THAI INSTITUTE OF DIRECTORS ASSOCIATION

สมาคมส่งเสริมสถาบันกรรมการบริษัทไทย

Corporate Governance Report of Thai Listed Companies 2005

Thai Institute of Directors Association

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Thai Institute of Directors Association (Thai IOD)

Established in December 1999, the Thai IOD is a membership organization that strives to promote professionalism in directorship. The Thai IOD offers directors certification and professional development courses, provides a variety of seminars, forums and networking events, and conducts research on board governance issues and practices. Membership comprises board members from companies ranging from large publicly listed companies to small private firms.

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Preface

This Corporate Governance Report of Thai Listed Companies 2005 (CGR 2005) is the fourth report of the corporate governance baselining study conducted by the Thai Institute of Directors Association (IOD). The project was initiated in 2001 and has been conducted annually since then. The original evaluation criteria were designed by McKinsey & Company, and was based on the Organization for Economic Cooperation and Development (OECD) Principles of Corporate Governance. It has been continually adapted and modified to cover newly introduced topics on international governance principles and best practices.

This report presents the corporate governance performance evaluation of Thai listed companies in 2004. The evaluation based on information available in public sources where investors can easily access. Therefore, the evaluation presented in this report reflects the Thai companies corporate governance from the outside investors and the general public point of view.

For the Thai IOD, it is very encouraging to see that over the past four years, the corporate governance performance of Thai companies has continually improved, and the CGR reports have been recognized for having played an important role in stimulating the companies to improve their governance. Therefore, in 2003 the National Corporate Governance Committee chaired by H.E. the Prime Minister, endorsed the project, and adopted it under the Committee's auspices.

In addition to the domestic recognition, the project is also accepted by the regional Institute of Directors in East Asia Network (IDEA.net) as a prototype for implementing the corporate governance evaluation system in their respective economies. Currently, three members of the IDEA.net have completed their first evaluation reports namely, Hong Kong, Philippines, and China.

The Thai IOD would like to express its sincere gratitude to the Stock Exchange of Thailand and the Office of Securities and Exchange Commission for their financial support to the project. We also would like to thank Professor Hiran Radeesri, Chairman of the project's Steering Committee and other members of the Committee for providing the guidance and suggestions throughout the project. Our special thanks also go to the Thai Investors Association for contributing essential information on shareholders meeting to the project. Finally, credit must be given to the Sasin Graduate Institute of Business Administration of Chulalongkorn University lead by Dr.Piman Limpaphayom, for scoring the companies and compiling the report.

Charnchai Charuvastr
President

Contents

I. Background and Objectives

After the onset of the 1997 Asian financial crisis, corporate governance has become a critical concern for investors and regulators in Thailand. Experts have pointed out that companies that suffered dramatic reversals of fortune as a result of the crisis also exhibited poor and ineffective corporate governance practices. Notably, ineffective boards of directors, weak internal controls, poor audit processes, and inadequate disclosure or lack of transparency are mentioned as some of the major causes of poor corporate governance. These weaknesses are believed to have partly contributed to the Asian financial crisis in Thailand and throughout the region. In the end, the crisis suggests that the issue of corporate governance is important not only for protecting investors' interests, but also for preventing the breakdown of the capital markets and maintaining economic stability.

Corporate governance arises as a result of a unique feature of modern corporations: the separation of ownership and control. In modern corporations specifically, owners may no longer be in charge of making day-to-day decisions. Managers are hired as agents of the owners and are supposed to act on behalf of the owners, the principal. Directors are also appointed to represent all shareholders in monitoring managers. Conflicts can arise at two levels: conflicts between the owners (shareholders) and managers, and conflicts between the controlling shareholders and minority shareholders. The root cause of the conflict stems from a conflict in incentives. Managers and/or controlling shareholders may have different incentives (e.g., excessively high salary) from outside shareholders (wealth maximization) and stakeholders (e.g., welfare of society). Problems occur when managers do not act on behalf of all stakeholders as they are supposed to do or when corporate directors fail to monitor managers for all shareholders. The Thai IOD posits that the board of directors is the pillar of a strong corporate governance system because board members represent all shareholders in monitoring the management. In the end, a sound corporate governance system allows managers to make decisions that will maximize firm value and, at the same time, provide effective protection for shareholders and other stakeholders.

The most common misunderstanding is that good corporate governance is not consistent with a company's stated goal of shareholder wealth maximization. Many managers use this myth almost as an excuse for not applying good corporate governance principles in their firms. These managers are wrong. In fact, good governance is a prerequisite of wealth maximization. In fact, good corporate governance is very much consistent with wealth maximization. The implication is also true for companies listed on the Stock Exchange of Thailand. The empirical results in this report also confirm that it also pays for listed firms to have good corporate governance. Specifically, listed companies that have good corporate governance also achieve better market performance than those that have lesser corporate governance. In fact, the evidence in Thailand is consistent with studies in other economies in the Asia-Pacific region.[1] These empirical facts refute any excuse offered by managers that corporate governance is too costly to implement. On the contrary, investors do care about governance and are willing to pay a premium for well-governed firms, increasing the firms' value. Consequently, it will be beneficial for all parties and the society if firms exhibit good corporate governance.

