; the ownership pattern data presented in Table 5 is static - essentially a snap-shot, drawn for this sample from the first wave of ownership disclosure in Europe and Asia that began

What explains this apparent failure of private blockholders to accept the “good governance deal” from FPI’s? Either blockholders were not motivated to adopt governance reforms because the private benefits continued to outweigh the FPI valuation benefits, or the blockholders were motivated to accept the “good governance deal” but were unable to press through governance reforms for other reasons.

Stock market valuation can motivate blockholders with money, but it cannot compensate blockholders for the psychological benefits of control, in terms of prestige, nationalism (as in the case of the *chaebol* founder-chairmen whose firms built the Korean “economic miracle”), or the satisfaction of placing children into jobs in the family firm.

Nor can stock markets protect the blockholder from the tax collector. It is easier for private blockholders to route private benefits through offshore tax shelters and to skip intergenerational taxation by passing their blockholdings to children. Anecdotal evidence suggests that many of the countries with the highest private blockholder weights also exhibit patterns of capricious taxation by the authorities and widespread tax evasion by business owners, as in Korea, Malaysia, and Taiwan.

Stock markets themselves can be capricious, and blockholders observed the rapid run-up and abrupt crash of emerging market valuations during the latter half of the 1990’s, which increased the discount rate they assigned to the “good governance deal”. In contrast to these market uncertainties, although the private blockholder is exposed to high firm risk because of his concentrated holdings, he also has the benefit of insider knowledge and (usually) accumulated expertise in his industrial sector. Moreover, since many blockholders control a horizontally diversified group of firms – with some family firms in Asia holding horizontal interests in industries including flour milling, semiconductors, and banks – the portfolio gains from the good governance deal may be limited.

Given these advantages (psychological benefits, tax evasion, and insider knowledge), why would private blockholders ever accept the “good governance deal” from FPI and tap stock markets? Though capricious, equity markets may provide the only means of raising capital for existing firms when a country’s banking market is shut down, as happened during the Asian Financial Crisis. Equity markets also provide the only means of raising capital for new entrepreneurs and for some knowledge-intensive industries, since banks are leery of start-up’s and are unable to evaluate the credit-worthiness of firms with intangible assets. In these cases, private blockholders may be strongly motivated to accept the governance deal despite a questionable trade-off between private

in the mid-1990’s. Until this analysis is repeated to provide at least a second set of more recent data points, it will not be clear how much ownership concentration has changed overall, and thus whether liquidation has taken place.

benefits and FPI valuation, as well as the undesirable attentions of the tax collector. Not surprisingly, the pioneers in adopting unilateral good governance practices in many of these markets have been high tech entrepreneurs, who often became the darlings of emerging market stock pickers at securities firms.

If blockholders are motivated to accept the “good governance deal”, they still face a transactions problem in selling off ownership in small increments to foreign portfolio investors while recovering the control premium. For a smooth transition to take place, the blockholder must issue a credible promise not to steal from the firm, and the FPI’s must promise to compensate the blockholder for giving up those private benefits of control – in effect, paying a premium over the current value of traded minority shares in that firm. If done in small increments, the marginal transaction that transfers control from the blockholder to the new minority investor must carry a price that embodies all the private benefits of control – a big price tag. No rational minority investor will enter this transaction, since all the previous shares were acquired at the lower traded price. Yet without such a price premium, no rational blockholder will sell to the point where control is threatened.

Unless this transaction problem is solved, blockholders’ support for the “good governance deal” may grind to a halt at the transfer of the 51st percent of control, leaving the private blockholder in charge and minority shareholders still exposed to expropriation. When private blockholders are motivated to sell, they may find it easier to trade ownership in large transactions to a foreign investor such as an MNC or a private equity fund that is able and willing to buy out the whole block at the necessary premium price. This becomes an FDI transaction, not FPI, and causes no efforts to reform governance institutions.²⁰

Finally, if blockholders are motivated to accept the governance deal and find a way around the control transactions problem, they encounter two collective action problems that may explain their apparent inaction in supporting governance reforms. The first problem is trust. In a market dominated by other blockholders and with weak governance institutions to protect minority shareholders, what blockholder will be brave enough to go first, adopting good governance institutions that limit his own private benefits, and exposing himself to expropriation as a trusting minority shareholder?

If the solution to “who goes first” is collective lobbying for governance reform through the industrial federation, which binds all blockholders to the same new rules, the private blockholders must contend for control of the business

²⁰ The firm is then de-listed from the local exchange; it only reappears as a public company as part of the valuation of the acquiring MNC in a global capital market, or if the acquiring private equity fund re-lists the firm in some form, either locally or on a global capital market. If it re-lists locally, of course, the private equity fund faces the same obstacles noted above. Data on this type of FDI, and especially on the behavior of private equity funds, rarely appears in public sources, though there is considerable anecdotal evidence of such transactions (and de-listing) in all of the countries in this sample.

federation with the professional managers of semi-privatized state-owned enterprises (SOE's) and large manager-controlled firms. These are usually larger than private blockholder firms and more skilled at interfacing with the bureaucracy, and they tend to dominate the agenda of big business federations in many economies, exhibiting only limited sympathy for the efforts of private blockholders to change the governance rules to enrich themselves.

The mixed motives of employee-managers with respect to the “good governance deal”, and their support for (or resistance to) governance changes, are discussed in the next section.

6. Tooth-and-Nail Resistance from Employee-Managers

What are the benefits and costs of governance change from the perspective of employee-managers? For managers, the equivalent of private blockholders' benefits of control may include lavish compensation, luxurious perquisites, empire-building, investment in low-yield or high-risk projects, or preservation of “stable employment” at the expense of profitability. All of these translate into agency costs for the shareholders.²¹ The good governance premium offered by FPI's consists of reforming governance institutions specifically to *reduce* these agency costs. It is not surprising that governance changes evoke intense resistance from employee-managers.²² Employee-managers control 90% of the firms in Japan, and the Japanese case provides extensive evidence of employee-managers striving to blunt corporate governance reforms.

In Japan, the so-called *zaibatsu* conglomerates that flourished from the late 19th Century through the 1920's were originally controlled by family blockholders, who kept careful watch on their hired managers and emphasized profitability as well as growth. The Japanese state chipped away at these blockholdings during the 1920's and 1930's, and the *zaibatsu* blockholdings were summarily wiped out by the Allied Occupation after World War II, leaving the managers in control. The family blockholdings of first-generation post-WWII entrepreneurs such as Akio Morita of Sony, the Matsushita's, and the Toyota's were diluted by a combination of generational taxation and shareholdings by financial institutions. The net result was to make employee-managers essentially unaccountable to anyone but themselves, and this is reflected in Japan's corporate governance institutions.

Employee-managers assumed control of the big business “corporatist” entities such as the Federation of Economic Organizations, the *keizai dantai rengokai* (or *Keidanren*) and used these entities to resist governance reforms that endorsed

²¹ As noted by Shleifer and Vishny, “...poor managers who resist being displaced might be the costliest manifestation of the agency problem.” Shleifer and Vishny, “A Survey of Corporate Governance”, NBER Working Paper #5554, April 1996, page 10.

²² This characterization of the preferences of employee-managers is not intended to impugn the personal integrity or professional motives of senior managers of firms, many of whom sincerely believe that they serve loftier goals than mere maximization of shareholder value.

the principle of maximizing shareholder value over goals such as market share, growth, or stable employment. For example, managers and the Keidanren repeatedly tried to water down or delay the tighter accounting rules and enhanced disclosure. In the face of calls for independent third-party audit, the Keidanren suggested instead some cosmetic changes regarding the role of the statutory auditor, or *kansayaku* – another insider. In response to increasing public criticism of insider boards in the late 1990's, managers and the Keidanren deflected this into a debate over the merits of reducing board size rather than bring on a majority of NED's. These smaller boards under the so-called *shikkô yakuin-sei* or "executive manager system" served to strengthen the grip of employee-managers rather than making them accountable to shareholders.

The principle of governance reform was also deflected by means of the Japan Corporate Governance Forum (JCGF). The JCGF, strongly influenced by senior employee-managers, carefully divided its recommendations into those that should be implemented in short order ("step A principles") and those that "should be aimed for in the early 21st Century...or which require legal reforms on a grand scale" ("step B principles"). The principle of a majority of outside independent directors was carefully designated as "step B," meaning someday, but not now.²³ Above all, the JCGF discarded the principle of shareholder value as the cardinal objective of a business firm, and condemned the sacrifice of "stable employment" in the pursuit of profit maximization.

As endorsed by the JCGF and the Keidanren, entrenched managers and employees of Japanese firms - whose unions are organized on a firm rather than industry basis - have managed to preserve the no-lay-off policy at the expense of shareholders. The agency costs implicit in this policy for a sample of two-hundred Japanese firms is approximately \$30 billion per year.²⁴

Japan's company law provides good minority shareholder protections, and a relatively straightforward mechanism by which potential blockholders could engage in contests for control. So far, such takeovers have been blocked by cross-shareholdings, so-called *mochiai-kabu*.²⁵ But mutual crossholdings as a

²³ "Coporato Gabanansu gensoku: atarashii nihongata kigyô tôchi o kangaeru," *Coporaato Gabanansu Gensoku Sakutei linkai*, Nihon Corporate Governance Forum, 5/26/98. The JCGF included a number of business economists as well as employee-managers.

²⁴ EVA measures the return on investment above the normalized costs of both debt and equity capital. EVA is useful comparative measure because it looks at the return on total capital employed, rather than just return on equity, and controls for differences in capital costs by measuring the spread between return and capital costs. Goldman Sachs did a ten year EVA analysis of Japan's Nikkei 300 non-financial firms and found an average return on capital of 3.9% over the period 1989-96. Their estimate of the weighted cost of capital for these same firms during this period was 5.7%, meaning that the EVA spread of TSE1 firms was a *negative* 1.8% from 1989 through 1996, implying an annual agency cost to shareholders of about \$30 billion over this period. Goldman Sachs *Japan Research: EVA Analysis*, May 1998.

