

# Corporate Governance and Firm Valuation in Asian Emerging Markets

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**Abstract** One of the most contentious issues in the corporate governance debate is the presumed benefits of adopting internationally accepted corporate governance practices. This study investigates the relation between the quality of corporate governance practices and market valuation for listed firms in five Asian economies: China, Hong Kong, Indonesia, the Philippines, and Thailand. Based on the OECD Corporate Governance Principles (Organization of Economic Co-operation and Development, 1999), we use a survey instrument to assess the quality of corporate governance practices of listed companies in these Asian emerging markets. The new instrument represents an improvement over existing instruments as it is more comprehensive, covering five aspects of corporate governance (rights of shareholders, treatment of shareholders, roles of stakeholders, disclosure and transparency, and board responsibilities). The survey instrument also captures variation in the quality of governance practices across firms. The empirical results show there is a positive relation between the quality of corporate governance practices and firm value in each of the five nations.

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## 1 Introduction

Since the late 1990s, corporate governance began to receive earnest attention from regulators and investors in the Asia-Pacific region. The reason for the scrutiny is that corporate governance was identified as one of the key factors believed to have caused the Asian Financial Crisis in 1997. Zhuang et al. (2000) contend that poor corporate governance practices led to poor investment and financing decisions among firms in East Asia. As a result of the heightened awareness of firms' corporate governance practices, considerable effort has been devoted to improving the quality of corporate governance practices among firms in East Asia.

Capital market regulators have been pushing for major corporate governance reforms throughout the region. However, efforts to reform or enhance corporate governance practices in East Asia have been met with resistance and indifference on two fronts. Many managers and company owners argue that the costs of adopting good corporate governance practices outweigh the resulting benefits. In addition, costly improvements in governance may not be appreciated or valued by investors. There is a widespread perception that many investors across East Asia are less sophisticated. These investors may not be able to discern the governance improvements implemented by managers. In addition, investors may also be unable to differentiate among firms the quality of corporate governance practices. Investors are thus unable to reward firms that do improve their governance practices.

To further cloud the issue, regulators face challenges if they use the empirical evidence gathered from US firms to guide their efforts to improve governance practices in Asia. One challenge arises because there is inconclusive empirical evidence surrounding the benefits of good governance for US firms. For example, there are a number of empirical studies examining the relation between board composition and firm valuation among US firms (see for example Agrawal and Knoeber 1996; Hermalin and Weisbach 2003). However, these two studies show conflicting results. A second challenge comes about because some governance practices may not be easily extended to Asia. For example, two frequently cited studies each use a takeover code to develop a corporate governance index as a proxy of the quality of governance practices (Gompers et al. 2003; Bebchuk et al. 2009). The authors then find a positive relation between improved governance practices, based on takeover codes, and market valuation. However, since takeovers are exceedingly rare in Asia, this finding may be of limited use.

The third challenge centers on the proxies used to assess corporate governance practices. The studies by Agrawal and Knoeber (1996) and Hermalin and Weisbach (2003) use board composition as the only measure of corporate governance. However, the number of independent directors on the board represents only one aspect of corporate governance. Similarly, the governance indexes in studies by Gompers et al. (2003) and Bebchuk et al. (2009) use only the protection of shareholder rights related to corporate takeovers as the proxy for governance. The

measures of corporate governance employed in these US studies fail to provide a holistic view of corporate governance practices.

A new set of problems may arise when regulators attempt to measure governance practices. Different aspects of corporate governance could be complementary. The breadth of the governance proxy thus becomes more important. In addition, it is vital to assess the quality of practices when examining the effect of governance on firm performance. The studies mentioned earlier note the presence or absence of a specific governance-related measure. With the measures these studies employ, it is not a straightforward task to distinguish between firms based solely on the overall quality of observed corporate governance practices. The key to examining the relation between governance practices and firm performance is a proper measure of corporate governance. The measure should be applicable across a wide range of institutional settings, incorporate sufficient breadth, and offer ways to discern the quality of practices between firms.

The objective of this study is to examine the relation between the corporate governance practices and firm valuation in five Asian equity markets: China, Hong Kong, Indonesia, the Philippines, and Thailand. Using annual, publicly available information from publicly traded firms, we rate the corporate governance practices of the major companies in each market.

This study makes three contributions to the literature. First, a comprehensive survey of corporate governance practices is used to assess the quality of corporate governance practices of firms in these five East Asian countries. The questions in the survey are based on the OECD Principles of Corporate Governance Principles (OECD 1999). These five principles are: (A) Rights of Shareholders, (B) Equitable Treatment of Shareholders, (C) Role of Stakeholders, (D) Disclosure and Transparency, and (E) Board Responsibilities. In each country, the survey was completed several times during 2002–2008. The survey quantifies the quality of the corporate governance practices in use. The results of the survey yield a Corporate Governance Index (CGI) value for each company. There is some variation in the surveys used in the five markets because of differences in the regulatory frameworks. While each market has a unique version of the corporate governance survey instrument, there are 81 criteria common to all five markets. To make a cross-country comparison, the CGI scores are standardized based on the common 81 criteria compiled from each market.

The second contribution concerns the procedure used to measure corporate governance practices. In many prior studies, researchers calculate the governance measure by searching for specific items of information in firms' annual reports and financial statements. Each firm receives one point for the presence of an item and zero points if an item is missing. The procedure in this study represents a major improvement from the methods commonly found in previous work. This study adds a qualitative element to the assessment of governance practices. We evaluate the amount and quality of information for many of the criteria in the governance survey. Consequently, the final CGI scores are more comprehensive, and the scores are more representative of the quality of the corporate governance practices, after taking into account the quantity of the reported practices.

For the final contribution, this study examines the relation between corporate governance and firm valuation in emerging markets in the Asia-Pacific region. We hypothesize a positive relation between the CGI and firm valuation. The reason is that a nation's corporate governance framework exists to encourage the efficient use of resources and to require accountability for the stewardship of the resources. As stated by Sir Adrian Cadbury: "Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. . . . The aim is to align as closely as possible the interests of individuals, corporations and society" (Iskander and Chamlou 2000, p. vi). Therefore, good corporate governance makes corporations more transparent and makes monitoring easier for shareholders and outsiders. Improved monitoring and transparency should improve the accountability of the managers, leading to better or more efficient investment decisions and eventually to higher shareholder value. An understanding of the relation between the quality of corporate governance practices and firm valuation has policy implications for capital market development. The results could also provide incentives for managers and founding families to adopt good corporate governance practices.

Previous studies have largely focused on developed markets such as the US and European markets; comparably few studies have been completed for Asian markets. Asia has been demonstrating rapid economic growth since the 1980s. As a result, investment interest has been rising, particularly investments targeting China and India. International fund management companies have launched a range of investment vehicles, some dedicated solely to Asia and some with explicit policies to invest a fixed portion of the portfolio in the region. Apart from the growth potential of the region, fund managers may seek to diversify away the risk inherent in developed markets, such as the US and Europe.

Asian equity markets are, however, quite different from those of western countries. Firms comprising the Asian business community are characterized by high family ownership and a lack of transparency. The 1997 Asian Financial Crisis was the key event spawning awareness of the need for corporate governance reform in the Asia-Pacific region. The traditional agency problem of managers versus shareholders is rarely applicable in Asia because there is seldom a separation of management and ownership. For example, it is common to find that the chairman of the board is also the chief executive officer in Asian listed companies. Top management teams are frequently peppered with family members who are also shareholders. In addition, market disciplinary mechanisms, such as hostile takeovers, cannot function properly in Asia because of the concentrated or family ownership. This could explain why corporate governance has had a slow start in Asia.

As another complication, the enforcement mechanisms in many Asian economies are relatively weaker than in the US. In most cases, the regulators in Asian countries do not have the kind of legal or regulatory power enjoyed by their US counterparts. In addition, investors in Asia are fragmented and often lack the legal powers that US investors possess. For example, class action lawsuits are not available in most countries in Asia. Consequently, it is possible that the lack of

enforcement and legal power makes the quality of corporate governance more important for firms in Asian markets.

