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2. Legal and Institutional Foundations of Corporate Governance in APEC Economies

INTRODUCTION

APEC economies have a diverse array of corporate organizational structures and surrounding legal environments and are interested in improving corporate governance within these environments. Our systems vary from the stated goal of corporate governance to most every element of implementation; they are a microcosm of the evolutionary processes that define corporate governance.

Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Yet, there is debate about how corporations should prioritize the interests of their stakeholders, how to set up corporate structures, or about what structures are optimal, in the APEC region or the world. Corporate governance may include competing corporate governance systems in different economies, because corporations in one economy may have to adjust their governance structure to compete with those from another. Recognizing the variety of answers to these questions and the lack of agreement on what corporate governance is, what does it mean to "implement good corporate governance"? Australia's description of corporate governance challenges powerfully illustrates these ambiguities:

For example, how should the primary duty of the board to equity holders be balanced against rules designed to provide protection to debt holders? What role should corporations play in promoting corporate social responsibility? Another challenge facing Australia's corporate governance system is whether shareholders participate to a sufficient level to assist good corporate governance practices.

Every APEC economy is actively engaged in work to answer these questions for their own economic system and adjust to their changing environment. For example, Korea and Chinese Taipei list corporate social responsibility (CSR) as a reform priority, and Russia talks about providing safeguards for creditors, government and society at large, a broader definition. Canada also notes the increasing importance of CSR in corporate governance.

PURPOSE

This chapter describes the breadth and range of APEC's diverse treatment of corporate governance problems, from legal systems to enforcement institutions and future reform efforts. By describing their function, rationale, and how they interact with another, we hope to increase understanding among and within APEC economies of how corporate governance works in APEC, as well as avenues for future reform. The particular features of each system are detailed in the IER section of Chapter 3. While a detailed discussion of each is not possible here due to space constraints, some examples are highlighted. The responsibilities of the various actors in corporate governance vary widely. Their evolution takes different turns and is path-dependent.

The end goal is not that a company has five directors or seven auditors; what matters is how well individuals in companies are motivated to work for the gain of the defined stakeholders and, through that, society as a whole.

In the APEC spirit of learning directly from the business community, we have prepared Table 2-1, which is based on a survey of numerous ABAC members on priorities for strengthening the economic and legal infrastructure in the Asia-Pacific region ordered by level of interest (average of the reversed rank in degree of disinterest, “Low,” and rank in degree of strong interest, “High”).²¹

Table 2-1

Level of Interest in Ways of Strengthening the Economic and Legal Infrastructure in APEC

Rank	Field
1	Facilitation of Incorporation
2	Improvement of Information Disclosure and Transparency for Creditor Rights
3	Corporate Information Disclosure
4	Harmonization with Application of International Accounting Standards
5	Enhancing Alternative Dispute Resolution Mechanism
5	Improvement of Competitive Market and Regulation of Anti-Competitive Practices
7	Facilitation of Fund Raising by Strengthening Creditor Rights
7	Measures to Promote Reorganization and Restructuring
9	Facilitation of Business Combination
10	Unification of Model Laws each APEC Economy Adopts

Disclosure and transparency are the functional result and method of good corporate governance. Investors want to know what is happening at their company to make sure they get the benefit of the bargain they strike with their agents and co-investors. They may prefer to have foreign subsidiaries, partners and joint ventures use the same accounting standards for easy understanding and disclosure and to reduce fraud, fiduciary breaches and agency costs via easier detection, punishment and dismissal.

Why are investors not so keen on model laws in this field? Unification of model laws in this diverse, evolutionary field would exemplify formalism, and as noted in Chapter 1, formalism is not helpful in corporate governance.

Similar priorities were identified in the AEPR in 2006:

The specification of shareholder rights; accounting and disclosure standards that encourage transparent business practice and the provision of appropriate information to the market; clearly defined duties for directors that ensure they behave in a transparent manner to protect shareholders’ investments; clearly defined procedures that define how boards may come to a decision and manage risk, and a regulatory, judicial and legal system capable of enforcing breaches of good corporate governance practices.

We write this chapter under this mandate and informed by businesses’ expressed interests in this field, beginning with a discussion of how some regulations in APEC economies act to

²¹ Survey conducted among 60 ABAC Japan member companies in Feb. 2010 on their expectations for strengthening economic legal infrastructure in the Asia-Pacific region. The response rate was 25%, with 15 total companies providing detailed information on their priorities in this area.

resolve basic problems in corporate governance to facilitate competition and thus improve corporate governance through market pressure.

COMMON ELEMENTS FOR CORPORATE GOVERNANCE IN APEC ECONOMIES

Desirable Attributes of Well-Functioning Systems

Shareholder Rights and Protections

How do APEC economies address agency costs, the classic corporate governance problem described in Chapter 1 where an agent fails to act in accordance with their principal's (corporation) best interests in mind? Economies impose fiduciary duties upon managers as a shareholder protection. APEC economies establish fiduciary duties through their corporate code or case law depending on their civil or common law legal system. HKC is transitioning from its former common law approach to a more code-based approach for the duty of care of directors. Disclosure and transparency help enforce these duties through legal mechanisms and reputational discipline.²² For example, transparency can reveal majority shareholders' influence over subsidiary companies and limit their ability to abuse their power through reputational discipline, making it expensive to attract a minority investment partner for future projects. When owners see the impact of their managers' actions, they can alleviate agency costs through corrective measures. Thus, any effective transparency measure is a shareholder protection and right.

Shareholders generally have two rights: the right to beneficial ownership of their investment and the right to vote in proportion with their ownership in any elections where their class of stock has a voting right, sometimes for directors directly or through a single elected officer. However, some APEC economies, such as Hong Kong, China (HKC), have shareholder votes by number of registered owners by default and only count shares upon request.²³ Also, the right to beneficial ownership may not give shareholders the right to receive any cash, because the right to declare a dividend or conduct stock repurchase may belong to management directors. However, if a dividend is declared, shareholders may have the right to receive it in accordance with whatever rights they have specified. The company may immediately owe them this money once directors declare their intention to pay a dividend. Shareholders may also have the ability to sell shares if the company is public and there are no unusual circumstances preventing their exercise of this right, and all economies limit this right, for example for insiders or in certain times and transactions. Also, shareholders may have appraisal rights to get some particular price when they sell their shares against their will.

Voting rights are meaningless without a meeting, so HKC and others allow shareholders to call for or require a shareholder meeting.

