CORPORATE GOVERNANCE IN EMERGING MARKETS

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Weak corporate governance and the East Asian financial crisis

On this topic of corporate governance in emerging markets, probably the first thing I would like to share with you is that this is a concern that dramatically came to East Asia in 1997 and 1998 during the height of the East Asian financial crisis. Now, the crisis revealed how weak our financial institutions and our corporations were in part because of corporate governance principles not being properly observed in our part of the world. Therefore, as part of the solution to the crisis, we had to rise up to the corporate governance challenge. We therefore imposed upon ourselves the duty of trying to reform corporate governance. In my case, it was first in the Philippines, and then we shared our experience in the Philippines with our neighbors in East Asia.

Now what did we do first? In our case, it was fortunate that our regulators, seeing the devastation in the East Asia financial systems in 1997 and 1998, saw very clearly the imperative for introducing changes in corporate governance practices more in line with the newly published *OECD Global Principles of Corporate Governance*.

Improving corporate governance in East Asia

At first, the debate in the Philippines – and I found out later, in the rest of East Asia – was whether global principles of corporate governance, formulated in Europe and influenced by the United States, could ever apply to our part of the world. So we looked at those principles very closely. At least we in the Philippines came to the conclusion that there really is no difference when it comes to principles of corporate governance, whether they’re formulated in Europe, pressured by the United States, and applied to the Philippines and East Asia. As one of my colleagues at the time said, “You know, theft is theft anywhere. If it is theft in the Philippines, it is also theft elsewhere.” This is what corporate governance imposes on all of us, the duty of being transparent, the duty of being socially responsible, the duty of being fair, and the duty of being accountable, not only to shareholders that invest their money in a corporation, but also to the society taken as a whole. Whether those duties apply only to the United States or Europe and not to China or the Philippines certainly should not be a matter for debate. So we went ahead and we said, “These principles apply to us.” And the first thing that we did was to make our corporations be aware of what those principles were.
Raising awareness and strengthening accountability

It is fortunate that in our part of the world, regulators can still require corporate directors to go through a compulsory training program on corporate governance. So all directors had to go through it and be certified as having attended a corporate governance orientation seminar. This is the awareness phase.

Now, after we were done with that, we said to ourselves, “Okay, people are aware, but you’ve got to get them to do things.” So we imposed a number of practices that are common in the United States and Europe, but not really common in the Philippines or East Asia, such as requiring boards of directors to take the responsibility of formulating strategies and overseeing the execution of strategies. They used to just leave this to management. Another practice, of course, is that, in a board, there must be a very serious, competent audit committee, whose members are financially literate (perhaps the more appropriate term is financially numerate). At least they should be able to read financial statements and see what is behind the numbers that are being reported to them. Risk management and risk oversight became very important too, and it was also put in place. Finally, we looked at the remuneration of directors and CEOs. We also imposed the requirement of having a corporate governance committee in every board.

Checklists and scorecards of progress

Besides making directors aware that there are corporate governance principles that they had to observe and live by, we also instituted a number of mechanisms, instruments and practices that boards should observe and live by to help them really give life, substance, and flesh to the corporate governance principles that they have now.

So we came out with a checklist. It includes the things that you absolutely need to do. You must have an audit committee. You must have independent directors. You must have this, you must have that. It is a quite long list. It’s a laundry list. Therefore, the culture of box-ticking came in. Well, do we have an audit committee? Do we have a risk management committee? Do we have a corporate retreat every year for the board so that they take a good, close look at the corporate strategy that is presented to them or the corporate strategy that is being reviewed? With that checklist, we started organizing what we call a corporate governance scorecard to check whether corporations are acting according to these new practices and mechanisms that we have instituted.

As a result of this scorecard, we found out that many of our corporations were initially scoring very low – 50 out of a 100. Second year, there was a slight improvement, not very much. But in the third year, because people were beginning to focus on the corporate governance scorecard and therefore the checklist, these scores started moving up. We found that a number of corporations that have truly taken corporate governance to heart were beginning to score in the 90s, 95, close to 100.
Improving performance with corporate governance

Surely there is something to corporate governance, more than just box-ticking, more than going through a laundry list of “do I have this, do we do this,” and so on and so forth. Corporate governance is about performance. We’ve got to deliver results. Because of all of these practices, corporations must deliver good results not only to the shareholders, but also to all of the stakeholders, the community as a whole, the society as a whole, and the economy as a whole.

