

Critical Issues of Corporate Governance & Sustainability Performance

By:

Philip TN Koh(philip.koh@mkp.com.my)

Advocate & Solicitor High Court Malaya

Private Sector Advisory Group Global Corporate

Governance Forum IFC / World Bank

Vice President Malaysian Alliance Corporate Directors

The Indian Mind

“There is Not a thought that has been thought of in the East or in the West that has not already been thought of in the Indian Mind .”

EP Thompson

- “Just as it is impossible to know when a swimming fish is drinking water , so it is impossible to find out when a [government servant / corporate steward] is stealing money .”
- From Kautilya’s *Arthashastra* (Science of wealth) 300 B.C.

Praxis :Theory & Practice

Someone tries to convince a bureaucrat of the merits of a policy and ends by exclaiming :

“ and it works in practice .” The Bureaucrat replies ,” That’s all very well , but does it work in theory ? ”

- Cited in Edward Luce , In Spite of Gods : the Rise Of Modern India(2007) (Anchor)

- Jagdish Bhagwati: *“Adam Smith’s invisible hand will guide you to an efficient allocation of resources only if markets yield prices that reflect the “true” social costs. If there are market failures, as when a producer pollutes the air but does not have to pay for this pollution, then the invisible hand can lead you in a wrong direction. Or to put it in flamboyant terms, it can immiserize you.”*

Definition of sustainability

“Sustainable development seeks to meet the needs and aspirations of the present without compromising the ability to meet those of the future.” Dr Gro Harlem Brundland Our Common Future (1987) U.N. World Commission on Environment & Development

“Sustainability is a 3 legged: Economic Prosperity / environmental stewardship / Social Responsibility”: Jef Hollender & S Fenichell What matters most (2004) (Random House)

- Tale of two CEOs:
- The Exxon Valdez Oil spill in 1989 & the toxic cloud that enveloped Bhopal, India in 1984 as result of Union Carbide incident
- CEOs apologized expressing contrition, regret, compassion for victims and personal grief but within weeks they were constrained to have 180 degree turnaround to minimize liability

- The main issue in economics jargon is How do a economic system constrain corporations to “internalize” their “externalities”
- At present: Two major modes regulatory and litigation. Growing modes of market incentive for good corporate behaviour: Reputation / Branding and reduced risk of both legal and moral liability.

Association between Sustainability and Financial Performance in Malaysian GLCs?

- *It is a key part of the GLC transformational programme to provide greater clarity to the role of GLCs in promoting national & social objectives and thus ensure that performance is not distorted...it must be stressed that while long term corporate performance requires good CSR, practising CSR cannot be used as an excuse for poor performance*

Tan Sri Nor Mohd Yakcop 2nd Finance Minister June 6, 2005

Bursa Malaysia & Securities Commission's Initiatives

- The Securities Commission & Stock Exchange of Malaysia has approached the sustainability issue via CSR route

Malaysian Sovereign Fund Khazanah & Sustainability

- Khazanah strategic thrusts included the embrace of shareholder value with the inclusivistic vision of Sustainability and CSR
- The Silver Book template (see website of Khazanah)

Company Law & Directors Duties

Stakeholders or Shareholders

- The Orthodoxy: shareholders value vs Stakeholder contestation
- The Hempel Report

Legal Excursus

- Most Common Law Jurisdictions do not define “interests of company” to include stakeholders but ONLY shareholder value
- Directors’ duties are through Care & Skill and Fiduciary
- Courts’ evaluation is through the above category .

Hempel

- Debate between Shareholder value and more inclusive stakeholders
- Hempel U.K Committee on CG notes
“to redefine the directors’ responsibilities in terms of the stakeholders would mean identifying all the various stakeholders groups; and deciding the nature and extent of the D’s responsibilities to each. The result would be that the D’s were not effectively accountable to anyone since there would be no clear yardstick for judging their performance. This is a recipe neither for good governance nor for corporate success

Objections To Stakeholders

- Giving Financing Rights to Noninvestors discourages Finance
- Create Inefficiencies in decision making investors & stakeholders have conflicting objectives
- Managerial performance for positive externalities is ill defined and unverifiable
- Sustainability criteria may be used to hide self serving conduct
- Imposes a de facto tax which escapes political accountability (see Jena Tirole , Theory of Corp Finance) (Princeton) (2006)

What is interests of Co.?