²² When performance is revealed to be good or bad through disclosure and transparency, the responsible director or officer's professional reputation is affected and their subsequent job responsibility and compensation accordingly. This sets up incentives for directors and officers to perform well and improve governance. This process is generally abbreviated as "reputational discipline" in the corporate governance context.

²³ The Listing Rules require listed companies to hold all shareholders' vote on a poll (Rule 13.39(4)).

Shareholder Equality

Another corporate governance problem is that majority shareholders have control and may use that control to influence the company to other shareholders' detriment or neglect. In APEC economies, a corporation's managers owe their fiduciary duties to all shareholders, not just one. However, when managers are selected by one shareholder, they may not act in accordance with this duty. One response is to establish a legal principle of shareholder equality, as Japan has done.²⁴ Another is to impose fiduciary duties on majority shareholders to protect minority shareholders.²⁵ Korea notes its Chaebols have worked to protect minority shareholders following the financial crisis to gain investment, an example of reputational discipline. Chile promotes free float for pension fund investments. Russia's highest free float is 49% and average control stake is 69%, posing unique challenges. APEC economies employ numerous methods. Peru even allows shareholders with 25% ownership to get registered and trade shares.

Regulatory Restraint

Businesses may have specific, targeted concerns on corporate governance, and these concerns vary. Regulations benefit or hurt some companies more than others, so they may impact which companies flee to a low-regulation jurisdiction or remain or seek out the premium of listing in a market said to be more rigorous. Corporate governance regulations in the capital market context, including government and exchange listing requirements and the related regulatory burden are financially significant for companies listed there and their competitors not listed there. Excessive regulation leads to capital flight and competitive disadvantage. Regulators, including stock markets, would be well-served to consider these possibilities. Mexico has noted this potential, in particular expressing concern about reform fatigue.

Choices to Provide Flexibility in Corporate Governance

No matter the reform, some companies wish to take advantage of it and others do not. In that context, what can APEC regulators do to ensure that their regulation helps and do not hurt business in their economy?

One solution is choice. Some investors and companies may prefer a board with a separate audit committee and majority independent directors. Others may prefer a board mainly composed of experienced insiders to better guarantee a long-term vision for the company's future. For some companies one structure works better, and for others another works better. Instead of forcing each company to conform to a particular structure, something the business world clearly does not want as expressed by its disinterest in unifying model laws; a regulator may introduce a new structure as a choice. Companies may choose to switch, and this switch, if positive, provides comparative advantage over competitors. Forcing companies to adopt an uncompetitive structure degrades their long-term performance and imposes needless transition costs. Some APEC economies introduce corporate governance reforms as an option or choice to resolve this. Korea's KOSDAQ allows an audit committee or full-time auditor, for example. HKC allows choice among IFRS or Hong Kong Financial Reporting Standards.²⁶ Singapore likewise allows choice among IFRS, SFRS and US GAAP.

Japan in 2002 provided its companies with a new management institution choice. The amended Commercial Code gives a "large company" the option to adopt a new corporate governance

²⁴ Article 109-1 of Japan's Company Law.

²⁵ For example, a fiduciary duty has been imposed on majority shareholders in numerous states in the United States, Canada and many other APEC economies.

²⁶ Companies with a primary listing must use either IFRS or HKIFRS (see Rule 4.11). Companies with a secondary listing in Hong Kong can use US GAAP (see Rule 19.39).

system. A company adopting such a system must establish committees, majority “outside” directors, and have no corporate statutory auditor. At a Company with Committees, the board may delegate a substantial portion of its management authority to officers. By providing companies with this option, Japan allowed successful companies to retain their existing board structure and continue to do business without interruption, the best result in corporate governance regulation. They also provided companies the option to change to a competing style of corporate governance. Some changed; some did not. However, all companies have to compete with other governance structures and are subject to market discipline. This allows the economy to benefit from governance options without disruption. By making a corporate governance change optional, APEC economies can get the full benefit of a regulatory mandate without much cost. Optional corporate governance reforms should be seriously considered in future reform efforts.

A related concept is the “comply or explain” system employed in Australia, Malaysia and other economies. Companies can choose not to comply with a rule, but must give a reason. This preserves flexibility, though it also adds some disclosure and compliance burden.

Overview of Other Specific Guidelines

What corporate governance is and for whose benefit corporations ought to work is a controversial, unresolved question. Corporate governance systems vary significantly and continue to evolve, so a universal set of principles, if overly detailed or formalistic, may in some instances limit rather than enhance reform efforts. However, they also serve as a valuable reference. Reflecting this concern, the OECD Principles note as follows:

[The Principles’] purpose is to serve as a reference point.

To remain competitive in a changing world, corporations must innovate and adapt their corporate governance practices so that they can meet new demands and grasp new opportunities. Similarly, governments have an important responsibility for shaping an effective regulatory framework that provides for sufficient flexibility to allow markets to function effectively and to respond to expectations of shareholders and other stakeholders.

[Corporate governance] relationships are subject, in part, to law and regulation and, in part, to voluntary adaptation and, most importantly, to market forces.

The OECD Principles have served APEC, the EC and some economies as valuable reference material. Thailand has made nuanced, positive use of the OECD Principles in evolving its system. However, Japan does not use them for reform, and Korea and Canada listed other influences for their reforms. HKC is emphasizing public input for its revised law. The more specific Principles could be implemented as options within an economy’s existing framework. Companies can thus capture any benefit that they find, resulting in more optimal adoption.

The Principles are written in the context of publicly traded companies in OECD member economies between 1999 and 2004. Also, some APEC economy views, such as those of Japan’s business community expressed in a comment to the drafters,²⁷ were not adopted in the formulation process. OECD economies have not implemented or adopted these principles wholesale. However, they are recognized as one of the 12 Key International Standards for Sound Financial Systems by the Financial Stability Board, which includes 11 APEC member economies. Leaders of the G20 economies re-committed to implementing the 12 Key Standards at the London G20 Summit in 2009.

²⁷ <http://www.keidanren.or.jp/english/policy/2004/014.html>

Director Selection and Board Composition

Who appoints directors within APEC economies varies widely, including (i) a shareholder-elected company chairperson or president, (ii) shareholders directly, and (iii) government officials or a designated independent person or institution for state-owned enterprises (SOE). New Zealand has an administrative body to decide who may be a director of a public company. Indonesia's 2007 revision requires a "Shariah Supervisory Board" for companies employing Islamic Finance, and generally employs a two-tier structure with a board of commissioners overseeing the board of directors.