²⁵ Japanese firms hold large blocks of non-traded securities on their balance sheet, including holdings in their main bank, a horizontal keiretsu, or vertical investments in subsidiaries and distributors. These securities are carried at purchase cost rather than market value, which had

percentage of total market capitalization have fallen from 52% in 1989 to 45% in 1997, and are still plunging.²⁶ In order to stop the unwinding of passive equity cross-holdings, which could open up the prospect of contests for control given Japan's straightforward voting rules, the Keidanren pushed for a variety of methods, employing tax changes and quasi-government entities to prop up stock prices and absorb these liquidated cross-holding shares.²⁷

As with private blockholders, under what conditions would employee-managers find the FPI good governance premium an attractive option, given the risks posed by oversight and control reforms? Large publicly-traded firms in all economies generate most of their cash flow needs either internally (from retained earnings and depreciation) or from debt markets, issuing new stock. The only conditions under which employee-managers would turn to equity markets are when debt markets dry up, or if industrial consolidation forces them to engage in merger activity funded by stock.

Japanese firms increased their use of equity markets during the various banking crises of the 1990's, and they also issued new stock to fund many overseas acquisitions. Because of a series of decisions by the SEC regarding the issuing conditions of American Depository Receipts (ADR's) which imposed Anglo-American standards of accounting and disclosure on foreign listing firms, but exempted such firms from complying with domestic standards of oversight or control rules, ADR listing became attractive for employee-managers of many non-U.S. multinational firms -- including state-owned enterprises (SOE's) facing the prospect of large share initial public offerings (SIPO's), as discussed in the next section.²⁸

created a cushion of unrealized capital gains. But these reserves are being rapidly liquidated to cover operating losses.

²⁶Goldman Sachs, Equity Derivatives Research: *The Liquefaction of Japanese Crossholdings*, September 1998.

²⁷ The Keidanren wanted a series of tax changes that would allow firms to swap each other's mutual holdings without running these transactions through a market clearing mechanism, thereby keeping stock prices high and keeping stock out of the hands of potential third-parties. It also proposed a Securities Finance Corporation to equity cross-holdings from firms and then hold them in trust, using the shares as collateral for loans from the Bank of Japan.

²⁸ In the 1970's the SEC drew a distinction between "hard" governance and "soft" governance issues for ADR listing rules. Accounting and disclosure were "hard," oversight and management were "soft," while control fell somewhere in the middle. The SEC adopted a principle of home country deference regarding the soft institutions of internal firm governance, and a principle of firm disclosure to U.S. standards regarding the hard information institutions. During the mid-1980's the U.S. market for control broke open and large Fortune 500 firms began to feel threatened by potential takeovers. Employee-managers of large U.S. firms lobbied to make hostile takeovers more difficult and expensive, resulting in a series of anti-takeover laws issued at the State, rather than Federal level (including a tightening of the Delaware statutes), and began experimenting with anti-takeover devices, including multiple classes of equity with different voting rights, in the European and Asian style. The SEC finally came down on the side of one-share one-vote in its ruling 19-C-4 in July of 1998, but with a specific exemption for foreign issuers on U.S. markets. Home country deference (or "carve-out's" in SEC *legalese*) arose again in the 1990's, as cross-border tender offers and business combinations expanded. The SEC chose in October of 1999 to exempt such transactions from extra-territorial application of its own rules,

Given the passivity of private blockholders and the resistance of employee-managers to corporate governance reforms, the next question must be: how does the state as blockholder respond to the FPI “good governance deal”?

7. Bringing the State Back In

The state as blockholder exhibits what is known in the governance literature as “the owner’s incentive problem”. Though ownership of a state-owned industrial enterprise or bank is nominally held in the name of “the people,” as a practical matter SOE’s are controlled by bureaucratic agencies, often multiple agencies, under the ultimate control of politicians. Politicians have many objectives in addition to maximizing the value of “the people’s” blockholding of an SOE, and thus the state’s response to the FPI “good governance deal” reflects a mix of personal and public policy motives. SOE’s provide politicians with patronage, excess employment (for which they can take credit), and political contributions or outright bribes. These are the equivalent of the private benefits of control, against which politicians must weigh the appeal of the governance premium.

These twelve cases suggest that politicians had two motives for embracing corporate governance reforms. The floodtide of FPI into East Asia was paralleled by two profound events in the political economy of these states. The first event was the privatization process (or, more accurately, quasi-privatization process) by means of share initial price offerings of SOE’s. The second event was the soaring price tag of moral hazard losses in the banking sector, a cost picked up by the state as guarantor of the banking system.

Both events forced politicians to make a choice between public fiscal pressure and their private benefits of SOE control. The FPI “good governance deal” provided a way out of the fiscal squeeze while retaining – at least for a while – most of the benefits of control.

Cashing in on SOE’s

Every country in this sample, including the Asian countries, witnessed a program of corporatisation and partial privatization of SOE’s, a program that began in the 1980’s and picked up speed during the 1990’s, the period of financial globalization that is the focus of this paper. The six Asian states raised a total of \$68 billion in current dollar equivalents from the partial sale of state ownership in SOE’s during this period, as shown in Table 7. On average, these proceeds accounted for 1.3% of total central government expenditure for these states during the decade period: for those running a fiscal deficit during these years (which excludes Taiwan and Singapore) SIPO revenues plugged an average of

based on its “Cross Border Release,” arguing that application of U.S. rules would only discourage the parties to such transactions from including shares held by U.S. residents in tender offers.

22% of the government fiscal gap.

Table 7: SOE SIPO Revenues (1989-99)

<u>Country</u>	<u>Offerings(#)</u>	<u>Proceeds(\$bn)</u>	<u>Residual State Ownership (%)</u>
China	17	9.5	74
Japan	6	42.8	38
Korea	3	7.3	85
Malaysia	5	3.8	94
Singapore	11	2.6	71
Taiwan	1	2.6	48

Moreover, these data understate the importance of SIPO revenues to the state, since these SIPO's freed the state from supplying capital funds to these "corporatised" SOE's. After the state liquidated part of its holdings, these firms obtained additional capital themselves from secondary equity offerings, bond issues, and loan syndication's, thereby reducing the cash-flow drain on the state budget and the state's contingent liability as sovereign guarantor of their debts. Even more attractive from the standpoint of the state is that these revenues were "quick and easy" incremental revenue compared to raising taxes.

As a result, the state in every country in this sample engaged in a partial sell-off of its blockholdings through SOE SIPO's, a substantial block of which was acquired by FPI's. In parallel, in four out of the six Asian cases, the state implemented a series of top-down governance reforms that enhanced minority shareholder protections to attract investors to these SIPO's and maximize the state's revenue stream from these offerings.

In Malaysia the state raised 2% of its revenue and plugged 58% of its budget gap with SIPO's totaling \$3.7 billion over the same period. Malaysia's SIPO's began with the sale of a 30% share in Malaysian Airlines in 1985, followed by larger transactions in Telekom Malaysia in 1990 and 1992, Tenaga National in 1992, Petronas in 1995, and Malaysia Airports in 1999. These SIPO's also eased the ability of these firms to directly tap private debt markets - air transport, telecommunications, and petroleum being capital-intensive sectors - thereby easing the fiscal burden for the Malaysian state while it continued to pursue its state-directed growth strategy. In parallel with these offerings, the state imposed a series of reforms in information, oversight, and management practices that gave Malaysia one of the highest conformance rankings in the twelve country sample.

The Korean government raised \$42 billion from SOE SIPO's over this decade, the lion's share in the last two years, immediately following the Asian Financial Crisis. These proceeds plugged 16% of the state fiscal deficit, on average, during the decade, and were critical to meeting Korea's fiscal commitments to the IMF

after the 1997-98 bailout, as discussed below. Although both POSCO and KEPCO had successfully engaged in partial SIPO's in 1989, the series of governance reforms that brought Korea's conformance levels rapidly from 0 in 1994 to 4 in 1999 were necessary to make Korea's less attractive SOE's marketable in more demanding markets, after the implicit sovereign guaranty of the Seoul government had been largely tattered.

The Chinese government began its strategy of corporatisation of SOE's to raise revenue for the central government in Beijing, which was perpetually tax-starved, and to shift the continuing losses of the SOE's out of the state-owned banking system by imposing a hard budget constraint, as SOE losses were estimated at 4-5% of GDP. As a result of a string of SIPO's during this decade, many SOE's were removed from the central government's books and brought in revenues equal to 1% of the central budget – thereby plugging 10% of the budget gap. In order to tap international equity markets, the state engaged in a series of top-down reforms in information institutions and cosmetic changes in other governance practices, relying heavily on the experience of market regulators in Hong Kong.

However, the state encountered stubborn resistance from entrenched employee managers, resulting in a combination of increasing agency and expropriation costs. As the World Bank observed, "As the nominal owners have only very limited control or even information about enterprise performance and asset use, control over Chinese SOE assets and cash flow rests increasingly with enterprise managers. The result of such a corporate governance vacuum is that managers (and other insiders) end up with *de facto* control over enterprises [resulting in] asset-stripping, poor investment decisions, decapitalization through excessive wage increases, and increase in other private benefits."²⁹

Although the Japanese state raised \$42 billion from SIPO's during this decade, which are in turn traceable to fiscal pressures, there is little evidence linking these SIPO's to specific governance reforms in Japan. Japan was a pioneer among the OECD countries in the privatization of SOE's, moving systematically to privatize a series of SOE's during the 1970's, well before the British and Chilean moves of the 1980's. Though several of these SIPO's were cross-listed on foreign exchanges, the compromises with FPI expectations about governance were minimal, as Japan had ample domestic savings and pliable financial institutions that could fully subscribe to these offerings. Although the data suggest that the MOF raised almost 10% of its revenue from SIPO's during this period, it appears that relatively little of this came from foreigners, and the MOF retained its tight caps on foreign subscriptions in all of these transactions. There are, therefore, few signs of conformance to global standards as a result of fiscal pressure; most of Japan's governance changes are traceable to the moral hazard problem, as discussed in the next section.