- An obligation to act in the interests of shareholders being the directors' subjective opinion as to interests of the corporators as a GENERAL Body, balancing short – term interests of the present members against the long term interests of future: *Savoy Hotel Investigation (1954 HMSO)*
- In take over Bids existing shareholders: *Heron International Ltd V Lord Grade [1983]*
- Treating shareholders fairly: *Re BSB Holdings Ltd (no2)(1996)* complex financing agreement BOD must consider effect of proposals on different groups of shareholders. Even if there is benefit for directors qua shareholders does not necessarily invalidate as no need for “*unreal region of detached altruism*”
- It is not that Company cannot have cake and ale but only when it is in best interest of its business as an on going concern

Paradox of Social Costs

“Organizations have to take “social responsibility.” There is no one else around in the society of organizations to take care of society itself. Yet they must do so responsibly, within the limits of their competence, and without endangering their performance capacity.”

Peter Drucker (1993)

The Three A s in Sustainability Investing

- Avoidance: Do no Harm
- Alternative: Seeking Those who do good
- Activist: Challenging and changing Status quo?

Building to Last

- As I look back on my life's work, I'm probably most proud of having helped to create a company that by virtue of its values, practices and success has had a tremendous impact on the way companies are managed around the world. I'm particularly proud that I'm leaving behind an ongoing organization that can live on as a role model long after I'm gone.

William R.Hewlett

Friedman Doctrine

- *Few trends would so thoroughly undermine the very foundation of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their stockholders as they possibly can. This is a fundamentally subversive doctrine.*
- *There is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say; engages in free and open competition without deception or fraud*

Milton Friedman (1962).

Milton Friedman's View Amended?

- The Role of Companies in society is undergoing a profound and fundamental change. Social expectations are very different from what they were ten or five years ago. No longer are only products being assessed by consumers; the companies behind the products are being assessed as well...
- Companies are seeing a real competitive advantage in adopting a positive corporate profile, not just a marketing advantage.

Key Issues of Sustainability vs Shareholder Value

- What are the Core Corporate Values?
- What is the Risk and Reputation profile of the Company?
- What has the Company done for Sustainability development?
- Accountability, Transparency Fairness & Responsibility

Link between Competitive Advantage with Sustainability

- Key Statement by Michael Porter & Mark Kramer Harvard Business Review Dec 2006
- Is it a COST / Constraint or mere Charitable Deed or can it be leverage for Competitive advantage?

Criteria for Evaluating of Sustainability

- Significance of Local Knowledge
- Level of a managerial responsibility for amelioration of problems
- Seeking a shared consensus amongst corporate stakeholders
- Linkage with financial performance

10 Propositions on Sustainability (1)

1. Key to understand the nexus between financial performance and sustainability
2. Managers & BOD members and investors are confronted by business decisions with social and ethical impact
3. Divergences in social ethical norms demonstrate healthy pluralism not complete relativism
4. The Trade off between profits and enhanced social responsibility performance need to be understood
5. No empirical evidence that firms rated high in sustainability suffers poor financial performance however Sustainability issues normally takes back seat if financial performance suffers

10 Propositions of Sustainability (2)

6. Sustainability is not subversive to economy nor company performance
7. There is no necessary connection between Sustainability and Government intervention
8. Many varied forms of Sustainability enhances and do not detract from Financial performance
9. The debate between shareholder value and stakeholder is complex and challenging
10. Sustainability need to be articulated in clear and unambiguous terms and enhanced communication between stakeholders is a necessary condition for successful implementation

Complementarity

The issue of democracy relates also to a further – a second connection, that between the lack of democracy and the nature of recent economic crisis. The financial crisis in some of these economies (such as Korea and Indonesia) has been closely linked with the lack of transparency in business, in particular the lack of opportunity of public scrutiny in reviewing financial and business arrangements. An effective democratic forum could have been influential in preventing malpractice, especially at the top (involving for example, underhand arrangements between high ranking government official and business families). “

Amartya Sen, *Beyond The Crisis : Development Strategies in Asia* (ISEAS,1999) 39, 41

The Shaping Hand of Regulator

- The regulatory agencies should be autonomous in their meting out penalties when regulations are contravened. Accountability of regulatory agencies must also be a focus of attention .The Juvenal's maxim : *quis custodiet ipsos custodes?* (who will guard the guardians themselves?) is a grim reminder of the realism of a politically supine or dominated regulatory agency ;

Two schools : Voluntary or Regulatory?

- John Cavanaugh Challenge : Purely voluntary efforts ...can create a dynamic and creative tension in combination with a useful regime of regulation , but are no substitute for regulation”: the premise is that externalized costs will never be significantly internalized unless reg forces biz to reflect those costs and level playing field .
- Reply : Will voluntary efforts be enough ? Absolutely not . But our position is this : Tell us what you want from us , tell us where to go ...hold us accountable, but let us find the way .