In the case of SOEs, a government appointed director or officer, even if not a government official or former government official, has fiduciary duties. However, given the opportunity to profit in a direction different from the government's wishes, such managers might breach their fiduciary duty to comply with the wishes of the government that appointed them. Also, regulators in an economy with both SOE and private enterprises may be tempted to punish the private enterprise and reward the state enterprise, destroying value in private companies. These drawbacks must be weighed against the public interest in having state-owned enterprises in an industry sector or economy. One mechanism to address these concerns is Russia's "professional attorney" institution, an SOE public governance institution on the board. Advantages may be found to outweigh disadvantages for public utilities, transportation monopolies and other crucial infrastructure. Chinese Taipei notes that it exercises its shareholder rights over SOE and encourages them to privatize. Korea, Canada and Russia also actively manage their SOEs on behalf of the public, though Russia notes it is moving away from this practice.

An increase in audit committee or statutory auditor independence coupled with sophisticated financial backgrounds reduce accounting irregularity frequency.²⁸ Accounting irregularities and scandals have a massive negative impact on stock. Despite this positive, increasing insider directors and the number of directors may have a positive impact on corporate performance. The combination of these results suggests that the better board structure for APEC is to have a certain number of inside directors who know the company inside and out, and in addition, independent verification that audits are conducted properly. Chinese Taipei, for example, requires 1/5 of certain large company boards to be independent, reflecting a balanced use of the concept. Peru requires none, except for some industries which must have one independent director. Chile requires one director for certain companies. HKC and Viet Nam require 1/3. Singapore's code requires 1/3 and its exchange requires two. New Zealand requires 1/3 rounded down, with an audit committee majority. Mexico requires 1/4 with an all-independent audit committee. The Philippines requires two or 20%. Indonesia's audit committees have an Independent Commissioner and two more outside members. Malaysia requires all non-executive audit committees and 1/3 independent directors overall.

Corporate governance scandals can arise in companies regarded to have independent boards of directors and excellent corporate governance prior to the scandal: Enron won an award for good governance right before being revealed to have defrauded its employees and investors.²⁹ Citigroup's outside directors' lack of familiarity with their business may have prevented them from monitoring their traders' risk management practices, magnifying the economic crisis. These incidents illustrate the dangers of formalism in corporate governance regulation. Chile cites its good corporate governance for its avoiding derivatives and much of the negative impact of the financial and economic crisis.

²⁸ See, e.g., "Audit committee, board of director characteristics, and earnings management", April Klein, *Journal of Accounting and Economics* Vol. 33 Issue 3, August 2002.

²⁹ *Chief Executive* magazine in 2001 ranked Enron as #3 in the best five boards in 2000.

Corporate Governance Rules in the Case of Insolvency

APEC economies vary widely in dissolution and liquidation rules. Dissolution and liquidation occur when a company lacks sufficient funds to pay off all of its existing obligations, but may be chosen by a company which no longer wishes to do business as a means to divide its accumulated profits equitably among debtors and shareholders. In corporate governance, dissolution and liquidation are primarily relevant for their impact on fiduciary duties.

Companies that lack sufficient funds to pay their outstanding obligations are said to be in the “Zone of Insolvency.” In the Zone of Insolvency, shareholders’ claim on company assets may be close to or at zero. When shareholders have limited hope to recover anything from their investment, if directors’ only fiduciary obligation were to shareholders, they would take the most high-risk high-return measures possible because the downside for shareholders would be zero and the upside positive; in other words, any gamble is a good gamble for shareholders in the Zone of Insolvency. To prevent such skewed incentives, APEC economies may adjust fiduciary duties both to shareholders and debt holders. This can be very complicated, as different types of creditors and shareholders may have very different incentives and views.

Russia recently reformed its insolvency system to provide creditors with avenues to seek compensation from directors and “shadow directors” and reduce administrative cost.

Corporate Structures and the Facilitation of Business Combinations

Improvement of Procedures Re Mergers, Spin-Offs and Business Transfers

Mergers, spin-offs and business transfers can trigger corporate governance requirements specific to the situation. For example, a supermajority shareholder vote may be required, or a company may become public or go private as a result, fundamentally changing applicable corporate governance requirements and shareholder protections. Also, an active M&A market is an integral part of many economies’ corporate governance systems.

APEC economies are improving procedures in this area. For example, Korea has provided flexibility in merger consideration.

Measures to Promote Reorganization/Restructuring

Reorganization and restructuring allow corporations with liquidity problems to continue operating under a new capital structure. This impacts corporate governance when it results in a change of control. Whether existing management can continue in a restructuring varies within and among economies. New managers may disrupt the existing business, further destroying value available for creditors to recover. Leaving existing managers in place enables them to continue to destroy value. Both narratives may be true, so APEC economies may have a judge or the creditors determine who should run the company. This uncertainty helps keep directors engaged and motivated in a failing company to retain control. Economies promote reorganization and restructuring to get companies back to normal, profitable operations and corporate governance situations or to unload failing businesses to those better able to run them.

Transparency Promotion through Corporate Information Disclosure

Obligation to Make Timely and Accurate Disclosure of Important Corporate Information

Transparency is essential and core to corporate governance because it enables governance quality measurement and so allows market pressure and other forces to remedy problems. Public disclosure and transparency requirements focus on public companies, with a few exceptions. Economies mandate disclosure for material or price sensitive information, including HKC, the United States, and others.

How much disclosure they must make and when varies by economy, stock exchange and even shareholder citizenship. Disclosures must be accurate, but how accurate, what is “material,” punishments for disclosure inaccuracies, and who is punished vary. Insiders face significant temptation to profit from securities sales by delaying or failing to disclose negative information, so APEC economies generally impose criminal responsibility on those responsible for disclosure inaccuracies. Even criminal punishment fails to deter all fraud. Corporate codes and guidelines can also work to help guide companies in developing internal governance systems to prevent fraud. For example, audit committees with independent directors with financial experience have been shown to be highly effective in reducing opportunities for fraud. Many companies have adopted institutions in line with such guidelines even when not required by law, suggesting that they can be helpful. Of course, if a particular set of guidelines or principles were required by law, it could also prevent companies from developing new principles and systems for internal governance simply because they are formalistically different from those required, even if better at preventing fraud.

However, the primary function of transparency and disclosure for public companies is to help the public, including shareholders and analysts, to understand how a company is doing. Companies periodically disclose financial statements and other information. These disclosures allow outsiders to verify corporate and management performance. Companies must also disclose significant events, such as transactions involving most of a company’s assets. Some corporate governance issues are significant enough to require shareholder approval.

