Corporate Governance

# Better Policies for Board Nomination and Election in Asia

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BETTER POLICIES FOR BETTER LIVES

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# *Foreword*

Established in 1999, the OECD-Asian Roundtable on Corporate Governance serves as a regional forum for exchanging experiences and advancing the reform agenda on corporate governance while promoting awareness and use of the OECD Principles of Corporate Governance. The Roundtable brings together policy makers, practitioners and experts on corporate governance from the Asian region, OECD countries and relevant international organisations.

Following the endorsement of the OECD-Asian Roundtable report, *Reform Priorities in Asia: Taking Corporate Governance to a Higher Level* in 2011, participants decided to pursue further work on Priority 4 "to enhance a board nomination process that is transparent, with full disclosure about prospective board members, including their qualifications". The Roundtable agreed to establish a Task Force on Board Nomination and Election (Annex A), with representatives from securities regulators, stock exchanges, institutes of directors, board secretary associations among others.

Three sections comprise this report: 1) an overview of the current policy framework; 2) a summary of the challenges to establishing a formal and transparent board nomination and election process in Asia; and, 3) policy options to improve the transparency of the board nomination and election process in order to reinforce more effective boards.

The report is the result of extensive consultation, commentary and discussion by the Roundtable and its Task Force members. It benefitted from the OECD Peer Review on Board Nomination and Election (2012) and the OECD Principles of Corporate Governance.

The OECD is grateful to the Asian Roundtable on Corporate Governance and its Task Force members for its work in developing this report and, in particular, John Lim for his guidance throughout the process and valuable input from Grant Kirkpatrick, Anne Molyneux, Sidharta Utama and Yuen Teen Mak. Special recognition goes to the Government of Japan for their financial contribution as well as all institutions supporting the Roundtable. This report was prepared by Fianna Jurdant, Senior Policy Analyst in the Corporate Affairs Division headed by Mats Isaksson of the OECD Directorate for Financial and Enterprise Affairs.

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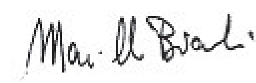
# *Preface*

This report proposes policy options for consideration by Asian Roundtable policy makers and practitioners as they seek to improve the transparency and effectiveness of the board nomination and election process in order to reinforce more effective boards. The report also provides an overview of the policy framework as well as highlights the challenges to establishing a formal and transparent board nomination and election process in Asia. It benefitted from the OECD Peer Review on Board Nomination and Election (2012) and the OECD Principles of Corporate Governance. The report is the result of extensive consultation, commentary and discussion by the Asian Roundtable and its Task Force members; it was broadly endorsed by the Asian Roundtable at its 15$^{th}$ meeting on 6 June 2013 in Kuala Lumpur, Malaysia.

We learned from the global financial crisis that corporate governance matters. Weak corporate governance practices have been identified as one of the causes of the crisis. Nomination and election of board members is one of the fundamental elements of a functioning corporate governance system around the world. Board effectiveness is now more important than ever, given the continued global economic slowdown and high profile corporate governance failures. Boards are operating in increasingly complex environments that demand new levels of commitment and engagement. Therefore, how directors are nominated and elected, the role of the board and shareholder participation in this process are critical to optimising the opportunities to have an effective board that adds real value to companies, shareholders and stakeholders.

The ownership structure of companies will have an impact on what is expected of the board and its role. In Asia, as in other parts of the world, many publicly listed companies are tightly controlled by a family group or the state. Under these conditions, a transparent and formal board nomination and election process may be a challenge. For example, the role of the board may focus on fulfilling specific roles, such as the oversight of conflicts of interest, including related party transactions, and the integrity of the accounting system, for example. Therefore, this report presents some policy options for consideration. While there may be a consensus on the general direction of these reforms, policymakers and practitioners need to adapt implementation to their specific jurisdictions.

The OECD Corporate Governance Committee, the standard setter on corporate governance, would like to express its appreciation to the members of the Asian Roundtable and its Task Force for committing to improved board nomination and election practices in Asia, as agreed in this report. The policy options identified will serve as a valuable reference, especially for other economies with concentrated ownership, and contribute to the future work of the Committee as well as the Asian Roundtable.



Marcello Bianchi, Chairman
OECD Corporate Governance Committee

# Executive Summary

## An effective board adds real value to the company

An efficient board can add real value to a company. The board is responsible for guiding corporate strategy, risk governance, monitoring the performance of management and achieving an adequate return for shareholders, while preventing conflicts of interest and balancing competing demands on the company. Consequently, the composition of the board is fundamental to a company's governance.

The board should be structured in such a way that it: has a proper understanding of, and competence to deal with, the current and emerging issues of the business, exercises independent objective judgment, encourages enhanced performance of the company and effectively reviews and challenges the performance of management. That is why it is so important to have well qualified, competent, committed and independent directors with diversity as a key ingredient to achieve board effectiveness. Studies show that a diverse board make-up can actually improve a company's bottom line.

Board effectiveness is now even more important than ever, given the global economic slowdown and high profile corporate governance failures. Boards are operating in an increasingly complex environment that demands new levels of commitment and engagement. Therefore, how directors are nominated and elected, the role of the board and shareholder participation in this process are important to optimizing the opportunities to have an effective board that adds real value to companies, shareholders and stakeholders.

However, almost by definition, boards of directors operate behind closed doors and outside of the public eye or investors. While the nature of confidential board deliberations makes it difficult to demand full transparency of board meetings, there needs to be trust and confidence in the proper functioning of the board. Uncertainty is bad for investment decisions.

Investor reactions during the recent global financial crisis have made the demand for improved boards even stronger. Shareholders rely on boards of directors to ensure that companies are managing their long term interests. It is difficult for shareholders to assess the performance of boards, and often, it is only when there are failures that attention is drawn to the fact that the board is not performing.

While the legal and regulatory framework as well as ‘comply or explain’ recommendations in codes can contribute to facilitating good board practices, the effectiveness of actual board behaviour cannot be mandated. The journey to more effective boards is not an easy one, especially in companies with a highly concentrated corporate ownership structure. It requires a concerted effort from many stakeholders to promote the business case that in the longer term, competent and effective boards, rather than compliant ones, are in the best interest of all shareholders, including controlling shareholders. An effective and transparent board nomination and election process is an essential and critical ingredient in this regard.

The election and nomination of board members should facilitate the formation of a board that is capable of performing the key board functions advocated in the OECD Principles of Corporate Governance. However, there is a big difference between *de jure* and *de facto* roles of the board. Evidence suggests that boards of controlled companies have little role in strategic functions and in appointing senior management, but they do frequently appear to be used in two key areas: monitoring and managing potential conflicts of interest such as related party transactions and ensuring the integrity of the corporation’s accounting and financial reporting systems. These are two areas where board nomination and election is especially important, staffing special board committees supported either by listing requirements or company law that define independence. However, special voting and nomination procedures, as exist in some countries, may need to be considered.

The board as a whole has a fiduciary responsibility to the company and to all shareholders including minority shareholders in fulfilling these duties. Following the recent financial crisis, a marked feature of several jurisdictions is a greater emphasis on minority protection and on objective independent judgment by the board which is related to board nomination and election (OECD, 2012). The manner in which board objectivity might be underpinned also depends on the ownership structure of the company. A dominant shareholder has considerable powers to appoint the board and the management. However, in this case, the board still has a fiduciary responsibility to the company and to all shareholders including minority shareholders.