Our empirical results show that the corporate governance practices of the listed firms in these five markets fluctuated during the sample period. More importantly, the empirical findings offer compelling evidence that good corporate governance practices matter in these five markets and that the market rewards firms with superior corporate governance practices. We observe a positive and statistically significant relation between firm valuation and the quality of corporate governance practices, as measured by the corporate governance index (CGI), even after the addition of variables to control for differences in firm characteristics. To check the robustness of our findings, we employ a simultaneous equations estimation technique to take into account the possibility that well-performing firms also tend to improve the quality of their corporate governance practices. Even after controlling for endogeneity, the results from the two-stage least squares (2SLS) regression analyses confirm the positive relation between the quality of corporate governance practices and firm valuation.

The remainder of this chapter is organized as follows. We provide a brief literature review in the next section, followed by overviews of the institutional backgrounds for each of the five nations we study. The data and empirical methodology are described in Section 4. Section 5 contains a discussion of the empirical results, followed by the conclusion in Section 6.

## 2 Literature Review

A growing body of literature studies the relation between corporate governance and stock market valuation or firm performance in both developed and emerging markets. In the past, the empirical approach has been to examine specific aspects of corporate governance such as ownership concentration (e.g., Himmelberg et al. 1999; Morck et al. 1988; Barontini and Caprio 2006), board composition (e.g., Agrawal and Knoeber 1996; Hermalin and Weisbach 2003), or executive compensation (e.g., Abowd and Kaplan 1999; Bebchuk et al. 2002). However, these empirical studies provide contradictory or inconclusive evidence of the presumed benefits of adopting good corporate governance practices.

Several recent studies have utilized a different approach by constructing an overall governance index and then examining the effect of overall corporate governance practices on firm value (Black 2001; Gompers et al. 2003; Klapper and Love 2003; Bebchuk et al. 2009; Durnev and Kim 2005; Black et al. 2006; Cheung et al. 2007). The logic behind this approach is that corporate governance mechanisms may be substitutes for one another. Consequently, one must consider the overall quality of corporate governance when examining the impact on firm performance.

In one of the most widely cited studies on corporate governance, Gompers et al. (2003) construct a “Governance Index” (G-Index) to proxy for the level of

shareholder rights at approximately 1,500 large U.S. firms during the 1990s. The G-Index consists of 24 provisions related to takeover defenses and shareholder rights. They find that firms with stronger shareholder rights have higher firm value, higher profits, higher sales growth, and lower capital expenditures. Firms with stronger shareholder rights also make fewer corporate acquisitions. They also document a statistically significant positive relationship between G-Index scores and stock returns over the sample period. They posit that weak shareholder rights create agency conflicts which, in turn, lead to low firm value in the long run. Because of this influential study, the G-Index has become one widely-cited benchmark for measuring the corporate governance quality of U.S. companies.

Bebchuk et al. (2009) also put forward a governance measure based around shareholder rights. The authors construct an entrenchment index based on six provisions: four “constitutional” provisions that prevent a majority of shareholders from having their way (staggered boards, limits to shareholder bylaw amendments, supermajority requirements for mergers, and supermajority requirements for charter amendments), plus two “takeover readiness” provisions that boards put in place to defend against hostile takeovers (poison pills and golden parachutes). These six provisions are selected from a total of 24 governance provisions developed by the Investor Responsibility Research Center (IRRC). Bebchuk et al. (2009) examine the relation between market valuation and performance of US firms during 1990–2003. They find a negative relation between the index scores and firm valuation, as measured by Tobin’s  $q$ . They conclude the entrenchment provisions lead to low market valuations among US firms. The two corporate governance indexes mentioned above make important contributions to the literature on takeover defenses in the US. However, the studies are of limited relevance to markets where hostile takeovers are rare.

Compared to research in developed markets, recent research on the relation between corporate governance and firm performance in emerging markets generates results more demonstrative of the benefits of good governance practices. Black et al. (2006) construct a corporate governance index for 515 Korean companies using a survey conducted by the Korea Stock Exchange. They also document a positive relation between the quality of corporate governance practices and market valuation, as measured by Tobin’s  $q$  and the market-to-book ratio. In addition, the two-stage and three-stage least squares analyses confirm their ordinary least squares regression results. Black et al. (2006) conclude that an overall corporate governance index is an important factor, and likely a causal factor, in explaining the market value of Korean public companies. For Russian firms, Black (2001) constructs a corporate governance risk measure and finds a positive relation between corporate governance practices and market valuation among a small sample of 21 Russian firms.

Cheung et al. (2007) examine the relation between corporate governance and firm value using a single year of data from major companies listed on the Hong Kong Stock Exchange. Their corporate governance index is based on the OECD Principles of Corporate Governance (1999). Unlike measures used in other studies, their index reflects not only the presence of good corporate governance practices

but also the variation in the quality of corporate governance practices. The authors show that company market valuation is positively related to the overall composite measure of corporate governance practices. In summary, their study provides cross-sectional evidence supporting the notion that, in Hong Kong, good corporate governance practices are consistent with value maximization.

Studies of Chinese firms show empirical evidence supporting the benefits of adopting good corporate governance practices. However, the results benefit an evolving economy, in contrast with prior research in developing markets. For instance, Cheung et al. (2008) find no contemporaneous relation between corporate governance and firm valuation when examining the relation between the quality of corporate governance practices and firm valuation. However, using more recent data, Cheung et al. (2009) show results in support of the notion that good corporate governance relates to market valuation in China. The finding that corporate governance matters in China is quite striking. In both studies, most of the firms in the samples are state-owned enterprises. Investors appear to take into account the quality of corporate governance practices of a firm when making their investment decisions.

There is another stream of research which compares the relation between the overall quality of corporate governance and firm performance among different markets. Durnev and Kim (2005) use an aggregate approach to assess whether corporate governance predicts firm market value. They employ the Credit Lyonnais Securities Asia (CLSA) aggregate governance index and the S&P disclosure score (Patel and Dallas, 2002) to measure corporate governance practices for a sample of 859 large firms in 27 countries. Durnev and Kim (2005) conclude that firms with higher scores are valued higher in their respective stock markets. In a separate study, Klapper and Love (2003) also use the CLSA aggregate governance index to examine the relation between corporate governance and firm performance for 374 firms in 14 countries. They find positive correlations between corporate governance and two performance measures: market valuation and return on assets. Doidge et al. (2007) show that country characteristics, such as the legal protection of minority shareholders and the level of a nation's economic and financial development, affect firms' costs and benefits when implementing measures to improve corporate governance and transparency.

### **3 Institutional Background**

The push for corporate governance reform in Asia originated at the onset of the 1997 Asian Financial Crisis, which exposed structural weaknesses inherent in many Asian economies. Since then, a wide range of regulatory changes and structural reforms have been implemented throughout the region. The following nation-by-nation overviews highlight the key elements in the corporate governance reform efforts in the five countries included in this study.

### **3.1 *China***

Two institutional features drive the governance framework in China. The first is the fact that the majority of listed companies are majority-owned by the government. The second feature is that the stock market is heavily regulated by the government, an approach to governance called “administrative governance” by Pistor and Xu (2005). The guiding pieces of legislation for the stock markets in China are the Company Law (1993) and the Securities Law (1998). Another important law, the 1985 Accounting Law, was revised in 1999. Cheung et al. (2008) note that the “administrative governance” actions may have stymied efforts to create an effective governance system in China. The authors also note that Chinese stock markets have “concentrated ownership by the state, . . . a weak legal system, inadequate financial disclosure, [and] expropriation of minority shareholders by controlling shareholders (p. 466)” as well as short-run speculative behavior by investors. These problems are serious challenges to the improvement of corporate governance practices in China.