Disclosure that improves corporate governance helps the market and regulators discipline management. The market and regulators comprise an enormous range of financial literacy, so it is difficult to determine the optimal disclosure format and level. Disclosure-related expenses can exceed millions of US dollars per year. Companies may choose to list in less burdensome economic zones and exchanges for this reason. However, disclosure’s benefits for market efficiency and governance have substantial value. If regulators carefully consider the target audience, they may be able to limit regulatory excesses and improve disclosure quality.

Fostering Specialist Groups

Requiring companies to disclose material and accurate information on a regular basis cannot guarantee uniform and understandable information. Meaningful transparency requires a strong accounting profession that understands how and when to account for and disclose financial information, a legal profession that understands when disclosure is necessary and what is significant to the business, and a close working relationship with trust between professionals and management. Certified professional organizations help maintain good disclosure standards. Such organizations can discipline members who fail to uphold these standards and incentivize members to act diligently and loyally. The accounting profession in particular serves an important function as a gatekeeper for public companies. The need to regulate must be balanced

with the importance of professional confidentiality to give professionals the opportunity to help management fulfill their duties.

Chinese Taipei, Japan, the US and most other APEC economies have a system for chartering or certifying licensing professional accountants (CPA). CPAs are employed for external audits and as internal or statutory auditors/audit boards, helping enforce compliance in two layers. APEC economies also have legal professionals to guide companies in conforming with corporate governance requirements.

International Accounting Standards Harmonization

Harmonization with international accounting standards is an issue that gains and loses momentum with some regularity but is relevant to corporate governance. IFRS are not universally accepted in APEC, and debate continues about their merits versus other accounting standards. In particular, there is a corporate governance concern that some accounting standards may be better at encouraging long-term, stable growth than at focusing on one accounting period's earnings.

However, there are also significant benefits to harmonizing accounting standards. Korea, Malaysia and New Zealand take advantage of these benefits via IFRS adoption. Some companies are listed on multiple exchanges around the world, and different economies and stock exchanges may require disclosure of financial documents under a particular set of accounting rules, requiring each such company to convert their financials and make different accounting judgments for each exchange multiplies administrative overhead. Harmonized standards allow further professional qualification internationalization. Universal accounting standards backed by universal professional performance standards would allow easy comparison among companies, enabling more efficient capital allocation and global corporate performance, as long as the standard chosen incentivizes long-term performance over earnings manipulation or smoothing. Such standardization increases pressure on companies by forcing them to compete for capital with all other competitors for capital in the world. However, if the standard chosen allows fraud to go undetected for some period, the world might suffer a global simultaneous accounting scandal crisis. Given the events of the past decade such a scenario should be considered. Thus, it may be important to maintain diversity in accounting standards, or even to allow companies to choose which standards to use along with choosing which economy and stock exchange in which to compete for capital.

Chinese Taipei will require listed companies to convert to IFRS by 2013.

Finance Facilitation from the Perspective of Corporate Governance

Stock Issuance Regulations for Investor Protection

Securities issuance and related fraud is an issue in every economy in the world. Private corporations are subject to much less oversight and disclosure requirements than public corporations, so they may not issue securities for sale to the general public. This forces companies to either become public and subject to public company corporate governance requirements or to confine their pool of investors to sophisticated, wealthy persons.

Stock issuance regulations require issuers to produce detailed documents explaining investment risks, what their company is, its financials, and who is involved in management. This ensures investors can inform themselves before they buy stock. Chinese Taipei recently strongly recommended listed corporations form a risk management committee for investor protection.

Stock Ownership Transparency

Stock ownership transparency is fundamental to corporate governance, because it ensures voting rights are exercised by their owners. Transparency of stock ownership limits stock voting fraud. Public companies are required to make disclosures about who owns their stock and how much as relevant to governance: who owns more than some threshold, any voting agreements, etc. The institution enforcing transparency and voting rights varies and overlaps in APEC economies among securities exchanges, government agencies, shareholder lawsuits, proxy agents, news media and others.

Stock ownership is now almost entirely electronic, e.g., in Indonesia's KSEI, though paper certificates remain in some APEC economies. Sophisticated and secure computer systems at securities settlement and clearing houses maintain registries of who owns how much of what, and actual certificates are rarely transferred. Individual investors buy stock through financial institutions that hold stock in their street name in trust for the investor. This improves ownership security and efficiency and makes it easier to prevent voting fraud. When an entity making a proposal attempts to get a shareholder list to communicate their proposal, it is easier to gather the information and does not require physically locating stock certificates. This improves corporate governance by making it easier to use and verify shareholder voting rights.

Russia's constitutional court dealt with share ownership fraud issues extensively in 2010; this is detailed at 6.2 in Russia's IER.

Executive Compensation and Incentive Programs

Incentive compensation is a hot issue in corporate governance. Some argue that incentive compensation align incentives between managers and stakeholders so that management gets "some skin in the game" and acts accordingly. Conceptually, this should help corporate performance by reducing agency costs, and it does improve director effectiveness. However, problems arise in implementation. Stock options grant dates, the differences between stock options and stock, and repricing options following negative shifts in share price have all spawned corporate governance scandals. It can be difficult to understand how these programs impact ordinary shareholders. How to avoid incentive abuse is an unsolved problem in corporate governance; however, incentive compensation remains an important partial solution to the problem of agency costs widely used in APEC economies. Australia's legislative framework empowers shareholders to limit excessive termination compensation, since such compensation is given at a time when the executive is not able to affect the future performance of the company.

ENFORCEMENT INSTITUTIONS AND PROCESSES

Courts and Corporations

General Courts versus Specialist Courts

Judicial enforcement mechanisms form the final backstop for corporate governance – when reputational discipline, internal governance procedures, financial audits, legal compliance and counsel, market discipline, listing requirements, corporate governance codes, and financially savvy independent directors or auditors, have failed and a perceived abuse has occurred, a lawsuit is brought against the alleged abuser. This type of enforcement can powerfully impact participants' incentives, and the specter of a lawsuit or enforcement is always on the minds of directors in board meetings.

Some economies employ ordinary courts exclusively in corporate governance, relying on lawyers, accountants and bankers to brief judges on the facts and law just like any other court case. Other economies have specialist courts that deal with corporate governance issues. Still others have no specialist courts per se but have allocated some courts or judges more corporate law cases and so developed some level of specialization.