**OECD Principles of Corporate Governance: Board nomination and election**

| ***OECD Principle*** | ***Focus*** | ***Rationale*** |
|---|---|---|
| *II.A.5* | *Shareholder rights* | Shareholders have a basic right to participate in the nomination of board members and to vote on and elect individual nominees |
| *II.C.3* | *Shareholder voting* | Effective shareholder participation in key corporate governance decisions, which includes the nomination and election of board members. The election of board members involves shareholders' voting on individual nominees or on different lists of nominees |
| *II.C.3 (Annotation)* | *Board* | The need for a nomination committee consisting mainly of independent board members to ensure compliance with specified nomination procedures and to support and organize the search for a qualified and balanced board |
| *II.C.3 (Annotation)* | *Disclosure* | The tasks, composition and working procedures of the nomination committee should be fully disclosed. Full disclosure of the nomination process and the professional experience and background of candidates is also necessary to enable an informed evaluation of the fairness of the nomination process and to allow well-versed assessment of the capability and suitability of the candidates |
| *II.C.4* | *Shareholder voting* | In order to participate effectively and vote in general shareholder meetings that include board member elections, shareholders should be able to vote either in person or in absentia. Therefore, voting by proxy should be accepted in general. Proxies are to vote in accordance with the command of the proxy holder, and disclosure is given in relation to how undirected proxies will vote. This principle further encourages the use of information technology in voting |
| *V.A.4* | *Disclosure* | The importance of disclosing information about the board selection process and board members' qualifications, including whether they are regarded as independent. The disclosure of the selection process, among others, include whether or not the process was open to a broad field of candidates, and this disclosure must be provided before any decision is made at a general shareholder meeting. Disclosure regarding the profiles of the nominated board members is important for effective shareholder |

| ***OECD Principle*** | ***Focus*** | ***Rationale*** |
|---|---|---|
| | | participation. Disclosure of the profiles of individual board members is also necessary to enable investors to evaluate their experience, qualifications and independence and to assess any potential conflicts of interest that might affect their judgment |
| *VI* | *Board* | A formal, proper, and transparent board nomination and election process is necessary to ensure that suitable board members are elected such that they are able to effectively fulfil their role and thus add value to the company |
| *VI.D.5* | *Board* | The board plays a key function in ensuring that a formal and transparent board nomination and election process is respected. The board or a nomination committee also plays a crucial role in searching for potential members for the board that possess the appropriate knowledge, competencies and expertise to complement the existing skills of the board. |

*Chapter 1*

# Policy options for improving board nomination and election in Asia

This chapter provides policy options to improve the transparency and effectiveness of the board nomination and election process in order to reinforce more effective boards in Asia. The measures include: ensuring a transparent, fair and formal board nomination and election process; empowering the nomination committee; facilitating the participation of all shareholders in the board nomination and election process; enhancing transparency and accountability of the board evaluation process as well as increasing the pool of qualified candidates to the board. An annotation under each proposed measure outlines the policy challenges in the board nomination and election process in Asia, in practice.

## Measures to improve the board nomination and election process in Asia

Responsible controlling owners, given the degree of their investment, typically have the incentive to monitor the company and/or management closely and carefully. While responsible controlling ownership can be a strength, there are also risks. These risks are commonly referred to as 'private benefits of control' that may put non-controlling shareholders at a disadvantage. This risk of misappropriation is a particular concern in markets with weak minority shareholder protection. That is why especially in this context, a more transparent and formal board nomination and election system is needed.

Even with 'real owners' there is a need to improve board quality. Board nomination and election is influenced by both formal processes and by the use of informal networks, this is common around the world. More recently, greater attention is focusing on the qualities of nominated candidates such as skills, independence and diversity that may be supported by the use of advisors and board evaluations. A key question is how are candidates with the desired qualifications and experience identified by those responsible for nominating candidates.

The traditional approach, such as in Asia, essentially revolves around information networks and personal acquaintances, especially of the controlling shareholders. Anecdotal evidence suggests that controlling owners often nominate friends, former colleagues, or relatives to the board regardless of their experience, qualifications or objectivity. Directors elected in this manner are likely to have a sense of loyalty to the controlling shareholder, potentially rubber stamping proposals, disregarding minority shareholder and broader company interests. Even where nomination committees exist, their objectivity and the transparency of the actual nomination and election process could be questionable as they are themselves nominated and elected by the controlling shareholder.

The ownership structure of companies will have an impact on what is expected of the board and its role. In some countries, such as South Korea and Indonesia, many companies are tightly controlled by a family group and this raises questions about the role of the board: does it appoint management and oversee strategy, often seen as the main board functions? In South Korea, this is often not the case, at least in the large company groups. The CEO, the management team and company strategy will often be determined by the group headquarters, with no or limited independent role for the listed subsidiary board. This is also the case in India. Under these conditions, board nomination and election may fulfil different roles, such as oversight of conflicts of interest, including related party transactions, and the integrity of the accounting system, for example.

Considering a broader set of skills and experience for directors, particularly financial industry experience and risk management expertise is increasingly perceived as important. Also, the following aspects are getting more attention in defining the strategy for board nomination and election (KPMG, 2012):

a) Leadership skills and industry experience of the board chairman;

b) Improving the robustness of the assessment of skills gaps on the board;

c) Improving the director search and nomination process, including people who are more likely to have different viewpoints and are willing to express them and improving diversity, especially gender diversity;

d) Improving the time commitment of directors;

e) Being more robust in reviewing independence of directors;

f) Paying greater attention to board succession planning and renewal, and to the long tenure of independent directors (ID);

g) Extending board and director performance evaluation to include Chairman and committee performance, and

h) Improving the board and director performance evaluation process, including the use of an external party as a facilitator.

Several measures can be suggested to improve board nomination and election in Asia. This report presents some policy options for consideration. While there may be a consensus about the direction of these reforms, policymakers and practitioners need to adapt implementation to their specific jurisdictions.

## *I. Ensure a transparent, fair and formal board nomination and election process*

- Introduce mandatory requirements for a transparent board nomination and election process; this should reduce the casual or ad-hoc approach to the process.

- Clarify board responsibilities, including the board's clear role in overseeing nomination of board members and key executives. In some economies currently this is not specified.
- Develop a clear policy at company-level on the disclosure of the nomination and election process. The policy needs to formulate the extent of the disclosure (e.g. detailing the steps of this process, including information about the nominated board member, such as qualifications, relationships to the controlling owners and management as well as number and identity of other boards they sit on) and determining the medium of disclosure (e.g. in the annual report, website). The steps, amongst others, could include:
  a) Determine the appropriate size, diversity and composition of the board;
  b) Request the nomination committee to provide a substantive assessment of the qualification and suitability of the nominees to sit on the board;
  c) Search for qualified candidates and selecting nominees;
  d) Provide the full board and shareholders' meeting with a final nominee list (depending on the jurisdiction).
- Further, it is essential that full information regarding candidates both for election and re-election to be made available to all shareholders well before the General Meeting of Shareholders (GMS) so that their suitability can be assessed. Candidates could be present to respond to questions and explain their motivation as well as qualifications. Going further, the nomination committee could be requested to explain their reasons for nominating candidates and the appropriateness of the candidates' qualifications in relation to the needs of the board and the company. This could minimise the nomination of unsuitable candidates. The media could be encouraged to publicise instances where candidates' suitability was challenged and provide balanced reports.

**Annotation**

As recommended by the OECD Principles of Corporate Governance and priority 4 of the 2011 Asian Roundtable on Corporate Governance report *Reform Priorities in Asia: taking corporate governance to a higher level*, the board nomination and election process should be transparent and include full information on the nominees, their qualities, number of other board seats and experience. Transparent and well-established procedures are especially important for family and state-controlled listed companies given that the nomination and election process may be more obscure as it is often based on informal relationships. In this regard, controlling shareholders may often play a dominant role in using their networks and in selecting candidates.

In practice, the process is mostly ad-hoc and informal. In some economies in the region, a formal nomination process is not required, is seen as being only partially disclosed and as the culture of secrecy is still common, companies are not pressured to follow a structured nomination process. The nomination and election processes of independent board members generally do not differ from those of other board members. Due diligence regarding the competence and qualifications of candidates is not perceived as being properly conducted. In addition, most companies in the region do not adequately disclose relevant information on board candidates or what other boards the candidates sit on before the shareholder meeting, although this is required in listing or other rules.

## *II. Empower the nomination committee*

- The national code on corporate governance or listing rules could provide guidance on the role, responsibility, and authority of the nomination committee (NC) in listed companies. In particular, to highlight the unique role of these committees in family-controlled and state-controlled firms. A NC plays an important role in reviewing the size, structure and composition of the board as well as its effectiveness and ultimately to recommend candidates that are appropriate for the company and the board to ensure it is balanced with the right people, skills and competencies.
- The NC could be chaired by an independent board member and consist mainly of independent board members to ensure transparency and accountability in carrying out specified nomination procedures, to support and organize the search for a qualified and balanced board. High levels of integrity and a strong reputation of the member is also important.
- The tasks, composition and working procedures of the NC should be fully disclosed. Full disclosure of the nomination process and the professional experience and background of candidates is also necessary to enable an informed evaluation of the fairness of the nomination process and to allow a well-versed assessment of the capability and suitability of the candidates.
- Disclosure ought to be made with regard to at least the following: the charter of the NC, the qualification of its members, and the activities of the committee in performing its duties. The activities

reported could include: the number and duration of meetings in the past year, the attendance rate of each member at the meetings, and how the committee carries out its tasks, including how many candidates are considered, shortlisted and interviewed.

**Annotation**

The Annotations of the OECD Principles specify that the means to a transparent and respected board nomination and election process includes mechanisms such as board nomination committees, identification of needed competencies and an open search process (OECD, 2004).