²⁹ The World Bank, *China's Management of Enterprise Assets: The State as Shareholder*, 1997, page 51

Singapore followed a similar path of partially privatizing its extensive state-owned sector, raising \$2.6 billion from SIPO's while adopting a set of governance practices that made these firms relatively attractive to foreign portfolio investors, who were enthusiastic buyers of these SIPO's. Singapore had established a track record of good governance practices with FPI's as early as the mid-1980's, when Neptune Orient and Singapore Airlines were groomed and then issued on international capital markets. Other pioneers in good governance were the string of high technology related SOE's for which the Singapore government engaged in SIPO's in the 1990's, including Singapore Electronics & Engineering, Singapore Computer, Singapore Technologies, and Singapore Telecom. Notably, the state retained ultimate control in every issue.

As Mak observes, " At the end of the 1980's, government linked corporations [GLCs] comprised 69% of total assets and 75% of profits of all domestically controlled companies in Singapore. In the 1990's, through a program of privatization, which dispersed the equity of these companies, those numbers have been reduced. However, the government continues to hold majority ownership in these GLCs. In many ways, these companies form the bulwark of the domestic economy and are often seen as opinion leaders in the practice of management. Since many directors of GLCs are also senior government officials, it is an indirect method for controlling and monitoring corporate activities and business policies by the government."³⁰

Taiwan's governance reforms, as in the case of Japan, are not directly traceable to SOE reforms, which only began in 1999, too recently to be picked up in the data used by this paper. Taipei's sole SOE offering, a series of tranches in China Steel Corporation between 1991 and 1995 was not notable for its good governance practices.

Moral Hazard Melt-Down's

The second event motivating these states to push governance reforms was the mounting price-tag of moral hazard losses in the financial sector during the 1990's in most of these countries. Corporate governance failures in the financial sector were one of the root causes of these losses, which were ultimately picked up by the state in these countries.

Prudential regulators wrestled with the peculiar corporate governance problem of financial institutions, especially banks, in all of these countries. Each flavor of insider governance poses its own risk to the state as lender-of-last-resort. Private blockholders are prone to use banks as a private piggy-bank to fund their other enterprises: this occurred in Korea, Malaysia, and Taiwan. The state

³⁰ Mak Teen and Phillip Phan, "Corporate Governance in Singapore: Recent Developments for the Next Millenium", National University of Singapore Working Paper, www.pes.org.ph/corpgov_sing.htm.

blockholder does such a poor job supervising managers of state-owned financial institutions and development banks that risk management fails and loan losses mount: this occurred in China, Korea, Malaysia, Singapore, and Taiwan. Banks controlled by employee-managers who are unaccountable to stockholders or an independent board also perform badly at risk management: this happened most spectacularly in Japan.

Politicians and finance officials in these countries realized during the 1990's that outsider governance combined with prudential regulation (to counter related party lending by private blockholders) could substitute market discipline for failed insider governance.³¹ This motivated the state to undertake many of the reforms that boosted the compliance rankings in Table 4.

For example, process-tracing of the burst of reforms in Korean corporate governance institutions in 1998 indicates that these reforms were rammed through by the newly-elected Kim Dae-jung government with a thin veneer of consultation with the blockholders, but essentially unilaterally by the state, under pressure from moral hazard losses during the Korean Financial Crisis.

Non-bank financial intermediaries (or NBFIs) controlled by the *chaebol* accumulated huge unhedged external liabilities during the 1990's, liabilities incurred as they borrowed on foreign markets and re-lent to other members of the *chaebol* group, thereby demonstrating the risk of private blockholder insider governance of banks. These unhedged borrowings were one of the major causes of the 1997-98 Korean Financial Crisis.

In a short period of time, the Korean government changed accounting to reflect the IAS, required third party audit (and increased the liability of accounting firms), enhanced disclosure requirements, and imposed the rule for a majority of independent directors on the boards of big firms, including the largest *chaebol*. The state put its stamp on control institutions by changing the rules for takeovers and imposing a strategy of industrial consolidation - the so-called "Big Deal" policy - whereby the government dictated the terms of asset transfers between the *chaebol*, rather than leaving this to the blockholders or the market.³²

Similarly, close examination of events in Japan suggests that moral hazard pressure was the prime mover behind reforms in accounting systems, standards setting, and third-party analysis.³³ The Ministry of Finance began to lose control

³¹ Jon Hartzell, *Corporate Governance in International Financial Groups*, Paper for the Seminar on Corporate Governance for Supervised Financial Institutions, Curacao, November 1996.

³² The state kept a large percentage of troubled or illiquid firms on life-support under the Financial Supervisory Agency, including a great many of the smaller 6-64 *chaebol*, and effectively dictated the terms of change in control.

³³ Although Japan's central government raised \$42 billion from SIPO's during the 1989-99 decade, thereby plugging 6.4% of the budget gap, there is no evidence linking these SIPO's to specific top-down changes in Japan's corporate governance practices. Aside from those firms that restated their financial figures in conformity with GAAP in order to cross-list on U.S. capital

over Japan's monetary policy in the mid-90's because of mounting concern over swelling bad debts in the banking system. As early as 1992, mid-level officials in the Ministry began to debate the need to tighten up the accounting system in response to mounting evidence of the moral hazard losses incurred during the excesses of Japan's bubble asset inflation. In 1994, slack reserve accounting for potential loan losses allowed Japanese banks to report good profits and pay dividends even as their loan portfolios were deteriorating and both the real estate and stock markets continued to implode.³⁴ This was opposed by other officials, who believed they could ride out the banking crisis on the basis of economic recovery and of administrative guidance through bank mergers.³⁵

The internal MOF debate over accounting institutions simmered until 1996-97. The first act in Japan's extended banking crisis was being played out in the Diet during the first half of 1996, when the MOF was forced to go to the Diet for 685 billion yen (about \$6.5 billion) to rescue the *Jusen* housing loan firms. This caused a political firestorm and subjected the MOF to intense criticism for its complicity in slack accounting policies, adding impetus to the long-standing desire on the part of politicians to dismantle and reorganize the Ministry.³⁶

A threshold was crossed in the last quarter of 1997, when a series of defaults by Sanyo Securities, Hokkaido Takushoku Bank, and Yamaichi Securities caused Tokyo's interbank market to freeze up, as the magnitude of the hidden losses from securities trading and the unreliability of reported financial figures became clear to market participants.³⁷ The Bank of Japan was forced to inject large amounts of liquidity to keep the financial system functioning.³⁸ MOF officials agreed that it was time to bite the accounting bullet; in any case economic

markets, few concessions were made to minority investor protections in terms of disclosure, independent oversight, or managerial compensation.

³⁴ Takahashi Yoiichi, "The Truth behind Japanese Financial Crisis," Princeton University manuscript, December 6, 1999.

³⁵ Because of the MOF's "convoy" principle, whereby the MOF arranged for weak or failing banks to be absorbed by stronger banks, combined with the MOF's implicit "no fail" guarantee, objective arms-length financial reporting data was unimportant for Japanese banks. Once stronger Japanese banks began to balk at these shotgun marriages, and foreign lenders began to question the MOF's blanket guarantee, this began to change, and the lack of good data for "counter-party" credit analysis began to loom larger. See Curtis Milhaupt and Geoffrey Miller, "Cooperation, Conflict, and Convergence in Japanese Finance: Evidence from the *Jusen* Problem", *Law and Policy in International Business*, Volume 29, 1997.

³⁶ *Nihon Keizai Shimbun*, Nikkei Weekly, "Volatile *Jusen* Issue: Finance Ministry Reform Looms after Resolution of Bad-loan Problem," 2/12/96, page 1.

³⁷ This was made abundantly clear by third-party analysts, who rapidly downgraded the ratings of leading Japanese financial institutions and lead to a stinging "Japan premium" that these firms were required to pay in the international money markets.

³⁸ "Japanese financial markets clearly experienced a kind of credit crunch because of a rash of failures, declining asset prices, and growing mistrust of financial statements and regulators. That resulted in a further contraction of credit in what became a vicious cycle. In other words, unreliable financial statements had proved a serious impediment to the functioning of a market economy." Mitsuhiro Fukao, *Financial Crisis in Japan*, October 26, 1999, Keio University manuscript, page 12.

recovery was stalled, and there was no end in sight for the banking crises. The MOF arranged for the Business Accounting Discussion Council (BADC) or *Kigyô Kaikei Shingikai*, to rapidly approve a series of GAAP principles for valuation and accounting, with special attention paid to accounting principles for financial institutions. The MOF's complicity in poor accounting continued to fester as a political issue in Japan, and it surfaced again in the reorganization debates that led to the creation of an independent BADC.³⁹

The institutions that define the fiduciary responsibilities of both management and the board (for they are equivalent in Japan) were sharpened by a flurry of stockholder suits of both the derivative and the class action variety, many of them brought against banks and bank managers by minority stockholders outraged at their losses, and others by citizens outraged at the scale of the taxpayer-financed bailouts.⁴⁰

Malaysia suffered moral hazard losses in the wake of the Asian Financial Crisis and the Malaysian state began its own program of top-down reform, pointing the finger at the governance sins of private blockholders. This reform was given a sharp political edge as the state was controlled by the United Malay National Organization (UMNO) and most of the private blockholders were ethnic-Chinese.⁴¹ In May 1998, the Securities Commission complained that "Private

³⁹ Japan's accounting standards-setting institution, the *Kigyô Kaikei Shingikai* (Business Accounting Discussion Council, or BADC), formerly under the thumb of the Ministry of Finance (MOF, now *Zaimusho*), was shifted to the new Financial Supervisory Agency (FSA). The FSA, JICPA, and Keidanren agreed to replace the BADC with a new standards-setting organ, independent of the Ministry, at least in principle, with a full-time staff and budget, to start functioning as of April 2001. *Nihon Keizai Shimbun*, Nikkei Weekly, "Accounting Standards to be set by Private Institution," April 3, 2000, page 13, and Yasuhisa Shiozaki, "*Nihon no kaikei seido ni shinrai o torimodoso*" ("Time to Restore Faith in Japanese Accounting"), *Toyo Keizai*, May 1999.

