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OF THE MONETARY AUTHORITY OF SINGAPORE
AT THE SINGAPORE CORPORATE GOVERNANCE SEMINAR
AT THE SINGAPORE INTERNATIONAL CONVENTION
AND EXHIBITION CENTRE
ON FRIDAY, 25 JULY 1997 AT 9.00 AM**

It is my pleasure to address today's gathering of representatives from listed companies and experts in the financial industry.

PRINCIPLES OF CORPORATE GOVERNANCE

It is timely for the Stock Exchange of Singapore (SES) to organise a seminar on Corporate Governance in conjunction with the SES Investment Fair. In recent years, we have seen impressive growth in the stock markets in Singapore and around the region. Amidst such positive market developments, it is easy to overlook that the market's long-term success depends not only on investors' confidence in its structure and the regulatory framework, but also on the standard of corporate governance.

Before considering the importance and benefits of corporate governance to individual companies and the market in general, I would like to touch on some general principles of corporate governance.

The issue of corporate governance arose with the formation of joint stock companies and the resultant separation of ownership and management of these companies. In a modern corporation, shareholders who own the company usually employ professional managers to run the business on their behalf. The managers therefore enjoy a fair amount of discretion in their day-to-day management of the company as it is impossible to dictate the managers' actions in all circumstances. Such delegation of control from shareholders to managers may give rise to principal-agent conflicts when the interests of shareholders and managers diverge. While shareholders aim to maximise equity value, managers may have other concerns such as their own remuneration, perquisites and job security.

Corporate governance is hence concerned with maintaining an efficient balance between the need for managers to have enough flexibility to run the company effectively and their accountability to shareholders. Such a balance will ensure that managers act in the best interest of all shareholders and are properly rewarded for their conscientious stewardship of the company.

In mature markets such as the US and UK, the corporate governance process emphasises full disclosure of information to shareholders for them to assess the management's decisions and performance. The threat of hostile take-overs also serves as a deterrent against management's acting to the disadvantage of the shareholders of a company. This market discipline works in the US and

UK for four reasons: a dispersed shareholding structure; sophisticated shareholders and investment analysts community; a high proportion of institutional shareholders who can exert pressure on the management; and the threat of class action against the management.

In Singapore and other markets in this region, such a market mechanism is yet to be fully entrenched, Indeed, many listed companies in Singapore and the region are family-owned businesses. In these companies, the major shareholders are often also directors and managers. These owner-directors find themselves in situations where their interests as majority shareholders may conflict with the interests of other stakeholders in their companies. The risk is that such owner-directors will run the companies like their own family businesses without regard to the interest of minority shareholders.

Given this characteristics of the emerging markets, the focus of corporate governance would be different from that of the well-developed ones in the US and UK. It would have to be more concerned with the possible conflict of interest of the large shareholders and the probity of related-party transactions. Hence, to achieve the right balance of corporate governance in this context means that every party, be they directors, shareholders, or auditors, must play a part.

As stewards of their companies, directors must ensure that their companies are managed in the best interests of shareholders and keep shareholders informed of material developments.

Non-executive directors are needed on the board of directors to infuse objective views on the actions taken by controlling shareholders and senior management. To discharge this role effectively, non-executive directors must be sufficiently independent of their companies, the major shareholders and management. They also need sound business judgement and a clear understanding of their companies' businesses.

One of the most important external monitoring mechanisms to ensure sound corporate governance is the external auditing of a company. Auditors, appointed by shareholders of the company, have the responsibility to verify the reliability and fairness of the financial statements prepared by management. By upholding and updating accounting standards, the accounting community can narrow the scope for errant accountants to window-dress accounts, and ensure that new financial risks are properly quantified and disclosed. In some jurisdictions, auditors have the duty to report any incident of fraud discovered in the course of their audit to the authorities.

Institutional and individual investors, too, have a role to play. Retail shareholders should find out more about the companies in which they invest. This will help them make informed decisions when transacting in the companies' shares or when voting at general meetings. Institutions, in their role as investors, should use their expertise to monitor the management and businesses of the companies they invest in. They have an added advantage: their sizeable shareholdings allow them to exert more influence on management.

The stock exchange can promote good corporate governance among listed companies by setting proper listing and disclosure requirement. Through enforcing these rules fairly and firmly, the stock exchange can secure investors' confidence in the bourse. Some may argue that such rules are unnecessary as our corporate legislation already imposes fiduciary duties on directors. While the threat of prosecution is an effective deterrent, the rules on corporate governance are meant to be preventive measures to ensure that management problems do not fester. It is cold comfort to shareholders who have lost their investments in the company to know that those guilty have been prosecuted under the law.

CORPORATE GOVERNANCE AND MARKET DEVELOPMENT

There exists a misguided view that proper corporate governance burdens companies, stifles enterprise and scares off potential users of the capital markets. On this premise, it has been suggested that guidelines for corporate governance should be kept to a minimum.

Such detractors cite the costs of maintaining adequate monitoring mechanisms, but they fail to recognise the importance of good corporate governance. First, proper procedures help directors to manage their companies' operations. Rogue traders at NatWest and Sumitomo could not have covered up their huge losses for so long had better internal controls been in place. Corporate frauds such as Bre-X further emphasises the huge cost to investors as a result of the breakdown in corporate governance.

Second, companies with high standards of corporate governance are more likely to win investors' confidence and be able to raise funds from the market at lower cost. In contrast, poor corporate governance could cause scandals, financial losses and companies to collapse. Investors would demand a higher rate of return for assuming such risks. This would increase the financing cost of companies with poor corporate governance. As the number of listed companies increase, investors will be more selective in their investment and will shun companies with lax governance. Such companies will find it increasingly difficult and costly to tap funds from the market.