Until now, nomination committees have not been mandatory in all economies in Asia. Nonetheless, the formation of nomination committees has been addressed in almost all jurisdictions (OECD, 2011). Current regulations in China and the Philippines require the establishment of nomination committees, whereas in South Korea the requirement applies to the nomination of outside directors in listed companies worth more than US$1.7 billion. In Indonesia and Singapore, the central bank requires banks to establish a nomination committee; listing rules in Malaysia require the establishment of nomination committees comprising exclusively non-executive directors, whereas in Singapore (for listed companies) nomination committees are a "comply or explain" requirement. Other economies permit but do not require the formation of these committees.

In practice these committees are still not common in several economies. The lack of effective and independent nomination committees may exacerbate the possibility of a weak board nomination process. The proposed options above seek to enhance the effectiveness of the nomination committee.

## *III. Facilitate the participation of all shareholders in the board nomination and election process*

- Identify and implement policies so that shareholder meetings are not mere formalities but provide a legitimate platform for all shareholders to select and elect directors. For example, policies requiring information about the backgrounds of candidates as well as what other boards the candidates sit on to be provided to shareholders sufficiently in advance of the GMS or enable shareholders to vote for candidates individually instead of for a slate of candidates.

- Propose alternative ways or simply remove barriers to facilitate shareholders' communication so that they can discuss and evaluate candidates before the shareholders meeting. The policy can allow enough time for all shareholders to receive the list sufficiently in advance (at least 21 days before the GMS), allowing them to coordinate voting. The communication should not be hindered by rules on proxy solicitation or similar requirements.

- Encourage institutional investors to be more active in the board nomination and election process as well as more transparent in disclosing their voting policies. Lower the threshold to 1-2% of shareholdings in order to be able to nominate board members. Barriers that impede institutional investors to use their voting rights should be reduced, such as blocking of shares prior to GMS.

- The company should introduce a mechanism that allows sufficient time (e.g. three months) for shareholders to present nominees to the board/nomination committee. Another policy option is to require companies to disclose if company articles of association or by-laws provide minority shareholders a right to nominate and/or elect board members. This will depend on the country's legal and regulatory framework.

- Other means to increase shareholder participation in the GMS include: (a) improving disclosure of the meeting agenda, (b) organising the meeting in an easily accessible location and (c) more convenient voting mechanisms such as electronic voting.

- The procedure of voting by proxy can be made simpler, such as by not requiring the proxy to be notarised by a lawyer. Wider use of electronic voting should also be encouraged, given that many shareholders reside in various parts of the world.

- A shareholder association or similar body with the purpose of protecting shareholders' and especially minority shareholders' rights can help minority shareholders effectively pool their votes for specific candidates.

- Listing rules can be modified to require disclosure of all votes, for, against, abstention, on each director candidate so that the market can evaluate how shareholders have voted.

## Annotation

Across economies in Asia, shareholders have the right to nominate and elect board members. The election is conducted at the GMS, but evidence indicates a low participation of minority shareholders. The actual voting process can be a problem, in some jurisdictions elections might be by show of hands rather than polling.

Due to the concentrated ownership structure of most listed companies, minority shareholders are skeptical about the effectiveness of exercising their voting rights. In principle, cumulative voting enables shareholders to apply all of their voting shares to one candidate and thus increase the likelihood of a candidate being elected. However, in Asia cumulative voting is rarely practiced even if permitted. Although often recommended, it is no panacea since it presumes a high level of shareholder cooperation which is rare except in cases where there are several block holders (OECD, 2012 and OECD, 2011). To date, little is being done to encourage shareholder cooperation/communication in the board nomination and election process in Asia.

Therefore, while on paper board members are elected by all shareholders at the GMS, in practice the controlling shareholder determines the candidates for the board. The suggestions above seek to facilitate more active participation by all shareholders in the board nomination and election process.

## *IV. Enhance transparency and accountability of the board evaluation process*

- A well-established and transparent board evaluation process should be encouraged and disclosed. This will also help identify gaps and future needs of board succession planning. Board evaluation also includes the evaluation of committees.
- Encourage companies to publicly disclose whether or not a structured board evaluation has taken place. This will ensure accountability of the process and encourage companies to adopt a well-established board evaluation process, although information may need to be kept confidential for fear of competition or in response to some other reasonable argument.
- Codes, guidelines or listing rules can formulate and elaborate key steps in a structured board evaluation process that is consistent with good corporate governance principles. Good practices for board evaluation could be outlined, linked to board and director development programs, and reported at the GMS. This process may involve self-evaluation, including of individual board members, or peer reviews. Increasingly companies are using externally-facilitated board evaluations. This adds credibility to what is an internal process, and could feed into nomination committees as well as disclosed to shareholders, if so desired. A number of professional bodies in Asia are developing board evaluation tools.

**Annotation**

In Asia, a number of regulations and codes mandate some form of board evaluation but few require reporting of the evaluation results and process to the GMS. In practice, many companies do not disclose the board evaluation process. As a result, shareholders and stakeholders may not know if a board evaluation takes place.

## *V. Increase the pool of qualified candidates to the board*

- Widen the pool of qualified candidates by encouraging board diversity in the search process, in terms of global reach, professional expertise and gender. Work with professional search firms and associations to expand the scope of qualified candidates.
- Recommend that board members attend training programmes (internal or external to the company), and that a training budget is approved annually. This policy may also include induction/orientation programs for new board members, if needed. But caution should be taken that certification and training programmes do not lead to a creation of a closed "guild of directors" where only those who complete training may serve on the board.

**Annotation**

The supply of qualified candidates for boards in some countries in the region is relatively limited depending on each circumstance or company. A lack of a well-functioning market for board members makes it challenging for shareholders and boards to select board member candidates who fill the company's needs, especially those who are independent.

Diversity is not often considered when selecting and nominating candidates, this may reduce the effectiveness of the board and encourage 'group think'. Evidence underscores a need for boards to diversify across Asia, especially when so many companies are at a turning point. As Asia continues to rapidly grow and play a key role in the global economy, the most effective boards will be the ones that are international, with functional, sector and gender diversity (Korn/Ferry Institute, 2011).

*Chapter 2*

# The corporate governance policy landscape in Asia

This chapter provides an overview of the corporate governance policy landscape and challenges to establishing a formal and transparent board nomination and election process in Asia. In particular, it stipulates the specific ownership and control structures in the region. It also highlights the framework for boards, such as the role of the board, nomination committee and nomination of independent directors. Nomination, election and voting by shareholders is covered. Emphasis is given to the disclosure of the nomination and election process, including meeting notices, candidate information and information sharing mechanisms. Finally, the chapter reviews the selection, training and evaluation of board members.

## Corporate governance frameworks

Asian economies started their reforms in the area of corporate governance after the 1997 financial crisis and these have continued actively in recent years. Since then, corporate governance has come a long way in the region, particularly with regard to improvement in the legal and regulatory framework, such as updates to company and securities laws, regulations, listing rules and corporate governance codes. Hong Kong, China, Malaysia, Singapore, and India went through a full review of their Companies Act and proposed significant changes, some still pending approval in Parliament. Codes have been recently revised or are undergoing change, (e.g. Hong Kong, China, Singapore, Malaysia, Vietnam, India, and the Philippines).

Enforcement has also been stepped up. For example, Pakistan's SEC has gained more authority over issuing regulations, codes, and guidelines. The Chinese Securities Regulatory Commission set up an inspection division to deal with cross-regional cases and India set up a Serious Fraud Investigation Office (OECD, 2010). Malaysia has a more macro approach to changes in corporate governance and has introduced a five year blueprint, the first deliverable of which is a new corporate governance code (SC Malaysia, 2012).[1]

Investor-led surveys and other corporate governance scorecards show that as a whole, regulators have stepped up their efforts to achieve better corporate governance. Almost all jurisdictions in Asia show a state-driven, top-down style of corporate governance reform but developments at the company level still need to catch up and are underway (CLSA et al., 2011).

The Asian Roundtable on Corporate Governance reviewed thirteen economies in Asia in its White Paper on Corporate Governance in 2003 and agreed to six priorities for reform. This was updated in 2011 and a new report *Reform Priorities in Asia: taking corporate to a higher level* was adopted on a consensus-basis by the Asian Roundtable. The report reveals that the framework for board nomination and election relies in Asia, as elsewhere, on a mix of laws (Company Law, Securities Law, Banking law, Bankruptcy Law etc.), regulations (exchange regulations, Listing Rules, Disclosure Regulations, regulations for mergers and acquisitions) and best practice codes on corporate governance, mostly endorsed formally by either government, stock exchanges or regulators.