Most importantly, the presence of a sound and effective corporate governance system within an economy should help provide a degree of confidence to investors, both foreign and domestic. The market-based economy will function efficiently as a result. In the end, good corporate governance ensures that firms are efficiently employing their resources, which in turn leads to sustainable growth. Firms' costs of capital will then be lower, benefiting all parties in the economy.

To assist managers and directors of listed companies in addressing structural weaknesses within their own companies, the Thai Institute of Directors Association has commissioned a study, called "Baselining Corporate Governance in Thailand." The objectives of the study are: (i) to establish a sound analytical basis for the design and evaluation of effective corporate governance practices in Thailand; (ii) to evaluate the historical development and the current state of corporate governance among listed companies in Thailand; (iii) to identify areas for improvements. The study involved in-depth analyses of the key characteristics of corporate governance among companies listed on the Stock Exchange of Thailand. The first study was launched in 2001 with technical cooperation from McKinsey & Company and financial support from the World Bank. There were two follow-up studies in 2002 and 2003 with financial support from the Stock Exchange of Thailand and the Office of the Securities and Exchange Commission of Thailand. Most importantly, the National Corporate Governance Committee has also endorsed the study since 2003.

[1] Black, B. H. Jang, and W. Kim (2005). Does corporate governance predict firm 's market value? Evidence from Korea. Working paper. Stanford University and Cheung, S. Y. L., J. T. Connelly, P. Limpaphayom, and L. Zhou (2005). Do investors really care about corporate governance? Evidence from the Hong Kong market. Working paper. City University of Hong Kong and Sasin Graduate Institute of Business Administration of Chulalongkorn University.

The 2005 study, the fourth commissioned by the Thai Institute of Directors Association, presents the most complete record and evaluation of corporate governance practices for Thai companies ever undertaken. A brief summary of the study follows in Section II, followed by a description of the methodology in Section III. Section IV presents and discusses the descriptive results of the study. Section V provides the analyses of the empirical results that show a clear and definitive link between corporate governance and firm performance and value. The study concludes with several recommendations for companies to improve their corporate governance practices as well as outlining the path ahead in creating the right climate for improving corporate governance practices in Thailand.

II. Summary of Findings

The *Corporate Governance Report of Thai Listed Companies 2005* examines a total of 371 listed companies from various business sectors as shown in Table 1 below. Given the large number of companies represented in the survey, this study provides a comprehensive description of the corporate governance practices for publicly listed companies in Thailand. The aggregate findings in this report can also be used to track changes in corporate governance practices in Thailand across time.

Table 1: Number of Companies Included in the Survey by Type of Business

Types of Business	Total
Agro & Food Industry	41
Consumer Products	38
Financials	59
Industrials	41
Property & Construction	55
Resources	13
Services	69
Technology	36
Market for Alternative Investment (MAI)	8
Companies under Rehabilitation	11
Total Companies	**371**

The survey instrument used in this study was designed to match the most internationally known and widely adopted principles of good corporate governance developed by the Organization for Economic Cooperation and Development (OECD). The five principles are:

(A) Rights of Shareholders [20 percent]

(B) Equitable Treatment of Shareholders [15 percent]

(C) Role of Stakeholders [15 percent]

(D) Disclosure and Transparency [25 percent], and

(E) Board Responsibilities [25 percent].

In the final version of the survey instrument, there are 23 questions on the rights of shareholders, 13 questions on the equitable treatment of shareholders, 8 questions on the role of stakeholders, 32 questions on disclosure and transparency, and 42 questions on board responsibilities. The final score for each firm is a result of a weighted average of all questions in each category for that particular firm. The weights, which are determined by the project Steering Committee for each of the categories are show in brackets. The methodology section provides detailed descriptions of each principle.

Table 2 presents descriptive statistics for the 2005 corporate governance scores, both by individual OECD category and overall. For each category, corporate governance practices are rated on a 0-100 scale. The total score is a weighted average of the five categories.