A Code of Corporate Governance of Listed Companies was released in 2002. The Code was jointly released by the China Securities Regulatory Commission and the National Economic and Trade Commission. The Code was based on the OECD Principles, and spelled out the foundations of a corporate governance system. In an effort to establish a corporate governance framework in China, both the Company Law and the Securities Law were revised in 2006. The revisions updated many aspects of governance, including improved shareholder protection, outlining the duties and responsibilities of directors, and improved disclosure requirements. Despite the recent improvements, the Chinese regulators continue to make a concerted effort to improve the quality of corporate governance practices among Chinese listed companies.

### **3.2 *Hong Kong***

Hong Kong has been recognized as having governance practices approaching international standards. The Securities and Futures Commission, which was established in 1989, oversees the capital market in Hong Kong. Hong Kong Stock Exchange has had, as part of its listing rules, a Code of Best Practices since 1993. In addition to the Code, the regulatory authorities have made significant efforts to improve corporate governance practices after the Asian Financial Crisis (World Bank 2003). Proof of these efforts came with the passage of the Securities and Futures Ordinance in 2003. The Ordinance was promulgated to improve governance practices and offer greater protection to shareholders. Amendments to the Companies Ordinance, effective in 2004, improved the protection of shareholders’ rights and expanded the requirements and expectations for directors.

Not content to rest on its good reputation, the Hong Kong Stock Exchange continues to update the requirements it sets for public companies. Recently, the Exchange announced new requirements, effective in 2012. The new requirements will bring Hong Kong firms closer to international best practices. For example, boards of directors must now have independent directors comprise one-third of the board, and boards must have a remuneration committee. The new requirements stress improved disclosure and transparency, and clarify and expand the obligations and requirements for directors. Through all the activity going into improving governance practices at listed firms, Hong Kong is striving to maintain its status as the financial center of Asia.

### ***3.3 Indonesia***

Indonesia has made drastic advancements in governance since the Asian Financial Crisis (World Bank 2004, 2010). Indonesia established a National Committee on Corporate Governance in 1999. The National Committee created and adopted the Code of Good Corporate Governance in 1999. The Code was then amended in 2006. A new Company Law was introduced in 2006. The revised Company Law listed the duties expected of board members. The revised Company Law also includes provisions for shareholders to seek compensation for violations of their rights. The capital market regulator (Bapepam-LK) is responsible for implementing the Company Law (1995) and the Capital Market Law (1995). Bapepam-LK issued updated regulations in 2008 and 2009 covering related party transactions, and increasing the level of disclosure required of firms. For example, the updated regulations now require independent shareholders to approve certain related party transactions that are deemed to be conflicts of interest.

Some weaknesses remain in the corporate governance system in Indonesia. For example, major shareholdings are required to be reported, but beneficial or ultimate share ownership is not. Ownership remains highly concentrated. Concentrated ownership and the lack of disclosure affect the ability of minority shareholders to influence the selection or appointments of directors. In the wake of the reform efforts, financial disclosure by firms has improved markedly. However, shareholders often face difficulty getting access to other company information, such as compensation for and the qualifications of board members. Corporate governance statements are voluntary. While many companies have statements, the statements that do exist often have limited content. In addition, listed companies are not required to “comply or explain” with the Code of Good Corporate Governance. As a result, compliance with the Code has slipped in recent years. In addition, awareness of the code by the general public has eroded somewhat. Nevertheless, the Indonesian regulators are still moving forward with new rules and regulations, working closely with listed firms to improve the quality of corporate governance practices in Indonesia.

### **3.4 *Philippines***

Corporate governance reform efforts in the Philippines began in earnest in 2000 when the Securities Regulation Code was passed (World Bank 2006). The Code gave new powers to the capital market regulator, established other important safeguards to protect minority shareholders, and made significant changes to enhance other regulatory agencies. For example, the Securities Regulation Code and the Code of Corporate Governance mandate that firms have at least two independent directors, or enough independent directors to comprise 20 % of the board. The Code of Corporate Governance also mandated that each firm have an audit committee, comprised of at least three board members. At least two members of the audit committee should be independent directors, with one independent director serving as chairman of the committee. In 2002, the Securities Exchange Commission (SEC), the capital market regulator, issued a Code of Corporate Governance. All listed companies were expected to observe the Code, and make available to shareholders a Manual of Corporate Governance. By 2005, the SEC required all companies to submit a self-assessment questionnaire. The objective of the survey was to get firms to evaluate their observance of corporate governance principles.

Corporate governance practices have been strengthened through the creation of a number of institutions and organizations, such as the Institute for Corporate Directors and the Corporate Governance Institute of the Philippines. IFRS reporting standards were implemented in 2005, improving the level of disclosure, the quality of financial reporting, and boosting disclosure and transparency. Provisions in the Corporation Code and the Securities Regulation Code help protect shareholder rights. The SEC now requires firms to provide a list of all shareholders. In addition, the Securities Regulation Code requires firms to disclose beneficial ownership and managerial ownership above certain thresholds. This requirement is especially valuable to shareholders, as public companies in the Philippines are largely family owned. Pyramidal shareholding structures are common. Despite the existence of many laws, rules, and regulation, there remains a notable divergence between observed practices at firms and the enforcement of the laws and regulations. The regulators in the Philippines continue to focus on improving legal enforcements and the quality of corporate governance practices in the Republic.

### **3.5 *Thailand***

The underlying legal and regulatory frameworks in Thailand are the Securities and Exchange Act (1992) and the Public Company Act (1992). The Securities and Exchange Act or SEA is enforced by the Securities and Exchange Commission, established in 1992 with the passage of the SEA. Although the stock market was growing at a very fast pace during the 1990s, corporate governance rarely received attention from the regulators, firms, or investors. Poor governance practices led to

excessive investments and aggressive financing, which, in turn, led to the Asian Financial Crisis in 1997.

Governance reform efforts began in Thailand in 1998, immediately after the start of the Asian Financial Crisis (World Bank 2005). Several institutions were created in the wake of the reform efforts, such as the Thai Institute of Directors Association in 1999. That year also brought the release of a Code of Best Practices for directors, written by the Stock Exchange of Thailand, and a new law requiring improved disclosure. Another landmark governance reform event came in 2001 when the Stock Exchange of Thailand (SET) released a wide-ranging report on governance. The report created governance principles and guidelines for listed companies. The guidelines spanned board practices, disclosure standards, and many other areas. New SET regulations promulgated in 2001 forced boards of Thai public companies to establish an audit committee, staffed with at least three independent directors. In the financial services sector, the Bank of Thailand introduced new regulations, aimed at tightening disclosure standards and forcing financial services companies to have an internal audit function. The National Corporate Governance committee was formed in 2002. The Committee included representatives from government ministries, industry associations, and regulatory bodies. That same year, the SET issued its 15 Principles of Good Corporate Governance. Newly listed companies were required to “comply or explain” with the Principles.

Since the flurry of activity immediately after the Asian Financial Crisis, governance reform efforts have continued. The SET has introduced measures to improve the exercise of minority shareholders’ rights at annual meetings and improve disclosure standards for executive and director remuneration. The SET recently introduced a measure to require public company boards to have independent directors comprise one-third of the board. In spite of the progress over the past decade and a half, the Thai government is still determined to improve the state of corporate governance in the Kingdom.

## 4 Data and Methodology

The sample consists of a select group of the largest public companies in five Asian nations: China, Hong Kong, Indonesia, the Philippines, and Thailand. The sample size varies depending on the number of firms included in the governance survey in a particular country in each year. Due to budgetary and logistical constraints, the surveys were not conducted in the same years in all the countries. In the end, there are total of 356 firm-year observations for China, 502 for Hong Kong, 514 for Indonesia, 330 for the Philippines, and 985 for Thailand. The descriptive statistics in Table 1 show the number of firms surveyed in each year for each nation.

