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Political Institutions and Corporate Governance Reforms in Southeast Asia

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Abstract

While the weak corporate governance has been identified as among the leading contributing factors that led to the Asian financial crisis, the progress in restructuring corporate governance has been rather modest in Southeast Asia following the crisis. Some common features of corporate governance in Southeast Asian countries, such as high concentration of ownership and lack of adequate disclosure, have been remarkably resilient to the frustration of the reformers. In this paper, we argue that the observed rigidities in corporate governance structure in Southeast Asia may be due to the political institutions as well as the interaction between these institutions and the corporate sectors. Our analysis also finds that there are substantive variations in corporate governance across Southeast Asian countries, and that the differences in political institutions among these countries may account for much of the variations.

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Introduction

The "Asian model" of economic development, once hailed as the engine for the unprecedented economic growth in East and Southeast Asian countries, has been under heavy scrutiny following the Asian financial crisis in 1997. In particular, the impacts of corporate governance structure on the crisis have received a great deal of attention in the literature. Evidences show that, at the macro level the weaknesses in corporate governance added to the vulnerability to the exchange rate depreciation and stock market collapse (Johnson, Boone and Friedman, 2000), and that at the firm level the ineffective corporate board, weak internal control and lack of adequate disclosure led to excessive exposure to debts (ADB, 2001). The governments in the region have responded decisively to these criticisms. Malaysia's new Code of Corporate Governance requires one third of board members in the public listed firms be independent; the Security Exchange of Thailand (SET) requires that financial information from listed companies be conformed to the International Accounting Standards. Similar measures have been undertaken in other countries throughout the region.

Despite of these efforts, however, the progress in reforming corporate governance in Southeast Asia has been rather modest. Ownership concentration remains at a high level (WSJ, 2003), new regulations are yet to be transpired to the real change in corporate behaviors, and there is even a perception that the quality of corporate governance has actually declined (Claessens and Fan, 2003). The resistances to the reforms indicate that there might be some rigidities in corporate governance in Southeast Asia. The existence of such rigidities may hamper firms' abilities to alter their

corporate governance practices in responding to either the changing economic conditions or governmental directives.

Such rigidities can be looked upon in light of the current debate over corporate governance convergence. The proponents for convergence argue that globalization (Hansmann and Kraakman 2001) and stock market competition (Coffee, 2002) will force the corporate governance systems in different countries to converge to an international norm. The opponents, however, claim that culture, legal tradition, and history have all played important role in the evolution of the corporate governance, and that corporate governance at the national level will continue to diverge in the future due to path dependence (Bebchuk and Roe, 1999). For those scholars, the sources of the rigidities in corporate governance stem from factors such as culture, legal tradition, history, and path dependence.

In this paper, we focus on the complementarities between political institutions and corporate governance to explain the rigidities in corporate governance. Corporate governance is concerned with the allocation of power, privileges and economic benefits among some of the most influential groups—such as investors, shareholders, mangers and employees—in any political system, and the relative strengths of claims made by these groups are often dictated by institutional factors such as party politics or electoral system. In addition, politicians and governmental officials often have vested interests in existing corporate governance structure, as they derive various resources from the corporate sector. Corporate governance reforms that would alter the existing resource allocation are likely to be resisted in the political system. Last, even if the alternative corporate governance structure may benefit the firms in the long-run, the firms may not

have incentives to change their current practices as these practices may represent the best response to the existing political environment. For example, firms may resist the demand for more transparency as doing so could potentially increase the chances of extortions by corrupted officials in an environment where corruption is pervasive.

While the prevailing political institutions are among the key determinants in the evolution of the corporate governance, corporate sector is not merely a passive participant in the political system. In fact, business elites can be involved in the politics in various capacities in order to secure and advance their interests. Political institutions and corporate governance structure mutually reinforce each other and become mutually dependent of each other. Such a mutual dependence may not only explain why dominant corporate government structure is persistent over time, but also in part account for the difficulties in reforming political institutions.

Understanding the linkage between political institutions and corporate governance has several important implications in practice. First of all, a corporate governance reform agenda that neglects the impacts of political institutions fuel unrealistic (high) expectation of what the reform can achieve. Political institutions determine the formation and quality of the corporate governance, and thus changes in corporate governance are likely to come out slowly and the outcome muddled if the existing political institutions remain unchanged. Second, understanding the role of political institutions in determining the corporate governance actually broadens the strategies and measures at the disposal of the government because the changes in political systems can effectively improve the prospects of the success of corporate governance reforms. Third, the complexity between the corporate governance and

political institutions imply that governments need to have a corporate governance strategy in dealing with the priority, scheduling and options of various reform initiatives in areas such as privatization and deregulation.