Specialist courts help keep a separate court docket so that ordinary criminal and civil cases are not delayed or crowded out by complex business litigation. Also, judges who handle these cases exclusively, or more than usual, are able to more quickly understand a case and deliver consistent results, making litigation more efficient. Specialist courts' advantages have caused jurisdictions worldwide to consider adopting some level of specialization. Peru is an example of a partially specialized system.

Some APEC economies with civil law systems focus more on regulatory enforcement than some APEC economies with common law systems. Many blend these approaches, as well. These distinctions are of uncertain impact, but they change the way corporate governance enforcement looks to the public. Viet Nam has settled all enforcement issues without court cases. Viet Nam has accomplished this by providing for Alternative Dispute Resolution (ADR) to settle disputes among shareholders, companies, regulators and other third parties in its 2009 revised Corporate Governance Code.

Methods for Integrating Specialist Knowledge into the Judiciary

A related issue is the training of judges generally. In some economies, judges are career judges with no other work experience. It can be difficult for such a judge to understand corporations without additional specialized education or training. Employing judges with career experience related to corporate law can help improve the quality and consistency of decisions. Thus, whatever court system an economy operates under, specialized training for judges in aspects of corporate governance is likely to be important for effective adjudication.

Whether or not an economy employs career judges, there are several other ways to integrate specialist knowledge in the judiciary. For example, economies can and do have continuing legal education requirements for judges. These can include training on corporate governance related legal issues to help improve the quality and consistency of legal decisions. Thailand, Malaysia, and Chinese Taipei, for example, have education programs on corporate governance for their judiciary.

Administrative Regulation and Enforcement

Administrative agencies can be heavily involved in regulating and enforcing corporate governance restrictions. A benefit of this approach is that it can help reduce the burden on courts resulting from corporate governance issues and encourage settlements. Administrative action can be swift and powerful compared with a lawsuit, which helps bolster the impact judicial enforcement can have on incentives to avoid situations where a lawsuit or administrative action might arise. On the other hand, administrative action (and judicial enforcement) can be so powerful that the remote possibility of such action can consume much of management's consciousness even when they are not engaged in suspect action, hurting business competitiveness. Even more care than judicial enforcement should be taken in administrative enforcement because of its immediate impact, particularly in the case of suspected securities fraud, and the lack of judicial process required before that impact occurs.

Administrative regulation is the prime mover in corporate governance regulation in many economies. For example, the transparency and disclosure requirements discussed above are implemented primarily through administrative enforcement in many economies. Thus,

administrative enforcement is pervasive in the discussion throughout this year's AEPR. Administrative regulation is also particularly important where shareholder lawsuits cannot be effectively pursued. Also, administrative agencies often operate the disclosure system itself, playing a central role in the information distribution chain.

Private Sector Regulation and Enforcement—Governance-Related Requirements for Companies to be Listed on Major Trading Exchanges

Various major securities exchanges impose corporate governance related requirements to list on their exchange. For example, NASDAQ and the NYSE in the US have detailed requirements for independent directors, defining them and their role and mandating numbers, as well as many other requirements. In Chinese Taipei, the Taiwan Stock Exchange and GreTai Securities Market impose corporate governance rules in addition to their Company Law. For example, Chinese Taipei's and Malaysia's exchanges mandate a few hours of governance training each year to continue listing. Canada and Singapore have self-regulating corporate governance systems and no mandatory director training. The Philippines requires director training. New Zealand's NZX writes its own rules subject to override by a minister. Exchanges enforce via public reprimand, delisting, or fines. However, corporate governance-related delisting is rare. Mexico and Peru, for example, know of none.

Exchanges may adopt these requirements for a number of reasons, including to preempt legislation that might be more burdensome, to guarantee a higher minimum standard of transparency and honesty in management and thus function as an exchange to certify some quality in its listed companies. Securities exchanges in APEC contribute to corporate governance in two ways: firstly, when an exchange imposes high, good listing requirements, domestic companies are required to adopt those corporate governance practices or leave the stock market entirely, so this can improve the governance of the pool of public investment opportunities; and second, international companies in economies with low listing standards can opt to be "bonded" to a higher standard in another economy, which is said to improve their governance.³⁰ However, there is also evidence that the "bonding" effect is overstated or even negative, calling listing requirements into question as a viable corporate governance institution.³¹

When exchanges mandate corporate governance practices, they limit access to a capital market to companies unwilling or unable to adopt these practices. In doing so, they may increase those companies' cost of capital. They also eliminate opportunities for investors in those exchanges to participate in these businesses. On the other hand, they may succeed in getting companies to change the way they run themselves in order to obtain a lower cost of capital. Whether they succeed in doing so will depend on whether the harm from adopting a new corporate governance requirement in disrupting the business or reducing the effectiveness in corporate governance is more or less than the benefit from reducing the cost of capital. They also give their government a powerful incentive to spread their corporate governance practices throughout the world, since if the practices the exchanges require do not spread, the stock exchange cannot compete for foreign listings. The Bursa Malaysia has requirements beyond those in the corporate code. Chile's Santiago Stock Exchange does not impose such

³⁰ "Racing towards the Top?: The Impact of Cross-Listings and Stock Market Competition on International Corporate Governance", John C. Coffee, Jr. *Columbia Law Review* Vol. 102, No. 7 (Nov., 2002), pp. 1757-1831

³¹ See, e.g., "Cross-Listing and Corporate Governance: Bonding or Avoiding?" Amir N. Licht, *Chicago Journal of International Law*, Vol.4 No.1, 141.

requirements, keeping itself open to different governance systems. Russia's RTS and MICEX have listing requirements including governance requirements, and it also has more than 10 voluntary codes of corporate conduct for industries.

Fraud and Fiduciaries

General Law on Fraud versus Securities Fraud and Related Institutions

Corporate governance deals with fraud because fraud represents a breakdown in relationships central to corporate governance: those between shareholders, directors and management. General law on fraud is tort law, which typically says that if one person knowingly makes a material misstatement in order to manipulate another who reasonably relies on this information to the financial advantage of the one and to the other's detriment, one is liable for these damages. Securities fraud comes in a wide variety of forms, from corporate fraud to pump and dump schemes, Ponzi schemes, late trading, boiler rooms, accountant fraud, etc.

For corporate governance, the most important type of securities fraud involves financial statement disclosure, as mentioned above. Misstatements are enforced against individuals and companies, and penalties in APEC economies range from fines to civil judgments, incarceration and execution. Enforcement mechanisms include administrative bodies, courts and securities exchanges.