With regard to codes, there are different approaches in the thirteen economies reviewed in the report. Six countries apply codes on a 'comply or explain' basis; four allow application of the national code to be voluntary and three make all or some parts of the code mandatory. While it appears that the basic elements of a good corporate governance framework are in place, practices across the region vary (OECD, 2011). In some jurisdictions, flexibility in the application of the Code through the use of 'comply or explain' and voluntary mechanisms have sometimes led to many code requirements not widely implemented in practice.

## Ownership and control structures

Concentrated ownership of publicly traded companies is an economic reality for most emerging economies (Gourevitch, 2005). In Asia, some two-thirds of public corporations have a controlling shareholder (Khan 2003, Morck et al., 2005). Listed companies are typically controlled by shareholders owning the majority of the company's shares, above 50% in India and Singapore and approximately 50% in Hong Kong, Indonesia and Malaysia (Claessens and Yurtoglu, 2012).

Most controlled entities in Asia are family companies. One measure of their dominance in the region is family businesses as the percent of total listed companies with market capitalisation above USD 50 million (Table 2.1).

In some countries and entities, the state is the controlling shareholder, exercising its shareholder rights, including through central ownership entities (e.g. Khazanah Nasional in Malaysia, Temasek in Singapore, or State-owned Assets Supervision and Administration Commission in China). State ownership is more prevalent in some economies than others – for example in China, the state is still the dominate shareholder of the top 100 listed companies and is the largest shareholder in 84% of these companies (CASS, Center for Corporate Governance, 2012). Indeed there is an expectation that the state will exercise its ownership rights in the best interests of the company but that it should balance passive ownership and excessive intervention in company affairs. Challenges arise when the state appoints board members who have been or are civil servants (especially ministries) and who lack authority, background or interest to fulfil their responsibilities (OECD, 2011).

**Table 2.1. Family businesses in Asia, 2011**

| | |
|---|---|
| India | 67% |
| Philippines | 66% |
| Thailand | 66% |
| Singapore | 63% |
| Malaysia | 62% |
| Indonesia | 61% |
| Hong Kong, China | 62% |
| South Korea | 58% |
| Chinese Taipei | 35% |
| China | 13% |

Source: Credit Suisse, 2011 "Asian Family Businesses Report"

A third type of controlling shareholder is a company group where companies, some related through family ties, marriage or traditional business groupings, operate together in the board nomination and election process. An example where this is prevalent is in business groups in India and Thailand, amongst others. Claessens et al (2002) report that almost 70% of listed companies in their sample of nine East Asian economies are group affiliated.

This concentrated ownership structure presents opportunities and risks. Responsible majority owners, given the degree of their investment, typically have the incentive to monitor the company and/or management closely and carefully. Their voting power can allow them to intervene on a timely basis and forcefully if the company's performance is not up to standard. Controlling shareholders also have the incentive and power to implement strategic and management changes. Finally, controlling owners usually have a long-term investment horizon and more patience to consider the long-term strategy of the company.

While monitoring may be the strongest tangible advantage of a controlling shareholder, there are perhaps less visible ones. In family companies, anecdotal and empirical evidence suggests that strong value attachments to the long-term success of family companies over several generations can bring rewards. Values may breed trust, which can add to higher performance. Cultural factors are also important, linked to motivating an entrepreneurial spirit and long-term economic incentives, such as reputation. (Hofstetter, 2005)

Although controlling owners can potentially reduce some agency costs compared to companies with dispersed ownership, the same influence also creates other risks. These risks are commonly referred to as 'private benefits of control' that may put non-controlling shareholders at a disadvantage. This includes, for example, an insider extracting from the company assets, information and opportunities, at prices or conditions more favourable to them than in an arm's length transaction. It might also include making decisions that minority shareholders may not consider optimal but that controlling owners have the discretion to make in order to create value for them.

This risk of misappropriation is a particular concern in markets with weak minority shareholder protection. This potential problem may be even more acute in Asia, given that a large number of listed companies in Asia have pyramidal capital structures, which enables the control rights of the majority shareholders to exceed their cash-flow rights. This divergence creates an incentive for controlling shareholders to expropriate the wealth of minority shareholders, for example through abusive related party transactions.

Family-controlled firms generally are less likely to have nomination committees than other firms (Nowland, 2008). Family shareholders tend to dominate the boards of directors and have less independent members (Anderson and Reeb, 2004, Yeh and Woidtke in Chen et al. 2010). The nomination and election of board members therefore tends to revolve around personal relationships and acquaintances, often referred to as 'the old boy's network'. Given the predominance of controlling shareholders and concentrated ownership throughout Asia, in practice minority shareholders often feel powerless to influence the outcome of board elections (OECD, 2012).

## Frameworks for boards

Unitary board structures predominate in Asia; however China and Indonesia have dual board structures while Chinese Taipei allows companies to choose. Board structures are usually defined by Company Law and/or the individual company's Articles of Association. Occasionally board structure may be set through the adoption of a mandatory model charter. These instruments set the rules for the size of the board and any required representation on the board. Generally the minimum number of board members is set (mostly 2-3 board members) (OECD, 2011). There is more variation allowed regarding the maximum number of board members.

Laws, regulations and codes also generally set the requirements for a specified number or percentage of independent board members or board members of special institutions such as securities companies and banks. The number of boards an individual director may sit on is limited in some cases and not in others. The maximum number of board seats a director can sit on is often quite high (up to ten board memberships), and in an exceptional case the number of board memberships a director may hold is twenty five. The number of board memberships for outside or independent board members is much lower than these standard limits.

**Table 2.2. Rules and procedures for nominating board members in Asia**

| | |
|---|---|
| **Bangladesh** | Casual vacancy to be filled by the Board |
| **China** | Both Board of Directors and Shareholders can nominate candidates |
| **HK, China** | Board members are generally nominated by the Board of Directors. Shareholders can also nominate candidates. The Code recommends that companies establish a nomination committee. |
| **India** | Voluntary Guidelines for listed companies state that the nomination committee recommend candidates to the shareholders |
| **Indonesia** | There is no special procedure in the law. Only for banks, nomination committees propose candidates to the board. |
| **Malaysia** | The nomination committee is composed only of non-executives; a majority of them are independent. |
| **Pakistan** | The Companies Ordinance provides for the nomination of directors by the creditors and federal/provincial governments respectively on the board of any company. The code also contains provisions concerning nomination of boards of listed companies. |
| **Philippines** | Board nomination and election is done at the GMS. Independent directors are short-listed; none are allowed to be nominated at the GMS. |
| **Singapore** | The Code sets out that the board should establish a nominating committee to make recommendations to the board on all board appointments. |
| **Chinese Taipei** | BoD or any shareholder holding 1% or more of the outstanding shares may submit to the company in writing a roster of director candidates. The BoD or other authorised conveners of shareholders' meetings shall examine the data of each director candidate nominee. The processes of operation for examining the director candidates nominated shall be recorded in writing and such records shall be retained in the file for a period. The Code recommends that listed companies establish nomination committees. |
| **Thailand** | Board members are generally nominated by the BoD; shareholders can also nominate the candidates. The Code recommends that listed companies establish nomination committees. |
| **Vietnam** | Shareholders holding 10% of total shares can nominate candidates, BoDs or other shareholders can nominate candidates in case of insufficient nominees. |

Source: Reform Priorities in Asia: Taking Corporate Governance to a Higher Level (OECD, 2011).

Terms of office for board members are, in most cases, limited in codes or regulation to three years with the option for additional terms of three years. Regulatory frameworks permit staggered election terms, again in most cases (OECD, 2011). Given the voluntary nature and/or 'comply or explain' regimes of corporate governance codes, there is evidence of independent board members serving even longer terms (MWSG 2011). The minimum number of board meetings is usually stipulated and a minimum number of meetings required are generally four per year (OECD, 2011).

### *Role of the board*

The expected role of the board and shareholders in the nomination and election of board members is stated in the OECD Principles. Both groups have a part to play and the corporate governance framework should clearly specify key board duties and essential behavioural norms for board members. This is especially important in a controlled ownership environment, (OECD, 2012).

In controlled companies, the actual role of the board in board nomination is difficult to ascertain. For example, how are insiders actually chosen and nominated for the board and what is the role of the controlling shareholder in effectively nominating independent board members? For the largest companies, South Korea now requires a nomination committee of independent board members to nominate both “insider” and “outside” board members. The *de facto* arrangements are much harder to discern and are debated in many jurisdictions. More importantly, the arrangements in South Korea only cover 116 of their largest companies (along with similar requirements for 48 listed and 109 non-listed financial institutions), with few special arrangements for the remaining 1 600 listed companies with predominantly insider boards. (OECD, 2012)

In most economies, the board of directors (or supervisory board in the dual board system) may nominate candidates for board members to be elected at the GMS. For example, the board of directors and the supervisory board (in China) and the board of directors (in Thailand) have a right to nominate board members. In Pakistan, however, the board of directors does not nominate board members but merely fixes the number. In Hong Kong, China, Singapore and South Korea, if there is a nomination committee, then the committee is in charge of selecting and nominating candidates to be proposed to the board. In cases of a vacancy, usually the board can nominate any person eligible to be a board member until he/she is formally elected at the GMS (OECD, 2011).