Table 2: Descriptive Statistics of the 2005 Corporate Governance Scores

Survey Category	Average	Median	Minimum	Maximum
A — Rights of Shareholders	65.8	65.1	37.0	97.4
B — Equitable Treatment of Shareholders	74.5	74.4	51.3	97.4
C — Role of Stakeholders	68.8	70.8	0.0	100.0
D — Disclosure and Transparency	83.1	84.0	48.0	97.1
E — Board Responsibilities	53.5	52.1	22.6	92.0
Overall Scores	68.8	68.4	45.1	92.2

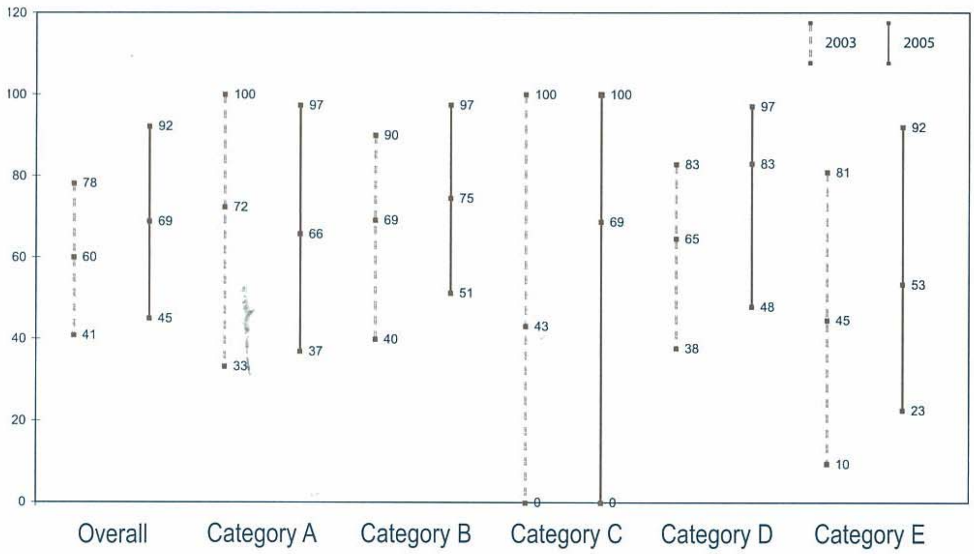
Overall, the results are encouraging. Thai listed companies receive average scores of more than 50 in all five categories with the average total score of 68.8. In summary, Thai companies have attempted to implement good governance mechanisms in order to maximize the wealth of their capital providers and preserve the interests of all stakeholders. However, the overall average still indicates that there are rooms for improvement. Most notable areas for improvements are the board responsibilities (lowest average) and roles of stakeholders (wide variation). Companies, regulators and investors should continue to put effort into improving corporate governance practices which would result in higher scores in the future.

Table 3: Overall Scores 2003 vs. 2005

	2003 (N=337)					
		Survey Category				
	Overall Scores	A—Rights of Shareholders	B—Equitable Treatment of Shareholders	C—Role of Stakeholders	D—Disclosure and Transparency	E—Board Responsibilities
Mean	60.0	72.4	69.2	43.2	64.7	44.7
Std. Dev.	6.5	11.2	6.6	18.9	8.0	11.4
Minimum	40.9	33.3	40.0	0.0	37.8	9.5
Q1	56.4	66.7	65.0	33.3	59.5	37.4

Median	60.2	73.3	65.0	37.5	64.8	43.9
Q3	63.8	80.0	75.0	50.0	69.7	51.0
Maximum	78.2	100.0	90.0	100.0	82.9	81.0
	2005 (N=371)					
		Survey Category				
	Overall Scores	**A—Rights of Shareholders**	**B—Equitable Treatment of Shareholders**	**C—Role of Stakeholders**	**D—Disclosure and Transparency**	**E—Board Responsibilities**
Mean	68.8	65.8	74.5	68.8	83.1	53.5
Std. Dev.	8.6	13.3	6.7	20.5	7.1	12.3
Minimum	45.1	37.0	51.3	0.0	48.0	22.6
Q1	63.4	55.6	71.8	58.6	79.0	45.2
Median	68.4	65.1	74.4	70.8	84.0	52.1
Q3	74.9	74.8	80.3	85.0	88.0	61.0
Maximum	92.2	97.4	97.4	100.0	97.1	92.0

Figure 1: Overall Scores 2003 vs. 2005



Data from this year's survey also provides an opportunity to benchmark corporate practices with the previous results in 2003. Table 3 shows descriptive statistics of the CG scores for the 2003 and 2005 surveys. Figure 1 compares the maximum and minimum values together with the mean CG score overall and by survey category.