The centerpiece of this study is an index constructed to measure the quality of corporate governance practices. Adapted from the OECD Principles of Corporate Governance (1999), we establish a set of criteria to measure corporate governance. The classification scheme for the criteria mirrors the five subsections of the OECD

**Table 1** Descriptive statistics of Corporate Governance Index by country and survey year

	Year	CGI	Section A	Section B	Section C	Section D	Section E	Number of firms
<b>China</b>								
Mean	2003	54.63	39.79	71.53	15.31	73.18	46.76	80
	2004	53.39	32.42	72.45	33.04	75.44	45.21	84
Std Dev	2005	58.72	57.73	71.84	23.81	80.40	46.31	96
	2006	50.78	57.33	60.94	26.76	67.43	42.95	96
	2003	4.84	8.56	8.34	13.70	6.88	10.41	
	2004	5.32	9.03	12.09	17.64	8.36	9.04	
Std Dev	2005	5.96	10.40	7.81	14.39	11.26	7.62	
	2006	7.21	12.79	12.47	15.25	15.75	10.05	
	<b>Hong Kong</b>							
Mean	2002	57.12	53.56	76.04	54.35	62.21	46.11	161
	2004	57.28	56.37	65.83	39.09	80.37	48.87	167
	2005	68.73	64.64	67.88	44.41	84.30	68.79	174
Std Dev	2002	6.80	10.36	7.69	19.48	7.83	12.69	
	2004	11.72	10.88	8.51	20.39	8.20	18.79	
	2005	9.20	10.06	8.80	19.33	7.97	14.47	
<b>Indonesia</b>								
Mean	2005	51.21	18.74	82.76	54.31	62.22	45.27	58
	2006	40.22	26.80	74.80	39.18	60.39	28.62	297
	2008	46.86	25.87	81.26	48.20	58.35	40.55	159
Std Dev	2005	12.56	7.69	6.22	29.39	17.86	19.49	
	2006	10.34	6.21	11.09	23.30	13.86	16.21	
	2008	11.72	7.15	7.06	21.12	18.79	17.11	
<b>Philippines</b>								
Mean	2005	52.32	34.07	82.67	42.50	71.54	33.43	45
	2006	53.62	45.80	75.28	42.36	67.59	37.17	54
	2007	62.20	64.81	82.71	57.51	77.00	44.92	107
	2008	72.41	77.08	87.10	66.09	78.05	59.11	124
Std Dev	2005	8.45	12.12	13.88	29.60	12.23	12.16	
	2006	10.91	18.04	15.55	29.88	15.00	13.13	
	2007	13.00	19.13	13.19	25.86	14.27	16.05	
	2008	14.21	18.98	11.09	24.31	17.27	19.04	
<b>Thailand</b>								
Mean	2002	57.61	72.45	69.32	43.06	55.54	49.26	294
	2004	61.30	63.68	72.52	61.80	74.05	50.09	327
	2005	61.79	64.40	74.85	64.04	73.09	50.84	364
Std Dev	2002	7.76	10.71	6.61	18.94	10.26	11.45	
	2004	9.37	13.03	7.61	20.07	7.68	13.30	
	2005	10.82	14.54	7.92	19.70	10.01	14.91	

This table presents the descriptive statistics of the corporate governance index (CGI) and the five sub-indices based on the OECD Corporate Governance Principles (1999). The CGI ranges from 0 to 100. The sample is drawn from publicly-traded firms in China, Hong Kong, Indonesia, the Philippines, and Thailand. The surveys were completed during 2002–2008 but not for every country in every year. The five subsections in the corporate governance indices are: rights of shareholders (Section A); equitable treatment of shareholders (Section B); role of stakeholders (Section C); disclosure and transparency (Section D); and board responsibilities (Section E)

Corporate Governance Principles: (A) Rights of Shareholders; (B) Equitable Treatment of Shareholders; (C) Role of Stakeholders; (D) Disclosure and Transparency; and (E) Board Responsibilities. In each nation, a small number of unique survey items apply only to that particular country. To enable insightful comparisons across firms and across different survey years, the core version of the survey, with the original 81 criteria, is used to build the CGI scores. The measurement instrument is attached in the [Appendix](#). A brief discussion of each of the OECD Principles follows.

The first section of the survey covers the protection of shareholders' rights through the corporate governance structure. The corporate governance structure should also make it easy for shareholders to exercise their rights. Basic shareholder rights include secure methods to register ownership and transfer shares, regular and timely provision of company information, the ability to participate and vote in general shareholder meetings, elect and remove members of the board, and obtain a share of the profits. A total of 15 measures are included in this section of the survey, designed to capture the actual rights of shareholders.

The next section assesses the equitable treatment of shareholders. In East Asia, it is common for majority shareholders to have an advantage over outside, minority shareholders (Claessens et al. 2002). Thus, the equitable treatment of shareholders is critical. All shareholders should be treated similarly whether they are a dominant owner, a minority owner, or a foreign shareholder. For example, equitable treatment would include the processes and procedures employed at shareholder meetings. Equitable treatment means that all types of shareholders can vote easily and inexpensively. There are 10 items used to evaluate the equitable treatment of shareholders.

The third section of the survey evaluates the roles of stakeholders in corporate governance, specifically the interactions of the firm with stakeholder groups such as employees, creditors, suppliers, shareholders, and the environment. The corporate governance framework should recognize the rights of stakeholders established by law or through mutual agreements, and encourage active cooperation between corporations and stakeholders in creating financially sound enterprises. This section assesses whether stakeholders can participate in the corporate governance process or have access to relevant and reliable information on a timely and regular basis. There are four survey items in this section.

The fourth section covers disclosure and transparency, the cornerstones of good governance. The firm should ensure timely and accurate disclosure of matters that are important to investors and regulators. Examples include the firm's financial situation, performance, and ownership. This section gauges whether the information was prepared and disclosed in accordance with acceptable corporate standards of accounting, as well as the standards for financial and non-financial disclosure. Further, it assesses whether the channels for disseminating information provide for equal, timely, and cost-efficient access to the relevant information by all users. Twenty-nine items in the survey assess disclosure practices.

The final section of the survey evaluates board responsibilities, an area that has generated extensive research. The OECD Principles assert that the board plays an

important role ensuring strategic guidance and effective monitoring of the managers. The board is accountable to the company and the shareholders. In total, there are 29 survey items used to assess board responsibilities.

From the standpoint of good corporate governance practices, the main concern in most Asian emerging markets is the well-being of outside/minority shareholders. Consequently, in this study it is more appropriate to assess the quality of corporate governance practices from the perspective of outside shareholders (i.e., assessments based on publicly available information obtainable when making investment decisions). Our data sources include annual reports, articles of association, memorandums of association, notices to call shareholders' meetings, annual general meeting minutes, company websites, analyst reports, and other sources available to the general public.

We rate each company on each criterion in the survey. The overall corporate governance index (*CGI*) for each company is the equally weighted score of the 81 criteria that are common to the surveys used in each country. We also create scores for five sub-indexes by using the equally weighted average score of all criteria contained in each section. All indexes, including the overall *CGI* and the five sub-indexes, are transformed so that the scores range from 0 to 100. We calculate a total corporate governance rating for each company, and this score ranges from 0 to 100. High *CGI* scores indicate good corporate governance practices whereas low scores indicate poor corporate governance practices. The *CGI* scores allow us to quantify the quality of corporate governance practices and investigate the effect of corporate governance practices, as measured by the *CGI*, on firm valuation.

Other financial data are obtained from Datastream. All data are matched according to the fiscal year of each sample firm. In the analysis, Tobin's  $q$  is used as the measure of firm valuation. Tobin's  $q$  is defined as the sum of the market value of equity plus the book value of total (all interest-bearing) debt divided by the sum of the book value of equity plus the book value of total debt. The values for Tobin's  $q$  have been winsorized to offset extreme values, which may have an undue influence in the regression analyses. To make sure that the results are not driven by firm heterogeneity, control variables are included in the regression model. The control variables used are: firm size (natural logarithm of the book value of total assets in local currency at the end of the fiscal year); leverage (measured as the debt-equity ratio or total interest-bearing divided by the total assets); liquidity (measured as cash holdings scaled by total assets); and the level of investment (measured as capital expenditures scaled by total assets). Variables to indicate the survey year are also included in the regression as a year fixed effect.