There are, however, differences that may occur between the *de jure* requirement and the *de facto* situation. In the presence of controlling shareholders, effective application of the Principles may be difficult. For example, often in large company groups, the CEO, the management team and company strategy will be determined at group headquarters with limited or no independent role for the company's listed subsidiary board. This is the experience in South Korea and Indonesia and is likely to be more wide spread in Asia (OECD, 2012).

### *Nomination committee*

The board's nomination committee plays a key role in identifying potential members for the board with appropriate knowledge, competencies and expertise to complement the existing skills of the board. Its authority should be clearly established and its functions stated in a committee charter. Where there is a controlling shareholder, a nomination committee can help balance the nomination process and help to ensure a transparent and well-established nomination process takes place.

Nomination committees are often charged with specifying a profile of directors desirable for the board. They can be combined with a remuneration committee or corporate governance committee. In most jurisdictions, the establishment of independent nomination committees is recommended, but the situation with implementation varies among jurisdictions (Table 2.3).

The nomination committee is traditionally charged with leading the director identification and nomination process. In Europe, 80% of companies have a nomination committee (Heidrick, 2011), whereas only 56% of companies in Asia have nomination committees (Grant, 2007). Some jurisdictions in Asia (e.g. China, the Philippines and South Korea for large listed companies) require by law or regulation the establishment of a nomination committee (OECD, 2011) to manage the board nomination and election process. Other economies permit the establishment of nomination committees, without requiring them, and even encourage them in voluntary codes or guidance.

In the presence of controlling shareholders, it may be useful if nomination committees were led by and composed of independent board members. In Asia, 9% of listed companies have fully independent nomination committees (Grant, 2007), whereas 56% of nomination committees in European companies are composed of independent board members (Heidrick, 2011).

The implementation of the OECD Principles to have a formal and transparent nomination process is a challenge when insiders are selected to the board, and in some cases become members of a nomination committee and are subject to the influence of the controlling shareholder/s. South Korea requires a nomination committee of independents to nominate both insiders and outsiders to the board. However, *de facto* arrangements in the selection process are harder to understand. In this context a typical profile of existing board members is a starting point, with the goal of a stronger, challenging board as a counterweight to management and controlling shareholders.

**Table 2.3. Nomination committees in some OECD and FSB countries**

| | Establishment | Composition |
|---|---|---|
| **Australia** | Recommended<br>*Poorly implemented* | - at least 3 members<br>- a majority and the chair should be independent |
| **Belgium** | Recommended | - a majority shall be independent non-executive<br>- The chairman should be the chairman of the board or other non-executive director |
| **Canada** | Recommended<br>*Fully implemented* | - fully independent |
| **Czech Republic** | Recommended<br>*Poorly implemented* | - |
| **Finland** | Recommended[2]<br>*Partly implemented* | - a majority shall be independent<br>- the managing director or other executive may not be appointed |
| **France** | Recommended | - a majority of independent directors |
| **Germany** | Recommended | - composed exclusively of shareholder representatives |
| **Hungary** | Recommended<br>*Not implemented* | - at least 3 members<br>- a majority shall be independent |
| **Indonesia** | Recommended<br>*Poorly implemented* | - chaired by an independent member of supervisory board |
| **Italy** | Recommended[3]<br>*Poorly implemented* | - a majority of independent directors |
| **Japan** | **Required for one-tier board**[4] | - at least 3 directors<br>- a majority of outside directors |
| **South Korea** | **Required to establish outside director nomination committee for large firms**[5] | - a majority of outside directors |
| **Netherlands** | Recommended<br>*Partly implemented* | - a maximum of one member may not be independent |
| **Poland** | - | - |
| **Portugal** | Recommended<br>*Poorly implemented* | (Candidate for non-executive members shall be nominated so as to prevent interference by executive members) |
| **Singapore** | Recommended | - at least 3 directors<br>- a majority, including the chair, should be independent |

| | Establishment | Composition |
|---|---|---|
| | | - the lead independent director, if any, should be a member |
| **Slovenia** | Recommended | - composed of external members and the president of the supervisory board<br>- at least one member is an expert in company law<br>- at least one member is an expert in corporate governance |
| **Sweden** | Recommended<br>*Fully implemented* | - majority of the largest owners or representatives from these owners[6] |
| **Switzerland** | Recommended<br>*Fully implemented* | - |
| **Turkey** | (Required)[7] | - The chairman should be an independent director<br>- CEO or the general manager cannot be a member |
| **United States** | **Required for NYSE and Nasdaq listed companies** | - NYSE: all the members are independent<br>- Nasdaq: either a committee of independent directors or a decision made by a majority of independent directors in executive session |

KEY: Fully implemented (80-100%), partly implemented (50-100%), poorly implemented (10-50%), not implemented (0-10%).

Source: Responses to OECD Questionnaire, Peer Review on Board Nomination and Election, 2012.

### *Nomination of independent board members*

Dahya et al. found a positive and statistically significant relationship between firm value and the percentage of the board made up of board members not affiliated with the dominant shareholder (Dahya, J. et al 2006). Sung and Jin-Young 2011 found positive market responses to companies with strong independent board members as compared with 'friendly' boards. Indeed, several studies do find a strong connection between board composition and market valuation of emerging market companies (Table 6, Claessens and Yurtoglu, 2012) and indicate better firms are more likely to have more independent boards. Black et al. (2006) report that South Korean firms with 50% outside board members have higher Tobin's q (roughly 40% higher share price). The positive effects of board independence documented in South Korea suggest that where a substantial level of board independence is mandated, board independence can play an important role, especially where control mechanisms on insiders' self-dealing are weaker (Black et al, 2006 as quoted in Claessens and Yurtoglu, 2012).

A specific number or percentage of independent board members on the board is stipulated in most jurisdictions in Asia. The minimum usually is two or three independent board members or 1/3 of the board. The number of required independent board members does not seem to be related to the number of mandated board committees (OECD, 2011). More than 50% of the listed companies reviewed in India, Singapore, and South Korea have a majority of independent directors on the board, while 8% of companies in Chinese Taipei and the Philippines (CLSA, 2012). Malaysia recommends that where the chairman of the board is not independent, the board must comprise a majority of independent board members (Malaysia Corporate Governance Code, 2012). In China, at many state-owned enterprises, the government selects the chair, while internal board members are approved by the government body that supervises state-owned assets. Independent board members are selected by an independent nominating committee and approved by the full board (OECD, 2008).

Questions remain as to the real objectivity of independent board members where they are nominated by controlling shareholders (CFA Institute, 2010 and OECD, 2012). In family-owned companies, where there are three or more family members on the board, it is a valid concern whether the board can effectively exercise checks on management. Further, the notion of independent board members means little if the definition of 'independence' is not clear and robust. The OECD Principles state that independent board members should have the ability to exercise objective judgment on all board matters in the best interests of the company. Further they ought to be sufficiently independent from both management and controlling shareholders to guarantee that minority shareholders rights are not violated. In Asia, independence definitions could be refined and require independence from both controlling shareholders and management in addition to persons related by blood or marriage (OECD, 2011).

Most economies have a similar nomination process for all board members, without distinguishing independent board members, and for minority shareholder participation in the nomination process. The exception to this trend is South Korea and is worthy of study and consideration for wider application. Minority shareholders may nominate their own candidates for outside board members by proposing them to the outside board members' nomination committee. In South Korea, large firms with assets more than US$1.7billion are required to have an outside board members' nomination committee, 50% of which must be filled by outside board members (OECD, 2012). Shareholders whose voting shares exceed three percent cannot exercise their voting rights when voting for non-executive board members who will serve on the audit committee (OECD, 2011).

One mechanism to encourage minority shareholders' participation in the nomination and election of board members is to allow them to vote for independent board members in proportion to their share of ownership and without the votes of controlling shareholders. Italy adopted this mechanism in 2005 (see Box 2.1) and a similar approached is used in Chile. Israel also has special voting arrangements to facilitate participation by minority shareholders (OECD, 2012). In Asia, since 2006, Chinese Taipei requires mandatory nominations (through the board's initiatives and proposals by shareholders holding 1% and more) of candidates for independent directors of listed companies. However, nomination of candidates for other board members is optional for now. When the GMS holds director elections, all votes are cast together, but candidates for independent directors and regular directors appear on different slates. Votes for the two separate slates are separately tallied. A plurality voting system is followed for all votes, where candidates receiving the highest votes in each slate are elected.