In this paper, we focus on the corporate governance practices in five Southeast Asia countries, namely, Indonesia, Malaysia, Philippines, Singapore and Thailand, and their relationship to the key characteristics of political institutions in these countries. The unique political and economic landscape of Southeast Asia presents an ideal setting for such a comparative study. There are striking similarities in corporate governance if comparing with countries in other region as a group, but the differences across these countries are also substantial.

The paper will be organized as followed. In the next section, we compare the corporate governance practices in the five Southeast Asian countries, and then present some stylized facts about the similarities and differences across these countries. In the third section, we discuss theories that link corporate governance with political institutions and examine their relevance in the context of Southeast Asia. In the fourth section, we conclude our analysis by pointing out some key policy lessons for the reformers in the region in designing and implementing corporate governance reforms.

Comparing Corporate Governance in Southeast Asia Countries: Stylized Facts

Since Southeast Asian countries display striking similarities in corporate governance structure, they have often been treated as a whole group in the literature; however, considerable differences do exist across these countries. Both the similarities and the differences form the building blocks of our analysis. This section draws heavily

from some recent research conducted at international organizations such as the World Bank and Asian Development Bank.

Ownership Concentration

Table 1 shows the ownership concentration for corporations in the five Southeast Asian countries. Three measures are presented to show the robustness of the results. The first one is the average percentage of shares owned by the insiders of corporations (the managers, directors and controlling shareholders). High concentration of insider ownership may raise the agency costs for outsider shareholders as it increases the risk of the expropriation of outsider shareholders by the insiders. The second and third measures show the percentage of shares owned by the largest one shareholders and largest five shareholders, respectively. All three measures consistently point to a trend that the ownership concentration is high in Southeast Asia. For example, In Indonesia the insiders own about 70% of the shares in the public-listed companies and the largest shareholders own roughly half of the equity stakes in the companies. On the other hand, regional variations are not insignificant—the average percentage of shares owned by the largest shareholders in Thailand is 30% as compared to about 50% in Indonesia.

While corporate ownership is indeed highly concentrated in Southeast Asia, it is nevertheless not a distinctive Southeast Asian phenomenon. In fact, La Porta et al. (1999) argue that dispersed corporate ownership as found in the US and UK is an exception rather than the norm, even in the developed world. For example, both France and Germany have high concentration of ownership, and the percentage of shares owned by

corporate insiders are 62.6% and 68.1%, respectively (Himmelberg, Hubbard, and Love, 2000).

The high concentration of ownership also should not be perceived as inferior to low concentration of ownership. Some empirical evidence from Asia and elsewhere even suggest the exact opposite. For example, Claessens, Djankov, Fan and Lang (2002) report that firm value is higher when the largest owner's equity stake is larger, and Joh (2003) finds that firm's accounting performance is positively related to ownership concentration. These findings are consistent with the principle-agent theory, which suggests that agency costs would be higher in the dispersed ownership than in the concentrated ownership.

However, ownership concentration in Southeast Asia does open the door for some corporate governance practices that are potentially harmful. High ownership concentration has facilitated the separation between ownership and control and the family dominance in Southeast Asian economies. It is over these practices some interesting and important patterns of variations have emerged across Southeast Asia.

Separation between Ownership and Control

Following the definitions used by La Porta et al. (1999), we define ownership as *cash flow rights*, and control as *voting rights*. Voting rights may deviate from cash flows in firms with high concentration of ownership because the controlling shareholders can use various mechanisms such as pyramiding and cross-holding to enhance control. The separation between ownership and control raises the agency costs for minority shareholders as their rights may be expropriated by the controlling shareholders (the

entrenchment effect). Table 2 shows that expropriation of minority shareholders is widespread in Southeast Asia.

The first column shows the ratio of cash flow rights to voting rights, indicating that the separation of the ownership and control occur more frequently in Singapore, Indonesia and Malaysia. The second column compares the uses of pyramid structures[2] and crossing holdings[3] in Southeast Asia. The uses of pyramid structures and crossings are prevalent in Malaysia (39% and 15%) and Singapore (55% and 16%); while the pyramid structures occurs most frequently (67%) among corporations in Indonesia, the uses of cross holdings are relatively rare in that country and the pattern is similar for Philippines. The figures also suggest that the separation of ownership and control occurs the least frequently in Thailand.

