



Practice Guide: Governance & Shareholders

By Paul A Zaman MBA, MSC

Why Governance

The origin of governance is from the Greek word *kubernetes*, the steersman and cybernetics. This is the melding of setting direction and having a system to monitor and provide feedback so that direction can be maintained. A bit like a NASA Apollo rocket to the moon, the direction is known and the thrust jets are continually tweaking the rocket on track, overshoot, correct on track over shoot. An Apollo rocket spends the most of its time off track within a very tight control range. Likewise there are now a few Board Room executive information systems and advisory firms able to monitor, analyze and provide advice on when a corporate is moving off track and the corrective measures needed.



There have been many studies of institutional investors and fund managers on the correlation between company's equity market value and good corporate governance. The findings indicate that companies with good corporate governance are rewarded with around a twenty-percentage increase in value compared to those with inferior governance.

Corporate Governance: Asian style versus Western.

Corporate governance is therefore then easy to explain what it is and its benefits. Corporate Governance is in one aspect of the Board of Directors dashboard and steering wheel. The question still remains whom sets the direction. This is recognized as the Board of Directors, choosing the strategic options that will grow shareholder value. However with a range of Executive and Non-Executive Directors, and varying strength and dominance of an Executive Chairman this becomes less clear. In America the usual approach is for the CEO to also be the Chairman and often the CEO and perhaps his CFO are the only two executive directors. Therefore it poses questions as to how much openness and transparency of the business is fed into the Boardroom. In Europe the tendency of for many more executive Directors to be on the Board, so that the re is more likely to be a

powerful balance to a Executive Chairman. The converse is that these executive directors may be focused on running the business and their own remuneration and bonus rather than the shareholders. In Asia, the home of the successful family dynasty, there majority owners are also often the executive Chairman and selectively both executive Directors and non-executive directors. The challenge in dynastic boards is looking out for minority shareholder interests. Clearly there are different approaches and all approaches can be very effective. The key is to develop an appropriate corporate governance style.

Minority Shareholders

Minority shareholders and free float in dynastic listed companies is often small around the 10% to 35% level and these shares are often tightly held for the long term by institutional investors. Whereas in American and European equity markets the free float of a listed company may be large, 40% to 80% with only a minority holding by a vested interest such as the founders family or the union and employee superannuation fund. However the shares liquidity and turnover on the equity market may mean that these free float shares are sold and resold typically between 50% and 200% each year. This means the minority holders change at perhaps once every two years and possible even as fast as twice a year. Clearly within this churn of ownership thee will remain some minority shareholders who invest for longer time periods. However the challenge is clear how can governance reflect the views of transient minority shareholders and should they?

What are Trust and the key values for governance?

Trust can be defined as a consistency of values and behaviors in specific situations and contexts. Trust is often a misused word and generalized in terms of the values, behaviors and context, which means that individuals are apt to break trust through no fault or error of their own. For instance values, such as the concept of fair play and related behaviors like passing and shouting for personal and team goals are likely to be different playing football in a Sunday morning friendly match versus in the monthly management meeting in the conference room. The only way to have a shared understanding of trust is by track record and dialogue on the three elements of values, behaviors and context.

The key values needed in governance are honesty and openness. Therefore Fundamental values of good governance for companies with minority shareholders are:

- Accountability to majority and minority owners
- Probity, which is an old English word which means honesty with wisdom



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- Transparency, meaning openness to all owners.

This in turn provides for two systemic outcomes that benefit the shareholders, in terms of lower risk and better investment returns;

- Lower cost of capital, that is interest rates and terms for raising debt and high quality strategic equity investors
- Improved corporate operational performance.

European versus American Approach to Corporate Governance

The continuum of styles on corporate intervention.		
American Style	European Style	Asia Style
Shareholder Focus	Stakeholder focus	Majority Shareholder Focus
Private Sector focus	Public Sector Focus	Private Sector Focus
Conduct Rules: One Size fits all	Principles: One Value Set fits all	Principles: One Value Set fits all
Criminal Intervention	Civil Intervention	Emerging legal framework
Risk Adverse	Entrepreneurial	Dynastic

Source: Qualvin Advisory Research

Where does the Asia style fit? Asia is a heterogeneous mix very diverse compared to America and Europe. The oldest securities markets are in Australia, Malaysia, Indonesia, India and Singapore. In these countries the cultures vary greatly and every code of religious practice is present.

Directors Primary Responsibility (English Law Precedents)

The Nominee Director must be free to exercise his best judgment in the interest of the company, which he serves. Whereas if the Nominee Director must follow directions set out by his sponsor, then those actions would be unlawful. Lord Denning 1963 (QB606).

Responsibility of the Board

- Formulating Strategic Direction and Foresight
- Reviewing and Making strategic choices
- Supervising and rewarding the management team
- Being Accountable to shareholders
- Being accountable to stakeholders.

Board Diversity

A board needs a diversity of members to debate and criticize constructively Tyson Report 2003/ Board and Directors Scope of Awareness for mindful action

- Political Environment
- Physical Environment
- Economic Environment
- Social Environment
- Technological Environment
- Trade Environment

South Africa is a leader in Corporate Governance

Mervyn Kings' Eight Questions on conflict ad corporate governance.

- Is there any personal conflict for me in regarding the issue before us? If so declare it no matter how remote or insignificant. Then do I vote or abstain?
- Do I have all the facts to make a decision? Remember the codes of care, skill and diligence.
- Is this a rational business decisions based on facts?
- Is this decision in the best interest of the company?
- Is the communication to the shareholders transparent/
- Is the company seen to be deciding in a socially responsible manner?
- Would the board be embarrassed if the decision appeared on the front page of a newspaper?
- Do I understand how the company makes money? what would kill the company in the next five years?

End

Qualvin Advisory was founded in 2003. We provide advisory services to the Board, CEO and CFO of listed and unlisted companies in S.E.Asia. Qualvin facilitates the Board in areas such as formulating corporate goals & strategy and governance & CSR. Qualvin also formulates and executes the financial investor relations strategy to: increase shareholder value and institutional following; firm the share price and raise new capital. Wish to contact the CEO, then email: pzaman@qualvin.com.