

Opening Speech at Istanbul

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It is my great honor and pleasure today to make this opening speech on behalf of Asian Institute of Corporate Governance, and Professor Hasung Jang of Korea University. He asked me to deliver his sincere apology for missing this important occasion due to his duties as the dean of the business school of Korea University.

Given this opportunity, I would like to talk about the current issues in corporate governance in emerging economies and what we can do as scholars, policy makers or practitioners.

Corporate governance is relatively a new subject of interest in emerging economy countries, and the Asian financial crisis has awakened its importance as a measure for protecting the value of companies, and the stability of national economy and its financial system

It was a general consensus that one of the reasons for the Asian financial crisis is the poor corporate governance of local companies and financial institutions in those countries. Even though the financial crisis had been triggered by the failure of financial institutions to roll over their short-term debts in international money markets, the performance of companies who owed the debts to domestic financial institutions has been deteriorated ever since early 1990s, and we have the evidence that confirm the poor performance of local companies during the period.

Ever since the crisis, emerging economies have improved the corporate governance of their companies either by regulatory or legislative approaches. Despite the controversy on the effectiveness of the new laws and regulations, I am sure we have accomplished substantial improvement in the corporate governance of local companies.

An issue that we now have in emerging economies including Korea is on the role of financial institutions or institutional investors as shareholders in the corporate governance of local firms. Actually, this issue extends to the corporate governance of financial institutions themselves. We know that it is the institutional investors who have

the economic incentive to monitor corporate managers while minority shareholders tend to free ride in the issue of corporate governance. In emerging economies where relationship rather than rules prevails, and where awareness on shareholder rights is relatively weak, and where external control mechanisms such as mergers and acquisitions are not in action, it is very important to have active institutional investors as a monitor on corporate managers.

However, in the emerging economies, many financial institutions including securities companies and sometime even commercial banks are under the influence of industrial companies since they are owned by industrial companies or their controlling shareholders or they have business relationship. In Korea for example, major non-bank financial institutions are owned by industrial companies. As the manufacturing affiliates can provide business deals as well financial and human capital for the growth of their financial affiliates, those financial institutions belonging to industrial conglomerates command high market shares, and usually dominate other stand-alone financial institutions.

Other than the fair competition issue, one serious problem in terms of corporate

governance, when financial institutions are widely owned by industrial companies, is that money trusted by customers for investments in financial instruments can be exploited by financial institutions to protect the control of controlling shareholders of industrial companies. Since the leverage of the financial companies tends to be very high, and the capital requirement on asset management companies that manage mutual funds is minimal, the effect of the ownership of financial institutions on protecting the control rights of controlling family can be substantial. The controlling shareholders of industrial firms can be easily entrenched if he can control a financial institution either directly or indirectly through his affiliated companies.

In this context, it is my best guess that any country, where financial companies and industrial companies are connected by equity ownership, may experience a more volatile economic performance and more volatile asset price returns. One good example is the case of the U.S.A which suffered the great depression in 1929 and then separated the commerce and finance.

As the proportion of stock ownership by institutional investors increases with growing capital markets, the importance of institutional investors would take more importance in

the corporate governance of local companies. However, institutional investors in emerging economies have been very passive in exercising their monitoring roles. Shadow voting rule where institutional investors simply do not affect the results of any voting on agendas at shareholders' meetings was abolished only after the Asian financial crisis in Korea. Even though they are now allowed to vote, they are still passive in exercising their shareholder rights. The main reason is that they are either owned by industrial firms or have business relationship to take care of. They also do not understand the importance of corporate governance, and therefore the importance of exercising their shareholder rights.

In an empirical analysis, I found that the ownerships by foreign investors are positively correlated with corporate governance scores of sample firms, but institutional ownership shows no significance. Either they don't know what corporate governance is, or they have their own corporate governance problem. In another analysis on the effect of ownership structure on corporate financial decisions, I found that foreign ownerships matter, but institutional ownership is irrelevant.

As the capital market tends to get institutionalized, the role of institutional investors

would get more important in the future. In this regard, we may have to pay more attention to the corporate governance of financial institutions in emerging economies, in addition to our interest in the corporate governance of manufacturing companies.

We need to find better ways to render our institutional investors to monitor the managers on behalf of their customers. It can be done by the market or the investors who trust their money to them, or it can be done by regulatory intervention if investors are do not move. Only when our institutional investors awake, I think we will observe another stage of development in the corporate governance of emerging economies. I hope we scholars can also contribute to the development by our academic research or participation in the regulatory process.

Now, that was my short comments on the current issue in emerging market, and I would like to thank all of you again for making this conference already a big success, especially those of you who organized and made the conference possible. I sincerely hope all of you enjoy this historical city of Istanbul if you can find some extra moment. Thank you very much again for your patience.