



**ICD**

**Institute of  
Corporate  
Directors**

# **Governance and DFIs**

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Chairman, Institute of Corporate Directors

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New World Makati Hotel

# The Presentation

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I. Good CG Practice vs. Untrammelled “laissez faire”



II. How CG Emerged at the Forefront of the Development Agenda



III. Developments in the Global Capital Markets



IV. Good CG, Stakeholder Interest Maximization and INCLUSIVE and SUSTAINABLE development



V. Appeal to the DFI Sector

# Good CG Practice vs. Untrammelled “laissez faire”

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- The savings and investment process, unregulated
- Movement of cash from “surplus” to “deficit” units of the economy *that will maximise its use*
- Fiduciary character of the process – nature of the “surpluses”
- Pressure (P&L, growth, etc.) on bank/FI leadership
- Short-term “temptations” leading to market gaps/failure

# Corporate Governance (“CG”) – What is it?

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“Procedures and processes according to which an organization is directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among the different participants in the organization...”

*Organization for Economic Cooperation and Development (OECD)*

“The system by which companies are directed and controlled.”

*Cadbury Committee, 1992*

“The system of rules, practices and processes by which a company is directed and controlled. Corporate Governance involves balancing the interests of the many stakeholders in a company – these include its shareholders, management, customers, suppliers, financiers government and the community.”

*Investopedia*



# Corporate Governance (“CG”) in Financial Sector

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Especially important because:

- The sector manages peoples’ savings
- Sector enjoys very special privileges (money creation, leverage, maturity mismatching, etc.)

In exchange, sector is expected to ensure:

- Maximization for the economy as a whole; appropriate risk management of the process
- As “lubricant” of the economy, the banking system has a profound impact on all sectors

# Financial Upheavals that brought Corporate Governance into Prominence

- Maxwell (UK)
- Bond (Australia)
- Nomura (Japan)
- Drexel Burnham/ Ivan Boesky (US)
- Carrian Investments (HK)

- Celebrated Cases: Lehman, Bear Stearns, AIG, Fannie Mae, Freddie Mac
- The Dodd – Frank Wall Street Reform Act

1980s

1990s –  
2000s

2008

- 1997 Asian Financial Crisis
- Accounting Fraud (e.g. Enron, WorldCom, Satyam)

# Some Recent Cases

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## Egregious Behavior

Company	Behavior	Consequence
AIG	Risk oversight of Board, excessive Board bonuses	Financial bailout, Increased number of independent directors
Toshiba	Padding of books, manipulation of profits	Intro of independent Board and significantly higher CG standards
Siemens	Corruption and weak internal control processes	Robust internal control policies; intro of strict compliance code, strengthened Board monitoring function
Michelin	Poor CG practices	Board structure and composition (presence of IDs)

# Good CG Practice and Economic Development

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## A. Improve institutional investor's perception (domestic & overseas)

## B. Encourage existing Philippine issuers

## C. Increase demand for Philippine market issues

- Confidence on Philippine issuers of capital market instruments

- Increase demand for Philippine market issues
- Increase supply of capital market issues

- By improving liquidity/ obviating institutional investor fear of being “locked-in” a small illiquid market



# Good CG Practice and Economic Development

## D. Encourage promising private companies to seek listing

- An increasing pool of public market funds.
- Substantial “non-threatening” capital.
- Increasingly attractive long-term capital – given a benign financial asset yield curve.

