

# Corporate Governance

## More than ticking the Box

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# CG – Does it Matter?

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- ❑ **Out-performance for stocks with high or rising CG**
- ❑ **In bear markets, periods of rising risk aversion, investors are less willing to take exposure to low CG companies**
- ❑ **Markets with high or improving CG - Russia, Korea - also outperformed**
- ❑ **Improving regulations & enforcement across markets – but commitment of corporates remains uncertain**

# CG issues – Asia is Different

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- ❑ **CG breaches in U.S often a function of agency-principal problem: managers are not shareholders**
- ❑ **In Asia the key is balancing interests of controlling shareholders against those of minorities**
- ❑ **Easier to install processes to check management; more difficult to check controlling shareholders**

# CLSA CG Scoring Methodology

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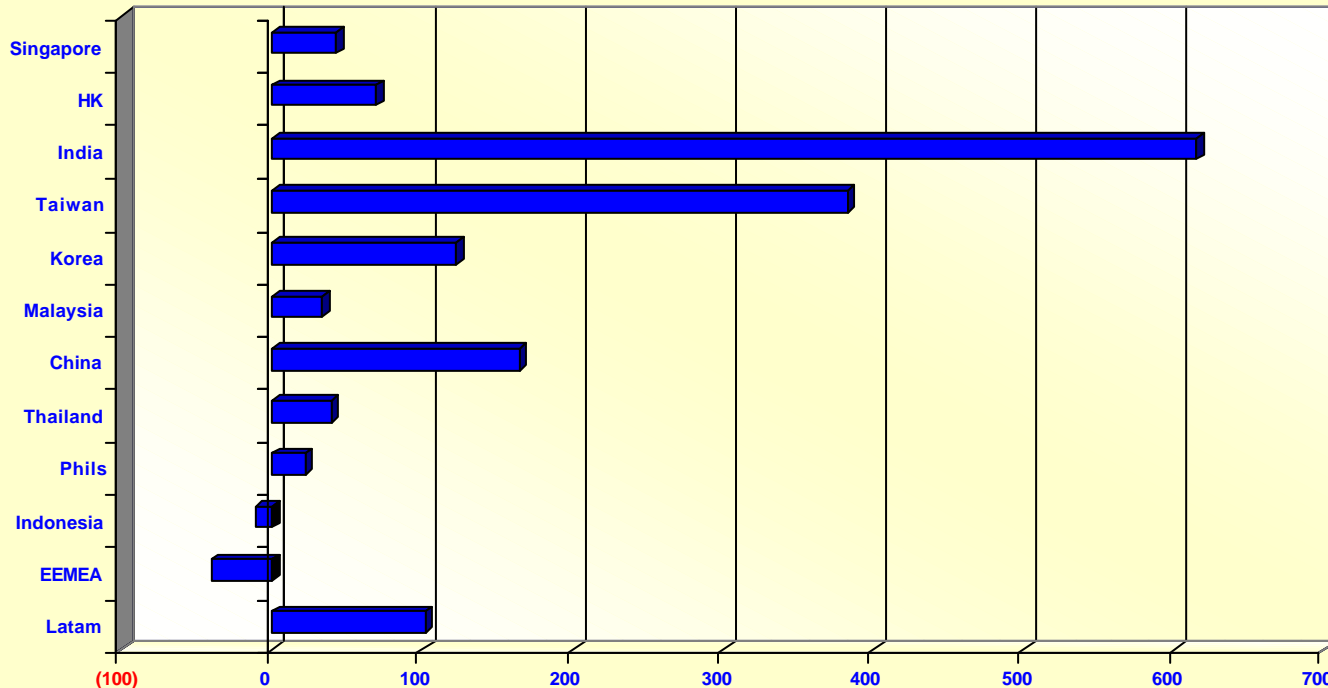
## 60 Questions covering 7 criteria

1. Discipline
2. Transparency
3. Independence
4. Accountability
5. Responsibility
6. Fairness
7. Social Awareness

## >500 companies across Asia scored

# Performance of top CG quartiles: 1996 - 2001

## Top CG quartile vs country index



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# CG correlation to stock performance

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- ❑ **Reflection of quality of management**

Hence better financial ratios

- ❑ **Investors not constrained to particular markets**

Need not buy best of a bad lot

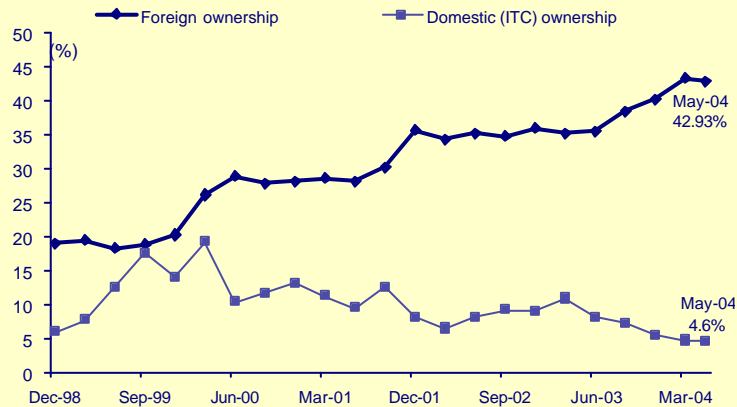
- ❑ **CG in itself becomes an investment criterion**