### Box 2.1. Nominating and voting systems for independent directors: some examples of special procedures

**Italy**

Minority shareholders can nominate candidates to their own slate. At least one board member must be elected from the minority slate that received the largest number of votes and who is not linked in any way, even indirectly to the shareholders who presented or voted the list that came first by number of votes. Some companies such as privatised ones (must be a fifth of the board) have reserved a higher number of board places for the minority slate. Company by-laws establish the mechanisms according to which board seats are distributed among the slates presented. More often than not, companies grant a majority premium to the slate receiving the highest number of votes, which takes all board seats but the quota reserved for minorities (one seat). However, a few companies adopt a proportional multi-winner system where any slate takes a number of board seats proportional to the votes it received.

Attributing the votes a slate receives to individual candidates is commonly undertaken using the quotient method: the votes received by each candidate are the result of the ratio between the total number of votes received by the relevant slate and the ordinal number associated to the candidate (the first candidate receives the total number of the slate's votes; the second candidate receives one half of total slate's votes; the third candidate receives one third of total slate's votes, etc). The quotients resulting from these calculations are progressively attributed to the candidates and those with the highest quotients are appointed, with a possible exception in order to meet legal or regulatory requirements for board composition.

…/

**Israel**

The Companies Law provides specifically for the appointment to the board of at least two independent directors, including at least one "outside director" who must be both independent and have special qualifications, i.e. accounting or finance expertise. If one outside director with such expertise is already in place, other professional qualifications are also acceptable to be designated as an "outside director." To be classified either as independent or outside directors; they must also not possess any connection to the company or hold any position that gives rise to a conflict of interest, including economic or family relations to corporate management or major shareholders (OECD 2011). Outside directors play a crucial role in chairing the Audit Committee.

The 2011 Company Law amendments also increased the percentage of non-controlling shareholder votes required to appoint outside directors from one-third to at least half (or that the total number of votes opposing the appointment from among the non-controlling shareholders is less than 2 per cent of the total voting rights in the company). While these "majority of the minority" provisions apply to appointment of outside directors, independent directors do not require such minority shareholder approval, but they must meet the above described criteria for independence. Outside director elections are further facilitated by the fact that directors are elected individually, rather than as part of a slate. The controlling shareholder is also no longer able to prevent the appointment of an outside director for a further 3-year term, if a majority of minority shareholders approve the appointment. There must also be at least one independent director on all board sub-committees other than audit. (OECD, 2012)

**Chile**

The Chilean capital market is characterized by six large pension funds which are encouraged to work with other minority shareholders, particularly in relation to voting for independent directors. As each fund cannot hold more than 7 per cent of a company's equity, they are allowed by law to vote as a group to maximize the number of independent directors on the board: there is a cumulative voting system. To obtain the support of a pension fund, he or she must be included on a register maintained by the securities regulator. Those candidates have to satisfy the minimum standards in terms of academic qualifications, and inform of any conflict of interest with the company to which they are nominated. Pension funds are forbidden to vote for a candidate related to the main shareholders. The pension funds appear to be supported by other minority shareholders since they have elected one or two directors in 60-70 per cent of companies renewing their boards. (OECD, 2011b)

**Latin America**

Some jurisdictions establish cumulative voting as the default mode of voting but give companies the option to establish a regular voting mechanism. However, if companies do so, they need to guarantee the representation of minorities. For example, the Colombian stock market law allows companies to adopt any type of voting system as long as it increases the number of representatives of minority shareholders, such as by the largest remainder method. In Brazil and Mexico, regular voting is the norm even though cumulative voting is permitted. However, the vast majority of elections are for a slate of candidates rather than individuals. (OECD, 2011c)

Source: OECD Peer Review on Related Party Transactions and Minority Shareholder Protection, 2011

## Nomination, election and voting by shareholders

Around the world, there is a general practice that permits shareholders to nominate and elect candidates to the board – although it should be noted that such rights are not always exercised. Nonetheless, the mere right by shareholders to nominate board members can serve as a powerful incentive for boards and shareholders to engage more actively with each other regarding board composition and effectiveness. In Asia, the right of shareholders to nominate and elect board members is recommended by most codes or listing rules, and the election is conducted at the GMS. Minimum shareholdings are required for shareholders to be able to nominate candidates for the board in China, Hong Kong, China, Malaysia, South Korea, Singapore, Thailand and Vietnam. Nomination procedures and thresholds are not set in Bangladesh, Chinese Taipei, India, Pakistan and the Philippines. In these cases, companies can define their own approach depending on the Articles of Association. Thresholds vary from 1% of outstanding shares to 10% of outstanding shares in Indonesia and Vietnam (OECD 2011). Singapore, Hong Kong, China, Malaysia and Vietnam have thresholds at 5% or above. Perhaps these thresholds could be lowered to enable increased shareholder participation in the nomination process (CFA Institute, 2010).

Some state-owned companies set out the nomination process in the company articles of association, guaranteeing to the government a special privilege of nominating one or more board members (OECD, 2012).

However, the prevalence of controlling shareholders in addition to the relatively low participation of minority shareholders at the GMS implies that the controlling shareholders effectively nominate and elect all board members, including those designated to be ‘independent’ board members (OECD, 2012). As mentioned above, there is a perception that independent board members are often essentially figureheads, serving the controlling shareholder rather than representing all shareholders equally (Lee and Pica, CFA Institute, 2010).

Some countries have introduced mechanisms to facilitate equitable treatment of shareholders in the process of board nomination and election. For example, the largest South Korean companies have an outside director nominating committee, Italy and Israel impose special voting arrangements for the appointment of independent directors, see Box 1 (OECD, 2012). Other countries prevent the issuance of shares with differential or multiple voting rights, such as China, Hong Kong, China and Indonesia (Singhai, 2002 and OECD, 2011).

In certain contexts, cumulative voting can help strengthen the ability of minority shareholders to participate more effectively in the nomination process but it is not a panacea and requires a high level of cooperation between shareholders, which is rare except in cases where there are several block holders. In Chile, public pension funds are encouraged to cooperate and moreover can hold stakes up to 7 per cent in a company. Cumulative voting is permitted in a number of Asia jurisdictions (e.g. Chinese Taipei, India, Pakistan, the Philippines, South Korea, China and Thailand). However, even when permitted, cumulative voting is rarely practiced in the region.

Another way to enhance minority shareholders participation in the board nomination and election process is to facilitate shareholder cooperation and communication, as specified in the OECD Principles. Importantly such cooperation has to be within 'acting in concert' rules. In Asia, to date no such rules to facilitate shareholder cooperation exist but in several jurisdictions, laws provide for disclosure of voting agreements (Utama, 2011). In Malaysia, the Malaysian Shareholder Watchdog Group facilitates such cooperation between shareholders (MSWG, 2011).

It is worthy to note that contested elections are very rare around the world. The associated costs might be a cause but more important reasons may exist. There is a possibility that shareholders are discouraged in cases of controlled companies where board members, even independent ones, are nominated and elected by majority shareholders. At the same time, there appears to be little point to contesting elections, except in contests between block holders. Extensive communications between important shareholders and companies about board membership could be more cost effective than contesting elections. It may also be more effective to discuss company strategy directly with the company, if necessary supported by a specific motion at the shareholders meeting that does not include board member elections (OECD, 2012).

### *Voting*

The proxy process often represents shareholders' principal means of participating effectively in the board nomination and election process. In general, the 'one share one vote rule' applies in all Asian economies. Proxy voting is allowed in all countries and voting with the use of information technology is encouraged. Voting by mail is possible in most economies (the exception is in Bangladesh, Pakistan, and Thailand, where voting by mail is not allowed). Some economies (e.g. China, India, Indonesia, Malaysia, the Philippines, Singapore, South Korea, and Chinese Taipei) also allow voting by electronic means, even though it is rarely practiced in several economies. Voting by telephone/video conferencing is not yet common across Asian economies, although permitted by Indonesia (Utama, 2011).

Practices such as voting by a show of hands are still widely used in the region and viewed as unfair by shareholders. Voting by a show of hands reduces the effectiveness of shareholder participation as it doesn't indicate the percentage of ownership that hands represent and can dilute the vote of some of the larger shareholders. With improved technology and earlier registration of shares to vote, full voting by poll can be more efficiently introduced. Mandatory voting by poll, which gives all votes cast their proper weight, started in Hong Kong China. It has also started in China, has become standard practice in Thailand, is being introduced in Singapore and more companies in Chinese Taipei are adopting it. In the Philippines, South Korea, Indonesia, and India voting by a show of hands is still common (CLSA, 2012). Recently, in Malaysia poll voting has become mandatory for related party transactions which require specific shareholder approval.