## E. Stimulate the domestic private equity market

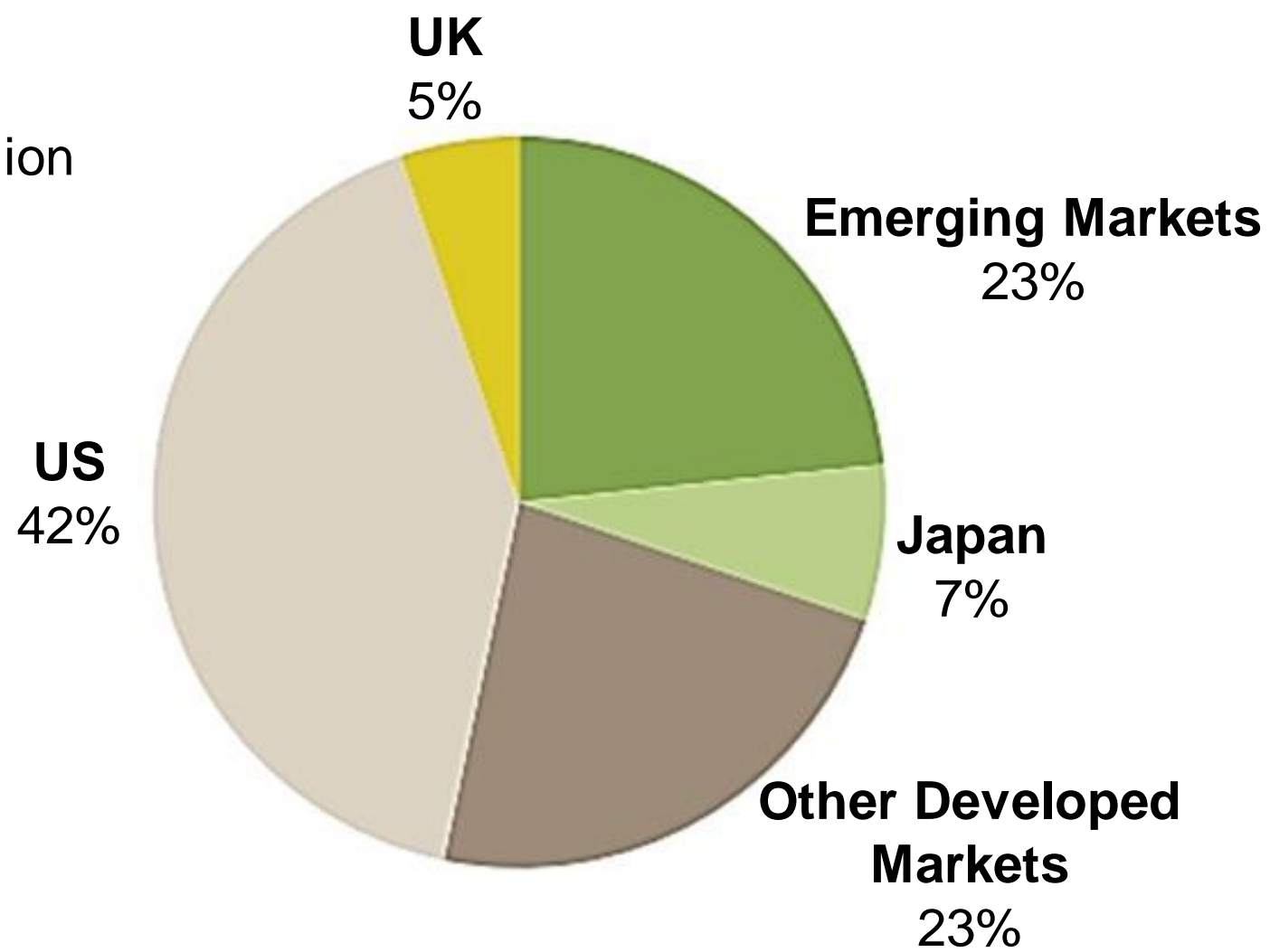
- By making the stock market a **realistic** exit option for venture capitalists/ private equity investors.
- Increase risk capital options for Philippine entrepreneurs and SMEs

## F. Encourage FDI growth

- By providing liquidity to strategic and financial investors

# Global Equity Market Capitalization (by Geography)

2014  
\$63.5 Trillion



Source: Standard and Poor's Global Stock Market Factbook, World Federation of Exchanges, European Central Bank



# Global Equity Market Capitalisation (Historical/by Geography)

(Market Value in \$ Billions)