Overall, the quality of corporate governance practices has improved in 2005 as compared to the last survey in 2003. Specifically, the average CG score in all but one category improved compared to the results from the 2003 survey. In Category A, however, the mean and median CG scores in 2005 dropped slightly from 2003. This is a result of some modifications of the original surveyinstrument that result in tougher scoring criteria employed in the 2005 study. Consequently, the change in scoring in Category A is not really comparable for the year 2003 and 2005. Nevertheless, the average score in Category A is quite high. Consequently, it is concluded that

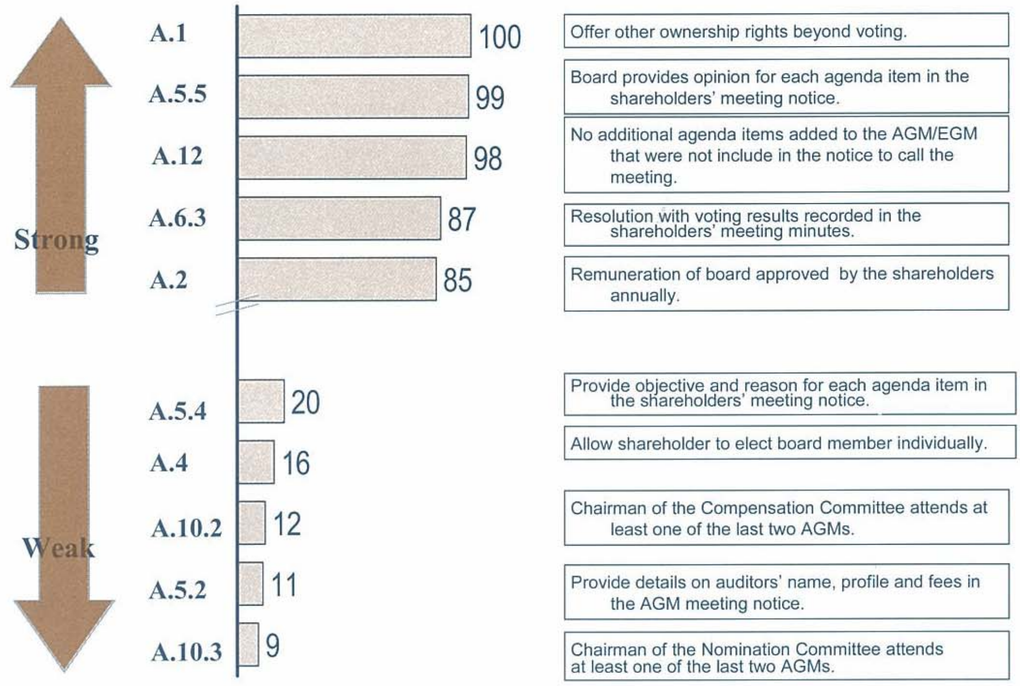
Thai firms still show solid performance in some aspects of shareholder rights. However, there are some areas of concerns in terms of the roles of stakeholders. The reason is that the minimum scores in Category C, Role of Stakeholders, remain at zero for both years. Although the average score for Category C is not the lowest among the five OECD categories used as the basis for the survey instrument, corporate social responsibility is considered the weakest corporate governance practice area among the sample companies in Thailand based on the wide range of scores (from 100 down to zero). Because of this wide variation, regulators and related parties should pay special attention to this aspect of corporate governance. The remaining three categories, Equitable Treatment of Shareholders, Disclosure and Transparency, and Board Responsibilities, also show marked improvement of corporate governance practices from the previous study in 2003. It should be noted that the area of board responsibility still exhibit the lowest average among the five categories. Although vast improvements have been made, the regulators and the companies should continue to focus their attention to improving the practices.

In conclusion, a comparison of the 2003 and 2005 surveys shows that corporate governance practices have improved. On average, the 2005 CG scores in all but one section (Rights of Shareholders) have improved since 2003. Among the five OECD categories, Principle C, Responsibilities to Stakeholders, which gauges corporate social responsibility, is considered the weakest area of corporate governance practice, as some companies could not score any points in this category. Finally, attention should still be placed on improving the scores on board responsibility.

In the end, it appears that this survey by the Thai IOD has accomplished its original purpose of improving the quality of corporate governance practices in Thailand through the use of a systematic evaluation process. Companies, regulators and investors are now aware of the concepts and applications of corporate governance. In fact, continuous improvements shown in the past few years have been very encouraging. If this trend continues, Thailand will become one of the countries that have best corporate governance practices in the region.

The following discussion highlights the survey key findings based on each of the OECD principle.

Figure 2: 2005 Survey Results – Rights of Shareholders



The first principle addresses the concept of shareholders, to see if shareholders' ownership rights have been established and can be exercised effectively. Figure 2 highlights the strengths and weaknesses exhibit by Thai firms. To the firms' credit and because of a legal requirement, all companies offer ownership rights (e.g., dividends and share repurchases) beyond basic voting rights. Further, all companies consistently disclose important information in their shareholders' meeting notices and meeting minutes resulting in informative documents for outside shareholders. In particular, more than 95% of companies include the board's comments and opinions. Likewise, more than 95% of firms stick to the agenda for annual general or extraordinary general meetings (AGM/EGM), and do not add extra agenda items that were not initially included in the meeting notice. A large majority of firms show the complete voting results for each agenda item. Shareholders' rights are also well protected. For instance, most companies submit their proposed board remuneration plans for shareholder approval every year. However, there are several areas that need improvement. For example, less than 20% of firms provide objectives and reasonsfor each agenda item in their meeting announcements. Furthermore, less than 20% of companies allow shareholders to elect board members individually. Also, few firms provide complete AGM attendance records that note the meeting attendance of important board committee chairmen, such as the chairmen of the compensation or nomination committees. Lastly, only 11% of firms provide details of the auditors' name, profile, and fee structure in the AGM meeting notice.