For each of the five nations, we conduct a regression analysis shown in Eq. 1 using all observations across all the years that data are available. We estimate the following model:

$$q_i = \beta_0 + \beta_1 CGI_i + \beta_2 Size_i + \beta_3 Leverage_i + \beta_4 Liquidity_i + \beta_5 Investments_i + \beta_t Year + \varepsilon_i \quad (1)$$

We hypothesize there is a positive relation between the quality of corporate governance practices, as measured by *CGI*, and firm valuation, as measured by Tobin's *q*. The regression coefficients for *CGI* will show the relation between the quality of corporate governance practices and firm valuation.

There is also a possibility that well-performing companies have incentives to improve the quality of their corporate governance practices. Therefore, the observed relation between *CGI* and Tobin's *q* may be a result of endogeneity in the relationship. To check the robustness of the results, we also perform the following two-stage least squares regression analysis, for each nation:

$$q_i = \beta_0 + \beta_1 CGI_i + \beta_2 Size_i + \beta_3 Leverage_i + \beta_4 Liquidity_i + \beta_5 Investments_i + \beta_t Year + \varepsilon_i \quad (2)$$

$$CGI_i = \beta_0 + \beta_1 q_i + \beta_2 Size_i + \beta_3 Leverage_i + \beta_t Year + \varepsilon_i \quad (3)$$

A positive and statistically significant coefficient for *CGI* in Eq. 2 will be supporting evidence of the positive relation between the quality of corporate governance practices and firm valuation in the five Asian nations in the study. This should confirm that the relationship is robust. We shall also observe the regression coefficient for Tobin's *q* in Eq. 3. If the coefficient for Tobin's *q* in Eq. 3 is statistically significant, it implies that there is a relation between firm valuation and the quality of corporate governance.

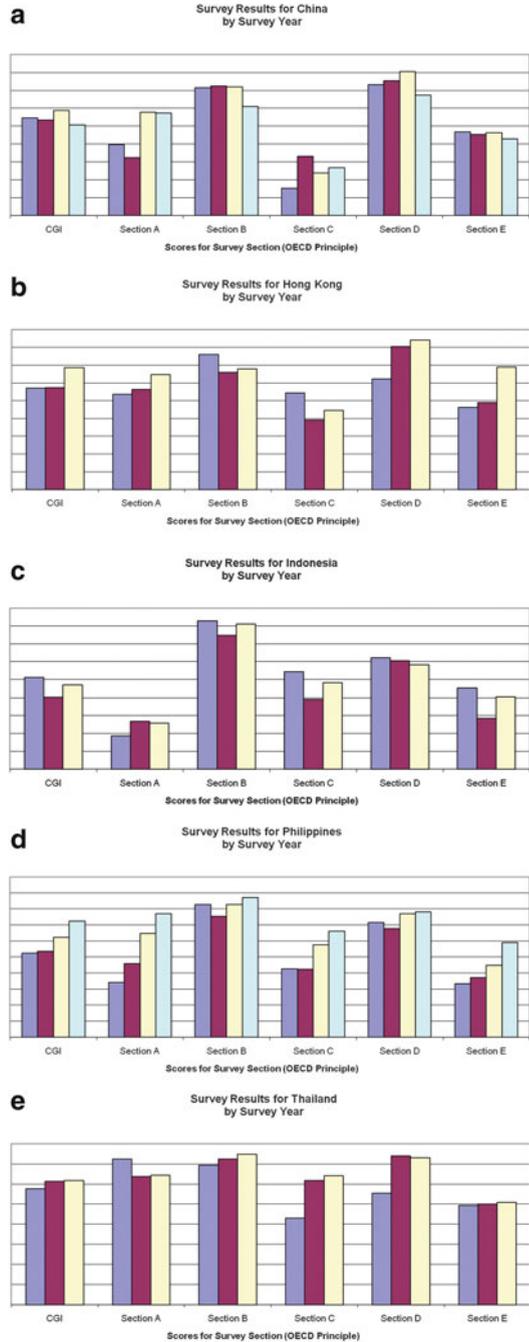
## 5 Empirical Results

### 5.1 Descriptive Statistics

Descriptive statistics for the *CGI* are contained in Table 1. For each nation, graphs of the overall *CGI* score and the scores for five survey subsections are shown in Fig. 1. The results are presented for each of the five countries in the sample, for each survey year.

For the firms surveyed in China, the yearly average *CGI* score does not exhibit a clear pattern. From an average value of 54.63 on the initial survey in 2003, the score falls slightly to 53.39, then rises to 58.72 in 2005 but falls to 50.78 in 2006. The scores on the individual subsections also do not show a clear pattern. The average scores for Section A, Protection of Shareholder Rights, rise from 39.79 in 2003 to 57.33 in 2006, but do not exhibit a consistent pattern of rises. The yearly averages for Section C, Rights of Stakeholders, also show the same pattern. In contrast, the average value for Section B, Equitable Treatment of Shareholders, is around 71 for

**Fig. 1** Average CGI scores by country. The following figures show the average scores of the Corporate Governance index (CGI) for each of the five nations surveyed: (a) China (2003–2006); (b) Hong Kong (2002, 2004, and 2005); (c) Indonesia (2005, 2006, and 2008); (d) the Philippines (2005–2008); and (e) Thailand (2002, 2004, and 2005). The data are taken from the years in which a corporate governance survey was conducted. The five subsections in the corporate governance survey are: Section A, Rights of Shareholders; Section B, Equitable Treatment of Shareholders; Section C, Role of Stakeholders; Section D, Disclosure and Transparency; and Section E, Board Responsibilities.



the first three years of the survey, but then the average falls sharply, dropping below 61 in 2006. This pattern is repeated for Section D, Disclosure and Transparency, and for Section E, Board Responsibilities. Overall, the descriptive statistics are consistent with the situation in China. Awareness of corporate governance is gradually gaining momentum. However, the adoption of improved governance practices by firms is still in the early stages.

Looking next at the survey results for Hong Kong, the *CGI* rises steadily across the three survey years, from an average of 57.12 in 2002 to 68.73 in 2005. This is consistent with the notion that the Hong Kong market has made continuous improvements and is moving to the forefront of the corporate governance movement in Asia. The subsection results for Sections A, D, and E show similar, steady improvements. However, the average values for Sections B and C do not show consistent improvement. The average for Section B is 76.04 in 2002 but then it falls to 65.83 and rises slightly to 67.88 during the two subsequent survey years. Likewise, the average value for Section C is the highest in the first survey year, then it tumbles and recovers in the two following years. This is the reason that the regulators in Hong Kong are still pushing new reform measures to protect minority investors and other stakeholders.

The results for Indonesian firms show an uneven pattern, as the *CGI* score rises from an average of 51.21 in 2005, then falls to 40.22 before rising to 46.86 in the most recent survey conducted in 2008. The patterns across the subsections are inconsistent. For Sections B, C, D, and E, the average values drop in the second survey year, but then rise in the last survey year. Section A shows a different pattern. The average value for Section A rises in the second year but then falls slightly in the final survey year. It is noteworthy that the values for Section A are by far the lowest of the five sections. It is possible that the uneven patterns may be the result of the large changes in the sample sizes for the three survey years. The first survey year covered only the 58 largest companies. The sample in the second year zoomed to 297 firms but only 159 companies were included in the third survey. The greater numbers of smaller firms included in the surveys could explain the observed drops in the *CGI* and subsection scores. Smaller companies often have governance practices that lag practices at larger firms.

Firms surveyed in the Philippines showed a steady improvement across the four survey years, as gauged by the *CGI*. The average value was 52.32 in the first survey year and the average rose steadily to 72.41 by 2008. This pattern was largely consistent across Sections A, C, and E. Sections B and D each recorded a slight decrease in the second survey year, but then the section averages increased steadily for the following two years. These results are noteworthy as the sample size more than doubled, rising from 54 firms in the second survey year to 107 firms and 124 companies in the third and fourth surveys. The results provide support to the notion that the reform effort by the regulators and related parties is gaining ground in the Philippines.