	Australia	Canada	France	Germany	Hong Kong	Italy	Japan	Neth.	Singapore	Switzerland	U.K.	U.S.	Developed Markets	Emerging Markets	World
2000	373	841	1,447	1,270	623	768	3,157	640	153	792	2,577	15,969	29,575	2,612	32,188
2001	375	701	1,174	1,072	506	527	2,252	458	116	626	2,165	14,614	25,334	2,573	27,907
2002	379	575	967	691	463	481	2,126	401	100	553	1,864	11,601	21,019	2,491	23,510
2003	585	894	1,356	1,079	715	615	3,041	489	149	727	2,460	15,146	28,262	3,774	32,036
2004	776	1,178	1,559	1,195	861	790	3,678	539	217	826	2,816	17,305	33,203	4,909	38,113
2005	804	1,481	1,759	1,221	1,055	798	4,737	593	257	939	3,058	18,757	36,183	7,026	43,209
2006	1,096	1,701	2,429	1,638	1,715	1,027	4,726	780	384	1,213	3,794	21,064	42,917	10,400	53,316
2007	1,298	2,187	2,771	2,106	2,654	1,073	4,453	956	539	1,275	3,859	21,573	46,301	18,171	64,471
2008	676	1,002	1,492	1,108	1,329	521	3,220	388	265	863	1,852	12,716	26,534	8,338	34,872
2009	1,258	1,681	1,972	1,298	2,305	317	3,378	543	481	1,071	2,796	16,903	33,563	13,818	47,381
2010	1,455	2,160	1,926	1,430	2,711	318	4,100	661	647	1,229	3,107	18,966	39,372	14,793	54,165
2011	1,198	1,907	1,569	1,184	890	431	3,541	595	308	932	2,903	17,494	34,943	11,556	46,499
2012	1,286	2,016	1,823	1,486	1,108	482	3,681	651	414	1,079	3,019	19,940	40,016	13,147	53,164
2013	1,366	2,114	2,301	1,936	3,101	615	4,543	818	744	1,541	3,743	25,712	47,103	12,743	59,846
2014	1,289	2,094	2,086	1,739	3,233	566	4,378	787	753	1,495	3,330	27,883	48,690	14,840	63,530

Note: Sources changed in 2013 due to discontinuation of S&P's Global Stock Market Factbook

Source: Standard and Poor's Global Stock Markets Factbook (prior to 2013), World Federation of Exchanges and European Central Bank (2013 on)

# Developments in the Global Capital Markets

Growing complexity (instruments, currencies, risks).

Resulting "institutionalization" vs. retail investor dominance.

Large aging populations in wealthy economies - explosive growth in pension, insurance and other savings pools.

Creation of all types of "Funds", "Unit Trusts" and endowments - a more structured, sophisticated and demanding "buy side".

# Business Case for Corporate Governance

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- Long-term sustainability
- Better operational/ financial performance
- Better access to resources:
  - Capital
  - Human resources: skilled, healthy employees
  - Raw materials extracted and used in an environmentally friendly manner
- Effective, strategic decision-making
- Improved oversight, monitoring and evaluation
- Succession planning
- Anti-corruption tool (ethics)
- If a listed company, commands a premium from investors



# Good CG/Stakeholder Interest Maximisation, **Inclusive** and **Sustainable Development**



Banks – DFIs having a particularly important **DEVELOPMENT** role.



GOCCs



InsCos/Other  
FIs



Family-owned  
enterprises, others



Other PLCs

# Good CG Practice and Enhanced Enterprise Valuation

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- Companies Circle Results vs Latin America
- Yan-Leung Cheung, J. Thomas Connelly, Jesus P. Estanislao, Piman Limpaphayom, Sidharta Utama: 5 Asian Country Study
- ASEAN PLCs Study

# **Good CG Practice and Enhanced Enterprise Valuation**

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## **Companies Circle Study**

Comparison of Companies Circle and 1,078 Latin American Listed Firms. Results showed that companies believed to practice good corporate governance



# Benefits of Perceived Good Governance

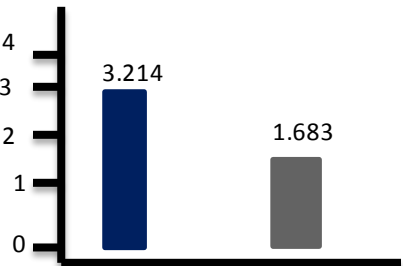
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Comparison of Companies Circle and 1,078 Latin American Listed Firms. Results showed that companies believed to practice good corporate governance:

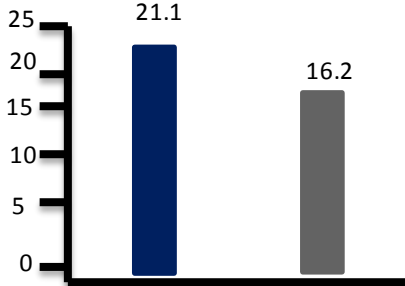
- ✓ More profitable, paid more dividends, better access to debt markets (more leveraged at lower cost).
- ✓ Better value perception by investors
- ✓ Less volatile during financial crises

# Comparison of Selected Market Indicators

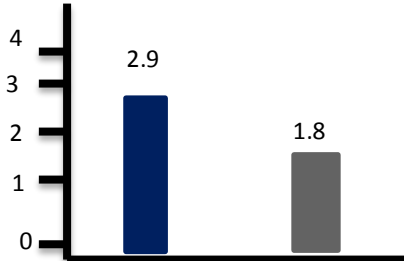
**LEGEND:** ■ Companies Circle members ■ Latin American Listed Companies



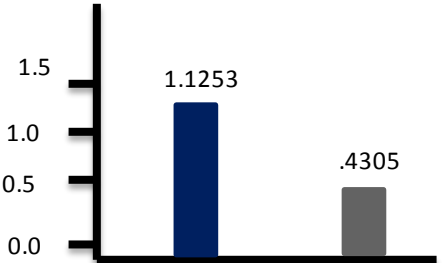
Market Capitalization in US\$ Billion Dollars  
(Number of Outstanding Shares x Share Prices)



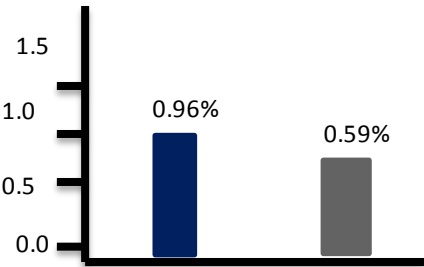
PE Ratio  
(Share Price/Projected Earnings per Share)



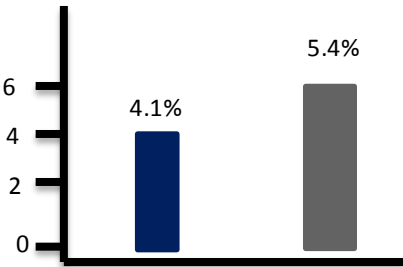
PBV  
(Share Price/Book Value of Shares)



Daily Volume of Shares Traded in US\$ Million Dollars



Liquidity Ratio  
(Calculated by Economatrica comparing each stock with its respective stock exchange)



Dividend Yield  
(Dividend per share during the year/share price in the beginning of the period)



# **Good CG Practice and Enhanced Enterprise Valuation**

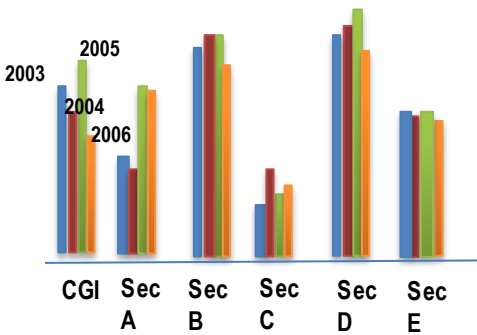
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**5 Asian Country Study by:**

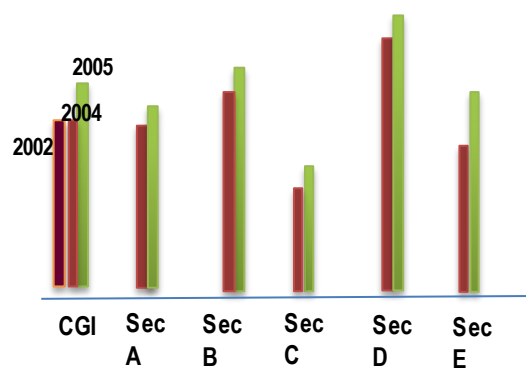
**Yan-Leung Cheung, J. Thomas Connelly, Jesus P. Estanislao, Piman Limpaphayom, Sidharta Utama**