Figure 3: 2005 Survey Results – Equitable Treatment of Shareholders

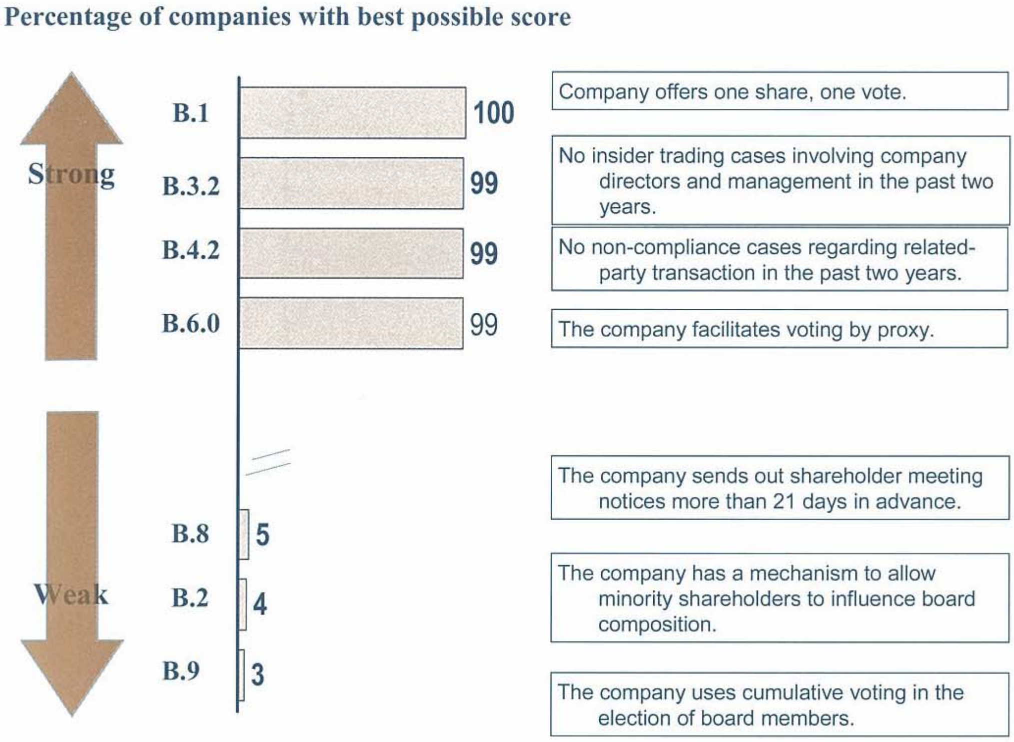
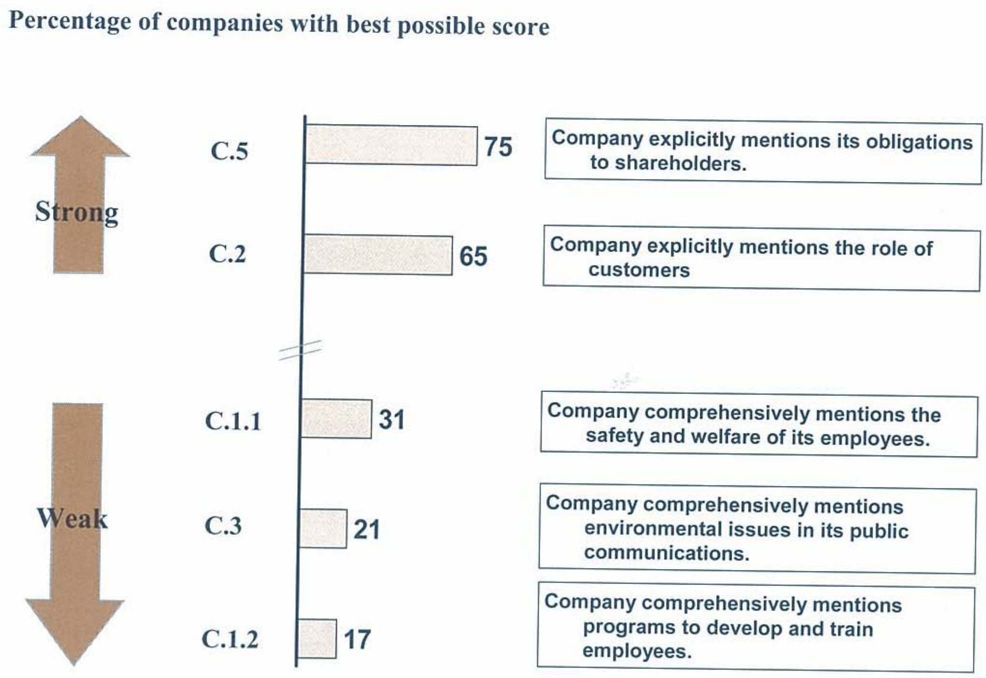