Fiduciary Duties

In the company law of nearly every APEC economy, managers such as board members may have a duty to act with complete loyalty to the interests of shareholders, or creditors in the zone of insolvency. Also, directors may have a duty of care. Breach of these duties may result in legal liability, so managers go to great lengths to avoid situations where they might be perceived as breaching these duties. When a decision is to be made that might impact their personal interests, a director might not participate in a vote or even leave the room or phone call during the discussion. Boards with multiple members with potential conflicts might set up a committee with only directors perceived to be neutral to make such decisions as compensation, whether to accept an offer to purchase all or a significant part of the business, or to audit the corporation's financial statements and choose independent auditors to review them. Companies might have an internal auditor or audit-board structure. To avoid breaches of the duty of care, boards make sure to discuss alternative courses of action in meetings before making a decision and to record that they did so in the meeting minutes.

Employees are usually disciplined through internal corporate policies. However, this does not always suffice to deter employees from self-dealing. To supplement these measures, some economies impose fiduciary duties on senior employees such as officers and even non-officers. Well-functioning internal controls, with well-separated purchase decisions and auditing functions, for example, help reduce opportunities for employees to steal. Compensation can also be arranged to mitigate incentives to act against the corporation's interest, although there may be natural limits to this approach. Korea is in the midst of reform on director liability via its Commercial Act. It is attempting to define outside directors, expand the definition of director self-dealing, and deal with the problem of corporate opportunity usurpation, problems which persist globally. Chile's 2010 reform dealt with these issues. Other economies are also engaged in reform efforts.

Shareholder Lawsuits: Extent of Effectiveness and Possible Improvement

In those APEC economies which allow them, including Korea, Chinese Taipei and the US, shareholder lawsuits have a real impact on corporate governance, although they remain rare in Russia, which legally regulated them in 2009. When a board is discussing a major decision, they carefully discuss both options and record that this discussion occurred, as discussed above under fiduciary duties.

Chinese Taipei has an administrative enforcement system via lawsuit, the Securities and Futures Investor Protection Center. It may initiate an action against management on behalf of the company or a lawsuit to dismiss a director or supervisor.

Policing versus Reputational Discipline

Judicial Enforcement Mechanisms for Various Frauds and Breaches of Duty

Monetary Penalties and their Appropriate Level, Incentives

When a corporate insider engages in self-dealing or for the benefit of a third party at the expense of the corporation, they may or may not be caught and punished. If the only possible negative consequence of this conduct were forfeiture, requiring them to return the money would not suffice to deter insiders from self dealing because they would get caught less than 100% of the time. However, most economies have additional penalties such as incarceration and execution, so it may be that returning the money is enough.

Criminal Penalties' Role in Corporate Governance

Criminal penalties are a very harsh punishment for economic crime. Considering the fine line between a freewheeling businessperson and a target of a corporate fraud investigation, it may seem excessive to impose criminal penalties in this field. However, financial penalties, and even criminal penalties, are not enough to deter all corporate wrongdoing. Removing criminal penalties might result in even more corporate governance abuses. Different economies draw the line in different places on this issue, but with a few exceptions noted above, flagrant securities fraud and corporate governance abuses lead to criminal penalties.

Market Discipline's Role in Corporate Governance

Directors and Management

If civil and criminal penalties do not suffice to deter businesspeople from corporate wrongdoing, how do corporations function at all in support of stakeholder value? Reputational and market discipline prevents fraud and encourage good performance. Once managers or directors have been publicly exposed to have acted against their company's interest, their career may be over. Having prominent businesspeople in a company in a position of responsibility signals to potential shareholders that this company is doing things right. The story of J. P. Morgan,³²

³² Ramirez, Carlos, "Did J.P. Morgan's Men Add Liquidity? Corporate Investment, Cash Flow and Financial Structures at the Turn of the Twentieth Century", *Journal of Finance* 50 (1995) 661.

directors in Meiji Japan,³³ and China's FoxConn's reputation in manufacturing exemplify this effect. How to create a business environment where prominent directors flourish and promote good corporate governance has not been perfected, but thinking about what good corporate governance means for individuals involved and their incentives can provide clues to inform future policy efforts.

In this context, there are a variety of approaches in selecting future company leaders. Selecting them internally improves performance by: (1) motivating employees to promote stakeholder value in pursuit of their career; and (2) motivating companies to invest in their employees' skills to develop them as future leaders within the firm, benefitting company performance. On the other hand, diversifying corporate leadership has also been identified as an important factor to maintain and improve a company's performance, especially in its international efforts.³⁴

Shareholders' Role in Governance and Markets

Canada cites shareholder self-governance as the most important corporate governance enforcement institution, in line with much academic work on shareholder rights.

Shareholders' role in governance through voting more particularly is discussed below. Briefly, shareholder self-governance involves giving shareholders a vote to determine which corporate governance practices are good for their company. Beyond voting rights, shareholders can also impose pressure by selling poorly governed stock, depressing share prices. Once share prices are fairly low, groups may buy the stock to pressure management to adopt better governance practices or give up management to a group who will, thus earning a profit through exercise of their voting rights and improving corporate governance. In this way, giving shareholders self-governance rights in corporate governance matters can create a virtuous cycle for better governance.

Limits on Market Discipline's Power

As discussed under the topic of criminal and civil enforcement above, for many or even most individuals the potential for reputational harm may not suffice to prevent corporate governance failures. However, civil and criminal enforcement can complement market discipline by making a public record of corporate governance failures. If enforcement were clear and consistently applied, it could deter bad governance along with reputational discipline. Unfortunately, clear and consistently applied enforcement in corporate governance is uncommon.

Mechanisms to Improve Market Discipline on Corporate Governance: Transparency, Disclosure and Markets for Corporate Control

Transparency and disclosure in the context of market discipline on corporate governance

Markets depend on public information to determine securities prices, which in turn determines a company's capital cost. The spread between a company's capital cost and its return on investment determines its fate in the long term. Greater transparency serves not only to expose companies which are doing badly or doing bad things but also to expose companies which are

³³ "The Value of Prominent Directors: Lessons in Corporate Governance from Transitional Japan", Y. Miwa and J. Mark Ramseyer, Harvard Law School John M. Olin Center for Law, Economics and Business Discussion Paper Series (1999)

³⁴ J. Stewart Black and Allen J. Morrison, "A Cautionary Tale for Emerging Market Giants", Harvard Business Review (2010.9)

doing well and acting in the interest of their stakeholders. Mandatory disclosures thus help reward the good and punish the bad, in tandem with market discipline for corporate governance.

