Protecting Minority Shareholders in Developing Asian Countries by Cooperative Governance

Mohammad Tareq, *PhD*
Assistant Professor
Department of Accounting and Information Systems
University of Dhaka, Dhaka 1000, Bangladesh
E-mail: mohammad.tareq@du.ac.bd

Background

- Many Asian developing countries reformed their governance systems in recent years e.g Malaysia after the Asian currency crisis, Bangladesh in 2006 and 2012, in India and so on.
- Reforms were initiated by international financial organizations like the World Bank and International Monetary Fund
- Many of these reforms have similarities with the Anglo-American Stockholders model and takes capital market as one of the corporate governance mechanism

Background

- However, many researchers have questioned the suitability of these reforms in developing countries *(Mukherjee-Reed 2002, Khadaroo and Shaikh 2007, Uddin and Choudhury 2008, Siddiqui 2010)*
- Some have suggested stakeholders model as an alternative model for Asian developing *countries (Liew 2008, Liew 2009, Siddiqui 2010)*

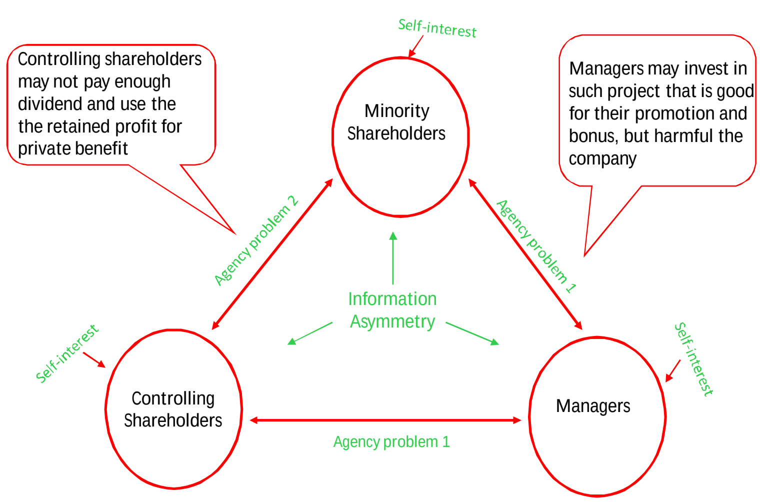
Background

- The main difference between the stockholder model and the stakeholder model lies in the philosophical position concerning in whose interest a company should act when doing business.
- According to the stockholder model, a company should serve the interests of the stockholders. In contrast, the stakeholder model posits that a company should be run in the best interests of its stakeholders.

Background

- Intuitively, if implemented properly, a stakeholder based model may make businesses socially responsible and may ensure all stakeholders right in an organization.
- However, including all stakeholders in the governance of corporation is costly, ignore private property right of shareholders and objectives of different stakeholders are difficult to exercise in corporations (Jensen 2002, Jensen 2001, Jensen 2010).
- The debate on stakeholders vs. stock holder model is still going on .....

Corporate Governance Problem



6

Agency Problem 2 in Asian Countries

- We see these two governance problems all over the world.
- Past research suggest agency problem 2 is high in most developing Asian countries.

Research Questions

- Most of the reforms are based on stockholders model. Intuitively, stockholders based corporate governance model is more suitable for protecting abuse of minority shareholders from controlling shareholder; but it has failed to so do in many developing countries.
- Therefore, two questions rise:

➢ *What are the deficiencies of the reforms in developing Asian countries?*

➢ *How the corporate governance can be successfully implemented in those countries?*

Deficiencies of the reforms in developing Asian countries

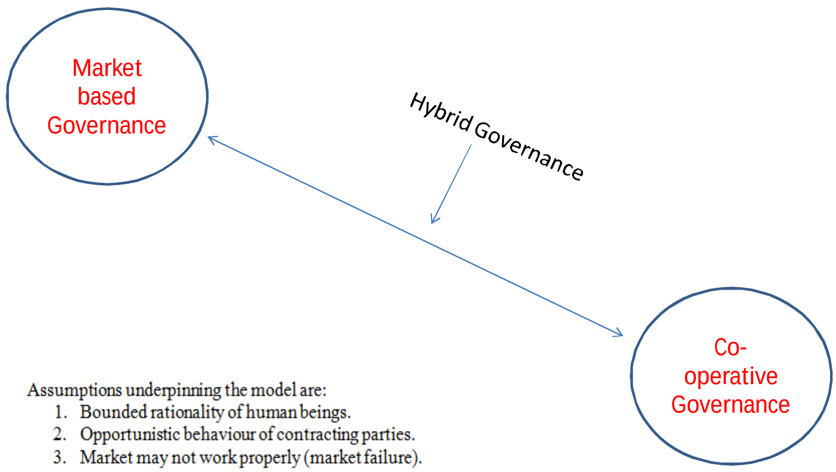
- Uddin and Choudhury (2008) and Siddiqui (2010) investigated the acceptability of the Anglo-American or shareholder-based corporate governance model in Bangladesh
- They found that the imposed Anglo-American model is not suitable for a developing country like Bangladesh