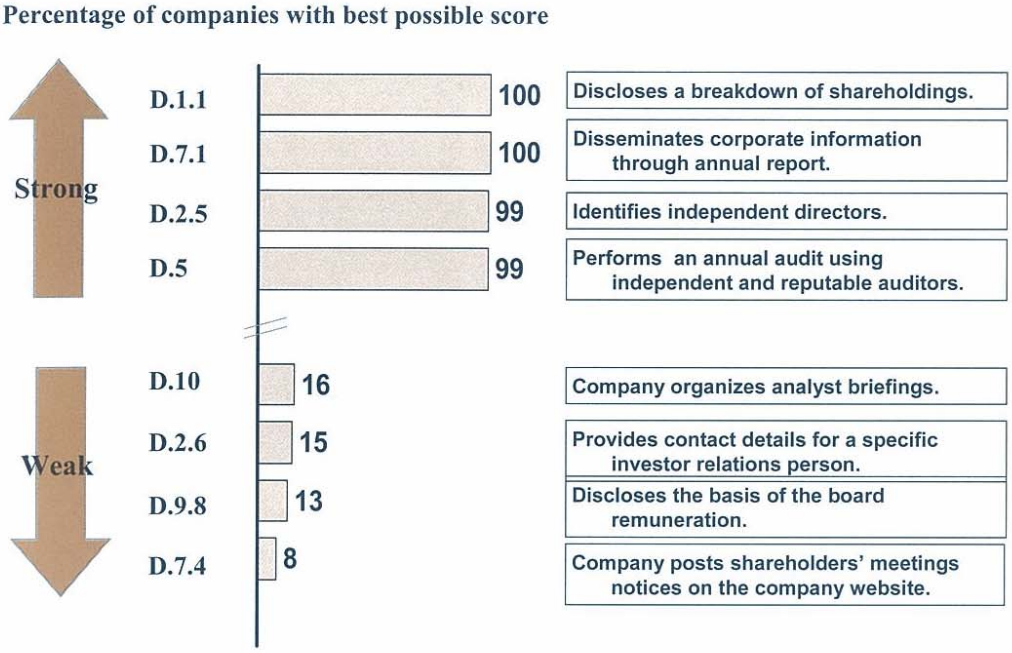
Figure 3 presents the highlights for the second OECD principle, which covers equitable treatment of shareholders and examines whether all shareholders, especially minority shareholders, are treated fairly and equally with respect to their ownership rights. The results show a number of strong areas. For example, all companies offer one share, one vote. Companies also are in compliance with legal and regulatory practices in the areas of related-party transactions and insider trading. For example, there have been virtually no non-compliance cases involving company directors and management during 2003-2004. Further, almost all companies attach a proxy form to the AGM notice to facilitate proxy voting. Again, there are also areas that deserve attention. For instance, only a few companies send out their AGM notices well in advance of the meeting, which would be consistent with international best practice. This issue on the lead-time for sending AGM notices will require additional assistance from related parties involved (e.g., the Stock Exchange of Thailand and Thailand Securities Depository) in order to find a feasible solution and improve the situation. Also, only a few firms have a mechanism to allow minority shareholders to influence board composition. Lastly, only a very small percentage of firms use cumulative voting when electing board members.

Figure 4: 2005 Survey Results – Role of Stakeholders



The third principle addresses whether companies are aware of their responsibilities to stakeholders – owners, customers, suppliers, creditors, employees, and the society. Figure 4 presents the highlights from the results in this section. From the survey, more than 75% of firms explicitly mention their obligations to shareholders and nearly two-thirds of firms mention their obligations to customers. However, less than one-third of companies comprehensively mention the safety and welfare of their employees. Also, only one-fifth of companies mention environmental issues and compliance in their public communications, which may indicate less than full awareness of their obligations. Still fewer companies describe the training and development programs established for their employees.

Figure 5: 2005 Survey Results – Disclosure and Transparency



The fourth principle suggests that companies should disclose accurate and complete corporate information to ensure factual presentation of vital information and transparent business practices. Based on the highlights in Figure 5, all firms show a breakdown of shareholdings and almost 100% of companies disclose the directors' and management shareholdings. All companies also make a good use of the annual report to communicate corporate information to investors. Independent directors can be easily identified in the company's public communications, such as the annual report. However, less than one-fifth of firms organize analyst briefings. Only 15% of companies provide specific contact details for an investor relations person. Fewer than 15% of firms fully provide the basis of board remuneration. Another area for improvement concerns better utilization of companies' websites as a means to communicate with shareholders, potential investors, and other stakeholders. For example, the company should post the notice to call shareholders meetings on the website.