⁴⁰ The tightening of the fiduciary responsibility of boards of directors towards shareholders was the outcome of negotiations between the Keidanren and the Ministry of Justice regarding modifications of Japan's commercial code in 1992-93 that reduced the filing requirements for plaintiffs who intended to bring suit against directors. Such suits had previously been deterred since plaintiffs were required to file a fee corresponding to a fixed percentage of the total claim: this required large sums to be deposited by the plaintiff for suits that could last five years or more. "[I]n a remarkable decision, the Tokyo High Court held in March 1993 that yen 8200 was the appropriate figure, thus creating a precedent that significantly changed the price of derivative actions....The court may have been influenced by the well-publicized impeding passage of the Commercial Code reform bill, which came only about 10 weeks after the court's decision....Without the reform plan, the decision would have been truly surprising given the Japanese court's usual reluctance to fashion new remedies and procedures." Mark West, "The Pricing of Shareholder Derivative Actions in Japan and the United States", *Northwestern University Law Review*, 88:1436 (1994), page 1465.

⁴¹ Although concerned by moral hazard losses, the Malaysian state did not have entirely clean hands itself. For example, losses in several well-connected *bumiputra* firms in 1997-98 resulted in a series of asset-stripping transactions and dubious changes in control, abetted by UMNO and at the expense of minority shareholders, which represented a significant step backwards in terms of governance reform in Malaysia. Examples include Renong Berhad's merger (and bailout) by United Engineers (UEM) in 1997, the Petronas acquisition (and bailout) of KPB in 1998, and the Koperasi Usaha Bersatu purchase (and bailout) of Sime Bank assets in 1999.

sector initiatives in the area of corporate governance in Malaysia have been disappointing and responses in this area have largely been a government-led effort. Companies in Malaysia must therefore shed their lackadaisical attitude towards good corporate governance standards. They must take responsibility for setting appropriate standards for conduct within the broad regulatory framework established by the government.”⁴²

This top-down reform project began with a High Level Finance Committee on Governance established by the MOF in March '98, which unleashed a series of regulatory changes through the Securities Commission, the KLSE, the Registrar of Companies.⁴³ These changes led to the creation of a Malaysian Corporate Governance Code, the Malaysian Institute of Corporate Governance, and the Minority Shareholder Watchdog Group, whose power stemmed in part from equity holdings by government controlled funds.⁴⁴ The success of the Malaysian state in creating a fully-funded pension system provided it with both a motivation and a means to implement government reforms – a powerful motivation for supply-side reforms to corporate governance institutions, as discussed in the next section.

How do these “supply side” pressures to change corporate governance interact with the pressures imposed by moral hazard losses and SOE’s? Although the evidence from this twelve country sample supports the argument that the state ownership is the prime mover in corporate governance reforms, it still leaves the state’s motives for reform causally overdetermined, as reforms can be traced to three events.⁴⁵ Which of these motives are most important from the standpoint of predicting the state’s support for reforming corporate governance institutions?

When they do hit the budget, moral hazard losses are much larger than SOE operating losses. They are also much more difficult to solve, involving unpleasant taxation or budgetary choices for politicians; moreover, whatever solution is adopted takes a long time to work out. In contrast, SOE privatization not only “solves” the drag of SOE losses on the budget, it also brings in revenue to help resolve the other two problems, and it does so quickly. It is not surprising that SOE privatization has the most direct and quickest impact on corporate governance change, at least with regard to information and management institutions.

⁴² “Private Sector Initiatives Disappointing”, *The Star (Malaysia)*, May 5, 1998, page 1.

⁴³ “Crusade for Better Governance,” *New Straits Times*, 5/04/99, page 13.

⁴⁴ “Minority Shareholders Watchdog Group looking for a Suitable Model”, *Bernama News Agency*, 8/16/99.

⁴⁵ All three motives stem from state ownership, either direct or indirect. State ownership of SOE’s is direct insofar as the MOF is usually the blockholder of record. The state’s ownership role in the financial sector is usually indirect, until the banks default and the state steps in with a rescue or recapitalization package. The state’s role in pension plans is also indirect, although the state becomes the plan principal when the gap between pension assets and pension claims is plugged with tax revenues.

The temporal primacy of SOE privatization, combined with the preferences of politicians discussed earlier, also helps explain the pattern of change between institutions. The overall conformance level for information and management institutions is much higher than for oversight and control practices. The state could reap SOE SIPO's on the basis of improved accounting and audit practices, with nominal changes in oversight, but without relinquishing control of these firms to value-maximizing outside directors. The employee-managers and directors of these firms (bureaucrats or political appointees) were compensated with stock options – pioneering the use of stock options in many of these countries. Hostile takeovers by a value-maximizing acquirer were blocked by anti-takeover and voting rule obstacles.

In all twelve countries (except China) SOE SIPO's were accompanied by careful consultation with labor unions. This is consistent with the empirical literature on privatization, which indicates that post-privatization lay-off's are limited to either “transition” or lower-income developing countries.⁴⁶ Nor is there much evidence that agency or expropriation costs declined after SIPO's.⁴⁷ Though the literature suggests that there are substantial performance improvements in post-SIPO SOE's, including greater output per employee and reduce leverage, it is not clear that this is due to lower expropriation costs by the state blockholder. In every country example, the state adopted changes in information institutions, in part to obtain the revenues from SOE SIPO's, but drew the line at changes in oversight practices or control institutions that would open these “privatized” firms to the discipline of a market for control.

There is little evidence that post-SIPO SOE's have boards composed of independent outsiders; perusal of a random sample of SOE share offering memoranda reveals boards filled with serving or retired government officials, politicians, and labor union representatives, with a small sprinkling of managers of large firms. More importantly, the state retains, on average, at least 50% of the voting rights in SOE's after the SIPO and several rounds of secondary offerings. This commanding blockholding, combined with various “golden share” and formal veto rights, effectively buffers these firms from any chance of a successful contest for control.

The dynamics of SOE privatization are less successful in explaining variation in governance conformance among countries, as opposed to variation among institutions. What differs among these states that would explain their varying reactions to these three pressures for governance change?

Classifying countries on the basis of whether they exhibit a so-called “developmental state” has little explanatory power.⁴⁸ Half the countries in the

⁴⁶ William Megginson, “From State to Market: A Survey of Empirical Studies on Privatisation”, *Journal of Economic Literature* (forthcoming), pages 32-34.

⁴⁷ Megginson, *op. cit.*

⁴⁸ There is a contentious and unresolved debate about what constitutes a “strong” or “activist”

sample had (at least until recently) an activist state – Japan, Korea, Taiwan, Malaysia, Singapore, France – but this does not correlate with the conformance rankings in Table 4.

Nor does the notion of a “corporatist state”, with consultative decision-making between Big Business and Big Labor under the guiding eye of the state, explain variations in conformance on the basis of the argument that employee-managers and labor unions make common cause against profit-maximizing blockholders in order to resist the FPI good governance deal.⁴⁹ Corporatist traditions are increasingly tattered in all of these countries; even for those in which it remains partly functional, some rank high in conformance (Singapore, Germany), some in the middle (Netherlands), and others quite low (Japan).

Classifying countries on the basis of external financial constraints also has limited value in explaining variation in conformance levels. Although all EU member states were subjected to the same Maastricht fiscal caps, they varied considerably in their rankings, from 4 to 7. Only Korea was subjected to direct IMF pressures for governance reform (Malaysia demurred from an IMF bailout during the Asian Financial crisis), and yet process-tracing shows ample domestic motives for the changes that took place.

There may simply be too little information in a sample of six countries to develop a testable hypothesis about the why some Asian states were more proactive than others in pushing through corporate governance reforms. This is a promising area of future research, armed with a larger sample and a finer analytic scalpel.

8. Conclusions and Implications

The picture that emerges of changes in corporate governance institutions in these cases is considerably at variance with the notion of market-driven convergence, whereby price incentives offered by FPI’s gradually bring all

state in the literature. See Kent Calder, *Strategic Capitalism: Private Business and Public Purpose in Japanese Industrial Finance*, Princeton University Press, 1993; Ha-joon Chang, "An Institutional Perspective on the Role of the State - Towards an Institutional Political Economy", forthcoming in L. Burlamaqui, A. Castro, and H-J. Chang (eds.), *Institutions and the Role of the State*, Edward Elgar, 2000; Peter Hall, *Governing the Economy: The Politics of State Intervention in Britain and France*. New York: Oxford University Press, 1986; Stephen Haggard, *Developing Nations and the Politics of Global Integration*, The Brookings Institution, 1996; and Robert Wade, *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization*, Princeton University Press, 1990.

⁴⁹ See Marco Pagano and Paolo Volpin, “The Political Economy of Corporate Governance,” paper presented at the European Corporate Governance Network, 10/99. Pagano and Volpin’s model describes how an equilibrium set of corporate governance institutions emerges from political bargaining among three parties: blockholders, minority investors, and workers, institutions which allow blockholders to extract expropriations costs and employee-managers to extract agency costs, both at the expense of minority investors.

countries and all institutions smoothly into line with global governance standards. Private investors set up the price inducements for adopting minority investor protections, but the mixed pattern of formal and informal changes, as well as the pivotal role of the state in these country examples, suggests a picture more complex than that of many atomized private parties interacting in anonymous markets.

