Good code, pity about the governance culture

Corporate Governance Council misses the chance to promote major transformation

By MAO YEN TEEN

Here is how much to commend in the final recommendations of the Corporate Governance Council on proposed revisions to the Code of Corporate Governance. It is pleasing to see that the council has retained most of its initial recommendations, including extending the definition of independence to include independence from substantial shareholders, increasing the proportion of independent directors in certain circumstances, and disclosure of remuneration of each individual director and the CEO.

Reforms of corporate governance are always subject to resistance from vested interests. The greater impact that a proposed reform will have on boards and companies, the greater will be the resistance. However, it is often precisely those strongly resisted reforms that are needed to create a step-change in corporate governance, as opposed to a gradual change, and to transform the corporate governance culture in companies. In my view, the failure to adopt strongly resisted reforms explains why systemic failures in corporate governance still occur throughout the world after years of so-called reforms in corporate governance.

It is therefore disappointing to see the council shy away from tougher guidelines which would have led to more transformational change in our corporate governance culture. Regulators have often cited our top ranking in the Asian Corporate Governance Association’s Corporate Governance Watch 2010, while ignoring the fact that the same report indicates that corporate governance culture remains our weakest link—scoring only 35 out of 100.

By sticking to the habit of being more strongly on the security of independent directors, number of directorships, and conflicts of interest relating to business relationships, and giving a stronger push to board renew- al, the council may have lost an opportunity to promote a transformation of our corporate governance culture.

The council has decided to water down the recommendation on the nine-year limit on independent directors by removing this from the criteria relating to independence. It has instead recommended that a "particularly rigorous review" for directors who have served more than nine years and for the board to explain why a director should still be considered independent after nine years. While many jurisdictions, including the UK and Australia, do allow independent directors to have longer tenure if the company explains it, it is rare for companies to explain the flexibility accorded by the "comply or explain" approach, especially when it comes to tenure of independent directors. Active institutional shareholder activism and intense media scrutiny help explain why this is so.

Unfortunately, in Singapore, companies do often tend to adopt an overly technical approach to implementing the code, by using the guidelines as the "ceiling". In their minds, these guidelines are meant to reflect "best practices" and there is little reason to do better than those "best practices". Indeed, some are using a prescriptive approach to independence, by getting a legal opinion to support the continuing committee’s determination of independence, when "independent director" is not a legal concept.

This brings me to the council’s reluctance to recommend specific limits on number of directorships. Some have consistently stated that the small number of directorships that currently sit on multiple boards, but have avoided the statistic that these small number of directorships are already outweighed in many companies by not putting specific limits, it will again allow boards following a technical approach to point to the fact that any limit is acceptable because no limit is specified in the code.

It is disappointing that the council did not see fit to consult on whether the code should state specific limits on number of directorships in the guidelines in which many have expressed the view over the past few years that specific limits are needed. By not consulting on whether the code should include specific limits, but only consulting on a recommendation that boards themselves set the limits and disclose them, it would have been difficult for the council to now recommend specific limits. As the council has noted, some respondents have advocated that the code include specific limits.

Conflicts of interest

Finally, on the guidelines on independence pertaining to business relationships, the council could also have done more. While it is true that business relationships will in some cases engender conflicts of interest, these relationships have not been dealt with in any meaningful way by the council. Conflicts of interest are often the result of a company's lack of independence and need to be addressed in that context, not simply as a separate issue.

Overall, my biggest worry is that while the revised code may help to maintain our high corporate governance ranking and even improve it, our corporate governance culture, implementation and enforcement will remain weak. I fear that complacency and self-delusion will in the longer term come back to haunt us.

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