Lastly, the survey results overall show a steady improvement in corporate governance among Thai firms. The sample of Thai companies was the largest of the five countries included in this survey. The average *CGI* value rose consistently

from 57.61 in the first survey year to 61.79 in the final year. Sections B, C, and E showed a similar pattern of steady improvement. The average for Section A exhibited a marked deterioration in the second survey year, with a slight improvement in the final year. However, the value had not returned to the level recorded in the first year. Section D showed a large improvement from the first year to the second, followed by a slight decrease in the last survey year. Interestingly, the scores on board responsibilities are always the lowest among Thai firms. The regulators in Thailand are still working to improve the quality and practices of boards of directors among listed firms in the Stock Exchange of Thailand.

Descriptive statistics for the firms in the sample are presented in Table 2, again separated by country. The values of Tobin's  $q$  show a wide range across the five countries in the sample. Chinese firms have the highest value of Tobin's  $q$ , with an average of 2.09 across four sample years. At the other end of the spectrum, the average Tobin's  $q$  value is lowest for Thai firms, with an average value of 1.28 across the three survey years. Within a country, this performance measure exhibits a large amount of variation, as shown by the wide range of annual values. For example, for the sample of Chinese firms, Tobin's  $q$  ranged from a low yearly average value of 1.48 in 2004 to a high of 3.06 in 2006.

The other company characteristics selected as control variables did not show as much year-to-year variation with a country. The values of leverage, as measured by the book value of total interest-bearing debt divided by total assets, were not excessive. Thai firms showed the highest values of leverage, with an average ratio of 25 % across the three survey years. The average values for the cash to total assets ratio (*Liquidity*) ranged from 10 % to 16 % across the five countries, while the average ratio of capital expenditures to total assets (*Investments*) spanned a low of 4 % in the Philippines to a high of 8 % in China. In summary, the financial variables show some notable differences when compared across countries. However, the ratios *within* a country seemed relatively consistent over time.

## 5.2 *Quality of Corporate Governance (CGI) and Firm Valuation*

Table 3 reports the results of multivariate regressions of Tobin's  $q$  on the corporate governance index and other explanatory variables, as shown in Eq. 1. The regressions are pooled regressions, incorporating all firm-year observations for single country in one regression. The regressions include year fixed effects. Table 3 shows that all regressions are statistically significant at the 1 % level or better.

With *CGI* as the independent variable, all five markets show a positive relation between the level of corporate governance score and firm valuation as measured by Tobin's  $q$ . All five coefficients are statistically significant at conventional levels. The regressions control for firm size, leverage, cash holdings, and capital expenditures. The positive relation between the quality of corporate governance practices

**Table 2** Descriptive statistics

	Year	Tobin's $q$	Market value (millions)	Size	Leverage	Liquidity	Investments	Sample size
<b>China</b>								
Mean	2003	1.82	34.52	16.53	0.23	0.15	0.08	80
	2004	1.48	30.90	16.71	0.24	0.14	0.09	84
	2005	1.89	37.48	16.70	0.20	0.16	0.08	96
	2006	3.06	94.94	17.05	0.23	0.15	0.08	96
<b>All years</b>		<b>2.09</b>	<b>50.75</b>	<b>16.76</b>	<b>0.22</b>	<b>0.15</b>	<b>0.08</b>	<b>356</b>
Std Dev	2003	0.72	103.57	1.39	0.16	0.10	0.07	
	2004	0.68	94.15	1.41	0.16	0.10	0.07	
	2005	1.00	128.07	1.58	0.16	0.15	0.07	
	2006	2.40	276.26	1.70	0.17	0.14	0.07	
<b>All years</b>		<b>1.55</b>	<b>173.21</b>	<b>1.54</b>	<b>0.16</b>	<b>0.13</b>	<b>0.07</b>	
<b>Hong Kong</b>								
Mean	2002	1.36	24.18	16.20	0.18	0.16	0.04	161
	2004	1.76	43.90	16.60	0.18	0.16	0.05	167
	2005	1.75	51.42	16.89	0.19	0.15	0.06	174
<b>All years</b>		<b>1.63</b>	<b>40.18</b>	<b>16.57</b>	<b>0.19</b>	<b>0.16</b>	<b>0.05</b>	<b>502</b>
Std Dev	2002	1.13	77.50	1.65	0.14	0.15	0.05	
	2004	1.19	140.90	1.57	0.15	0.15	0.07	
	2005	1.40	155.09	1.54	0.16	0.14	0.07	
<b>All years</b>		<b>1.26</b>	<b>130.13</b>	<b>1.61</b>	<b>0.15</b>	<b>0.14</b>	<b>0.06</b>	
<b>Indonesia</b>								
Mean	2005	1.80	11,118.85	22.53	0.22	0.14	0.06	58
	2006	1.39	4,042.38	20.59	0.23	0.10	0.05	297
	2008	1.27	4,645.40	21.14	0.22	0.13	0.06	159
<b>All years</b>		<b>1.40</b>	<b>5,027.43</b>	<b>20.98</b>	<b>0.23</b>	<b>0.11</b>	<b>0.05</b>	<b>514</b>
Std Dev	2005	1.30	18,675.01	1.59	0.19	0.12	0.07	
	2006	1.09	15,113.72	1.86	0.20	0.12	0.08	
	2008	1.06	15,029.21	1.97	0.21	0.16	0.09	
<b>All years</b>		<b>1.12</b>	<b>15,649.98</b>	<b>1.96</b>	<b>0.20</b>	<b>0.13</b>	<b>0.08</b>	
<b>Philippines</b>								
Mean	2005	1.36	37.90	17.74	0.24	0.11	0.04	45
	2006	1.73	51.25	17.40	0.20	0.14	0.04	54
	2007	2.05	31.73	15.80	0.15	0.14	0.03	107
	2008	1.29	16.37	15.91	0.17	0.14	0.05	124
<b>All years</b>		<b>1.62</b>	<b>29.99</b>	<b>16.37</b>	<b>0.18</b>	<b>0.14</b>	<b>0.04</b>	<b>330</b>
Std Dev	2005	0.78	60.12	1.35	0.19	0.13	0.05	
	2006	1.16	81.58	1.56	0.16	0.14	0.04	
	2007	2.06	74.65	2.05	0.16	0.14	0.04	
	2008	1.51	43.70	2.05	0.16	0.14	0.07	
<b>All years</b>		<b>1.62</b>	<b>64.95</b>	<b>2.05</b>	<b>0.17</b>	<b>0.14</b>	<b>0.05</b>	
<b>Thailand</b>								
Mean	2002	1.14	5.48	14.90	0.25	0.10	0.05	294
	2004	1.41	11.39	15.08	0.25	0.10	0.06	327
	2005	1.29	11.92	15.10	0.25	0.10	0.07	364
<b>All years</b>		<b>1.28</b>	<b>9.82</b>	<b>15.04</b>	<b>0.25</b>	<b>0.10</b>	<b>0.06</b>	<b>985</b>

(continued)

**Table 2** (continued)

	Year	Tobin's $q$	Market value (millions)	Size	Leverage	Liquidity	Investments	Sample size
Std Dev	2002	0.68	16.01	1.53	0.24	0.13	0.07	
	2004	0.98	41.03	1.56	0.22	0.11	0.09	
	2005	0.79	47.24	1.58	0.21	0.12	0.07	
<b>All years</b>		<b>0.84</b>	<b>38.28</b>	<b>1.56</b>	<b>0.22</b>	<b>0.12</b>	<b>0.08</b>	

This table shows the descriptive statistics of the listed companies included in our sample. The sample is drawn from publicly-traded firms in China, Hong Kong, Indonesia, the Philippines, and Thailand. The data are taken from the years in which a corporate governance survey was conducted. *Tobin's q* is the ratio of the sum of the market value of equity at fiscal year end plus total (all interest-bearing) debt divided by the sum of the book value of equity plus total debt. Market value is the market value of shareholders' equity, in millions, in local currency. *Size* is the log of total assets. *Leverage* denotes the debt ratio (total interest-bearing debt divided by total assets). *Liquidity* is represented by the cash to assets ratio, defined as the balance sheet value of cash and equivalents divided by total assets. *Investments* is defined as the ratio of capital expenditures divided by total assets. The sample was winsorized to eliminate extreme values.