Deficiencies of the reforms in developing Asian countries

- After the Asian currency crisis the Malaysian government was under pressure from the World Bank and the International Monetary Fund (IMF) to reform the country's corporate governance system (*Liew 2007*, *Liew 2008*, *Liew 2009*).
- Khadaroo and Shaikh (2007) argued that coercive, normative and mimetic pressures had a huge influence on corporate governance in Malaysia. Similar finding in India (*Mukharjee Reed 2002*)
- All of these researchers have questioned the suitability of Anglo-American model in Asian countries because of the different of corporate characteristics in Asian countries:

- High Ownership concentration
- Family firms
- Weak legal enforcement

Oliver Williamson's *Market and Hierarchy* Model (1975, 2008)



Assumptions underpinning the model are:

1. Bounded rationality of human beings.
2. Opportunistic behaviour of contracting parties.
3. Market may not work properly (market failure).

Oliver Williamson's *Market and Hierarchy* model

- Governance by market: This form of governance requires some attributes, such as, information to all the parties, full transparency and so on.
- We often see market mechanism, such as, hostile takeover can remove inefficient and corrupt management from corporations in developed countries. Furthermore, market can signal inefficiency and discriminatory behaviour of controlling shareholders by affecting share price negatively.
- Governance by all the parties
- Hybrid governance

Market Inefficiencies in Developing Asian Countries

- For proper functioning of the market information symmetry among corporate stakeholders, true and fair information are pivotal. Stakeholders who use information for decision making may be misleaded by fraudulent information that can distort the market.
- Many countries (especially in developing Asian countries) market fails completely or partially and therefore seldom gives protection to minority shareholders from the discriminatory behaviour of controlling shareholders.

Hybrid Governance in Developing Asian Countries

- The appointment of independent directors and independent audit committee members are done by mostly by controlling shareholders (Uddin and Chowdhury 2008).
- If independent directors and audit committee members are truly independent and act in the best interests of minority shareholders, then they can protect the interest of minority shareholders in corporations.
- This is unlikely if the appointment of independent directors is not genuine. Because colleagues or friends of controlling members are ineffective to curtail their private benefit in corporations (Monks and Minow 2003, Dahya et al. 2008)
- Therefore, minority shareholders protection through direct participation in the companies becoming important!!!!

Minority Shareholder Participation Reform in Developing Countries

Year	*Reforms*
2005-2006	China, and Tunisia – amend law to require companies to open books for shareholders inspection
2006-2007	Slovenia – require approval of shareholders for related party transactions
2007-2008	Albania, Azerbaijan and Tajikistan – require approval of related party transactions by shareholders. Egypt introduces prior review of related party transaction by external party.
2008-2009	Colombia, Dominican Republic, Macedonia, Rwanda and Tajikistan – make it easier to sue directors. Dominican Republic and Rwanda – allow access of company book by shareholders
2009-2010	Chile and Swaziland – require approval of related party transaction by shareholders. Georgia, Swaziland and Tajikistan – make it easier to access corporate information.

Source: Tareq et al. (2011)

Minority Shareholder Participation Reform in Developed Countries

- Israel, NewZealand, Norway, Sweden require approval of shareholders for related party transactions.
- In Australia, for example, CLEARP 9 gives shareholders the right to participate in the voting of the adoption remuneration report by directors and to ask questions about the remuneration report.
- It further requires minority shareholders be allowed to submit questions to the auditor about their audit.

Concluding Remark

- This paper contributes to the existing literature by identifying the deficiencies of the current corporate governance reforms in developing Asian countries.

- This involved the analysis of the reform measures and presenting evidence on obstacles of reform measures in corporations from literature. It also presents cooperative governance through minority shareholders participation as a major way of protecting minority shareholders right in developing Asian countries.

- This paper argues that minority shareholders participation is necessary due to lack of developed capital market, high and ubiquitous influence of founder family members in the corporations, lack of effectiveness of independent directors in developing Asian countries.