Although the direction of change is monodirectional, towards greater minority shareholder protections, the path is uncertain. Convergence is not a sure thing; shallow convergence on information and management institutions appears more likely, with less change in terms of oversight or control. The speed with which change takes place and the sequence in which governance institutions change varies considerably, country by country, depending upon the preponderant ownership type, and on the actions of the state.

These conclusions are subject to three research *caveats*. First, the FPI “good governance premium” rests on a combination of anecdotal and survey evidence. Because of the lumpy nature of country institutions, and the relatively small sample, it is hard to estimate these preferences statistically. On-going work to refine these preferences using valuation proxies such as Tobin’s Q for a larger sample of countries, and a more systematic survey of FPI’s, may resolve this problem.⁵⁰ Secondly, the conformance rankings in Table 4 rely on subjective assessments, and provide static snapshot of institutions rather than tracking a moving target. Thirdly, the data on ownership type in Table 5 are reconstructed from a hodge-podge of primary sources, often with different methods, and the underlying primary data is incomplete and static.

Setting aside these caveats, the findings from this twelve country sample have several novel implications for political economy theory and for practical public policy.

The scholarly debate over whether there are one, or many, versions of capitalism may be clarified by viewing institutional formation through the more parsimonious lens of ownership type. Ownership determines where the potential income cleavages run in response to international inducements and pressures, and the shifting terms of state ownership are a key determinant. In order to predict how these cleavages affect policy outcomes, political science and international relations theorists may have better results using the ownership hypothesis when examining the effect of exogenous forces on domestic choices.⁵¹

⁵⁰ FPI’s themselves may not be monolithic in their institutional preference. There is some evidence that the investment time horizon and therefore the preferences of pension funds, mutual funds, and money managers in different asset classes varies, in which case the composition of the FPI in each country market would have to be disaggregated in order to assess its influence with regard to governance. See Brancato, *op.cit.*

⁵¹ See Robert Putnam, “Diplomacy and Domestic Politics,” *International Organization* 42 (1988), 427-60 and Helen Milner, *Interests, Institutions, and Information: Domestic Politics and International Relations*, 1997.

A great deal of ink has been spilled in the political economy literature creating elaborate taxonomies of “stakeholder versus shareholder capitalism”, “producer versus consumer capitalism”, and even “Nippo-Rhenish versus Anglo-American capitalism” in order to explain contrasting institutions and policy outcomes. However, these findings suggest a mundane question of “who gets the money?” may provide a more parsimonious explanation.⁵² In an early study of how external economics affects domestic institutions, Zysman focused on the structure of the banking system as the key explanatory variable, arguing that “by knowing the financial system one can predict the nature of the process of adjustment.”⁵³ These twelve cases suggest the paraphrase “by knowing the *ownership type* one can predict the nature of the process of adjustment.”⁵⁴

As for the debate on whether non-state actors matter in policy outcomes, the corporate governance example proves unambiguously that they do: the state’s mediation of financial inducements offered by FPI determine the shifting pattern of corporate governance around the world. As a result of the FPI tidal wave and higher ratios of stock market valuation to GDP in all of these countries, the state and foreign investors are locked in an uneasy embrace that either party would find expensive to relinquish.⁵⁵

The corporate governance example suggests that convergence to a global standard of governance is not a “race to the bottom,” in which the state that deregulates fastest wins by attracting the most capital at the lowest cost.⁵⁶ On the contrary, the state with the most impartial, efficient protection of minority

⁵² See Berger and Dore, *National Diversity and Global Capitalism*, 1996; Hollingsworth and Boyer, *Contemporary Capitalism: the Embedded ness of Institutions*, 1997; and Michel Albert, *Capitalism vs. Capitalism*, 1993, all of which speculate on institutional divergence or convergence as a function of many variables, including the state, but not as a function of ownership type.

⁵³ John Zysman, *Governments, Markets and Growth: Financial Systems and the Politics of Industrial Change*, 1983, page 91.

⁵⁴ Traditional political science terms such as Business and Labor are poor predictors of who wins and who loses in response to exogenous influences such as FPI. As demonstrated by these twelve cases, “Business” can represent any one of three different ownership groups – private blockholders, state blockholders, or employee-managers – with radically different institutional preferences.

⁵⁵ The state cannot sit down with FPI’s and “hammer out a deal” regarding the terms and conditions of corporate governance. This contrasts to bank debt markets, in which the MOF can sit down with a dozen or so big banks and work out an agreement on, say, debt swaps in a crisis. It is also unlike FDI markets, in which the state can summon the investor and negotiate (from a position of considerable strength) the terms of the deal. FPI’s face the inverse problem of collective action in responding to the state. There are many of them, with heterogeneous preferences. They are limited in their ability to flee from a given country: rapid exit incurs high transactions costs, especially during a financial crisis, and they are increasingly constrained in exit by the practice of portfolio indexing: for example, the top 25 U.S. institutional investors use indexing to manage 60% of their equity portfolio. Once committed to such an index, for example, investors are predisposed to leave a given percentage of their portfolio in a given country market: if they don’t like the corporate governance standards, they must work to improve them.

⁵⁶ Dani Rodrik, *Has Globalization Gone Too Far?* 1997.

shareholder rights is the one that wins by attracting the most capital at the lowest cost.

The spread of Anglo-American style corporate governance is not equivalent to *deregulation*, for capital markets are embedded in a set of sophisticated formal and informal institutions: in many respects the market-ordering Anglo-American model requires more institutional support than private-ordering or state-ordering models.⁵⁷ Nor is it a simple process of *re-regulation*, whereby the state uses a different set of tools to pursue the same objectives, as interventionist bureaucrats attempt to harness equity markets to their existing developmental model.⁵⁸ Instead, it results in *para-regulation*, with a shift of authority to investors above the level of the state, combined with a greater shift of authority to independent statutory regulatory agencies below the state level.⁵⁹

Explanations of institutional changes in response to global markets do not require the invocation of “American hegemony” or similar notions of state power that frequently pop up in discussions of globalization.⁶⁰ The spread of the Anglo-American model of corporate governance has little or nothing to do with policy goals of the United States government; FPI markets and sovereign states are the key actors in bringing about governance changes, at least in this twelve country sample. Any influence acquired by the state in Washington or London as a result has been obtained the same way that Britain acquired its global Empire, “in a fit of absentmindedness” rather than by design.⁶¹ In any case, quasi-independent para-regulatory entities such as the FASB or the NYSE are a poor policy tool for central governments, difficult to harness to a foreign policy goal.

From a policy standpoint, “reforms” to corporate governance institutions, particularly in emerging markets, must be careful to deal with agency and expropriation costs in balance. Governance institutions *ex ante* the introduction of FPI are complementary, and they rely on each other to mitigate, if not eliminate, both expropriation and agency costs.⁶² Changing just one institution at

⁵⁷ The complexity of the Anglo-American governance model should give pause to the conventional wisdom assumption that the Anglo-American model is easier to imitate than Japanese or German models, which require “idiosyncratic” governance institutions. See Bernard Black, “Creating Strong Stock Markets by Protecting Outside Shareholders,” paper for the OECD Conference on Corporate Governance in Asia, March 3-5, 1999, pages 6-7.

⁵⁸ Steven Vogel, *Freer Markets, More Rules: Regulatory Reform in Advanced Industrial Countries*, 1996.

⁵⁹ The Anglo-American model is based on securities regulation by quasi-independent agencies such as the SEC, accounting rules by semi-private bodies such as the FASB, and enforcement of minority rights and fiduciary responsibility by independent common-law courts, rather than by Ministries of Finance or Ministries of Justice.

⁶⁰ See for example Robert Gilpin, *The Political Economy of International Relations*, 1987, and *The Challenge of Global Capitalism*, 2000, or Loriaux, *op.cit.*

⁶¹ “We [the English] seem, as it were, to have conquered and peopled half the world in a fit of absence of mind.” Sir John Seeley, *The Expansion of England*, 1883.

⁶² Heinrich, Ralph. 1999. “Complementarities in Corporate Governance: A Survey of the Literature with Special Emphasis on Japan,” Kiel Working Paper No. 947, Kiel Institute of World Economics, Kiel, Germany.

a time, without examining the question of complementarity, may have undesirable effects.

For example, efforts to reduce expropriation costs by improvements in NED oversight, which in effect levy a heavy “tax on entrepreneurs”, may blunt the ability of private blockholders to discipline managers. The unintended consequences of these reforms can be soaring agency costs – with entrenched employee-managers now free to manage badly. Indeed, in the corporate governance debate in some countries, calls to “professionalize” managers are often a code phrase for “reduce the influence of blockholders.” Conversely, efforts to reduce agency costs - changes that open the door to free-for-all takeover contests - may result in high expropriation costs, as blockholders emerge to discipline (or expropriate) employee-managers and, in the process, compensate themselves for these efforts at the expense of minority shareholders.⁶³

In terms of industrial organization, convergence may halt at shallow equilibrium, with potentially unpleasant consequences for product/market competition. States are extremely sensitive to the potential fall-out from hostile takeovers. Even if states gradually adopt a para-regulatory approach to supervising corporate governance, this will not necessarily change the political disincentives associated with market-based contests for control, or make these states more willing to expose corporatised SOE’s to such contests. As noted earlier, the pattern of conformance has stopped well short of accepting market-based contests for control in ten out of twelve of these cases.⁶⁴

States’ distaste for such contests, particularly for the corporatised SOE’s that now account for such a large weight of their stock market capitalization, suggests that one result of the SOE corporatisation trend in the late 1980’s and 1990’s may be higher agency costs. Because of remaining state majority control, or because of voting restrictions or “golden shares” imposed by Ministries of Finance, the managers of these firms are likely to become more entrenched and less disciplined by the threat of hostile takeover’s, while strengthening their “stakeholder” common cause with the rest of the SOE workforce – especially if that workforce is unionized and politically mobilized.⁶⁵ They may also engage in

⁶³Blockholders can expropriate employees by breaking implicit contracts on the sharing of the firm’s “quasi-rents” or simply by looting their pension funds (as in the Robert Maxwell scandal). See Margaret Blair, *Ownership and Control: Rethinking Corporate Governance for the Twenty-First Century*, 1995.

