

Asian companies open their doors

AT A GLANCE

- Asia's corporate governance and regulatory regimes have improved as companies adopt standards of governance and transparency typically observed in developed markets.
- Regulatory reform which began in the aftermath of the Asian crisis made companies stronger.
- Stronger governance structures may contribute to a reduction in risk premiums demanded by investors in the region's stock and bond markets.
- Enforcement of regulations remains a considerable regional challenge.

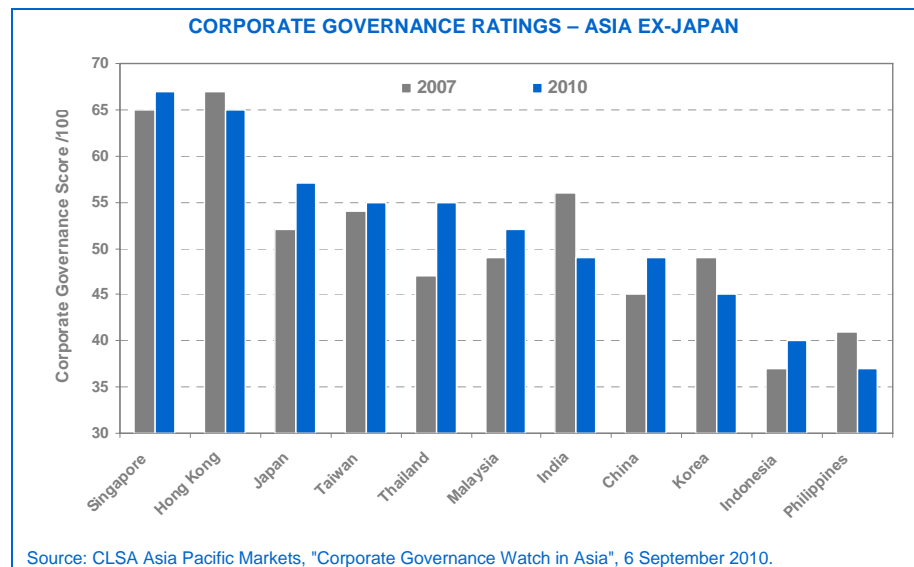
Investing in emerging markets usually means investors are challenged by under-developed disclosure regimes. Accessing reliable information from companies in these environments becomes a risk in its own right, but some Asian markets are making strides in creating an investor-friendly culture. Which countries are leading the way?

CORPORATE GOVERNANCE AND THE SIGNALS TO INVESTORS

Corporate governance is the way a company is run and how it complies with its regulatory environment. Understanding an individual company's adherence to corporate governance principles can improve or hurt the trust investors have in a company. Good governance is therefore important to bond and equity investors. In assessing the qualitative aspects of corporate governance, transparency, disclosure and observance of environmental and ethical standards rank highly in the minds of investors. It's also an area of considerable subjectivity, which places the onus on investors to cast their own judgment on the quality and credibility of a company's management and its business operations.

THE RISKS OF POOR GOVERNANCE

Sub-standard corporate governance has been regarded as a risk of investing in the Asian region. Inadequate corporate governance practices have stemmed from under-developed regulatory systems. But a recent study¹ shows many Asian countries are making advances in developing stronger corporate governance regulations and increasingly adopting tighter governance practices. To reach this conclusion, CLSA analysts completed a review of 580 companies in the region, making assessments on discipline, transparency, independence, accountability, responsibility and fairness to determine a score out of 100. The results of the questionnaire indicated that seven out of the 11 countries improved their rating on these corporate governance measures over the prior three years.

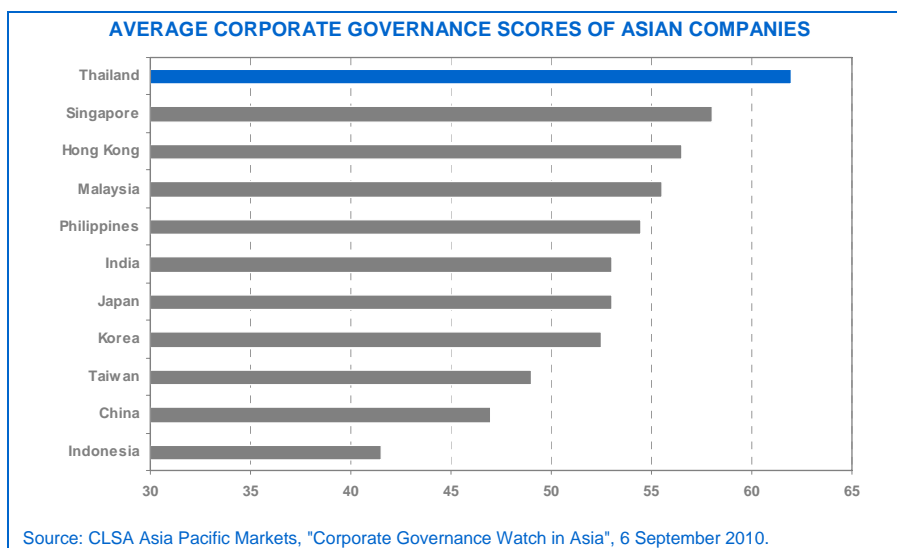


Source:

1. CLSA Asia Pacific Markets, "Corporate Governance Watch in Asia", 6 September 2010

Japan and Thailand were regarded as the biggest improvers of the group. Thailand has risen from ranking 8th out of the 11 Asian countries in 2007 to an equal 4th place alongside Taiwan. The higher rating has come largely as a result of developments in its regulatory structure. As an example, Thailand is now the only emerging Asian country to have voting by poll at company general meetings as a mandatory requirement. Even US technology powerhouse, Apple, restricted shareholders from voting on the appointment of company directors until recently.