The last column in Table 2 indicates the percentage of the managers who are affiliated with the controlling shareholders (family ties or otherwise). For 85% of the firms in Indonesia and Malaysia as well as about 70% of firms in Singapore and Thailand, the control and management are not separated. The only exemption is Philippines, but Tan (1993) attributes it to the fact that many Philippines corporations have interlocking directorates and management boards. The high percentage of the affiliated managers suggests that the use of professional managers has not been a standard practice in Southeast Asia.

[2] Defined as owning a majority of a stock of one corporation which in turn holds a majority of the stock of another, a process that can be repeated a number of times (Claessens, Djankov, and Fan, 2002).
[3] Defined as a company further down the chain of control has come shares in another company in the same business group(Claessens, Djankov, and Fan, 2002)..

The adverse effects of the separation between ownership and control on the value and performance of the firms are reported by a number of recent studied. The separation of ownership and control lowers firms' value (Lins, 2003), and decreases their financial performance (Yeh, Lee and Woidtke, 2001).

Family Dominance and the State Control

Another key feature of corporate governance in Southeast Asia is the dominant role of family businesses in the economy. Table 3 shows the distribution of control across Southeast Asia. Companies are divided into widely-held and with ultimate owners, and five ultimate owners are presented: family, state, widely-held financial corporation, and widely-held non-financial corporations. In comparison to firms in East Asia, widely-held firms are rarity in Southeast Asia, with the exception of Philippines. Families control the majority of the public listed firms in Indonesia (72%), Malaysia (67%), Thailand (62%) and Singapore (55%). In Philippines, where relatively high percentage of firms are widely-held (19%) compared to its Southeast Asia neighbors, the share of family-controlled firms is still the highest (45%) of all types.

Perhaps a more striking feature of corporate governance in Southeast Asia is the concentration of economic power in extremely small number of families. Table 4 shows the percentages of the capitalization in the stock exchanges in these economies are owned by one, five and ten largest families. In Indonesia and Philippines, the largest families control 17% of the total market capitalization, and the largest 10 families control over 50% of the total market capitalization! Substantial regional variations do exist

across the five countries. For example, in Singapore and Malaysia, the largest 10 families control about a quarter of the total market capitalization, very close to the level in Korea.

The dominance of families in the corporate sector in Southeast Asia presents some special challenges for corporate governance. First of all, it may amplify the problems caused by the separation of ownership and control in a vicious cycle of pyramiding controls and family dominance: pyramiding controls strengthen the family dominance which affords them an increased capacity to engage in more pyramiding controls. Second, the family control subjects the minority shareholders to a sets of risks—such as intra-family disputes and exploitation of some family members by others—which are absent in firms that are not controlled by families (Morck, 2004). Third, the high concentration of economic power in the handful of families adds to the vulnerabilities to the overall macroeconomic environment, because decisions made by a handful of business elites—private in nature—may lead to disastrous consequences to the whole economy for which they cannot be held accountable.

In addition to high concentration of family control, another noticeable feature in corporate governance in Southeast Asia is the important role played by state-controlled corporations, although the degree of importance varies greatly from country to country, as shown in Table 4. Singapore has the highest share of the state-controlled corporations (24%), followed by Malaysia (13%), Indonesia (8%) and Thailand (8%). The only outlier in this group is Philippines, where the share of state-controlled is merely 2%, similar to Japan and Korea.

Corporate Governance Performance

While certain characteristics of the corporate governance, such as family dominance or corporate control through pyramiding and cross-holding, expose minority shareholders greater risk of being exploited by the insiders, it is overly simplistic to assume that there exits an one-to-one relationship between the structural characteristics of corporation corporate and their actual performance. Therefore, we have added the corporate governance performance as a separate dimension in comparing the five Southeast Asian countries.

The importance of measuring the corporate governance performance has been recognized by a number of countries in the region. For example, in Thailand a corporate governance rating agency has been established to provide corporate governance rating services to companies listed in SET; in Singapore, *Business Time* has started to issue its corporate governance rating for some leading companies in Singapore. Several international consulting firms, such as *PricewaterhouseCooper*, *McKinsey & Company* and *Credit Lyonnais Securities Asia* (CLSA), have also began their coverage of corporate governance measure at either the country or firm level.