Chinese Taipei's Securities and Futures Institute conducts an Information Transparency and Disclosure Ranking among all listed companies annually, helping impose market discipline to improve transparency and disclosure.

Markets for corporate control

When functioning well, a market for corporate control is a highly effective form of market pressure for corporate governance. Management is subject to pressure to treat shareholders as well as they would treat themselves because if they do not, an outsider could buy the company.

Regulation in corporate control markets varies widely, but briefly, APEC economies with well-functioning corporate control markets have the following characteristics:

1. One can buy a company against the management's wishes if the shareholders think it is the best offer they are likely to get and a good time to sell;
2. Management has a meaningful opportunity to negotiate on behalf of the shareholders with the would-be purchaser for a better price; and
3. Offers are not permitted to be coercive, that is, pressuring shareholders to accept early for fear of getting a worse deal later in the event of a squeeze-out.

Markets for corporate control keep management focused on adding value, so some economies are working on ways to develop such a market. For example, Japan has issued guidelines³⁵ for "Poison Pill" shareholder rights plans so that companies can develop means to negotiate with a would-be hostile acquirer with an appropriate time limit and shareholder vote to ensure that the acquirer has an opportunity to make their case. Cross-shareholding and shareholder voting in these situations is another area Japan has focused on as it develops its market for corporate control. HKC has an active takeover market.

AREAS FOR FURTHER REFORM IN CORPORATE GOVERNANCE LAW AND REGULATION

Corporate Governance Improvement Tacks

Shareholder Rights and Responsibilities (right to dissent and obtain payment for shares, procedure for executing dissenter's rights, etc.)

APEC economies have been making rapid and powerful progress in the area of implementation and improvement of commercial and corporation laws surrounding shareholder rights and responsibilities.

Some economies provide rights for dissenters or to obtain other payment for shares. For example, if a merger is approved by the management but some shareholders believe the transaction is unfair, these shareholders may elect to have their shares appraised to get what

³⁵ "Guidelines Regarding Takeover Defense for the Purposes of Protection and Enhancement of Corporate Value and Shareholders' Common Interests", available at http://www.meti.go.jp/policy/economy/keiei_innovation/keizaihousei/pdf/shishin_hontai.pdf

they argue is their due rather than accept the terms of the merger. Alternatively, when a company is owned largely by a single shareholder who wishes to make that company a wholly-owned subsidiary, shareholders may be subject to a squeeze-out, a forced sale of their shares. Chile, New Zealand, the US and others provide for squeeze-out and redemption rights. Appraisal rights serve as a check on management's self-interest and help shareholders get a fair deal.

Role of Shareholders in Corporate Governance

Shareholders are the owners of the beneficial interest in a company, so they have a strong incentive in improving the company's financial performance. Chile's Pension Fund Administrators are one APEC example of institutional investors helping corporate governance. However, in companies with dispersed ownership, shareholders may have difficulty organizing to exercise their influence to control a company. This problem is an issue in any economy with dispersed shareholder ownership, a particular issue in any economy that moves from predominantly controlling shareholders or institutions with block ownership toward more dispersed shareholders. Several methods have been proposed to improve this. Some examples include to make shareholder proposals and proxy fights generally less costly to make, or even free in some situations; to allow shareholders to amend corporate bylaws through shareholder proposals at annual or special meetings; or otherwise allocate additional controls to shareholders. Korea, for example, allows shareholders with >3% of outstanding shares to make written proposals. Russia allows >2% shareholders to add agenda items to meetings. Peru has a special administrative organization that can call general or special shareholders' meetings. Viet Nam allows >10% shareholders to make proposals, or less as per the bylaws.

The management-centric view of corporate governance resists these efforts, arguing that directors are better able to make decisions in the interest of shareholders than shareholders due to directors' superior knowledge and experience. However, studies show convincingly that increased stock ownership corresponds to better firm performance, and the reason for appears more likely to be alignment of incentives than superior information.³⁶ If increased director stock ownership leads to better governance, shareholders might make better decisions for the company than directors to the extent an informed and procedurally fair shareholder vote can be held. In that light, economies committed to the vision that shareholder participation improves corporate governance will be interested in reforms that enable shareholders to add items to the company proxy statements and agenda for general shareholder meetings. The US has also recently shifted in this direction with the Dodd-Frank Act (USA, July 2010). However, many US academics, judges and directors retain the management-centric view, and the appropriate degree of shareholder rights remains a hotly contested issue. Chinese Taipei and HKC have Company Act provisions for minority shareholders to make proposals at board meetings and other protections. APEC economies would be well served to carefully analyze these sorts of proposals and ensure that they are made available to shareholders as an option for self-organization. Similarly, Japan's corporate law and guidelines have enabled shareholders to vote on a takeover proposal within a short time.³⁷

The United States this year followed this movement by enabling the SEC to make rules to allow shareholder proxy access. This is significant because it reduces proxy fight expenses; with access to company proxies, activists can run more governance battles and impose

³⁶“Does Skin in the Game Matter? Director Incentives and Governance in the Mutual Fund Industry”, Martijn Cremers et al, *Journal of Financial and Quantitative Analysis*, 44:1345 (2009).

³⁷ In HKC, no shareholder approval is required for a general offer to take over a company (except for privatizations).

competitive pressure on management. While the bill restricted governance freedom in listed companies by requiring compensation committee directors be all independent, with a few exceptions, it left a few areas open after a lively debate. This in turn means the new proxy access regulations, if and when effected, allow shareholders to vote to that increase competition among corporate governance styles within the US on such issues as whether to impose majority voting in director elections or to combine or separate the board chair and CEO positions.

Equitable Shareholder Treatment

Japan has enacted and enforced laws to develop a market for corporate control, shareholder proposals and votes to add another competitive marketplace to effect corporate governance reforms. Japan enacted a law providing for a “principle of shareholder equality” in its new Corporate Code. The Bull Dog Sauce case saw this law applied in a hostile takeover / “poison pill” case. The case held that treating shareholders differently does not violate this principle where the treatment results from a proper shareholder vote and the differently treated shareholder receives appropriate compensation. The hostile acquirer received an amount calculated to compensate for dilution at a price equivalent to its proposed tender offer price, which the Supreme Court found reasonable and not in violation of the meaning behind the principle of shareholder equality. Japan’s new law as interpreted by the Supreme Court may result in a highly efficient market for corporate control, as long as *ex ante* poison pill plans coupled with cross-shareholdings are subject to reasonable limits.³⁸ On the other hand, Japan continues to have less hostile takeover activity than is typical for economies with an active market for control.