⁶⁴The two examples of hostile takeovers discussed above, the Vodafone-Mannesmann transaction in Germany and the Olivetti-STET transaction in Italy, may not indicate a fundamental change in those two countries.

⁶⁵ The “grabbing hand” model developed by Shleifer and Vishny suggests that in many cases politicians can extract as many private benefits from SOE’s that are partially or even fully privatized as long as they can retain control over the profits of the firm through discretionary regulations. Depending on the degree to which corruption is tolerated, they will take these private benefits in cash or in terms of excess employment for favored unions or regions. Shleifer and Vishny, *The Grabbing Hand*, pages 176-78.

classic empire-building by acquiring other firms at above-market prices, while being protected from such take-overs themselves by the state, and insulated from the financial market discipline that otherwise makes such acquisitions dangerous to the employee-managers.⁶⁶

The minority shareholders of these firms, domestic and foreign alike, are unlikely to be cheerleaders for continued deregulation, if it poses a threat to the earnings (rents) of the largest stocks by value. This may lead to a new “shallow equilibrium”, with states and FPI’s aligned with entrenched employee-managers - all three of whom now resist further deregulation and competition, and jointly collect respective portions of the rents.⁶⁷ In this way, an unintended consequence of SIPO’s and increasing FPI may be a roadblock erected in the path of continued product-market deregulation, while encouraging inefficient acquisitions and cross-border mergers.

This process could quickly become politically contentious, not just domestically, but across borders as well. There is already considerable political fallout within Europe as corporatised SOE’s spar with each other in attempts at cross-border acquisition and consolidation. The process of consolidation among “national champions” is even more delicate in Asia, as witnessed by the squabbles between Singapore Telecom, Malaysia’s Time Telecom, and Hong Kong Telecom. In both regions, hostile cross-border contests can rapidly escalate into high politics. At that point, states may realize that they have adopted, more or less by default (if not in a “fit of absentmindedness”) a set of market-driven Anglo-American corporate governance institutions without having forged the domestic political consensus to deal with the consequences.

However, demographics and increased competition in financial markets will keep the process moving forward, albeit in fits and starts. As states begin to fund their pension systems, and as households and firms assert more control over their pension assets, this places more pressure on pension fund managers to seek

⁶⁶ “Golden shares prevent that bad bidders become good targets. In an unconstrained control market an acquirer that failed to achieve synergy would run into difficulties and would become a prey of other companies. Golden shares protect potential bad bidders. Partial public ownership also protects potentially bad acquirers, since governments may value control of the company for political reasons more than cash flows derived from selling ownership rights. There seems to be an asymmetry in that some firms still controlled by the public sector (through partial ownership or golden shares) are active acquirers abroad while their governments keep important restrictions at home. The Spanish government vetoed the merger between KPN and Telefónica and the Italian government vetoed the merger between Telecom Italia and Deutsche Telekom.” Francesc Trillas, *Mergers, Acquisitions, and Control of Telecommunications Firms in Europe*, paper for the Regulation Initiative, August 2000, www.london.edu/rj, page 7.

⁶⁷ A shift on either the supply or demand side of this equation could upset equilibrium at shallow convergence. On the supply side, FPI’s could tire of swelling agency costs at corporatised SOE’s, driving the stock price of these firms to embarrassing lows. On the demand side, fiscal pressure on the state could force it to liquidate the balance of its equity holdings in these firms. Either factor could lead to a contest for control of these SOE’s, whereby private blockholders buy out the state’s interest in private transactions, gobbling up bits and pieces of the former “national champions” and natural monopolies, or engaging in nasty public contests for control.

higher returns domestically and abroad. These changes in pension plans will mobilize a huge amount of previously passive savings into active equity investment, especially in Japan and continental Europe. Active equity investment leads to a more systematic use of the governance discount (or premium). This suggests that regulations regarding the structure and function of pension plans are a central issue of public policy, with enormous long term consequences for equity markets generally and for corporate governance specifically. Pension plan reforms may turn out to be the tail that wags the corporate governance dog.

Retrospectively, the explosive growth of assets managed by institutional investors in the United States and the United Kingdom during the three decades between 1970 and 2000 caused Anglo-American investors to become serious players in international equity markets during the 1990's, thereby providing the price incentives for adopting the Anglo-American model of corporate governance.⁶⁸ Looking forward, as states increasingly permit domestic savings to freely enter the FPI pool, these minority shareholder protections will lose their "Anglo-American" appellation, the para-regulatory practices that support these protections will spread, and countries may be impelled from shallow to full convergence.

⁶⁸ This growth was driven by tax changes (such as 401-k plans) and rules regarding private pension plans such as the ERISA statutes.

Appendix 1 : Governance Changes in Asia

China

China's experiment with publicly-traded firms and stockmarkets is only a decade long, and – in a country that is still nominally Communist – not particularly friendly towards FPI's. As Walter and Howie point out, "In China the markets are operated by the State, regulated by the State, legislated by the State, raise funds for the benefit of the State by selling shares in enterprises owned by the State. No doubt there is some self-conflict in this. In the entire system, the only things which do not belong to the state are the actual money, or capital, put up by predominantly individual investors and the market itself."⁶⁹

The China Securities Regulatory Commission (CSRC) requires all Chinese firms that are publicly traded to use a common Chinese Accounting Standards (CAS) that resembles IAS and GAAP, but differs on key points such as the treatment of debt, asset valuation, and revenue recognition principles. The Ministry of Finance issued the "Provisional Accounting Regulations for Joint-Stock Limited Enterprises" in 1992, which served as the foundation for CAS, with subsequent refinements and modifications. CAS itself replaces an arcane and unwieldy previous accounting system that varied by industrial sector, originally developed for government monitoring of firms, rather than management decision-making or investment analysis. All Chinese firms listing in Hong Kong, New York, or other international exchanges must use IAS, as a reconciliation to GAAP or IAS is mandated by listing authorities.

The CSRC requires that listed firms use a third-party auditor to verify financial statements. The MOF began to license CPA's and accounting firms in 1993 when it issued a regulation on "Professional Qualifications of CPA Firms," This regulation began a process of creating auditing firms from the accounting sections of government financial bureaux, establishing professional standards under the aegis of the China Institute of Certified Public Accountants (CICPA), and formal licensing by the MOF.⁷⁰ Aside from the Big Five and their local affiliates, there are 4500 accounting firms in China, but only 106 are licensed by the MOF. The domestic market share of the Big Five has risen from almost zero in 1990 to approximately 10%. All listings on the Hong Kong and New York exchanges use a Big Five auditor.

⁶⁹ Carl Walter and Fraser Howie, *To Get Rich is Glorious! China's Stock Markets in the '80's and '90's* (forthcoming), page 10.

⁷⁰ China Securities and Regulatory Commission, *Information Disclosure and Corporate Governance in China*, paper for the OECD Conference on Corporate Governance, Hong Kong, pages 8-10.

China's mandatory supervisory committee, similar in function to Germany's Aufsichtsrat, is irrelevant to governance in China, being effectively a rubber-stamp for the board of directors. Between 80% and 90% of the board members of Chinese SOE's are non-executives (meaning non-employees), but the majority are concurrently government employees, at one level of government or another, and thus serve the state's interest rather than any notion of fiduciary obligation to all shareholders.⁷¹ In an analysis of 154 firms traded on the Shanghai and Shenzhen exchanges, Xu and Wang found that 50% of directors were state employees, and another 40% were employees of state-controlled "legal persons," an ambiguous category that includes other SOE's and state-owned banks.⁷² Anecdotal evidence suggests that there are few independent directors on the boards of public Chinese firms.

The nominal rules regarding voting rights and contests of control in Chinese Company Law are straightforward in terms of protecting minority rights in principal, but disclosure, notification, and voting procedures make it very difficult in practice for minority shareholders to exercise those nominal rights. More important, minority shareholders are placed in a different class with regard to ownership rights than shares held by state entities, and as a result, China has a bewildering variety of share types, the net result of which is to nullify the control rights of minority investors in general and foreign investors in particular.⁷³ In addition, external and foreign ownership caps effectively rule out the prospect of contests for control of SOE's. The state continues to hold, on average, 65% of the equity of traded SOE's, and on average only 35% of the equity is tradable as either A or B shares. Moreover, foreigners are only allowed to trade B shares. Merger and acquisition activities involving large SOE's have been engineered by the state for industrial policy reasons, or to palliate moral hazard losses in the state-owned banking sector.

There are performance contracts for senior managers, but these are subject to political interpretation and intervention. Some steps have been taken towards incentive compensation for managers in some big SOE's, but these are small, with little disclosure, and it is unclear how they are tied to firm performance or shareholder value; anecdotal evidence suggests that around 2% of their total compensation is based on incentive compensation. These performance bonuses

⁷¹ Ironically, China's company law explicitly forbids government employees to serve as SOE directors.

⁷² Xiaonian Xu and Yan Wang, *Ownership Structure, Corporate Governance, and Firm's Performance: The Case of Chinese Stock Companies*, World Bank paper, May 1997, page 32.