The corporate governance rating by CLSA is selected as the benchmark of our analysis for several reasons. The first is that it covers all five Southeast Asian countries included in our analysis. The second reason, perhaps more important, is that it embraces a broader definition of corporate governance instead of narrowly focuses on the protection of shareholders. For example, "social awareness," referring to the company's emphasis on ethical and socially responsible behavior, has been a component of their corporate government rating. The third is that it combines both the subjective responses as well as objective measurement in their rating. For example, the rating on

independence of the board of directors for a particular company not only reflects the analysts' opinion but also is based on an actual investigation of the relationship between the directors and the controlling shareholders. Table 5 shows the corporate governance ratings for the five Southeast Asian countries.

There are substantial variations in the quality of corporate governance measured by the ratings across different countries. Singapore is consistently rated the best in the region in all of these categories except for accountability and social awareness, and companies in Indonesia perform the worst in corporate governance over almost all categories. The weighted overall scores are shown in Table 6.

Table 6 also demonstrates the correlation between corporate governance ratings and share price performance. While the dramatic fall in share price reflects the devastating effects of Asian financial crisis, which in part due to poor corporate governance in some Southeast Asian countries, it indicates that the investors have clearly recognized the importance of corporate governance and adjusted their valuation accordingly.

A number of questions emerge from our comparison of corporate governance in Southeast Asia. Why are so few companies widely held in Southeast Asia? Why are family businesses so dominant? Why the concentration of family businesses in the economy vary greatly from country to country? What are the implications of the extremely high concentration of family businesses in the economy? Why do countries perform so differently in corporate governance ratings even though similar corporate governance structure is in place? If some features of the corporate governance structure, such as family dominance and low transparency, are proved to be harmful to the

investors, why have they been persistent for so long? And why are the structural characteristics of the corporate governance so resilient despite the tremendous efforts devoted to the reforms?

In the next section, we show that the analysis based on the linage between political institutions and corporate governance may provide some plausible answers to these questions.

Linking Political Institutions and Corporate Governance in Southeast Asia

A clear definition of political institutions is in order as the term might mean different things for different people. We define policy institutions broadly as to include constitutional structures, political party systems, regulatory arrangements, various forms of public-private linkages, and informal rules and constraints govern political interaction. Political institutions influence corporate governance through structuring the incentives of the demand and supply in the political marketplace for a particular type of corporate governance regime.

Veto Power and Coalition

Much of the politics is concerned with the allocation of power, and this is where we launch our inquiry of the linkage between political institutions and corporate governance. Hall and Soskice (2001) argue that the preference over different ownership concentration levels rest on the ability of a government to make credible commitment to maintain a regulatory regime to protect private investment. Highly concentrated ownership will be more likely if the government cannot credibly commit to its claims

because concentrated ownership gives the investors more flexibility to deal with the *ex post* shifts when the government behaves opportunistically[4]. What type of political system do a better job in preventing government from behaving opportunistically?

The number of veto players matters. Beck et al. (2001) explain that a political system with multiple decision makers may offer greater protection from arbitrary government to individuals and minorities. Hall and Soskice (2001) report that, when the number of veto players rises, the dispersed ownership becomes more likely.

Another important dimension of the investor protection is policy implementation, because governments' ability to take actions decisively also matters. Asian financial crisis is a good case in point when both policy credibility and decisiveness are both essential. In contrasting the policy failures in Thailand and Indonesia during the Asian financial crisis, Andrew MacIntyre (1998) writes:

> *"The institutional problems in Thailand and Indonesia were quite different, but ultimately produced the same outcome – massive loss of investor confidence. Where Thailand suffered policy paralysis as a result of weak multiparty parliamentary government, Indonesia suffered from almost the opposite set of institutional circumstances: massive centralization of power which left government vulnerable to deep problems of credibility due to unreliable policy commitments. Thailand's system of government suffered from too many veto points and Indonesia suffered from too few."*

The key is that institutions such as multiple veto players have to be coupled with coalition with breath and depth to guarantee the implementation of policy. Hicken and

[4] Haber, North and Weingast (2003) argue it is almost intrinsic for governments to engage in such opportunistic behavior as they are often confronted with many, and often conflicting, objectives, in dealing with the corporate sector.

Ritchie (2003) define the coalitional breath as "the number of different interests represented in the coalition, such as labor, business, landholding elites, peasants, and at time civil service," and coalition depth as the level and extent of participation." Table 7 shows how the five Southeast Asian Countries would fall into the typology developed by Hicken and Richie.