The OECD Principles recommend timely publication of voting results and the counting of all votes. Processes to ensure the counting of all votes and the publication of voting results would also increase the transparency of the voting process. Studies show that publication of voting levels in individual companies encourages shareholder participation in successive years (PWC, 2010). Around the world, practices notifying the results of GMS resolutions are evolving. In some countries, such as the United States, good practice is to post the results of the meeting resolutions on the public part of company websites within four business days of the GMS. In the Netherlands, the results must be posted within 15 days. Companies should report the number of votes cast for and against each resolution as well as abstentions and shares held by brokers for which there was no voting authority (OECD, 2012).

Companies that schedule their GMS on the same dates can also be a concern for voting on board nominations. For example, investors who plan to vote actively or attend a GMS in Chinese Taipei have encountered problems even before the meeting season begins, with annual meetings scheduled on the same dates over a span of two weeks, usually in June (Lee, 2010). This is despite the fact that the Company Act allows companies to hold their GMS within six months of the end of their fiscal year. In order to help rectify the situation, regulators in Chinese Taipei notified all listed companies in 2012 that no more than 120 meetings could be held on the same day; in previous years, up to 600 took place on one day. However, companies that voluntarily adopt electronic voting are not subject to these limits.

The OECD Principles also recommend that impediments to cross-border voting be eliminated. However, cross border voting remains an unresolved issue among a number of jurisdictions in Asia (OECD, 2012). The problems of cross border voting are related to the opacity of share ownership chains, jurisdictional legal differences, especially related to transparency, methods by which shareholders can cast votes and the rights shareholders can exercise at the GMS, cost and the 'free rider' issue, the use of technology and the availability of sufficient information (Zetzsche, 2008; Schouten, 2009; Lapido, 2003 and Eckbo et al, 2009 and 2010).

As noted in Table 2.4 special voting mechanisms have been introduced in a number of jurisdictions. They are often in response to the judgement that independent directors nominated and voted by controlling shareholders might not bring objective independent judgement to the board as recommended by the OECD Principles.

**Table 2.4. Voting mechanisms, 2012**

| | Issuing shares with limited right to vote for board members* | Voting for: individual candidates / list | Cumulative voting | Voting for separate list by minority shareholders |
|---|---|---|---|---|
| **Australia** | **Allowed** (Preferred shares) | **Required individual** | N/A | N/A |
| **Belgium** | **Allowed** | **Allowed both** | **Allowed** | |
| **Brazil** | **Allowed** (The limit is 50% of the total shares) | **Allowed both** *Commonly for list* | **Required** (if required by SHs of certain % of voting shares) | **Allowed** (1-2 members of the board may be elected separately by minority shareholders) *28% of board members are recommended by minority SHs* |
| **Canada** | **Allowed** | **Allowed both** *Slate voting still exists in contested elections* | **Allowed** | N/A |
| **Chile** | **Allowed** (Preferred shares) | **Required individual** | **Allowed** | **Required** - At least **1 independent member** shall be elected for large capitalization and diversified ownership firms |
| **Czech Republic** | **Allowed** (Preferred shares) | **Required individual** | **-** | N/A |
| **Estonia** | **Allowed** (Preferred shares) | **Required individual** | **Allowed** | **Allowed** Not more than half of the members of the supervisory board can be elected/ appointed in a different manner |

| | Issuing shares with limited right to vote for board members* | Voting for: individual candidates / list | Cumulative voting | Voting for separate list by minority shareholders |
|---|---|---|---|---|
| **Finland** | **Allowed** | **Allowed both** | **Allowed** | **Allowed** |
| **France** | **N/A** | N/A | N/A | N/A |
| **Germany** | **Allowed** (Preferred shares) | **Recommended individual** | **Allowed** | N/A |
| **Greece** | **Allowed** (Preferred shares) | **Allowed both** | N/A | N/A |
| **Hungary** | **Allowed** (Preferred shares) | **Recommended individual** | **Not allowed** | N/A |
| **Indonesia** | **Allowed** | **Allowed both** *Commonly for list* | **Allowed** | N/A |
| **Italy** | **Allowed** (Preferred shares: The limit is 50% of the total shares) | **Required slate voting** | **Not allowed** | **Required** At least 1 board member shall be elected from the slate of candidates presented by shareholders owning a minimum threshold[8] of the company's share capital |
| **Japan** | **Allowed** | **Required individual** (one individual vote per seat on the board) | **Allowed for directors** (not for statutory auditors) | N/A |
| **South Korea** | **Allowed** (Preferred shares: The limit is 50% of the total shares) | **Allowed both** *Commonly for individual* | **Allowed** (Firms can preclude(*1)) | N/A |
| **Mexico** | **Allowed with the prior authorization by CNBV** (The limit is 25% of the total shares) | **Allowed both** | **Allowed** | N/A |
| **Netherlands** | **Prohibited** | **Allowed both** *Commonly for individual* | **Allowed but limited** | N/A |
| **Poland** | **Allowed** (Preferred shares) | **Allowed both** *Commonly for individual* | **Allowed** (Group voting can be requested by shareholders representing at least 1/5 of capital) | N/A |

| | Issuing shares with limited right to vote for board members* | Voting for: individual candidates / list | Cumulative voting | Voting for separate list by minority shareholders |
|---|---|---|---|---|
| **Portugal** | **Allowed** (Preferred shares) | **Required to vote for separate competing lists** (A single vote for separate competing lists) | **Not allowed** | **Allowed** - For maximum 1/3 of board members, **isolated appointment** may be made from candidates proposed by group of shareholders (10-20% shareholding) - Minority represents at least 10% of the share capital may appoint at least one director |
| **Singapore** | **Allowed** (Preferred shares) | **Required individual** (one individual vote per seat on the board) | **Not allowed** | N/A |
| **Slovenia** | **Allowed** (Preferred shares: The limit is 50% of the total shares) | **a single vote for lists** | N/A | N/A |
| **Sweden** | - | **Required individual** | **Not allowed** | |
| **Switzerland** | **Prohibited** | **Allowed both** | **Allowed** | **Allowed** Where more than 2 different share classes, the shareholders of each class shall be entitled to elect at least one representative to the board |
| **Turkey** | **Allowed** | **Allowed both** | **Allowed** | **Allowed** Where more than 2 different share classes, the shareholders of each class can elect their representative to the board |
| **United States** | **Allowed** | **Shareholders can vote for, against, or abstain for each nominee for director** | **Allowed** | |

* Issuing shares with limited rights normally requires formal procedures, as the Principle III.A.1 calls for "Any changes in voting rights should be subject to approval by those classes of shares which are negatively affected".

Source: Responses to OECD Questionnaire, 2012 – Peer Review on Board Nomination and Election.

## Disclosure of the nomination and election process

The quality of board nomination and election depends to a large extent on establishing a transparent process: transparency about the candidates, the selection process and the elections. Requiring disclosure of the board nomination and election processes as well as the degree of disclosure (the steps in the process) as well as the outlet for the disclosure (e.g.in the Annual Report and/or on the company website) would go a long way in improving the results. Some countries have started this. For example, in Malaysia the listing rules require mandated disclosure of the board nomination and election process and criteria used by nominating committees in the selection process. Disclosure must be included in all annual reports starting in 2014.

Disclosure of corporate governance practices in the annual report is required in most jurisdictions in Asia. With respect to board members, generally companies are required to disclose information on their education and professional experience, total remuneration, and deviations from corporate governance codes (OECD, 2011).

Governments and regulators are encouraged to strengthen their monitoring as well as enforcement of reported information. In the region, most companies do not disclose adequate details about board members and their contributions to the board. For example, companies could do more to disclose the board and board committee(s) evaluation process, nomination committee composition and process to identify and select nominees as well as use of an external search firm.

### *Meeting notices*

Listed companies in Asia could do more to notify their shareholders of a GMS sufficiently in advance of the event in order to allow more informed decision-making. The information contained in the notice could go beyond the basic information on the time, venue and a list of draft resolutions for the meeting.

Also, the short notice in many jurisdictions (7 days in a couple of countries and 14 days in several jurisdictions) does not facilitate either shareholder attendance or shareholder capacity to vote (OECD, 2011). Global good practices suggest a 30 day notice period to allow cross-border and remote voters time to arrange attendance and/or to submit proxies (ACGA, 2011).

Other issues hindering the practical exercise of shareholders to attend and elect board members are last minute changes in board agenda sequence and information not available in English for non-national shareholders.