Disclosure and Transparency

Disclosure and transparency measures are necessary to have share prices that reflect company value and thus impose market pressures on management to operate in the stakeholder interest. Disclosure and transparency measures are the most powerful tools for corporate governance.

In principle, shareholders could elect directors who would engage in disclosure beyond that required to enable them to make informed decisions on whether to buy or sell stock, or to buy or sell the company as a whole. In practice, this does occur to some extent. However, shareholders may face organizational difficulties when there are many small, dispersed shareholders with limited time to invest in that particular company, so there is a natural role for administrative disclosure regulation, and administrative agencies are therefore typically the most important player in this space. However, regulators are not in the best position to determine what information shareholders want and in what format. Legally mandating a greater voice for shareholders, at least in determining what kind of disclosure they get, might achieve better disclosure and transparency than those required by exchanges and government regulation. Canada’s approach to shareholder self-governance, for example, and the US’s new approach under Dodd-Frank may lead their companies in this direction.

Duties and Responsibilities of Governing Bodies (Board, Officers, Auditors)

The appropriate role, duties and responsibilities of individuals involved in corporate governance is the subject of an ongoing policy debate around the world and laws (and bylaws and listing requirements) on the subject remain in flux. As discussed above, these individuals

³⁸ Nels Hansen, “Japan’s First Poison Pill Case, Bulldog Sauce v. Steel Partners: A Comparative and Institutional Analysis P.166 *Journal of Japanese Law*, No.26 2008 (J.Japan.L.(no.26/2008) (abstract available online at: http://www.djiv.org/ZJapanR26_01.htm).

are subject to numerous legal requirements, and their structure is regulated more or less loosely in various economies and public and private regulators within economies, from those which provide a sample of choices (Japan for large public companies) to those open to a variety of structures (HKC's stock exchange), as well as some innovative new structures (Russia's Professional Attorney). Some economies, individual companies and regulators are trying out separating CEO and Chairman functions; and some are moving to multi-tiered structures with different functions. How this area can be further improved is widely debated and uncertain, but it remains active as described above and in the IERs.

Financial Accounting

One trend in accounting is to move toward fairly valuing a company's labor force with training specific to the company as an asset. For example, some companies have elaborate training programs to ensure that everyone from the lowest levels to the highest levels in a company has a shared understanding of how the business works. This can help ensure that directors, for example, understand how the business works and thus can effectively act in their role as gatekeepers. This in turn improves corporate governance. By including such items in accounting assets, good corporate governance may be encouraged and reflected in a company's balance sheet.

On the other hand, the capitalization of internally generated assets is currently not allowed under the International Financial Reporting Standards, despite the fact that it is indeed a growing trend. It is also arguable as to whether there is a need to fairly value a company's workforce for those who have attended training, since these value increases may be internalized to share value in the capital markets already.

Efforts toward Harmonization, Benefits and Drawbacks

Some stakeholders, however, such as labor unions in Europe, are interested in harmonization to expand their role in corporate governance internationally. Such harmonization efforts aim to reflect such interests' views in the way corporations are run globally and reduce the competition corporations have from foreign corporations lacking, e.g., labor union involvement in governance so that these corporate governance provisions cause less harm to their own corporations' competitiveness. Drawbacks of these efforts, though, include hurting economic productivity internationally by reducing competitive pressures on management in the same way. Another drawback is reduced competition among corporate governance forms resulting in inefficient management structures and inappropriate regulatory burdens. A majority of APEC economies including the United States, Japan and Canada, have moved away from harmonization in this field in their respective reform efforts, perhaps to avoid the economic harm from a homogenous, bloated corporate governance regulation system that fails to account for differences among industries, economies, company size and legal system, or perhaps because each economy's corporations' diverse array of governance styles and evolutionary history means harmonization efforts in corporate governance are misguided. Also, HKC is not part of a move to harmonize corporate governance standards as a goal, and in amending their requirements, HKC has benchmarked itself against standards adopted in other jurisdictions, particularly the UK, but not with a view to harmonization.

However, efforts to learn from different legal systems' corporate governance structures and regulatory systems can be useful to solve domestic problems. Capacity building projects that explain how a system works in context could be useful.

Align Management Incentives with Shareholders through Compensation Structure

The discussion of shareholders' role in corporate governance above has significant implications for compensation and corporate governance. If directors perform better when they are more closely aligned with shareholders, and our goal is to have management for long-term growth, the following compensation scheme could mitigate short-termism and governance scandals:

Mandate that all compensation above the cost of living be in the form of restricted stock automatically sold over the course of 5-10 years after the stock grant. Also, require that this stock position not be pledged or offset by any other means.

This simple solution has the disadvantage of taking away flexibility in incentive compensation. If this were implemented in one economy alone and that economy's managers were highly mobile, this could risk some talent flight. Still, if the compensation is competitive in total value, and if the managers are relatively liquid, good managers should stay and bad managers should leave. Also, the basic premise of mandatory corporate governance regulation is that we cannot trust companies to handle self-governance. Therefore, to avoid future scandals and do away with the need for a tremendous amount of enforcement and regulation surrounding insider trading, we suggest regulators consider requiring incentive compensation be limited to restricted stock along these lines to better align management incentives with shareholders.

Japan enacted an improvement to its stock-option system in 2001. The restrictions that had been placed on persons to whom stock options could be granted and the maximum number of shares that could be issued by exercise of stock options and the permissible exercise period no longer existed. Moreover, though a special shareholders' resolution was still necessary to authorize certain facets of stock options, the breadth of those facets had been reduced.

The United States' Dodd-Frank Act increases compensation disclosure, adds claw-back provisions for incentive compensation related earnings restatements, requires all-independent director compensation committees, and once in a while to give the shareholders the right to express a non-binding opinion on executive pay. It remains to be seen whether this will rationalize executive compensation, but this is an innovative reform effort. The act also provides for hedging disclosure, to show whether management is permitted to offset their financial interest in the company with other financial instruments. This is essential to make any incentive compensation scheme meaningful. Economies with similar concerns about executive compensation and corporate governance will find aspects of this legislation useful to consider.

Australia is working on a two-strike system to strengthen its shareholder vote on pay. It may also require shareholder approval to declare an open board position closed. Canada also has seen increased "say on pay" activity, with 35 companies adopting the system. Japan recently required management compensation disclosure where in excess of 100 million yen per year in public companies, and HKC has a proposal to require a director compensation report even for some private companies. Indonesia makes director pay public.