



Taiwan has been rocked by recent financial scandals. But the fallout has resulted in a strengthening of corporate governance measures.

BY NATHAN KAISER

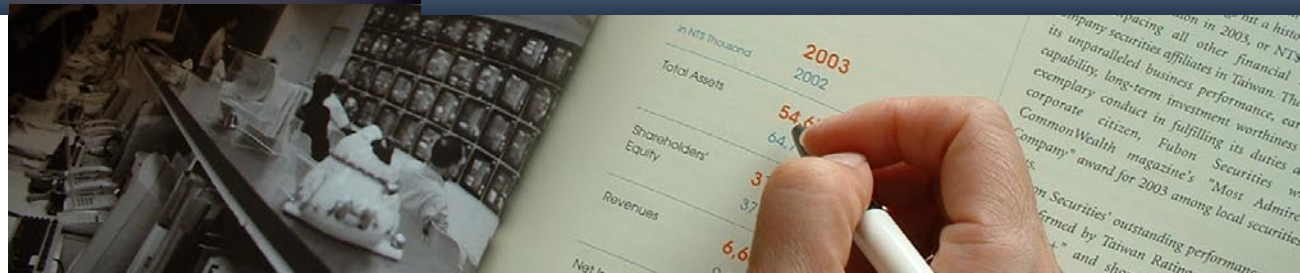
# Cleaning up

CORPORATE GOVERNANCE has been a buzzword for many years around the globe and Taiwan is no exception. Although discussions focusing on corporate governance often seem less fierce in Taiwan particularly when compared with the US and Europe. But still it matters. And so let's take a brief look at why this is so and what the current state of the principal issues surrounding corporate governance are in Taiwan.

Over the past two decades, in line with other Asian markets, the trend of ownership structures has moved steadily from family-owned businesses to those representing more widespread ownership. This change has meant an increase in the problem of agency – whereby ownership and management are in separate hands. Such separation can be seen, for example, within the Rebar Group, in which management control often remains with the original founders (and exacerbates an already perilous problem).

Coupled with changing ownership structures has been a raft of new developments in the Taiwan stock market due to recent upgrades made by international rating companies. This has led to massive increases of foreign shareholdings. Compared with the average individual and arguably corporate domestic investor, foreign shareholders are both more active and have the resources to back up such shareholder activism.

Alongside this equity-related development, debt also has a place in driving corporate governance practices forward. Gone are the days when international banks issued bonds for US\$20 million for some shady steel company in Kaohsiung, whereby the same bonds would shortly thereafter be qualified as 'wallpaper' (worthless) by local financial analysts. Instead, Taiwan now has an unprecedented level of foreign players entering the banking scene.



This recent flow of international players has invested in and taken over some of the local banks that seemed ripe for the picking for many years. This foreign investment in the financial sector in turn leads to an increase in the levels of corporate governance among local banks since their clients and corporate borrowers will demand a higher level of good working practices. Of course, the new foreign shareholders will enforce their own high home standards with a minimum of delay, raising the bar on standards.

Last year, it looked like corporate governance practices took a back seat in the pursuit of profit. The 41, or thereabouts, local Taiwan banks suffered at the hands of the 'credit crunch' ('crunch' here meaning the revenue crunch after write-offs and reduction in interests earned). The fallout from this though has been positive with banks and their clients taking a hard-line on corporate governance practices. The recent impressive maintenance and lowering of non-performing loan ratios in the banking sector is testimony to stronger management standards.

Corporate governance has also become an issue within government-owned businesses, and other entities with a government stake. As long as political bickering can be kept to the sidelines management will have a clearer path to improving and raising the level of governance. However, struggles between professional managers, civil servants, government and stakeholders will continue for the foreseeable future. An example of this was Chunghwa Telecom's protracted privatization and the changing of the Taiwan Post's company name.