**Table 3** Regression results for market valuation and *CGI*

	China	Hong Kong	Indonesia	Philippines	Thailand
CG index ( <i>CGI</i> )	0.015 <sup>a</sup> (1.28)	0.030*** (5.37)	0.012** (2.19)	0.013* (1.67)	0.012*** (3.68)
<i>Size</i>	-0.273*** (-5.71)	-0.139*** (-3.66)	0.044 <sup>a</sup> (1.31)	-0.245*** (-4.68)	0.030 <sup>a</sup> (1.53)
<i>Leverage</i>	-2.616*** (-5.78)	-2.329*** (-6.45)	-0.535** (-2.16)	0.042 (0.08)	-0.190 <sup>a</sup> (-1.50)
<i>Liquidity</i>	1.293** (2.08)	1.436*** (3.57)	0.187 (0.50)	1.937*** (3.14)	1.423*** (6.18)
<i>Investments</i>	0.395 (0.38)	3.021*** (3.59)	2.803*** (4.57)	0.420 (0.26)	1.605*** (5.00)
Intercept	5.879*** (5.97)	1.924*** (3.13)	0.097 (0.15)	4.806*** (5.68)	-0.168 (-0.66)
Year fixed effects	Yes	Yes	Yes	Yes	Yes
Adjusted R-squared	0.325	0.233	0.083	0.128	0.110
F-statistic	22.38***	22.85***	7.62***	7.02***	18.40***
No. of observations	356	502	514	330	985

This table presents ordinary least squares regression results with *Tobin's q* as the dependent variable. The sample is drawn from publicly-traded firms in China, Hong Kong, Indonesia, the Philippines, and Thailand. The data are taken from the years in which a corporate governance survey was conducted. *Tobin's q* is the ratio of the sum of the market value of equity at fiscal year-end plus total (all interest-bearing) debt divided by the sum of the book value of equity plus total debt. Market value of equity is the market value of shareholders' equity, in millions, in local currency. The corporate governance index (*CGI*) is based on the OECD Corporate Governance Principles (1999). *Size* is the log of total assets. *Leverage* denotes the debt ratio (total interest-bearing debt divided by total assets). *Liquidity* is represented by the cash to assets ratio, defined as the balance sheet value of cash and equivalents divided by total assets. *Investments* is defined as the ratio of capital expenditures divided by total assets. Year fixed effects are included in the regressions but the coefficients are not reported. t-statistics are reported in parentheses. \*, \*\*, and \*\*\* denote statistical significance at the 10 %, 5 %, and 1 % level (two-tailed) respectively.

<sup>a</sup>Denotes statistical significance at the 10 % level (one-tailed).

and firm valuation is strongest among listed firms in Hong Kong, Thailand, and Indonesia. The coefficient for size is negative and significant for three out of the five countries. This result indicates that smaller firms have higher values of Tobin's  $q$  in these three nations. The coefficient for leverage is negative and significant for four out of five countries, indicating that as leverage rises, Tobin's  $q$  decreases. The coefficient for liquidity, as measured by the ratio of cash holdings to total assets, is positively related to Tobin's  $q$ . Lastly, the level of investment, as measured by the ratio of capital expenditures to total assets, is positively related to Tobin's  $q$  for three out of five countries.

Table 4 shows the results for the two-stage least squares regression analyses. Overall, the results confirm that the relation between the quality of corporate governance practices and firm valuation still holds even after controlling for the influence of firm performance on the quality of corporate governance practices. Interestingly, the regression coefficients for Tobin's  $q$  in Eq. 3 are statistically significant in Hong Kong, Indonesia, the Philippines and Thailand. We interpret this finding as evidence of a feedback loop in the relation between the quality of corporate governance practices and firm valuation. Nevertheless, the main hypothesis – a positive relation between  $CGI$  and firm performance – receives strong empirical support from the two-stage least squares regression analyses.

## 6 Conclusion

The benefits of good corporate governance practices on firm value remain one of the more contentious issues in corporate finance. Despite the large body of research investigating this question, there remains scant evidence of the benefits among Asian emerging markets. This study provides empirical evidence to support the notion that good corporate governance has a positive association with firm performance in Asian emerging markets. The study utilizes a comprehensive corporate governance index to measure the levels of corporate governance in China, Hong Kong, Indonesia, the Philippines, and Thailand. Furthermore, this study is the first to use an international standard, the OECD Principles of Corporate Governance (1999), as a benchmark to assess the progress of these five markets in terms of corporate governance reform.

The findings show governance practices have improved across these five markets. The improvements can be taken as evidence that East Asian listed companies have been making progress in their efforts to adopt internationally accepted corporate governance practices. The improvements in the quality of corporate governance practices are quite important because the improvements enable listed firms in East Asian markets to participate more effectively in the international capital market. Having firms that employ internationally accepted corporate governance practices could encourage the international investment community to invest in listed East Asian firms.

Table 4 Two-stage least squares regression results for market valuation and *CGI*

Dependent variable	China		Hong Kong		Hong Kong		Indonesia		Indonesia		Philippines		Philippines		Thailand	
	<i>CGI</i>	<i>q</i>	<i>CGI</i>	<i>q</i>	<i>CGI</i>	<i>q</i>	<i>CGI</i>	<i>q</i>	<i>CGI</i>	<i>q</i>	<i>CGI</i>	<i>q</i>	<i>CGI</i>	<i>q</i>	<i>CGI</i>	<i>q</i>
CG index ( <i>CGI</i> )		0.309* (1.73)		0.155*** (3.08)		0.067* (1.67)		0.108 <sup>a</sup> (1.33)								0.068*** (2.89)
<i>q</i>	0.510 (0.70)		1.942** (2.47)		4.746*** (2.85)		4.449*** (2.95)								4.890*** (4.29)	
<i>Size</i>	1.080*** (3.98)	-0.465*** (-3.19)	2.467*** (9.34)	-0.529*** (-3.27)	3.375*** (12.15)	-0.181 (-1.09)	4.015*** (8.28)	-0.379*** (-2.58)							3.098*** (16.16)	-0.169** (-1.99)
<i>Leverage</i>	2.292 (0.82)	-2.279*** (-2.69)	0.348 (0.11)	-1.989*** (-3.43)	-3.921* (-1.78)	-0.199 (-0.55)	1.699 (0.39)	0.249 (0.33)							-1.852 <sup>a</sup> (-1.33)	-0.028 (-0.17)
<i>Liquidity</i>		2.793* (1.93)		0.141 (0.18)		-0.226 (-0.46)		1.017 (0.87)								0.989*** (3.01)
<i>Investments</i>		1.812 (0.87)		1.435 (1.00)		2.183*** (2.72)		-2.700 (-0.80)								1.375*** (3.60)
Intercept	35.241*** (5.88)	-7.265 (-0.90)	14.101*** (2.78)	0.934 (0.88)	-31.564*** (-5.99)	2.442 <sup>a</sup> (1.36)	-25.092*** (-2.50)	0.998 (0.33)							5.772** (2.14)	-0.580* (-1.70)
Year fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Adj. R-squared	0.237	0.120	0.366	0.101	0.429	0.066	0.389	0.060							0.305	0.082
F-statistic	19.36***	7.04***	58.96***	9.05***	78.13***	6.16***	35.96***	3.64***							86.43***	13.51***
No. of observations	356	356	502	502	514	514	330	330							985	985