Table 7 shows the challenges facing countries in Southeast Asia in promoting dispersed ownership in the economy. Concentrated veto power undermines policy credibility in Philippines, Indonesia and Malaysia, while in Thailand, dispersed veto power coupling with shallow-narrow coalition leads to frequent gridlock of decision process. This explains why the ownership concentration has been so high in Southeast Asia, and unless significant changes in the political system can be expected, business owners would not be keen to giving up their controlling shares. Figure 1 shows the results from World Business Environment Survey, and original question asks the firms "do you regularly have to cope with unexpected changes in rules, laws or regulations which materially affect your business?" The results are generally consistent with the typology developed by Hicken and Bryron (2003). Most business owners in Singapore believe that the government is capable of making credible commitment to their approaches while two thirds of business ownership in Indonesia think that unexpected changes in rules, laws and regulations are likely.

Vote Buying and Money Politics

Several Southeast Asia countries such as Indonesia, the Philippines, and Thailand have made some significant progress towards democratization in recent years.

Both the electoral politics and electoral process have undergone changes of paramount importance to corporate governance reforms. Callahan (2000) reports that election in many Asian countries often requires huge amount of resources because of the widespread practices of vote-buying. If this holds true, then increased electoral competition resulting from democratization may reinforces the family dominance in economy, as families are best poised to supply with the much needed resources to the system—money, network and politicians. In addition, the involvement of family businesses in politics helps to solve the free-rider problem normally associated with the political contribution.

Party politics and electoral system in Thailand offer an interesting example. Most Thai parties are loosely structured groups of factions, and don't have the national network, and as a result, there is no long tradition of mobilization and organization at the local level. Parties have to rely on vote-buying to obtain the support at the local level. In addition, because the cabinet position is awarded on the number of the Members of Parliament (MPs) a faction leader controls, MP-buying is also a widespread practice. During the 1996 general election, it is estimated that Bt 20-30 billion (Wingfield, 2002) were spent on the election (campaigning, vote-buying, MP-buying). On the other hand, however, Thai's parties don't have mass base and thus cannot depend on membership subscriptions for funding party campaign (Wingfield, 2002), and the chief mean for political parties to secure this level of funding is to through political patronage through their connection with the corporate sector. The vote-buying and party financing open the door for growing business participation. In 1992, 68% of the assemblymen were businesspeople. Callahan (2000) describes the nature of the growing business

participation and its relation to the politics: "political power allows them to firm up and expand their business activities, while income generated from business gives them access to business power."

The commercialization of Thai's electoral gives the edge to family conglomerates to use their economic strengths to advance their interests because their size gives them some comparative advantages in the competition for political power. On February 9, 2001, Thaksin Shinawatra, the richest man in Thailand, was appointed prime minister of Thailand. His party—Thai Rak Thai—a single party presenting the interests of business, won 41% of the votes. Commentators believe that with the direct access to power, the wealth will be even more concentrated in just a few families and "narrow rather than broadening opportunities in the Thai market place (*Far Eastern Economic Review* 4/1/2001)".

The rise of the Thai family conglomerates in the political arena may have been an extraordinary case. However, money politics in Indonesia, Malaysia, and the Philippines have been well documented (Callahan, 2000; Eklof, 2002; Gomez, 2002) and vote-buying has also been reported for Indonesia and the Philippines. Campaign financing provides an important venue for the family conglomerates to further their economic power by securing rent-seeking arrangements from politicians who demand financial contributions. Ironically, policies designed to roll back the state involvement in the economy, such as privatization and deregulation, have bred the "new rich" who are not to be outdone by the old ones as new group of family conglomerates have emerged from newly deregulated and privatized sectors in the region.

Quality of Regulatory Environment and Corruption

The corporate governance reform is a regulatory reform in nature, and just as any other type of regulatory reforms, the ability of the government to implement the rules and regulations will depend on the quality of regulatory environment. Table 8 shows the linkage between the quality of the regulatory environment and the compliance of corporate governance rules across Southeast Asia.

There are discrepancies between the rules and their implementations for all five countries with varying degrees. Malaysia has very tough corporate governance rules and regulations, but the enforcement is of very poor quality. The regulatory environment of the five countries measured by rule of law, the protection of property rights and competence of public officials are also of law quality, with the exception of Singapore, where all rankings are considerably higher than other Southeast Asia countries. It is clear that that regulatory environment is not up to the task to implement the corporate governance standards—which are low to start with in several countries—and that poor regulatory environment leads to poor quality of enforcement.