Third, a high standard of corporate governance instills confidence in the company's management. Shareholders will feel secure that the management has acted in their best interest. In turn, the managers will benefit as shareholders will be prepared to reward them accordingly. Even when market conditions are poor, managers with a reputation for good corporate governance are likely to garner shareholders' support for their business proposals and cash calls.

A high standard of corporate governance is also essential for gaining foreign investors' confidence. Many developing countries in Asia rely on foreign capital inflows to finance their economic development. Financial scandals and incidents of corporate collapse will undermine investors' confidence in a market. Investors avoid markets which pose such risks, and economic growth will suffer.

Good corporate governance has become more vital to our market as a result of two recent trends. First, the expansion and regionalisation of many companies listed on the SES have made the task of managing these corporations more complex and demanding. Unless a system of good corporate governance is in place, unscrupulous employees can exploit control weaknesses in their companies to enrich themselves at the shareholders' expense.

Second, our financial markets now have a more international outlook. At the moment, 36 companies listed on the SES are foreign-incorporated. These firms hail from legal and regulatory environments which differ from Singapore's.

To maintain the integrity of our market, both domestic and foreign firms must have a common high standards of corporate governance.

RECENT DEVELOPMENTS

I would now like to touch on some recent developments in Singapore.

In Singapore, the stock exchange focuses on ensuring timely and fair disclosure, and preventing directors and controlling shareholders from using their influence to their personal advantage. The SES has continually fine-tuned its listing rules to encourage listed firms to set up self-regulatory mechanisms. These mechanisms promote good corporate governance without the SES having to intrude excessively into the companies' affairs.

Two new chapters in the SES Listing Manual were introduced last year: Chapters 9A and 9B. Chapter 9A streamlines supervision of listed companies' transactions with their substantial shareholders and directors. Instead of requiring all dealing between listed companies and their major shareholders and directors to be subject to the approval of minority shareholders, Chapter 9A sets two materiality thresholds: only substantial transactions which lie above the higher threshold require shareholders' approval. With the materiality thresholds set at appropriate levels, the SES has removed the need for companies to convene general meetings to approve immaterial transactions. The new guidelines are also more transparent than the old ones.

Chapter 9A is based on the principle which I discussed earlier, that is, to balance the commercial flexibility which the managers of listed companies require and their accountability to shareholders. This is achieved by allowing immaterial related-party transactions to be considered by the board of directors and focusing shareholders' attention on significant ones.

With greater flexibility accorded to the management of listed companies, it has become essential for listed companies to enhance their self-monitoring mechanism. The Audit Committee is an important part of such a mechanism. Hence, Chapter 9B was introduced to provide guidelines for the appointment of independent directors to Audit Committees and to give Audit Committees a greater role in monitoring related-party transactions of listed companies.

The new Chapter also recognises the role of shareholders in deciding the appointment of independent directors. Chapter 9B requires the board to identify those directors who will sit on the Audit Committee as independent directors before shareholders elect the board at the general meeting. Previously such appointments were decided solely by the board. The new guideline enhances the transparency of the process by which Audit Committee members are appointed.

Chapter 9B establishes the audit committee as an independent voice within the board of directors. It can commission and examine the findings of internal reviews. Any suspected fraud or irregularity will be reported to the board of directors, and if no satisfactory measure is taken by management, directly to the SES. This facilitates early detection and prompt rectification of any irregularity which might have an adverse impact on the listed company's financial position.

I note that Chapter 9B has met with some initial resistance from listed companies. The SES has since obtained feedback from listed companies and will fine-tune the guidelines to ensure that they do not impair the proper management of listed companies. I would like to correct the mis-impression among some managers of listed companies that the SES guidelines would curtail the business discretion of listed companies or create an adversarial relationship between management and shareholders. The aim of the guidelines is in fact to enhance shareholders' trust and confidence in the management as they will be assured that the management has put in place mechanisms which will protect shareholders' interest.

The SES recognises that no amount of regulation can prevent deliberate fraud. The main purpose of the measures taken by the SES is to inculcate an attitude of public accountability by directors of public listed companies. Shareholders, individuals and institutions alike must also realise that ultimately the company belongs to them and they must exert their rights under the law to ensure that their company is managed properly. In the long run, it is this spirit of public accountability by directors and the market discipline exerted by vigilant shareholders that will underpin the sound development of the securities market.

I would like to conclude by pointing out that the standard of corporate governance is not a localised issue. To remain as an attractive market for international investors and thereby sustain rapid economic growth in the whole East Asian region, there must be good corporate governance throughout the region.

Amidst the rapid expansion of the region's capital markets, there is a temptation to relax standards of corporate governance to spearhead further development of our markets. If we do so, standards will fall and the risk of investing in the region, increase. In the long run, the region will lose its investment rating and attraction among foreign investors. Investor confidence is a scarce commodity; once lost, it will not be easily revived. In contrast, if we build on a basis of good corporate governance our markets will rise in standing and be able to attract more foreign capital inflows. These will then provide the impetus for continued economic growth in the region.

Developments in other mature markets have shown that corporate governance is an evolving process. As a market matures, domestic and foreign investors will demand greater transparency and accountability by the management. Companies and markets alike should realise that refusing to enhance their standard of corporate governance would be detrimental to them in the long run.

On this note, I wish you all a productive and interesting seminar.

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