In 1997, many Asian countries experienced the beginnings of what has since been called the East-Asian financial crisis. It is widely believed to have originated in Thailand, mainly because of its relatively weak corporate governance system, compared to other jurisdictions. All Thai financial institutions were affected; some collapsed. This paper discusses the crisis and the factors that contributed to it, the reforms implemented after the crisis, and the ongoing challenges ahead.

Corporate governance: definition and principles

In this article, we will define corporate governance as the manner in which a corporation is directed and laws and customs affecting that direction. Good corporate governance underpins market confidence, integrity and efficiency, and hence promotes economic growth and financial stability.

The ideal corporate governance structure differs from country to country but one could argue that essentially, it strives to ensure the balance between the social and economic goals of a business. Its absence can contribute to catastrophic events. For example, the snowball effect of the weak Thai corporate governance system on several other countries within the same region contributed materially to the East-Asian financial crisis.

Reasons behind this financial crisis

The East-Asian financial crisis arguably began in Thailand following the liberalisation of its financial market in 1993. The establishment of an international banking centre in Bangkok encouraged the injection of short-term foreign capital at very low interest rates into the Thai economy. This led to the collapse of domestic finance and securities companies. The sudden withdrawal of this foreign capital dried up the short-term capital inflow, which culminated in what is fundamentally considered as a private sector debt crisis in Thailand.

These events drew attention to the importance of corporate governance; that the long-term health of any financial system or economy is strengthened by good corporate governance practices. To better understand what happened, one must look at the underlying factors that caused the disaster. These include: concentrated ownership, weak incentives to comply with the law, poor protection of minority shareholders and weak information standards. Thailand’s fixed exchange rate policy, coupled with financial liberalisation and deregulation in the absence of an effective regulatory and supervisory system further contributed to the crisis. We must also look at cultural factors. These factors will be discussed in more detail below.

Concentrated ownership

Thai business ownership is concentrated within a limited set of wealthy, well-established and well-placed families. Of Thailand’s publicly traded companies in the banking, finance, securities, agro-industry and telecommunications sectors, 61.6% are family controlled. Many Thai corporations own subsidiaries that have incurred high local debt as a result of comfortable relationships with local banks and financial bodies. In this context, the incentives to improve disclosure and corporate governance are not strong. The high levels of debt were not reported, leading to a false perception of the Thai economy.
Senior management positions in these family-owned corporations are often kept within the family, limiting the use of professional managers. This situation increased risk-taking behaviour and led to slower responses to changing market conditions.

**Protection of minority shareholders**

The concept of shareholder rights and duties as corporate owners is relatively new to Thailand. The Public Company Act 1992 (PCA) B.E 2535, which offers basic protection of shareholder rights, was only introduced in 1993. The various legal rights afforded to shareholders include:

- ability to vote by mail
- authority to call an emergency shareholders’ meeting
- authority to dismiss company directors
- shareholder asset protection against fraud, managerial or controlling shareholder self-dealing or insider wrongdoing
- authority to require an audit of financial statements and directors
- requirement to deposit shares with the company or financial intermediary before shareholder’s meeting
- cumulative voting may be allowed as a method for selecting directors: cumulative voting requires that a sufficient number of minority votes must be cast for a candidate to be successful
- the right to sue directors or resell shares to the company if shareholders object to fundamental changes such as a major asset sale or a merger
- a lower percentage of votes is required to call a shareholder meeting; if the percentage was higher, it would be harder for minority shareholders to call a meeting.

Significantly, the PCA does not provide for mandatory shareholder approval in interested transactions, which is the most common method of corporate fund expropriation in Thailand. Minority shareholders also rarely exercise their rights because they are not aware of them.

The weak Thai judicial system also undermined the enforcement of minority shareholder rights.

**The board of directors**

The highly concentrated ownership environment in Thailand as described above, means that board members are often appointed without the approval of minority shareholders, which may result in the interests of large shareholders being favoured. The appointment of friends and family with similar goals and ideals, rather than qualified professionals, means that it is difficult to create a board of directors that is independent of management.

Thai law states that directors are jointly responsible to perform their duties according to the law to achieve company objectives and decisions made at shareholder meetings with honesty and integrity. This principles-based law necessarily gives no concrete guidance for Thai corporations in how to comply with this law, and therefore, Thailand’s regulators may need to provide further practical guidance on this issue.

**Accounting standards and practices**

While the accounting standards ‘on paper’ were moderately robust, the implementation and regulation of these standards need to be greatly improved.

Unreliable financial data has also created distrust among creditors and debtors. This has led to the existence of two accounts in many Thai companies: one for management and another for the relevant authorities. There are also flaws with the valuation methods used, while unclear rules provide accountants with opportunities to manipulate their accounts.