But a possible boon for further improvement in corporate governance within Tai-

wan may come from an unexpected new institutional investor on the block: Taiwan's own massive pension fund.

However, an investment limit in local stock market shares is set at around 20% for the government pension fund because local corporate governance realities may well have spooked the government, which is keen to avoid any investment mishaps.

But could we soon expect a US CalPERS-style corporate governance requirement from the Taiwan pension fund and its investment commission? Only time will tell, but in view of the enormous amounts of cash it is holding, the impact could be substantial with regards to improving corporate governance standards. Pension funds from the US and Europe have managed to flex their muscles through their shareholdings of companies to ensure financial books are as transparent as possible.

Still, the framework of Taiwan's written law bodes well for the composition and functionality of the board of directors, a key element of 'good' corporate governance. This includes such crucial elements as Taiwan's listing rules requiring independent directors; and the Company Law based on the German two-tiered (dualistic) board structure – including a supervisory board on top of the board of directors.

The former is an effective reflection of the growing awareness of corporate governance principles – crucial for Taiwan's national competitiveness. As for putting the law into practice, while in the past the lion's share of responsibility was borne by the chairman in Taiwan, it can be observed that fellow board members have come to shoulder a greater portion of the responsibility in acquiescence to the principle of

board liability as stipulated in article 193 of the Company Law.

As for the protection of voting rights (i.e. protection of minority shareholders), Taiwan continues to see lively shareholder fights for board seats and consequently for management control. While the Company Law does offer some minimal rights of representation for minority shareholders within the board, it has been said that current listing rules, and more precisely its de-listing requirements, are a possible tool for a board to de-list a company against the will and notably against the economic interests of minority shareholders.

Remedies such as delisting thresholds implemented by the Hong Kong Stock Exchange as a result of successful shareholder activism are worth highlighting. But this kind of action is still frowned upon in Taiwan, largely defended by the somewhat simplistic arguments that it is not necessary and the current safeguards are sufficient.

As far as communication and reporting are concerned, the catastrophic events of the Rebar Group scandal demonstrate that much remains to be done. It started with two Rebar subsidiaries 'unexpectedly' filing for bankruptcy protection where liabilities had grown to over US\$1.2 billion, seemingly without anyone noticing for years. The delay in notification of the bailout request by the management to the Taiwan Stock Exchange seems minor when compared to the question of the role of the boards of directors, the boards of supervisors, and possibly of external auditors with regard to the financial and communication holes.

But in view of the resulting NT\$50,000 fine for delayed notification, according to media reports, it becomes apparent that

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such notification obligations hardly need be placed high on the priority list when managing a troubled company.

The upside for corporate governance is that the impact of the group's fall has impressively shown the importance of reporting requirements and transparency within the tight network of cross-shareholdings, cross-credit, and cross-supply arrangements within corporate Taiwan. In the wake of the scandal corporate governance is now regarded not only as a matter to the small stakeholder or shareholder, but also to other larger players. Indeed, the list of companies directly affected by the fall of Rebar reads like a 'Who's Who' of corporate Taiwan.

Historically, the limits put in place on Taiwan companies in terms of capital investments or chip manufacturing in China have in fact been a challenge to good corporate governance. This is because commercial considerations have led some companies to disregard these limits in creative ways, thus foregoing regulatory compliance and transparency towards shareholders.

Management of companies circumventing Taiwan rules risk ruining the reputation of the company. They also run the risk of the authorities making an example out of them. For example, the case of semiconductor outfit UMC and its links to the China-domiciled Hejian has shown the growing assertion of power by Taiwan's authorities

and aggressive prosecutors.

Criminal investigations by prosecutors are one top-down approach to force companies, and more to the point, its directors and top-level management to implement stricter standards of corporate governance. But such heavy-handed approaches to corporate governance remain the exception.

But as long as Taiwan companies adopt good corporate governance measures, ensuring that managers, directors and shareholders also embrace the principles it will be good for business and investors. ■

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