⁷³ "...the regulations were imbued with the spirit of state planning, state control, and state interest. This is best seen in the very definition of shares which proceeded based on who owned them rather than on the particular economic rights they might represent in a company. Thus, if an agency of the government owned the shares, the shares were state shares, if a state enterprise with legal person status owned them they were legal person shares, and so on. Shares were given names based on the relationship of the particular owner to the State and it is absolutely amazing how many permutations of this relationship came to light over the next few years." Walter and Howie, *op.cit.*, page 42.

are swamped by the huge, across-the-board salary “bonuses” that are often awarded to the employees of SOE’s regardless of the performance of the firm. A survey of 680 SOE’s between 1980 and 1994 “...shows that among the profit-losing enterprises in the sample period, on average, more than 80% of them issued extra bonuses, i.e. bonuses at least 25% of the basic wage bill...In other words, over one third of financial losses could be avoided had the insiders of those state enterprises been prevented from distributing extra bonuses for themselves.”⁷⁴

Japan

Japanese institutions of accounting are moving fitfully towards international accounting standards (IAS), especially with regard to consolidation and asset valuation, but as yet fall well below conformance with global standards. Until 1999 Japanese firms continued to report on an unconsolidated basis, thereby allowing firms to “park” losses at unconsolidated affiliates. Japanese accounting practices also allowed Japanese firms to carry assets at book rather than market value, permitting managers to avoid recognizing losses on deflated real estate or securities holdings – a serious issue in the aftermath of Japan’s post-Bubble asset collapse. Fiscal year 2001 promises to be a revolution in Japanese financial reporting, as firms must report fully consolidated balance sheets, use a mark-to-market basis for asset valuation, recognize unfunded pension liabilities on their balance sheets, and generally disclose much more data than before.

Despite improved accounting standards, Japanese firms are still under no obligation to use external auditors, much less one of the Big Five accounting firms, to sign off on their figures. Instead, cosmetic changes have been made to the role of the internal auditor, or *kansayaku*, that marginally improve the internal auditor’s standing with regard to management, but that still fall far short of independent external auditing by global standards. Yet demand for the services of Big Five accounting firms in Tokyo exploded, as foreign-affiliated lenders and potential acquirers of Japanese assets engaged their services to validate the shaky data provided by potential acquisition targets in Japan.

There has been little movement towards creating independent, outside boards of directors in Japan, where employees dominate the boards: 80% of Japanese corporations have no outside board members, another 15% have no more than two outside directors, who are usually affiliated parties.⁷⁵ A handful of firms have announced reductions in the size of their boards, in some cases splitting the board into a supervisory board on top, in charge of strategy, and an executive board below, in charge of operations. But there has been little progress in the

⁷⁴ David Li, “Insider Control, Corporate Governance, and the Soft Budget Constraint: Theory, Evidence, and Policy Implications”, in B.Chen, J. Dietrich, and Y.Fang, *Financial Market Reform in China: Progress, Problems, and Prospects*, 2000, page 372.

⁷⁵ Robert Monks and Nell Minow, *Corporate Governance* (1995), pages 272-273.

key area of bringing independent outsiders onto the boards, much less ceding them control over audit or compensation committees. However, the institutions that define the fiduciary responsibilities of both management and the board (for they are equivalent in Japan) have been sharpened by a flurry of stockholder suits of both the derivative and class action variety.⁷⁶

No change has taken place in terms of Japan's formal control institutions for shareholder rules and minority protections: the rules embedded in Japan's long-established commercial code to provide nominal protection for the rights of minority shareholders (including FPI's) are superior to those in many other markets.⁷⁷ More importantly, no change has occurred in Japan's informal control institutions, despite a large number of tempting targets whose market capitalization is much less than their asset book value and a set of formal control institutions that should make takeovers fairly straightforward. Japanese institutional investors, such as trust banks, insurance companies, and pension fund managers, do not tender their shares in hostile takeovers.

There are only two recent departures from this solid wall of indifference to the merits of (and financial gains available from) an active control market. Cable & Wireless managed to acquire a majority of the unlisted shares of IDC in 1999, to complete what was essentially a foreign direct investment (FDI) transaction, and M&A Consulting failed to obtain a majority of the listed (and steeply undervalued) shares of Shoei, a Canon affiliate. One has to go back more than a decade, to T. Boone Picken's failed attempt to obtain a board seat after purchasing a sizeable minority stake in Koito Manufacturing, to find another example of a hostile takeover attempt in Japan.

The managers of large Japanese public firms continue to be either promoted from within, meaning selected by their predecessors and chairmen, or in some cases to step down from a senior government post, as an *amakudari* official. These managers are increasingly immune to being fired for poor performance; once ensconced, there is no way to remove the president short of a palace revolt. Miyajima's probit analysis shows that the turnover of Japanese senior managers as a function of financial performance has been steadily declining over the five periods of his study (from 1959 through 1993), which the author

⁷⁶ For example, in April 1997 the Takashimaya board settled a shareholder suit with a payment of 170m yen in restitution for breach of their fiduciary duties. In the same month similar suits were filed against the boards of Daiwa Bank and Sumitomo Shoji, and the next month suits were brought against Nomura Securities and Midori Juji. On December 2000, the former management of bankrupted Sogo Department store was assessed a fine of 11.2 billion yen (about \$100 million) for poor management and fraud, under Japan's new Corporate Rehabilitation Law. "Tokyo District Court Rules that Former Management of Group had failed to Perform their Duties", *Financial Times*, 12/11/00.

⁷⁷ Carl Kester, *Japanese Takeovers: The Global Contest for Corporate Control* (1991), page 97. Certain filing and pre-notification requirements for undertaking a tender offer make it more difficult and expensive to engage in contests for control, but these requirements are comparatively less limiting than the U.S. state-level anti-takeover statutes that were passed in the early 1990's.

attributes to the declining ability of Japanese banks to monitor these firms.⁷⁸

Japanese top managers still have the lowest ratio of incentive compensation to total compensation of any state in the present sample set: only 9% of total managerial compensation, which includes both cash bonuses and stock options, is tied to the financial performance of the firm.⁷⁹ This is despite regulatory changes in 1997 that made it easier for firms to issue stock options, and Japan's remarkably favorable tax treatment for such options when they are exercised -- the 26% capital gains rate is far below the marginal income tax rate for ordinary income for most managers.

Korea

Korea has moved rapidly to embrace global accounting standards, a stronger role for auditors, independent standards setting, and better disclosure. In 1998 Korea's newly-launched Financial Supervisory Commission (FSC) overhauled Korean Financial Accounting Standards (KFAS) to bring them largely in line with the IAS, and external auditors were made mandatory for use by listed firms. New regulations also require detailed disclosure of financial transactions between chaebol blockholders and public firms. A newly independent institution for accounting standards, the Korean Accounting Standards Board (*Hanguk hoegyeye kisun wiwon hoe* or KASB), was created in June 1999, separating it from the Ministry of Finance and Economy.⁸⁰

In Korea a broad series of measures were taken by the Kim Dae-jung government to create independent, outsider boards of directors, in contrast to the former *pro forma* boards that simply rubber-stamped the orders of the founder-chairmen (or *chong-suh*). Chaebol must now obtain 50% of their directors from outside, with a strict set of conditions to ensure the independence of these directors from a controlling blockholder. The legal obstacles to filing a derivative

⁷⁸According to Miyajima's database of 100 leading public Japanese firms, the correlation between turnover and financial performance began to disappear in the period 1984-88. Miyajima's more recent findings override earlier studies by Kaplan, which argued that Japanese executive turnover was little different from U.S. or European turnover. Hideyaki Miyajima, "The Impact of Deregulation on Corporate Governance and Finance," in L. Carlile and M. Tilton (eds.), *Is Japan Really Changing its Ways? Regulatory Reform and the Japanese Economy* (1998), page 68. Steven Kaplan, "Corporate Governance and Corporate Performance: A Comparison of Germany, Japan, and the US.," *Journal of Applied Corporate Finance*, Vol. 9 (1997), No. 4.

⁷⁹Incentive compensation data in Japan, Germany and Korea is based on a 1999 internal survey by Towers & Perrin. There is considerable debate over the relationship between incentive compensation and firm performance, but recent research on the U.S. demonstrates a median elasticity of top manager compensation to firm performance (as measured by stock price) of 3.9. Brian Hall and Jeffrey Liebman, "Are CEO's Really Paid like Bureaucrats?," NBER paper #6213, 10/97. The ratio of incentive compensation to total compensation for U.S. top managers is 52%, the highest in the Towers & Perrin sample and more than twice the mean.

⁸⁰Il-Sup Kim, "Financial Crisis and its Impact on the Accounting System in Korea," Korea Accounting Standards Board, KASB manuscript (January 2000).

suit against a firm were reduced, from 1% to .01% of the stockholding, which made it much easier for small shareholders to bring such suits. A flurry of such suits have been filed, of which several were won by the plaintiffs. Significantly, efforts to make class action suits easier to bring have been rejected by the National Assembly, allegedly due to counter-lobbying by the chaebol.

Similarly, the change in institutions that shape contests for control in Korea has been dramatic – at least on paper. Korean regulations that limited hostile takeovers by capping such acquisitions at 10% of the target firm were removed. This was buttressed by abolishing the ban on acquisitions by foreigners and the requirement to obtain MOFE approval for merger and acquisition (M&A) transactions, and altering the tender requirements attached to minority share acquisitions to make it easier to acquire large blocks short of majority control. Korea has also witnessed changes in shareholder rules, such as regulations that increase the scope for minority shareholders to place items on the agenda of stockholder meetings and obtain access to company documents.

Senior Korean managers still tend to be promoted and rotated within the chaebol group. Recent changes in Korean regulations make it easier to use stock options, but in actual practice their use remains low; as a result the ratio of performance-based compensation to total compensation in Korea remains well below the mean, at 16%.

Malaysia

Malaysian information institutions have rapidly moved to conformance with international standards across the board. Malaysian GAAP (MGAAP) is virtually equivalent to IAS, with a few minor deviations. Reflecting the strong professional legacy of the Commonwealth, the accounting profession is well-organized through the Malaysian Institute of Accountants (MIA) and the Malaysian Association of CPA's (MACPA), and the Malaysian Accounting Standards Board (MASB) is relatively independent and professional in standards setting – an independence buttressed by a commitment, in principle, to IAS. The Companies Act mandates third-party audit, a requirement backstopped by the Kuala Lumpur Stock Exchange (KLSE).