The auditing profession suffered further damage to its reputation when the Stock Exchange of Thailand (SET) temporarily withdrew the auditing certification of two well-known auditors from two reputable companies (one local, one foreign). While such a penalty is not financially severe, the reputations of the auditors and their firms were severely damaged. The auditing profession also has difficulty managing the conflict between developing good business relationships with clients and auditing them. Auditors would therefore sometimes overlook irregularities in their clients’ accounts to preserve good business relationships.

There is also a general shortage of well-qualified accountants and auditors, which is exacerbated by the myriad of statutory and other requirements that need to be met, to enter the profession.

**Thai culture and its influence on business practices**

Rigidly hierarchical Confucianist concepts are highly visible in the Thai culture as well as Buddhist ideals and a general acceptance of ‘the way things are’. Religious beliefs may form the basis of moral judgment, support, welfare, education and officialdom, but as for commercial behaviour, fraud is still committed and business transparency needs to improve.
The government in the past was overly centralised, unresponsive and plagued by legal inadequacies, social inequity and corruption.12 Nepotism is commonplace. As family connections and relationships are integral to the success of a Thai corporation, business transactions are often carried out informally, based on trust and loyalty.

The Thai culture generally shies away from formal judicial proceedings, preferring personal negotiations and therefore minimal confrontation and exposure.

Changes made post-crisis

Thailand’s regulatory structures
Since the crisis, Thailand has put substantial efforts into effecting reforms and improving its corporate governance structure.13 These include the improved National Economic and Social Development Plan,14 amendments to the PCA and the Civil Code, and a review of how the Securities and Exchange Commission (SEC, established in 1992) and SET perform their roles.15 2002 was even declared as the Year of Good Governance.

The PCA was revised by SEC to guarantee greater rights for minority shareholders and to promote more equitable treatment of shareholders. Revisions include voting rights when electing directors, ability to call emergency shareholder meetings and timely access to reports.16 Misconduct in areas of corporate governance is now met with more serious penalties. The previously light penalties led to repetitions of the same misconduct. Now, however, SEC has initiated serious punitive and preventive measures against corporate malfeasance, criminal and civil sanctions are being imposed and names of corporate law violators are being disclosed in a public ‘black list’, as mentioned above.17

To protect creditors’ rights, the Bankruptcy Act 1940 was amended to align with the US Bankruptcy Code. This reform strengthened creditors’ ability to make companies and managers more accountable, protect creditors’ rights and facilitate the restructuring of corporate debt. ... The Foreclosure Act was also amended to reduce delays in foreclosure proceedings.

Corporate ownership structures
The financial crisis restructured the Thai corporate sector. The increased cash flow required by many family-owned corporations was a result of the accumulated debt of its subsidiaries. As a result, these subsidiaries were sold to foreign investors to increase cash flow.20 In contrast, the privatisation plan of Thailand’s State Enterprise Sector Reform Program sets out a requirement to create transparent management structures for their privatized state enterprises. This will allow these entities to function with minimal intervention from government regulators and policy makers, allowing the company to enhance operational efficiencies.21

Shareholders and other stakeholders
The provision of a proxy statement to shareholders has been suggested as a way of improving the proxy solicitation process to enable shareholders to voice their opinions on the issues at hand.22 SET and SEC now require all listed companies to implement cumulative voting and has introduced class actions.23 Businesses also have responsibilities to other stakeholders such as creditors, employees, government and society. The penalties for misconduct include dismissal and being listed in a public ‘black list’, as mentioned above.24

To protect creditors’ rights, the Bankruptcy Act 1940 was amended to align with the US Bankruptcy Code. This reform strengthened creditors’ ability to make companies and managers more accountable, protect creditors’ rights and facilitate the restructuring of corporate debt. The aim was to prevent bankruptcy due to temporary liquidity problems, and eliminate ambiguities that may delay proceedings and disadvantage creditors. The Foreclosure Act was also amended to reduce delays in foreclosure proceedings.25

Reporting and disclosure requirements
According to the International Monetary Fund and the World Bank, the free market is the most effective method of allocating resources and disciplining corporate management, but information accuracy and transparency is essential, to enable investors to make informed investment decisions. To ensure this, SEC is passing laws that require better disclosure by Thai corporations.