Asian crisis revealed fiasco's

Enron/ Parmalat - reminder of need for investor vigilance

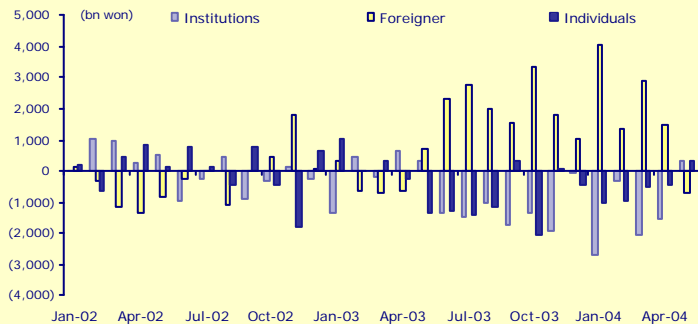
Cash returned to shareholders increasingly key benchmark

# Korean Equity market – Foreigners now own >40%



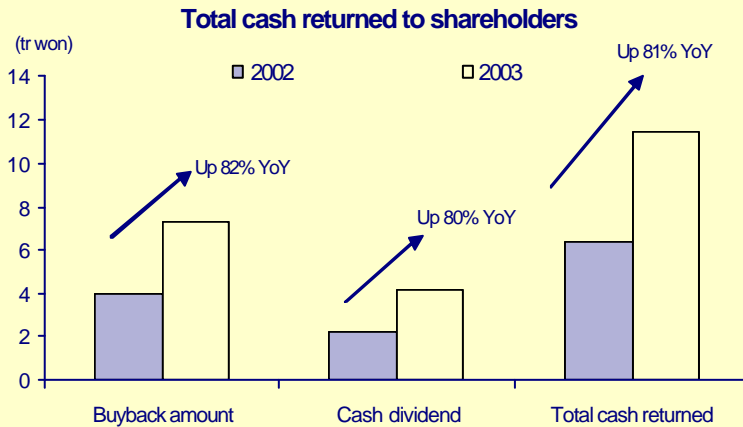
- Over \$20b of net buying in the past 12 months
- Meanwhile ITC equity ownership falls below 1998 levels
- Weight of foreign ownership beginning to act as catalyst for change

Kospi – net fund flows by investor



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# Rising cash IS returning to Korean shareholders



- ❑ For the top 50 companies, cash returned rose 81% in 2003
- ❑ This represented a jump in the payout ratio from 17% to >40%
- ❑ Large caps lead the way
- ❑ Buybacks will remain prominent whilst dividend taxation penalises majority shareholders

# Growing focus on corporate governance in Korea

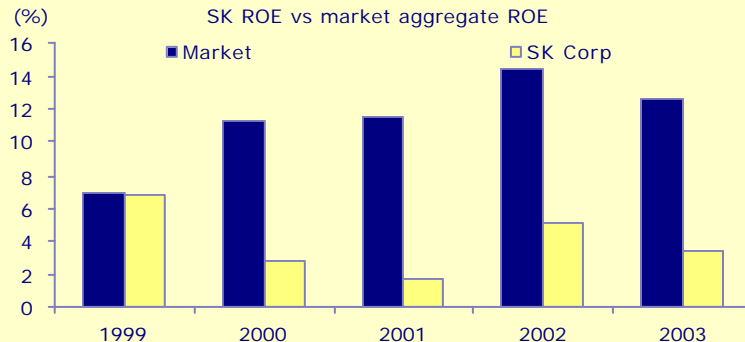
Shareholders of SK Corp	SK	Sovereign	Other
Known SK friendly	30.8	0.0	0.0
Known Sov friendly	0.0	43.3	0.0
Unknown allegiance			25.9
<b>Total</b>	<b>30.8</b>	<b>43.3</b>	<b>25.9</b>

Base-case forecast	SK	Sovereign	No vote
Known SK friendly	30.8	0.0	0.0
Known Sov friendly	0.0	43.3	0.0
Unknown allegiance	15.9	5.0	5.0
<b>Total</b>	<b>46.7</b>	<b>48.3</b>	<b>5.0</b>

☐ SK Corp AGM (March 12<sup>th</sup>) was a bellwether event to demonstrate the existence of a genuine market for corporate control – not yet.

☐ BUT a precedent has been set.

☐ Meanwhile a continuing increase in foreign ownership means the threat remains credible.



# SK Corporation – thin end of the wedge?

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- ❑ **The SK Corp case embodied much of what CG is about**
  - Lack of stewardship (a \$3bn hole in the balance sheet)
  - Lack of accountability (who does the “chaebol” report to?)
  - The inherent conflict of interest between controlling families and minority shareholders
  
- ❑ **The proposed chaebol reforms of the FTC, high foreign ownership & a lot of “hidden” value in various holding companies mean this will remain topical**

# CG a global issue, though, not Korean

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## ❑ Australia in the 1980's

Bond, Rothwells, Adelaide Steamship, State Banks of Vic/ S.A

## ❑ U.S post-Nasdaq bubble

Enron; Tyco; Worldcom...

## ❑ Europe not immune either

Parmalat; Shell

**Key to remember is CG abuses will prevail. Key for investors is to identify red flags - "Parmalat Smokescreen Test"**