This table presents two-stage least squares regression results for each of the five countries in the sample. In the first model, the dependent variable is the corporate governance index (*CGI*). In the second model, the dependent variable is *Tobin's q*. The sample is drawn from publicly-traded firms in China, Hong Kong, Indonesia, the Philippines, and Thailand. The data are taken from the years in which a corporate governance survey was conducted. The corporate governance index (*CGI*) is based on the OECD Corporate Governance Principles (1999). *Tobin's q* is the ratio of the sum of the market value of equity at fiscal year end plus total (all interest-bearing) debt divided by the sum of the book value of equity plus total debt. Market value of equity is the market value of shareholders' equity, in millions, in local currency. *Size* is the log of total assets. *Leverage* denotes the debt ratio (total interest-bearing debt divided by total assets). *Liquidity* is represented by the cash to assets ratio, defined as the balance sheet value of cash and equivalents divided by total assets. *Investments* is defined as the ratio of capital expenditures divided by total assets. Instruments used in the regressions include the ratio of plant, property, and equipment to sales, return on equity as a measure of firm profitability, and an industry dummy variable for financial services firms (except for the Philippines). Year fixed effects are included in the regressions but the coefficients are not reported. t-statistics are reported in parentheses. \*, \*\*, and \*\*\* denote statistical significance at the 10 %, 5 %, and 1 % level (two-tailed) respectively.

<sup>a</sup>Denotes statistical significance at the 10 % level (one-tailed).

The second part of the paper examines the relation between the *CGI* and the market valuation of the major East Asian listed firms. The key research question is: Are internationally accepted corporate governance practices beneficial to East Asian listed firms? Conventional wisdom suggests that good corporate governance should lead to better performance and, in turn, higher firm valuation. The reason is that good corporate governance helps ensure that managers will act on behalf of shareholders and make decisions that maximize firm value.

The empirical results show a positive relation between firm valuation and corporate governance practices among the major listed firms in five Asian emerging markets. The paper provides empirical evidence that firms in select Asian emerging markets have made strides toward adopting more internationally recognized corporate governance practices. This finding is also significant from the viewpoint of the regulators in emerging markets. Regulatory authorities and government agencies have pushed for changes in each of the five markets we study. Managers and investors are not always convinced of the benefits which can accrue when firms improve governance practices. The regulatory changes have continued despite occasionally facing skeptical managers and apathetic investors. The pace of change may be slow at times, and the regulators face a challenge as they try to prevent backsliding by firms. However, the results from this study show the reward for the regulators' efforts: in Asian emerging markets, firms benefit from adopting good governance practices. Market valuations are higher for firms with better quality corporate governance practices.

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## Appendix: Corporate Governance Survey Instrument

Question number	Criteria
<b>Section A</b>	<b>Rights of shareholders</b>
A.01	Does the company offer other ownership rights beyond voting?
A.02	Is the decision on the remuneration of board members or executives approved by the shareholders annually?
A.03	How is the remuneration of the board presented?
A.04	Quality of notice to call a shareholders meeting in the past one year (i) Appointment of directors, providing their names and background

(continued)

Question number	Criteria
	(ii) Appointment of auditors, providing their names and fees
	(iii) Dividend policy, providing the amount and explanation
A.05	Did the chairman of the board attend at least one AGM in the past two years?
A.06	(i) Did the CEO/managing director attend at least one AGM in the past two years? (ii) Is a name list of board attendance available?
A.07	Do AGM minutes record that there was an opportunity for shareholders to ask questions/raise issues in the past one year? (i) Is there a record of answers and questions? (ii) Is any resolution being resolved?
A.08	Does the company have anti-takeover defenses? (i) Cross shareholding (ii) Pyramid holding (iii) Board members hold more than 25 % of shares outstanding
<b>Section B</b>	<b>Equitable treatment of shareholders</b>
B.01	Does the company offer one-share, one-vote?
B.02	Is there any mechanism to allow minority shareholders to influence board composition?
B.03	Have there been any cases of insider trading involving company directors and management in the past two years?
B.04	Does the company provide rationales/explanations for related-party transactions affecting the corporation?
B.05	Is the company part of an economic group where the parent/controlling shareholder also controls key suppliers, customers, and/or similar businesses?
B.06	Have there been any non-compliance cases regarding related-party transactions in the past one year?
B.07	Does the company facilitate voting by proxy?
B.08	(i) Does the notice to shareholders specify the documents required to give proxy? (ii) Is there any requirement for a proxy appointment to be notarized?
B.09	How many days in advance does the company send out the notice of general shareholder meetings?
<b>Section C</b>	<b>Role of stakeholders</b>
C.01	Does the company explicitly mention the safety and welfare of its employees?
C.02	Does the company explicitly mention the role of key stakeholders such as customers or the community at large (or creditors or suppliers)?
C.03	Does the company explicitly mention environmental issues in its public communications?
C.04	Does the company provide an ESOP (employee share option program), or other long-term employee incentive plan linked to shareholder value creation, to employees?
<b>Section D</b>	<b>Disclosure and transparency</b>
D.01	Does the company have a transparent ownership structure? (i) Breakdown of shareholdings (ii) Is it easy to identify beneficial ownership? (iii) Are director shareholdings disclosed? (iv) Is management shareholding disclosed?
D.02	Does the company have a dispersed ownership structure?
D.03	Is the company's actual ownership structure obscured by cross-shareholdings?

(continued)

Question number	Criteria
D.04	Assess the quality of the annual report, in particular, the following: (i) Financial performance (ii) Business operations and competitive position (iii) Board member background (iv) Basis of the board remuneration (v) Operating risks
D.05	Is there any statement requesting the directors to report their transactions of company stock?
D.06	Does the company use an internationally recognized accounting standard?
D.07	(i) Does the company have an internal audit operation established as a separate unit in the company? (ii) To whom does the internal audit function report?
D.08	Does the company perform an annual audit using independent and reputable auditors?
D.09	Are there any accounting qualifications in the audited financial statements apart from the qualification on uncertainty of situation?
D.10	Does the company offer multiple channels of access to information? (i) Annual report (ii) Company website (iii) Analyst briefing (iv) Press conference/press briefing
D.11	Is the financial report disclosed in a timely manner?
D.12	Does the company have a website, disclosing up-to-date information? (i) Business operations (ii) Financial statements (iii) Press releases (iv) Shareholding structure (v) Organizational structure (vi) Corporate group structure (vii) Annual report downloadable (viii) Provided in two languages (local language plus English)
<b>Section E</b>	<b>Role of the board of directors</b>
E.01.1	Does the company have its own written corporate governance rules?
E.01.2	Does the board of directors provide a code of ethics or statement of business conduct for all directors and employees?
E.01.3	Does the company have a corporate vision/mission?
E.02	Does the regulatory agency have any evidence of the firm's non-compliance with rules and regulations over the last three years?
E.03	Assess the quality and content of the audit committee report in the annual report (i) Attendance (ii) Internal control (iii) Management control (iv) Proposed auditors (v) Financial report review (vi) Legal compliance (vii) Conclusions or opinions

(continued)

Question number	Criteria
E.04	Have board members participated in training on corporate governance?
E.05	How many board meetings are held per year?
E.06	(i) Is the chairman an independent director? (ii) Is the chairman also the CEO?
E.07	Does the company have an option scheme with incentives for top management? (i) Did the company have an option (and/or other performance incentive) scheme in the past which is still in effect? (ii) Does the company currently have option (and/or other performance incentive) schemes?
E.08	Does the board appoint independent committees with independent members to carry out various critical responsibilities such as: audit, compensation and director nomination? (i) Audit (ii) Compensation (iii) Director nomination committee
E.09	What is the size of the board?
E.10	How many board members are non-executive directors?
E.11	Does the company state in its annual report the definition of ‘independence’?
E.12	Among directors, how many are independent directors?
E.13	Does the company provide contact details for a specific investor relations person?
E.14	Does the company have a board of director’s report?
E.15	Does the company disclose how much they paid the independent non-executive directors?
E.16	Does the company provide training to directors (including executive and nonexecutive directors)?

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