At least on paper, Malaysia's oversight institutions also comport with international standards. Recent studies suggest that 90% of listed companies have at least two NED's, and the Malaysian Code of Corporate Governance has set a minimum of 30% independent NEDs on boards. Malaysia's legal system also imposes strong standards of fiduciary duty to minority shareholders, and the courts entertain derivative suits for breach of this duty, although class-action suits are not possible. The obligations of directors are also monitored by the Government Minority Shareholder Watchdog Committee, which was created at the recommendation of the High Level Finance Committee on Corporate Governance.

The Watchdog Committee, the Securities Commission, and the KLSE also enforce the one-share-one-vote rule, and ensure that minority shareholders have at least a voice in key corporate decisions. This has not led to an active, competitive market for control, however, despite Malaysia's Code of Takeovers and Mergers, which resembles the City Code in most respects. The state continues to exercise a veto right over most M&A decisions, including transactions involving the privatized state owned sector and all so-called *bumiputra* firms. The state imposed a 30% cap on foreign ownership of *bumiputra* firms and banks, although this cap has been increased, removed, and re-imposed over time, which reduced the ability of foreign firms to engage in competitive contests for listed Malaysian firms.

Malaysia's market for managers is strongly affected by the state, which exercises considerable political influence over senior hiring decisions of state-affiliated and leading *bumiputra* firms, which are clustered in the property, transportation, and services sectors. Listed firms make extensive use of incentive compensation, well above the mean, and these are fully disclosed by the listed firms.

Singapore

Singapore's information institutions conform to FPI governance standards in most respects. Singapore GAAP is functionally equivalent to IAS. In fact, the independent standards-setting committee, the Disclosure and Accounting Standards Committee (DASC) of the Institute of CPA's of Singapore (ICPAS) has recommended that Singapore adopt IAS in its entirety. All companies in Singapore are required by law to be audited by approved auditors, who must hold a practicing certificate issued by the Public Accountants Board (the regulator), and such practicing accountants must also be members of ICPAS. The Big Five have a large market share in Singapore, and their professional standards are, according to anecdotal evidence, among the highest in Asia.

Oversight institutions in Singapore are reasonably fair in protecting the interests of minority investors, and the listing rules of the Singapore Stock Exchange (SSE) include NED's on all boards of public firms. The ratio of NED's is estimated at 60%, although with the high proportion of private blockholders in listed companies, it is likely that many of these are nominees in practice. Like France, Singapore has a cadre of professional manager-bureaucrats that moves back and forth between the public and private sectors, and many of these individuals can be found on the boards of both private and privatized SOE firms on the SSE. Singapore law imposes a strong fiduciary duty on directors, and these are backed up by a court system that is generally fair and fast in the case of financial disputes.

By the same token, Singapore company law provides for a one-share-one-vote rule, and the Voluntary Code on Takeovers is similar in most respects to the U.K.

City Code and is, by most accounts, reasonably effective in protecting minority rights during changes of control. But public contests for control are extremely rare, due to the remaining regulatory caps on foreign ownership (although these are in the process of being removed), the large presence of private blockholders (around 60%), the state's exercise of informal guidance regarding M&A transactions, and finally due to the state's preponderant position as an institutional investor through Temasek.

The market for managers in Singapore is competitive by international standards; the quality is generally high, with quite a bit of turnover and extensive use of incentive compensation, among the highest in the twelve country sample at 31%. Approximately half of the listed firms on the SSE have a stock option plan.

Taiwan

Despite its vigorous foreign trade, high levels of both inward and outwards FDI, and relatively untrammelled product-market competition, Taiwan has long had a highly regulated financial sector, and has systematically discouraged foreign portfolio investment. Foreign investors were limited with both company-specific and overall market caps, through a cumbersome system of Qualified Foreign Institutional Investor (QFII) approvals and other bureaucratic red-tape. Not surprisingly, there has been little official rush to make Taiwan's corporate governance institutions more attractive to global investors.

Taiwanese GAAP is similar to IAS and GAAP, but differs in several key areas, including asset valuation. There is poor disclosure of related party transactions. An independent standards-setting committee, the Accounting Research and Development Forum (ARDF), was established in 1984, and the recommendations of the ARDF are recognized by the MOF. The Securities and Futures Commission (SFC) requires third-party audit of listed firms, and corporate by-laws require a statutory internal auditor; as a result, the Big Five an estimated 80% market share in Taiwan through their local affiliates.

Taiwan's oversight institutions provide little protection for minority investors, and are dominated by private blockholders.⁸¹ The Taipei Stock Exchange and the SFC have listing requirements to include NED's on boards, but according to anecdotal evidence these are overwhelmingly filled by family members or blockholder nominees.⁸² The state has stepped in to modify oversight institutions,

⁸¹ C.Ko, K.Ding, C.Liu, Y. Yeh, "Corporate Governance in Chinese Taipei", paper for OECD Conference on Corporate Governance in Asia, 3/5/99, page 10.

⁸² "The closest thing to a requirement of independent directors is Rule 9(12) of the Listing Review Rules of the TSE. It requires all directors and supervisors to independently examine their functions and duties. Often, listing companies which are family-owned will agree to install independent directors after the IPO. This now accounts for 90% of the listing applications. However, such commitment to the TSE has only binding moral force. Often, such listed companies will re-elect back a majority of family members or affiliates in the next election. Therefore, the current status reflects a "cat and mouse game." Lawrence Liu, "Corporate

with the requirement that 20% of board seats of privatized SOE's represent employees, an arrangement that resembles Germany's *Mitbestimmung* rules.

The Taiwan Company Law sets a threshold of 5% for derivative suits by minority shareholders, which effectively discourages such litigation, and other procedural rules make class action suits very difficult.⁸³ A Minority Investment Protection Act is pending that would tighten the fiduciary responsibilities of directors by laying out the rules for stockholder suits. In the meantime, the state itself has created a watchdog agency, the Securities and Futures Market Development Institute, that periodically sues blockholders for insider trading and other acts of expropriation, with the state as plaintiff and with minority shareholders piggybacking on these suits.

Taiwanese company law provides for one-share-one-vote principles, but there are very few market-based contests for control, for several reasons. Private blockholders control 65% of the listed firms in Taiwan, making hostile offers unlikely to succeed. Moreover, the state has imposed tight limits on foreign holdings of any single Taiwanese firm, moving this cap only gradually from 15% to 30% to 50% over the years. In 1997 the SFC moved to ban the practice of separating voting proxies from underlying shares, which had provided an opening for hostile bids. Finally, the SFC requires prior approval for tender offers, including hostile takeovers, and the state bureaucracy exercises informal guidance on large M&A decisions.

Managers are hired and fired competitively, as would be expected in a private blockholder-controlled market. Taiwan's booming high tech sector mimics in many ways the management practices of high tech firms elsewhere, including performance-based compensation and stock options; but these practices are still rare in the rest of the industrial sector.

Governance in Taiwan", paper for International Conference on Corporate Governance of Chinese Listed Companies, 11/2/2000, Shanghai, page 5.

⁸³ Coordination costs are high, court and claim fees must be paid up front by the plaintiffs, and there is no civil discovery. Liu, *op.cit.*, pages 10-11.

Table 4: The Shifting Terrain of Conformance

1989 Conformance

Corporate Governance Conformance									
	INFORMATION		OVERSIGHT		CONTROL		MANAGEMENT	TOTAL	CHANGE %
	Accounting	Audit	NED	Duty	Voting	Takeover	Incentive		
Belgium								3	30.0%
China								0	0.0%
France								2	20.0%
Germany								1	10.0%
Italy								0	0.0%
Japan								1	10.0%
Korea								0	0.0%
Malaysia								3	30.0%
Netherlands								1	10.0%
Singapore								4	40.0%
Spain								0	0.0%
Taiwan								1	10.0%
TOTAL	0	5	3	2	5	0	1	16	
% CHANGE	0.0%	41.7%	25.0%	16.7%	41.7%	0.0%	8.3%	19.0%	
GROUP TOTAL		5		5		5	1		
% GROUP CHANGE		20.8%		20.8%		20.8%	8.3%		

1994 Conformance

Corporate Governance Conformance									
	INFORMATION		OVERSIGHT		CONTROL		MANAGEMENT	TOTAL	CHANGE %
	Accounting	Audit	NED	Duty	Voting	Takeover	Incentive		
Belgium								3	30.0%
China								1	10.0%
France								4	40.0%
Germany								2	20.0%
Italy								1	10.0%
Japan								1	10.0%
Korea								0	0.0%
Malaysia								5	50.0%
Netherlands								3	30.0%
Singapore								5	50.0%
Spain								1	10.0%
Taiwan								2	20.0%
TOTAL	3	8	4	2	5	0	6	28	
% CHANGE	25.0%	66.7%	33.3%	16.7%	41.7%	0.0%	50.0%	33.3%	
GROUP TOTAL		11		6		5	6		
% GROUP CHANGE		45.8%		25.0%		20.8%	50.0%		

1994

1999 Conformance

Corporate Governance Conformance								
	INFORMATION		OVERSIGHT		CONTROL		MANAGEMENT	TOTAL CHANGE %
	Accounting	Audit	NED	Duty	Voting	Takeover	Incentive	
Belgium								3 30.0%
China								1 10.0%
France								4 40.0%
Germany								3 30.0%
Italy								3 30.0%
Japan								2 20.0%
Korea								4 40.0%
Malaysia								6 60.0%
Netherlands								3 30.0%
Singapore								6 60.0%
Spain								2 20.0%
Taiwan								3 30.0%
TOTAL	6	10	5	5	6	0	8	40
% CHANGE	50.0%	83.3%	41.7%	41.7%	50.0%	0.0%	66.7%	47.6%
GROUP TOTAL		16		10		6	8	
% GROUP CHANGE		66.7%		41.7%		25.0%	66.7%	

1999