Aside from regulatory improvements, Thai companies were assessed as demonstrating the best corporate governance practices in the Asia ex-Japan region. They collectively scored well on transparency, fairness, independence and accountability.² The Thai stock exchange has been doing its part to promote better business practices by offering awards to listed companies for outstanding corporate social responsibility initiatives.



ASIAN CORPORATE DEBT – THEN AND NOW...

	January 2011	July 1997
Market Size (US\$ billions)	40.9	4.8
Number of Securities	93	25
Average Credit rating	BB	B

Source: Bloomberg, BOFA-Merrill Lynch Asian Dollar Corporate High Yield Index, sourced 21 February 2011. Credit ratings from Standard and Poor's.

Sources:

2. CLSA Asia Pacific Markets, "Corporate Governance Watch in Asia", 6 September 2010

3. Saw Centre for Financial Studies, "Governance reforms in the Banking sector in Southeast Asia: Economic and Institutional Imperatives", May 2005)

BANKS HAVE LED REFORM IN ASIA

Reforms for Asia's governance regimes have been under development for well over a decade. In Thailand's case, delivering on reforms following the Asian crisis of 1997 has come at a considerable cost, estimated at 24% of its gross domestic product in 1998.³ Despite the significant costs associated with absorbing losses on non-performing loans and undertaking government bailouts of troubled banks, changes were necessary. Banks became particularly vulnerable to excessive risk taking as a result of concentrated ownership. Often banks were under family control or linked to industrial bodies, resulting in a moral and systemic hazard.

In Indonesia, some banks were found to have extended loans to staff or related parties on more favourable terms than available to the public. In 1997, Indonesian bank ratios of capital to assets fell to -13% and the cost to the government of assuming bank obligations exceeded 100% of its gross domestic product.³ Widespread adoption of the Basel accord on capital adequacy has since placed banking operations in South east Asia on a stronger footing.

Stronger regulation and disintermediation of corporate financing in today's market means that banks play a smaller role in funding corporations today than in 1997. Greater transparency has promoted corporate bond markets as a new avenue for many corporations to raise capital. Since 1997, the number of Asian high yield bond issuers has risen from 25 to 93. Spreads, or level of compensation demanded for corporate debt risk, have fallen considerably since the 1997/98 Asian crisis although spreads temporarily spiked in 2000 following a spate of sovereign debt defaults and the dot.com market crash. For bond investors, further reforms in corporate governance should lead to a decline in the governance risk premium on Asian investments and enhance investment returns.



STRONGER REGULATION HAS BEEN ACHIEVED, BUT ENFORCEMENT IS LACKING

The Organisation for Economic Cooperation and Development (OECD) believes rules governing Asian corporations now reflect the most developed thinking on the topic.⁴ Increasingly, boards of companies include independent directors, audit functions are conducted outside of the company's operations and international accounting standards have been adopted in most countries. However, governance practices have improved from a very low base. CLSA's research suggests a corporate governance score of 80 is required to attain a world class standard. Fidelity's own 2011 Asia Pacific Analyst Survey⁵, which sought views on general themes, issues and opportunities within companies across the region, found that 50% of respondents believe it will take 10 years or longer for companies they meet with in Asia to adopt global standards of corporate governance.

Singapore and Hong Kong are the highest ranked on regulatory frameworks by CLSA, but fall well below global standards on enforcement. The US experience shows that tight regulations alone were not enough to avert corporate scandals at Enron, WorldComm and the famous ponzi scheme run by former NASDAQ Chairman, Bernard Madoff. These high-profile failures highlight the implications of regulatory failures and present valuable lessons for Asia.

Large investors in Asia like Norway's NOK2.9 trillion (US\$513 billion) Government Pension Fund; the €237 billion (US\$318 billion) ABP Dutch pension fund and the US\$230 billion California Public Employees' Retirement System (CalPERS) pension fund are taking a more proactive approach to governance risks by cracking down on sub-standard practices in Asian markets.⁶

Asia has made major advances in strengthening corporate governance, evidenced through stricter regulatory practices and the actions of companies to improve transparency. While the improvements are viewed positively, there is more to be done before Asian countries can be regarded as having world class governance regimes. New rules may encourage compliance, but promoting cultural change within corporations will also need to continue.

Source:

4. OECD, "Enforcement of Corporate Governance in Asia-the Unfinished Agenda", 2007.

5. Fidelity International, "Insights and themes impacting Asia Pacific companies", February 2011

6. Figures based on latest available data published by the fund.



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