Figure 6: 2005 Survey Results – Board Responsibilities

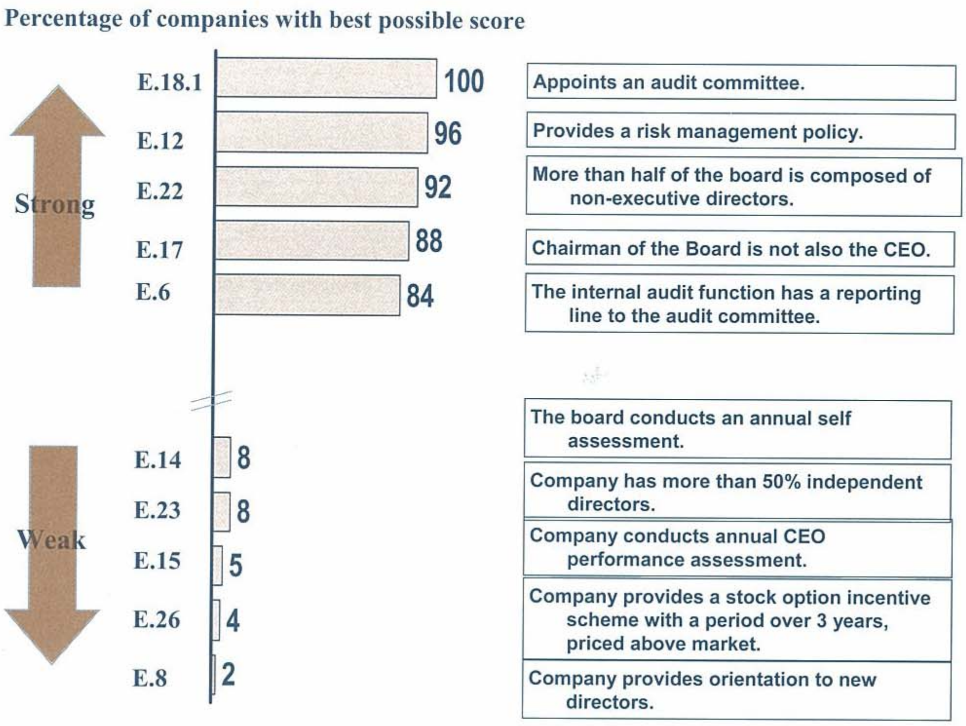
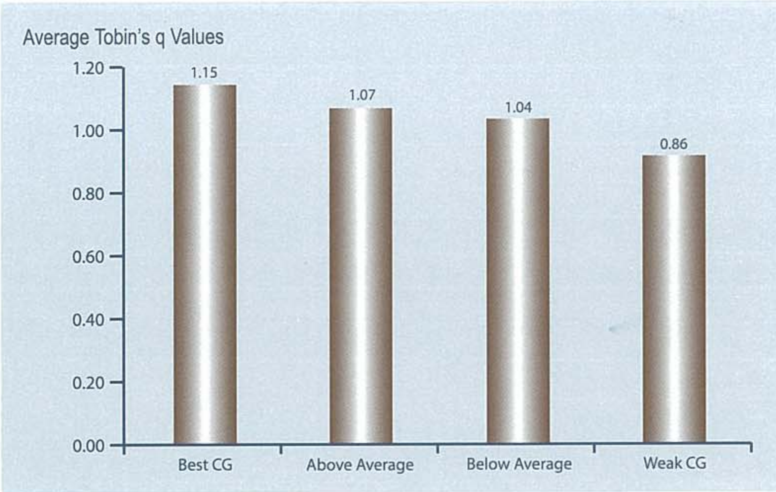


Figure 6 presents the highlight for the fifth principle, which analyzes the duties and responsibilities of the board of directors to ensure that director interests are aligned with the interests of all the shareholders. All companies comply with the law by establishing an audit committee staffed with all independent directors. Nearly 100% of firms have established a risk management policy. More than 90% of firms have a board of directors composed of a majority of non-executive directors. Nearly 90% of firms have split the jobs of Chairman of the Board and the top operating executive, separating the monitoring (board chairmanship) and the management (operating) responsibilities. Another strong area is that more than 80% of companies also have an internal audit function that reports directly to the Audit Committee. However, only a few boards explicitly conduct an annual self-assessment. Fewer than 10% of companies surveyed appoint a majority of independent directors to their boards. Only 5% of companies conduct an annual performance review of the CEO. Further, only a small fraction of companies provide an option incentive scheme for managers or provide orientation or training to new directors joining the board.