Theorists have postulated several explanations. La Porta et al. (1999) show that countries with poor legal and regulatory environment are likely to have concentrated ownership. This is because both the state and individual owners can enforce property rights, and enforcement by individual owners (in the form of concentrated ownership and family businesses) will gain more importance in the absence of effective enforcement by the state. Shleifer and Wolfenzon (2002) argue that the concentration of ownership becomes dominant as large shareholders cannot sell out in a low quality regulatory environment because becoming a diversified passive investor in other firms

is simply not a viable alternative. Morck and Yeung (2004) claim that family ownership and groups will become dominant choice of the institutional arrangements based on the theory of transaction costs: the transaction costs among family members and closely affiliated corporations will be lower, because they face a lower degree of information asymmetry problems. The last column in Table 8 shows the high level of concentration by family businesses does seem to correspond to the quality of regulatory environment.

Focusing the incentives of the corrupted officials, Morck and Yeung (2004) argue that family pyramids are preferable trading partners for corrupt politicians. Family firms are more likely to return past favors because of a longer continuity of management. Being involved with a few families instead of a large number of firms also could reduce the chances of being exposed because politicians only need to deal with only a few patriarchs. In addition, families controlling pyramids are more able to come up with side payments because they are able to pay by expropriating minority shareholders (Morck and Yeung, 2004).Given the importance of the global fight against corruption, our analysis shows that reducing the level of corruption can decrease a country's reliance on a small number of families and such benefits should be taken into considerations by the policy makers in designing the anti-corruption strategies.

The existence of widespread corruption would potentially undermines the efforts in toughening the rules on corporate information disclosure, because firms that comply with the regulations might find them in a weakened position when deal with the corrupt officials. The accurate information reported by the firms can be used by the corrupted officials for increased level of extortions. Root (2001) points out that business transparency may be dangerous in the poor quality regulatory environment because

firms that disclose profits can still be subject to arbitrary government audits and expropriations, and this forces the firms to internalized risks by maintaining a closed production system. In this case, firms might be discouraged to participate in the equity financing through listed in stock markets because of unreasonable high level of rules and standards.

Figure 2 shows the occurrence of bribery activities reported by firms in the five countries based the World Business Environment Survey. The levels of corruption faced by the firms in some Southeast Asian are astonishing: 68% of firms in Indonesia and 79% in Thailand pay bribes to public officials on a regular basis! The size of the bribe is often substantial. Findings from the 2001 Indonesia national survey show that 27% of businesses reported paying over 10% of their companies' total revenue as bribery. Smith notes that In Indonesia most bureaucrats took *pungli* payments ("informal tax) to supplement meager salaries, and the government expected this since it reduces the needs for more formal tax (Smith, 2001).

The important dynamic effects of the relationship between quality of regulatory environment and the various characteristics of the corporate governance structure should be paid sufficient attention. Claessens, Djankov and Lang (2000) discuss the possibility of the endogeneity of the legal systems, that is, the dominance of family business hampers the development of legal and regulatory environment as these firms have more resources to shape the government and they have vested interests in the continuation of the existing regulatory environment.

Conclusion: Policy Lessons for Corporate Governance Reforms in Southeast Asia

Our analysis of the linkage between political institutions and corporate governance offers several important policy lessons for designing and implementing corporate governance reforms in Southeast Asia. First of all, the policy makers in the region should consider the differences in political institutions before they commit to a comprehensive set of reform measures that might be promoted as universally desirable. Different countries face different challenges in corporate governance based on how their corporate governance system matches up with the prevailing political institutions, and thus would demand different set of solutions. Policies should be devised to reflect on the key features of the underlying political environment. Ignoring the relationship between political institutions and corporate governance significantly reduces the relevancy of the reform policies.

Second, governments should not commit to a set of comprehensive reform measures prematurely because much of the real progress might depend on what happens to firms' political environment. Firms' corporate governance practices are largely shaped by forces outside the corporate boardrooms. For example, there are little chance the adoption of international accounting standards would lead to high quality disclosure as long as both the firms and their political patrons have vested interests in defending the secrecy of the existing rent-seeking schemes critical for the survival for both. Tightening standards for listed firms prematurely can even backfire as firms contemplating equity financing may give up this option altogether if they are convinced that it is impossible to meet their these standards in the prevailing political environment.