SET and SEC have also successfully brought criminal proceedings against company executives who deliberately prepared incorrect or incomplete
Companies failing to submit financial reports on time are also being suspended from trading.26

**Audit and accounting**

Thai accounting standards have been amended to align with international accounting standards.27 SEC now requires the mandatory formation of audit committees by listed companies to scrutinise company disclosures and accounting procedures.28

SEC is also proposing to lower the threshold level of equity share that will trigger the requirement for consolidated accounting, from 50% to 30%.29

Auditors failing to abide by the regulations will have sanctions imposed on them, including the suspension of auditing licences.29

**Board effectiveness**

Although there is no requirement in the PCA for public companies to appoint independent directors,30 the Bank of Thailand established the Institute of Directors (IOD) to outline governance, transparency, and the responsibilities of directors to their shareholders. The IOD also holds seminars to clarify the roles and responsibilities of all relevant stakeholders.31 SET’s new regulations also require a two-tier board structure consisting of main and executive boards.32

**Ongoing challenges**

**Cultural factors**

Thai culture and the dominance of Confucianism, as discussed earlier, have given rise to an abundance of family-owned corporations. Consequently, minority shareholders are considered to be little more than a distraction and have nothing to do with the running of the company.33

Predictably, insider trading and poor disclosure of information still result from Thailand’s corporate culture.33

The Thailand Development Research Institute found that almost half of surveyed companies have less than the minimal requirement of three independent directors. However, many companies find it difficult to find three independent directors who are also willing to be part of an audit committee, due to the responsibilities involved and the stringent qualifying criteria. This is compounded by the fact that many companies are still in financial difficulties.35

Changing Thailand’s corporate culture will be difficult but must happen, for good corporate governance is be established and integrated for the long term.

**Political, legal and regulatory factors**

The Thai political system inhibits the implementation of laws and regulations due to the various stages of approval required from different levels of the political hierarchy. Regardless of the reforms that have already taken place, nepotism is still a serious issue within the political hierarchy. As such, regulations requiring total transparency within corporations are unlikely to be enforced.

The areas of responsibility of SEC and SET should be clearly defined, but there has long been confusion over their jurisdictional boundaries. This has resulted in inefficiencies, leading to setbacks to any implementation of change.

In addition, unlike parallel laws in the US and UK, Thai judges are prohibited by civil law procedure from basing their rulings on past decisions or applying discretion to a case. It is unsurprising therefore that there have been no successful criminal prosecutions for fraud.34

Thai investors and shareholders are simply unaware of their rights and the nature of breaches of corporate law. Very few resources exist in Thailand to provide information for investors. In Thai culture, family and company loyalty may often conflict with obligations to shareholders.

**Recommendations**

So far, the quality of Thailand’s corporate governance ranking by the International Institute for Management Development (IMD) is not enviable at 32.29 (Best ranking is 1, worst ranking is 49).37

Learning from the lessons from developed countries will be helpful but in a limited way, as they are built on a different set of factors including the country’s institutional and legal framework, corporate ownership and control structures, and the local culture.

To continue improving Thai corporate governance, a multi-disciplinary approach is recommended.

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**Figure 1: Corporate Governance Disciplines**

![Corporate Governance Disciplines](image-url)
Firstly, the Thai government should be working more closely with regulatory bodies to strengthen the foundations and enforcement of the laws and regulations. Regulatory supervision must be strengthened and penalties made harsher for breach of legal obligations.

Secondly, the accountability of directors must be enhanced through checking mechanisms in the board structure and through other arrangements. SET has issued a code of best practice for directors of listed companies. The various codes of best practice should be refined, consolidated and integrated into the fabric of Thai business culture. Supervision of this integration should be strict.

Thirdly, market-wise, investors and banking institutions play an important role in enhancing corporate governance. Investors need to be educated in their legal rights, and both these parties should be encouraged to use their power to improve companies’ governance practices.

To make the above model work, a voluntary approach should be considered, as a complement to the legislative and regulatory framework. The key idea behind the voluntary approach is to change the mindset of all stakeholders involved so that the acknowledgment of the vital importance of good corporate governance motivates them to adopt good governance practices in their daily work. In this model, regulators could also use their powers to help educate and motivate the companies they regulate.

Notes

8. Nikomborirak and Tangkitvanich, n.4 at 2
10. Alba, Hernandez and Klingebiel, n.3 at 2
14. Limpaphayom, n 5 at 2
16. Nikomborirak & Tangkitvanich, n.4 at 2
17. Trairatvorakul, n. 21 at 6; Nikomborirak, n.20 at 5
19. P Limpaphayom, and JT Connelly, Review of Corporate Governance in Asia, Corporate Governance in Thailand, Thai Institute of Directors Association, 2004
22. Trairatvorakul, n.21 at 6
23. Nikomborirak & Tangkitvanich, n.4 at 2
24. Trairatvorakul, n.21 at 6
25. Limpaphayom, n.5 at 2
26. Nikomborirak, n.20 at 5
27. Limpaphayom, n. 5 at 2
29. Nikomborirak, n. 20 at 5
30. Nikomborirak, n. 19 at 5
32. Limpaphayom, n.5 at 2; Trairatvorakul, n.21 at 6
33. Fagan, n. 33 at 7
34. Fagan, n. 33 at 7
35. Nikomborirak, n 1 at 5
36. Fagan, n. 33 at 7
37. IMD, World Competitiveness Yearbook, 2002