The next analysis focuses on the value of engaging in good corporate governance. An examination of the relation between corporate governance and market performance should provide solid evidence on the benefits of having good corporate governance practices. The analysis is conducted by dividing firms into four groups based on their corporate governance scores. The comparison of market performance between companies with good corporate governance and poor corporate governance should provide an answer to the question on the value of implementing good corporate governance practices.

Figure 7: Average Market Performance by Corporate Governance Scores



Corporate Governance Quartiles

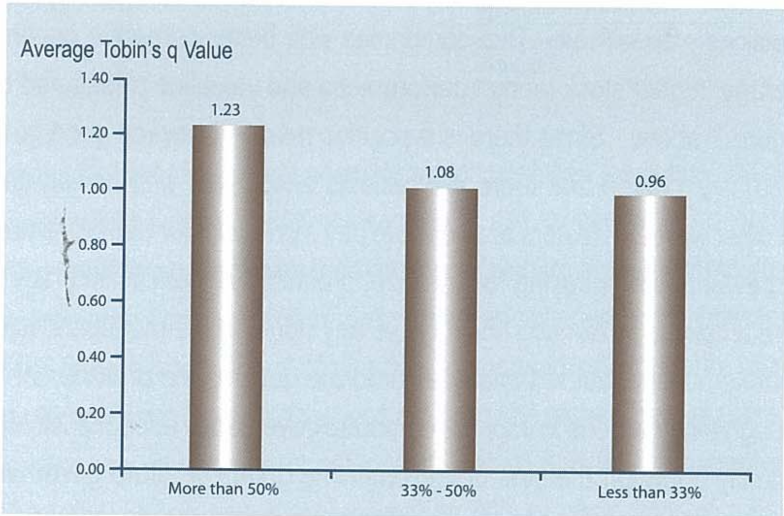
In the end, the empirical analyses reveal that it pays for Thai companies to have good corporate governance practices. Specifically, Thai companies with better corporate governance scores achieve, on average, higher stock market performance and valuation (measured by Tobin's Q), as shown in Figure 7 above. Since there is a positive relation between good governance and firm performance, it is proven that there are benefits associated with having good corporate governance. In other words, investors are willing to pay a premium for well-governed companies. The results hold even after controlling for firm size, profitability, financial leverage, and industry differences. The empirical evidence should erase any doubt in the managers' mind when they decide to undertake actions that will improve corporate governance practices of the firm. It is shown that although those actions to improve corporate governance appear costly on the surface, the benefits actually outweigh the cost of implementing good corporate governance practices within a firm.

Further, corporate governance scores appear to vary significantly across industries, which imply varying corporate governance practices across the business sectors. Investors and regulators should be aware of the variation across industries. Table 4 shows the number of companies in each sector that are ranked in the top quartile with respect to the corporate governance scores. The Resources sector shows the best performance with the majority of companies achieving corporate governance scores in the top quartile (10 of out 13 firms). Although the Financial sector has the most number of firms representing in the top quartile, the proportion (21 out of 59 firms) is rather small and needs to be improved. In contrast, the Agribusiness and Food sector only has 3 firms (out of 40 firms) representing in the top quartile. The Consumer Product sector also performs rather poorly having only 5 out of 38 firms representing in the top quartile.

Table 4: Top Performing Companies by Business Sector

Types of Business	Total	Top Quartile
Agro & Food Industry	41	3
Consumer Products	38	5
Financials	59	21
Industrials	41	7
Property & Construction	55	14
Resources	13	10
Services	69	16
Technology	36	15
Market for Alternative Investment (MAI)	8	1
Companies under Rehabilitation	11	1
Total Companies	**371**	**93**

Figure 8: Average Market Performance by Proportion of Independent Directors



Proportion of Independent Directors

This study also provides the answer to the question on the benefits of independent directors on the board. Conventional wisdom suggests that independent directors provide monitoring for all shareholders. Independent directors are also beneficial for the firm if they can provide valuable guidance to the top management in making strategic decisions which, in turn, leads to better performance. However, firms may argue that outsiders may create conflicts and problems in board meetings. This is an empirical question that needs a firm answer. The analysis is conducted by comparing market performance of companies by groups that are separated by the proportion of independent directors represented on the boards of directors.

In the end, the connection between good corporate governance practices and performance is also quite apparent in Thailand, as Figure 8 above shows. Companies with independent directors making up more than 33% of the board achieve better market performance. Specifically, companies that have at least one-third of the board made up of independent directors show market performance and valuation superior to companies with lower proportion of independent directors on the board. It is concluded that the addition of outside directors to the board is beneficial to firms. Not only do outside directors provide additional insights to the management, they also perform monitoring tasks that in turn lead to better market performance and firm value. Finally, it appears that the optimum board size should not be higher than 15 members.

The empirical results reveal that firms with more than 15 members on the boards tend to exhibit poor performance when compared with firms with smaller board size.

The next section describes the OECD principles and the methodology employed in this study.