Third, our analysis of the importance of political institutions doesn't mean that our choice set of reform measures are narrowed by any means. In fact, the scope of

effective measures for corporate governance can be broadened because a new set of instruments focusing on the firms' political environment may now be at disposal of the reformers. For example, reducing corruption might decrease the incentives for the family conglomerates to further their territory. In addition, while the fundamental changes in the political changes take time and are often outside the scope the reformers, they can position themselves in anticipation of the arrival of favorable conditions. In many Southeast Asian countries, substantial changes in both political and economic institutions are taking place. Reformers should couple the strategies for good corporate governance principles with some changing characteristics in the political institutions. The recent surge of interests on political corruption, for example, offer important window of opportunity for make improvement in corporate governance issues such as bribery and information disclosure.

On the other hand, however, ignoring the linkage between political institutions and corporate governance might not only lead to the waste of otherwise golden opportunities, but also aggravate problems. The experiences in public sector reforms such as privatization and deregulation in Southeast Asian provide some important examples. For example, while the original intention of the deregulation is to undermine the state's regulatory discretion and to allow more competition in the marketplaces, what has happened in reality is the transfer of the public monopoly to the private hand which further strengthens the power of family conglomerates at the expense of weakened economy and risen inequality. It is crucial to put in place appropriate corporate governance structure to spearhead the process of public sector reforms in privatization and deregulation.

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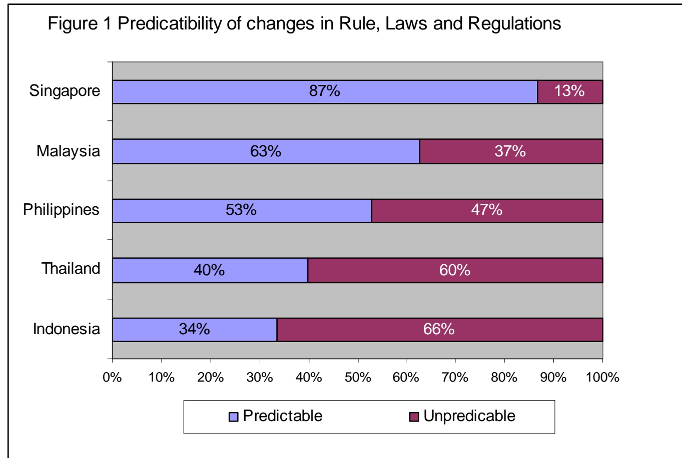
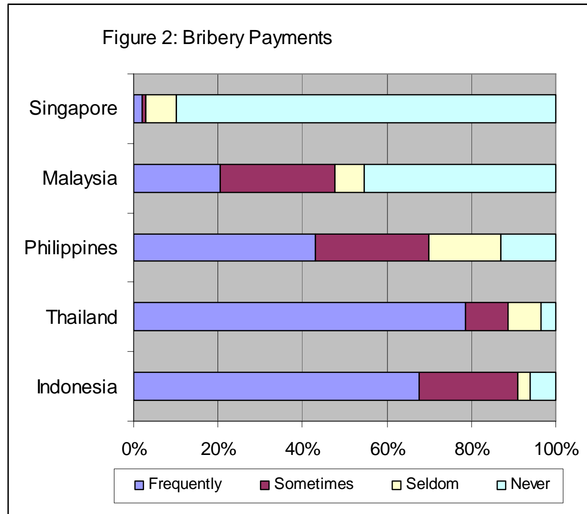


Data source: World Business Environment Survey, World Bank, 1999.



Data source: World Business Environment Survey, World Bank, 1999.

Table 1: Concentration of Ownership

	% of shares owned by the insiders*	% of shares owned by the largest top shareholder**	% of the shares owned by the largest five shareholders**
Indonesia	68%	48%	68%
Malaysia	50%	30%	59%
Philippines	55%	34%	60%
Singapore	55%	-	-
Thailand	45%	29%	57%
Japan	41%	-	-
Korea	29%	20%	39%

Data source:
*Himmelberg Charles P., R. Glenn Hubbard, and Inessa Love, *Investor protection, ownership, and investment*, Columbia University, 2000.
**Asian Development Bank, *Corporate Governance and Finance in East Asia*, 2001.