## *Candidate information*

Specific information about board member nominee qualifications, in a timely manner, is essential to ensuring a transparent nomination process and to facilitating effective shareholder participation. In some countries, such as the US disclosure rules require companies to disclose information about each director and nominee, including specific qualifications (Walter E., 2011). In Asia, disclosure of nominee information is particularly poor.

To enable shareholders to assess the qualifications of board member candidates, it is important to disclose the background and professional experience of the candidates prior to the GMS (OECD, 2012). While in most jurisdictions information about candidates is required to accompany the GMS notice; in practice this information is often minimal. Quality board election notices need to consist of much more than a list of names, for example information about the education, professional experience, board and committee memberships held, and any significant relationships with management or other shareholders (Lee, 2010). It would also be helpful to disclose the rationale for selecting the candidate(s) and specify what contribution the candidate(s) are expected to make to the board. More complete information about nominees would facilitate the exercise of shareholder's rights to elect or re-elect members to the board (World Bank ROSC reviews) and facilitate greater shareholder participation.

Singapore, Malaysia, Hong Kong, China and the Philippines require significant disclosure under their listing rules. However other jurisdictions, such as Indonesia and Vietnam, do not require extensive disclosure of board members' profiles at the time of/before their election (Utama, 2011).

## *Information sharing mechanisms*

In several countries in the region, there is no mandate for companies to maintain a company website or to provide access by shareholders to documentation related to the board nomination and election process. For example, in Indonesia in 2008, only 13.6% of companies published notices for a shareholder meeting on their website. This diminishes transparency, whereby shareholders and investors are expected to acquire the relevant information by directly contacting the company's corporate secretary, rather than through public disclosure (OECD, 2012).

In some countries, such as South Korea, information about candidates' backgrounds must be published by the company at least two weeks prior to the GMS, including the candidate's name, career information, qualifications, the nomination process, the recommender, the relationship between the recommender and the candidate, the relationship between the candidate and the largest shareholder, and the reason for the nomination. This information is made available to all shareholders and the public via the Financial Supervisory Service's Data Analysis, Retrieval and Transfer (DART) system and the South Korea Exchange's "KIND" on-line information system. It is an improved system, but there is no requirement to disclose which other boards those candidates serve on or to limit their number, except that they do not qualify as an outside director if they are also on the board of an affiliated company (OECD, 2012).

Some companies use email communication between investor relations departments and shareholders to elicit, in a timely manner, questions shareholders wish to ask at the GMS (e.g. BHP Billiton plc). These questions and the answers are posted on the company website in its report on the GMS. Others use electronic voting systems at the GMS (e.g. Marks and Spencer Group plc) which also collates all proxies previously received with the vote at the GMS and some (e.g. Royal Dutch Shell plc) provide a dedicated shareholder email contact address for company/shareholder communications (PWC 2010). Such innovative use of technology is to be encouraged and facilitates shareholder participation in the affairs of the company and in the board nomination and election process.

## Selection, training and evaluation

Since the 2008 financial crisis, there has been increased focus on the quality of boards and board composition, which is important to achieve superior board performance. With the increasing demands on boards and growing investor expectations, the skills required of board members are becoming more complex and diverse and may include industry, finance, legal, marketing and other special expertise. Globalisation and a more complex CEO role have made it crucial for board members to become younger, from alternative backgrounds, with international experience and outlook and professionally recruited (Heidrick & Struggles, 2011).

Good practices show that board members with the appropriate mix of competencies, skills and experiences positively contributes to their ability to meet the dynamic and complex needs of companies. A board also needs intangible qualities such as interpersonal skills, the ability to communicate, courage, diplomacy and leadership.

A factor that would influence the selection process of board members would be expanding the pool of qualified board members. This has been raised in smaller or less developed economies as an issue especially for independent director positions. Institutionalized databases as well as the involvement of search firms may assist the selection process. In most Asian economies, there is limited availability of qualified board member pools, including independent board members.

The *de facto* recruitment process in the region is largely informal and based on personal relationships and networks. Well-established, transparent and accountable search processes, with clear director profiles, an institutionalized search process possibly involving professional search firms to identify suitable candidates, and a review of qualifications with interviews is still rare. This process is also still evolving in other countries (Heidrick & Struggles, 2011).

Experience shows that corporate boards perform better when they include the best qualified people who come from a range of perspectives and backgrounds. In the search for better boards and when considering board composition, diversity issues also need to be taken into account, such as gender, expertise and international diversity. For example in Europe, with the average size of boards being twelve people, 24% are now non-national board members, 12% are women and 43% are independent non-executive board members (Heidrick & Struggles, 2011). In Asia, there are only 4.7% of women on boards (Davies, 2011).

Rules in Asia are generally silent on diversity requirements for boards. However, this is starting to change with governments and regulators introducing disclosure requirements concerning diversity This is the case in Malaysia, where listing rules require companies to provide a statement about the activities of the nominating committee which includes a policy on board composition and diversity. In bringing together diverse elements on the board, nomination processes and committees are advised to consider cohesion in a variety of personal styles, culture and shared values (Heidrick & Struggles, 2011).

Continual learning is another important aspect of this, for board members to stay up to speed with changes in legislation or rules as well as best practices. In the past ten years, institutes of directors and other professional associations (e.g. corporate secretaries) have been established in a number of economies with the purpose of providing continuing professional education, such as training for board members.

Across Asia, a number of economies do not specify the need for board members to attend continual training. The exceptions are in Chinese Taipei, India, Malaysia, Pakistan and the Philippines. In Malaysia, this must be disclosed in the annual report and if any of its directors have not attended training, the reasons why. Induction/orientation training for new board members is still not common in the region (OECD, 2011).

Achieving a quality board with balanced competencies is difficult and requires a comprehensive approach to succession of the board, especially independent board members. With regard to succession planning on the board, this could translate into three essential components, such as defining a long-term strategy and planning, defining a process and criteria for selection. This approach — planning, process, and criteria — can facilitate selection that will not only lead to but also alignment with the overall strategic objectives of the board.

The need for effective board evaluation is identified as one of the lessons learned from the global financial crisis. The economic chaos resulting from inadequate board oversight indicates the need for greater vigilance to ensure the accountability of boards. Board evaluations can play an important role in the planning for re-nomination and election of sitting board members as they offer the board itself and shareholders a credible way to judge the performance of board members. Such an approach can review board processes and structures as well as experience and technical gaps, challenges and diversity in the board team. However, a box-ticking/compliance approach should be avoided. Many regulations and codes mandate some form of board evaluation but few require the reporting of the evaluation results and process to the GMS. An example of an exception is Malaysia's listing rules that will require disclosure also of the assessment criteria in the annual report, starting year-end. In Europe, 75% of boards now undertake an annual evaluation process but 50% of companies do not disclose the method of evaluation. Studies show that there was no real progress in the quality of board evaluations (Heidrick & Struggles, 2011). In Asia, board evaluations are relatively rare in practice. Codes or listing rules could be amended to require board evaluation. This was recently done by Singapore in their revised 2012 Code, which could also be used to establish training and succession plans for the board.

## Notes

1. Changes have focused on demanding greater accountability from boards and increased protection of minority shareholders, strengthening board composition, reinforcement of the role of independent directors, clarity of roles of board and management, increased transparency, even beyond minimal reporting, ensuring better and stronger relations with shareholders.
2. If the general meeting or supervisory board has established a "nomination board" consisting of shareholders or representatives of shareholders in order to prepare the election of directors, instead of a nomination committee, the company shall disclose the election process, composition and operations of the nomination board.
3. The role of a nomination committee is limited in the Italian context, where the slate voting directly entrusts shareholders.
4. Listed companies may adopt either "company with statutory auditors" model (traditional) or "company with committees" model (traditional). 97% of TSE-listed companies are with statutory auditors (two-tier).
5. In addition to the 116 largest companies where it is required, 30 firms have established the committee voluntarily.
6. The Swedish Corporate Governance Code prescribes that the nomination committee is appointed by the owners (rather than the board). This is done in two ways, either the members of the NC are appointed by name at the GMS or the GMS decide on a procedure for later appointments of some or all of the members. The typical size is five members. All NC members, regardless of how they are appointed, promote the interests of all shareholders. Independence requirements include: the majority are to be independent of the company and its executive management and have at least one member independent of the company's largest shareholder. The NC also evaluates the performance of directors, often with the participation of outside professionals.
7. It is now under the process of revising relevant rules and codes.
8. The Commercial Act offers a company an option to reject the shareholder's proposal of cumulative voting system through its articles of incorporation. 1 457 out of 1 531 listed companies ruled out a cumulative voting system in 2010.

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