So we started shifting slowly, away from mere compliance, box-ticking, checking against a list and therefore scoring high in the corporate governance scorecard. We moved more and more into the use of corporate governance for performance, which is what is should be. In other words, it’s not the words of corporate governance principles, but the substance behind those principles so that, in fact, corporations would begin really delivering maximum long-term value not only to the shareholders, but also to everybody else that has a stake in the corporation.

The Companies Circle

How do you do that? How do you focus on performance? We started organizing a group of corporations, which are put together into what we call as the “Companies Circle.” These were the corporations that started to score very high in their corporate governance scorecard because they were taking corporate governance seriously. They were really interested in using it as a tool for producing good business results. Having organized the Companies Circle, we had models of corporations that really took strategy formulation very seriously and took strategy execution as part of the major duties of the board. Beyond overseeing proper strategy execution, they translated corporate strategy, corporate values, corporate ethics, and corporate social responsibility, together with all of the targets that are set in the corporate strategy map, into everyone’s everyday job.

Corporate strategy that includes everyone

Strategy is not for board of directors alone. Strategy is not a piece of paper that top management and the board would formulate, approve, and adopt. No, strategy is something that has got to be translated into operational terms, so that, in fact, the corporate values, corporate social responsibility to business targets, and corporate results that are set in the strategy map would become a day-to-day challenge for everyone, from the CEO, the chairman of the board, down to the last employee. So now what we’ve done is taking advantage of a corporate strategy that has been formulated. We assist corporations to make corporate ethics, corporate social responsibility, and the business targets set in a corporate strategy, real guiding lights for the day-to-day operations of the different departments, units, and everyone who works in the corporation.
Now, am I talking theory? No, we’ve done it. We’ve actually laid out a pathway for corporate governance improvement in terms of actual performance, of which there are four phases. First, corporations get to be initiated into the pathway. Then they become compliant with all of the demands in the pathway. Then they become very proficient in terms of their strategy execution. Finally, corporate governance gets to be institutionalized the moment corporate culture and business targets, based on this strategy, would be linked to individual performance, which enters into the performance evaluation system.

Corporate governance principles

What are the major principles of corporate governance? We talk about fairness. Performance-related corporate governance invites every corporation to be fair not only to the controlling majority shareholders but also the minority shareholders. Corporations need to be fair in treating them and in striving as much as possible to deliver long-term maximum value to all the shareholders. It’s also fairness to all of the stakeholders, including fairness to employees – how employees are treated - fairness to the environment, fairness to the economic system, fairness to the political community in which the corporation operates so that they pay the right taxes, do not bribe, and do not participate in corruption.

All of this gets incorporated into corporate governance, designed for performance that is supposed to deliver results. So fairness and transparency become an important responsibility to be able to show everyone that the corporation has nothing but the best interest of all of the shareholders, without any exception. All of the transactions must be transparent. Reports must be transparent according to international financial reporting systems. And then of course you have responsibility, which comes together with fairness. But responsibility is also on the part of everyone in the corporation to deliver the results that have been targeted for the business unit, from the department down to the last individual. There is accountability and responsibility; therefore, through this mechanism, we are able to really give life, flesh, and substance to corporate governance principles.

The progress made in the emerging markets

Now where are we? In the Philippines, in emerging markets, we’re through with the first phase of awareness, box-ticking, and compliance. We’re now into the second phase of using corporate governance as a tool for performance, as a tool for delivering the appropriate results that corporations must deliver to their shareholders and to the economy as a whole. This is going to be a lot of struggle. We have started with the Companies Circle of model companies. Our work is to make sure that these model companies do not remain few and that their positive influence will spread throughout our system and, in the process, bring in the tide that will lift as many boats as possible. That is what we’re doing in corporate governance.
We do not believe that there is a different set of principles of corporate governance that apply to the United States and Europe on one hand and then a different set to China, the Philippines, and East Asia. We believe that the principles are the same. The practices may vary a bit, but this is where we learn from one another. That is why we continue working because we continue learning that what works well in one economy may well work also in other economies. In this process, there is a competition, not down to the bottom, but moving up to higher standards for corporate governance practices. We may be in an emerging market. But we think our economies can emerge much more quickly into progress if we succeed in this move of spreading proper corporate governance practices, not only at the compliance level, but also at the performance level.

Thank you for listening to me.

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