Table 2: Separation of Ownership and Control

	Ratio of Cash Flow to Voting Rights	Pyramids with Ultimate Owners	Cross Holdings	Management
Indonesia	0.784	67%	1%	85%
Malaysia	0.853	39%	15%	85%
Philippines	0.908	40%	7%	42%
Singapore	0.794	55%	16%	70%
Thailand	0.941	13%	1%	68%
Japan	0.602	36%	12%	37%
Korea	0.858	43%	9%	81%

Data source:
Claessens, Stijn, Simeon Djankov, and Larry H.P. Lang, The Separation of Ownership and Control in East Asian Corporations, *Journal of Financial Economics* 58 (2000) 81-112

Table 3: Control of the Public listed Companies

Country	Widely held	Family	State	Widely held financial	Widely held corporation
Indonesia	5%	72%	8%	2%	13%
Malaysia	10%	67%	13%	2%	7%
Philippines	19%	45%	2%	8%	27%
Singapore	5%	55%	24%	4%	12%
Thailand	7%	62%	8%	9%	15%
Japan	80%	10%	1%	7%	3%
Korea	43%	48%	2%	1%	6%

Data source:
Claessens, Stijn, Simeon Djankov, and Larry H.P. Lang, The Separation of Ownership and Control in East Asian Corporations, *Journal of Financial Economics* 58 (2000) 81-112

Table 4: Concentration of Family Control

	Average number of firms per family	% of total market capitalization that families		
		Top 1 family	Top 5 families	Top ten families
Indonesia	4.09	17%	41%	58%
Malaysia	1.97	7%	17%	25%
Philippines	2.68	17%	43%	53%
Singapore	1.26	6%	20%	27%
Thailand	1.68	9%	32%	46%
Japan	1.04	1%	2%	2%
Korea	2.07	11%	30%	27%

Data source:
Claessens, Stijn, Simeon Djankov, and Larry H.P. Lang, The Separation of Ownership and Control in East Asian Corporations, *Journal of Financial Economics* 58 (2000) 81-112

Table 5: CLSA Corporate Governance Ratings

	Discipline	Transparency	Independence	Accountability	Responsibility	Fairness	Social awareness
Indonesia	36	57	22	21	34	53	37
Malaysia	49	63	67	38	52	70	60
Philippines	41	44	46	34	36	41	78
Singapore	56	67	81	45	70	76	54
Thailand	36	65	43	63	47	70	65

Description of variables:
Discipline—management's commitment to emphasize shareholder value and financial discipline
Transparency—the ability of outsiders to access the true position of the a company
Independence—the board of director's independence of controlling shareholders and senior management
Accountability—the accountability of the management to the board of directors
Responsibility—the effectiveness of the board to take necessary measures in case of mismanagement
Fairness—the treatment of minority shareholders receive from majority shareholders and management
Social awareness—the company's emphasis on ethical and socially responsible behavior.

Data Source:
Credit Lyonnais Securities Asia (CLSA), 2001, *Saints & Sinners: Who's Got Religion?*

Table 6: Corporate Governance Rating and Share Price Performance

	Overall CG Score	5-year share price performance (%)
Indonesia	37	-61.4%
Malaysia	57	-40.1%
Philippines	44	-61.4%
Singapore	65	62.7%
Thailand	55	-41.9%

Data Source:
Credit Lyonnais Securities Asia (CLSA), 2001, *Saints & Sinners: Who's Got Religion?*

Table 7: Veto Power and Coalition

	Broad-deep coalition	Shallow-narrow coalition
Concentrated veto power	Decisive Policy stability Implementation *Singapore*	Decisive Policy volatility Lack of implementation *Philippines* *Indonesia* *Malaysia*
Dispersed veto power	Decisiveness of difficulties Policy stability *US*	Decisiveness difficulties Policy stability Lack of implementation *Thailand*

Source: Hicken, Allen and Bryron K. Ritchie, The Origin of Credibility Enhancing Institutions in Southeast Asia, 2003.

Table 8: Quality of Regulatory Environment and Compliance of CG Regulations

Country	Clear, transparent and comprehensive rules and regulations	Committed and effective enforcement of rules and regulations	Rule of Law (out of 10)	Property rights (rank out of 79 countries)	Competence of public officials (rank out of 79 countries)	Top ten families
Indonesia	4	2	4	63	48	58%
Malaysia	8	2	7	33	65	25%
Philippines	5	2	3	53	58	53%
Singapore	9	7	10	6	1	27%
Thailand	7	2	3	37	44	46%

Data source:
Credit Lyonnais Securities Asia (CLSA), 2001, *Saints & Sinners: Who's Got Religion?*
Global Competitiveness Report, 2001-2002