# The Sample and CG Criteria Surveyed

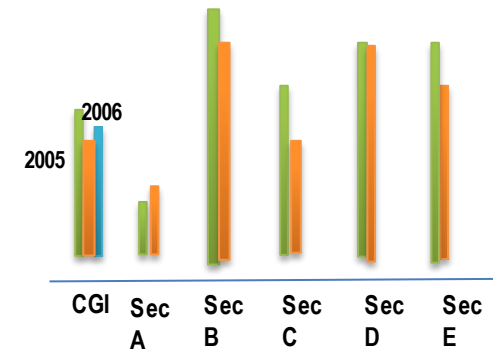
## CHINA



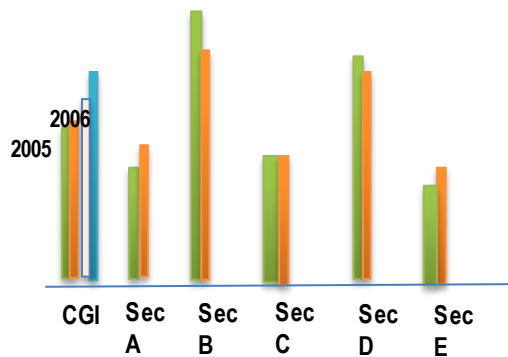
## HONG KONG



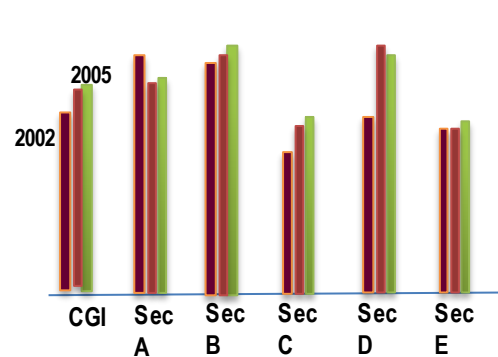
## INDONESIA



## PHILIPPINES



## THAILAND



Country	Number of Firms
China	356
Hong Kong	502
Indonesia	514
Philippines	330
Thailand	985

LEGEND: 2002 (red), 2003 (blue), 2004 (dark red), 2005 (green), 2006 (orange)



# Asian Country Study – What does Empirical Data Suggest

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- **POSITIVE CORRELATION** between the **CORPORATE GOVERNANCE SCORE** and **FIRM VALUATION**
- **Good Governance** correlated with **good financial performance, better investment attractiveness** and **enhanced sustainability**

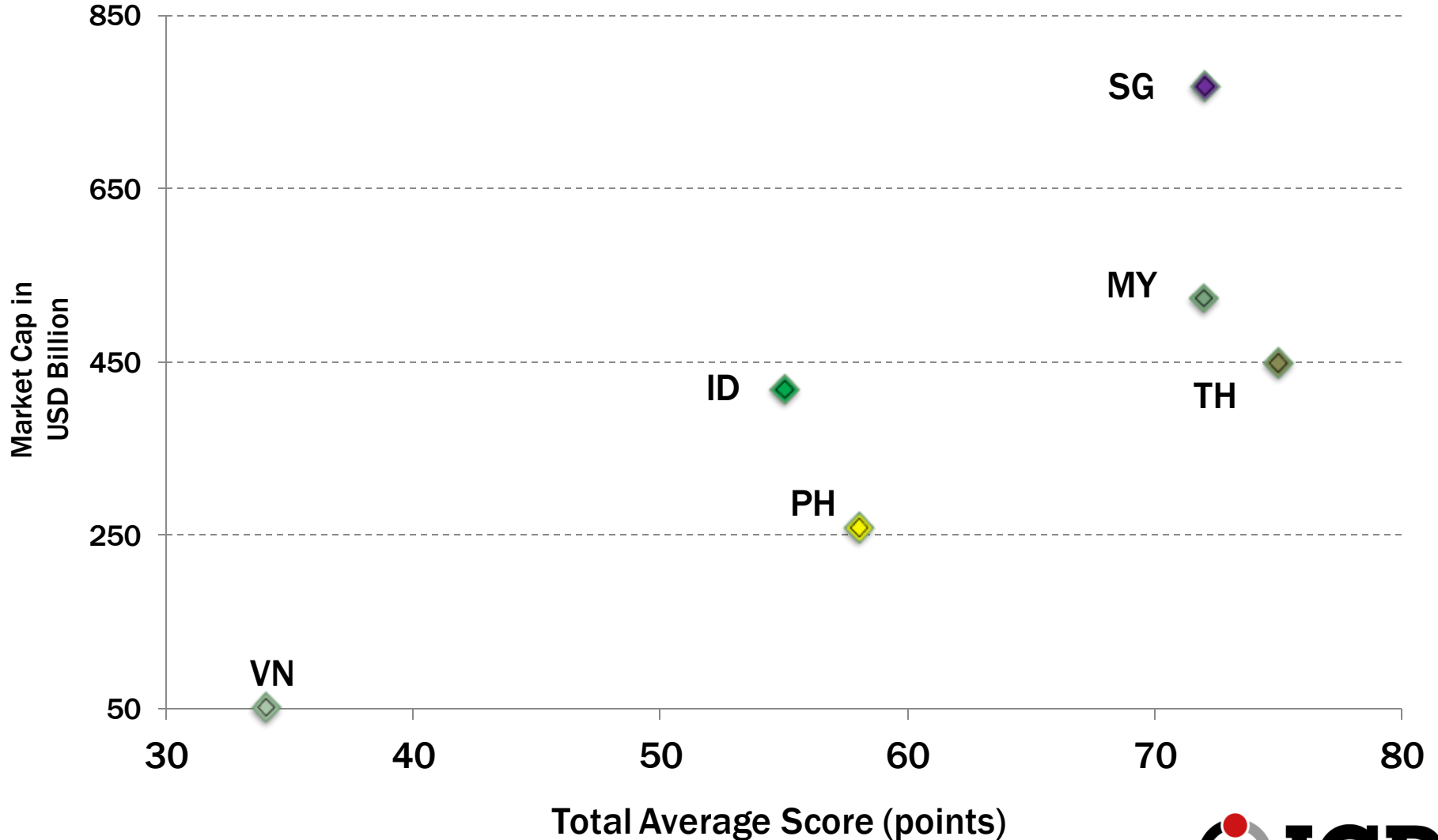
# **Good CG Practice and Enhanced Enterprise Valuation**

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## **ASEAN Corporate Governance Scorecard Study:**

**Observes that better scores are correlated with higher market capitalization**

# Total average CG Score vs. Market Capitalization (per country)



# The Philippine Effort to Improve SOE Governance

Laying down principles and standards for the creation, management, administration, supervision and liquidation of GOCCs

Defining the guidelines in determining the areas or activities of government in which the corporate form shall be utilized

Setting down policy measures to improve the organizational and functional capabilities of GOCCs



# **Objectives of the Governance Commission for Government Owned Controlled Corporations Legislation**

AN ACT TO PROMOTE FINANCIAL VIABILITY AND FISCAL DISCIPLINE IN GOVERNMENT-OWNED OR -CONTROLLED CORPORATIONS [GOCCs] AND TO STRENGTHEN THE ROLE OF THE STATE IN ITS GOVERNANCE AND MANAGEMENT TO MAKE THEM MORE RESPONSIVE TO THE NEEDS OF PUBLIC INTEREST AND FOR OTHER PURPOSES.

*Full Title of R.A. No. 10149*

# Appeal to the DFI Sector

1

- Begin with your board, executive leadership and staff.

2

- Require borrowers and investee company leadership to undergo CG training.

3

- Strongly encourage borrowers/investees to adopt CG best practices.

4

- Consider offering "carrots" and "sticks".

5

- Contribute to a "virtuous CG" cycle.



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# THANK YOU!

**Mr. Francis G. Estrada**  
Chairman, Institute of Corporate Directors

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New World Makati Hotel

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