

Does Foreign Investment Really Improve Corporate Governance? Evidence from Thailand ***Sudarat Ananchotikul***

APPENDIX A: Construction of the Corporate Governance Index

In this appendix I describe in details the method used to score answers corresponding to corporate governance questions, and weighting schemes used in creating a composite governance index. A full set of questions is also provided at the end of this appendix.

Scoring Method

Most of the questions have binary (yes/no) answers. For these questions, I use an indicator variable that takes the value of 1 whenever the answer is associated with best practices, and 0 otherwise. The remaining questions have quantitative answers such as the number of independent directors on the board, average director meeting attendance, the number of securities law violations, etc. These answers are transformed into either 0-1 indicators or continuous values in the range of 0 and 1. For the former, I develop thresholds that are chosen in association with best practices in identifying good or poor governance. For instance, companies are assigned value of 1 if the proportion of independent directors in total directors is greater than 1/3, 0 otherwise. As another example, a company gets a score of 0 if the chairman of the board holds director or management positions in more than three (publicly held) companies, because time and productivity constraints can greatly reduce his ability to fully perform monitoring function in the company he chairs the board.¹

Quantitative questions for which answers are translated into continuous values from 0 and 1 are those generally believed to be positively correlated with the quality of overall governance. For instance, average director meeting attendance is scored as its ratio to the total number of meetings, since higher attendance rate implies higher accountability of the board of directors.

Most questions receive a maximum score of 1.² There are two items, however, that are considered more important or more directly indicative of corporate governance quality of a company, namely, the records of violations of securities or corporation laws such as insider trading or failure to comply with disclosure regulations. I assign a maximum score of 3 to each of these items. Missing data are replaced by lowest scores in corresponding entries. Since a lack of corporate governance information should be correlated with poor corporate governance, this practice should not lead to large errors.

¹ A list of directors and their positions are available only for publicly held companies from the SET's Director Database.

² A main question and its sub-questions if any comprise one question for the purpose of scoring.

The full questionnaire and the calculation of scores are described in Table A1 below. Questions marked with * are those available only in year 2004 and excluded from the CGI 2000 calculations.

Table A1: Structure of Corporate Governance Index

Code	Questions	Scoring Rule	Max. Score	Weight
A. BOARD STRUCTURE			6.00	20%
a1	What is the size of the board of directors?	1 if 5 ≤ a1 ≤ 12; 0 otherwise	1.00	
a2	What is the size of executive board?	1 if a2 ≤ 12; 0 otherwise	1.00	
a3	How many directors are also managers?	1 if a3/a1 < 1/3; 0 otherwise	1.00	
a4	How many directors are "independent"? ¹	1 if a4/a1 > 1/3; 0 otherwise	1.00	
a5	Does the firm state the definition of "independence" in the disclosure report? ¹	1 if a5 = 1; 0 otherwise	1.00	
a6	How many directors have attended director training programs by the Thai Institution of Directors Association? ²	1 if a6/a1 > 1/2; 0 otherwise	1.00	
B. CONFLICT OF INTEREST			8.00	25%
b1	Is the Chairman the same person as the CEO?	1 if b1 = 0; 0 otherwise	1.00	
b2	Is the Chairman "independent"?	1 if b2 = 1; 0 otherwise	1.00	
b3	How many public companies does the Chairman concurrently serve as a director or a manager?	1 if b3 ≤ 3; 0 otherwise	1.00	
b4	Does an audit committee exist?	1/2 if b4 = 1; 0 otherwise	0.50	
b5	- chaired by independent director?	1/6 if b5 = 1; 0 otherwise	0.17	
b6	- role and responsibilities clearly stated?	1/6 if b6 = 1; 0 otherwise	0.17	
b7	- performance or meeting attendance disclosed?	1/6 if b7 = 1; 0 otherwise	0.17	
b8	Does a nominating committee exist?	1/2 if b8 = 1; 0 otherwise	0.50	
b9	- chaired by independent director?	1/6 if b9 = 1; 0 otherwise	0.17	
b10	- role and responsibilities clearly stated?	1/6 if b10 = 1; 0 otherwise	0.17	
b11	- performance or meeting attendance disclosed?	1/6 if b11 = 1; 0 otherwise	0.17	
b12	Does a remuneration committee exist?	1/2 if b12 = 1; 0 otherwise	0.50	
b13	- chaired by independent director?	1/6 if b13 = 1; 0 otherwise	0.17	
b14	- role and responsibilities clearly stated?	1/6 if b14 = 1; 0 otherwise	0.17	
b15	- performance or meeting attendance disclosed?	1/6 if b15 = 1; 0 otherwise	0.17	
b16	Does a corporate governance committee exist?	1/2 if b16 = 1; 0 otherwise	0.50	
b17	- chaired by independent director?	1/6 if b17 = 1; 0 otherwise	0.17	

b18	- role and responsibilities clearly stated?	1/6 if b18 = 1; 0 otherwise	0.17
b19	- performance or meeting attendance disclosed?	1/6 if b19 = 1; 0 otherwise	0.17
b20*	Does the firm have a policy that specifies a minimum number of independent directors?	1/3 if b20 = 1; 0 otherwise	0.33
	Does the firm discuss the following internal-control issues in the disclosure report?		
b21	1) Organizational and control environment	2/15 if b21 = 1; 0 otherwise	0.13
b22	2) Risk management	2/15 if b22 = 1; 0 otherwise	0.13
b23	3) Management control activities	2/15 if b23 = 1; 0 otherwise	0.13
b24	4) Information and communication	2/15 if b24 = 1; 0 otherwise	0.13
b25	5) Monitoring and evaluation	2/15 if b25 = 1; 0 otherwise	0.13

C. BOARD RESPONSIBILITIES

13.00 20%

c1*	Number of board meetings per year	1 if c1 > 4; 0 otherwise	1.00
c2*	Average director's meeting attendance	c2/c1	1.00
c3*	Average independent director's meeting attendance	c3/c1	1.00
c4*	Is there a board meeting solely for independent directors?	1 if c4 = 1; 0 otherwise	1.00
c5*	Number of audit committee meetings per year	1 if c5 >= 4; 0 otherwise	1.00
c6*	Average audit committee meeting attendance	c6/c5	1.00
c7	Is there at least one accounting expert on the audit committee?	1 if c7 = 1; 0 otherwise	1.00
c8	How many public companies does the chairman of audit committee serve as a director or manager?	1 if c8 <= 3; 0 otherwise	1.00
c9	Does the firm clearly distinguish the role and responsibilities of the board and management?	1/3 if c9 = 1; 0 otherwise	0.33
c10*	Does the firm disclose that directors evaluation system exists?	1/3 if c10 = 1; 0 otherwise	0.33
c11	Does the firm have an option scheme which incentivizes management?	1/3 if c11 = 1; 0 otherwise	0.33
c12	Has there been any legal dispute where the firm was claimed to be at fault during the past year?	1 if c12 = 0; 0 otherwise	1.00
c13	Has there been any sanction to the board, management, or other insider(s) for violations of Securities and/or Corporations laws in the last two years? ³	3*(1-c13)	3.00

D. SHAREHOLDER RIGHTS

8.00 10%

d1*	Does the firm hold an annual general shareholder meeting?	1 if d1 = 1; 0 otherwise	1.00
d2*	Does the firm employ one-share-one-vote rule?	1 if d2 = 1; 0 otherwise	1.00
d3*	Is cumulative voting allowed in electing directors?	1 if d3 = 1; 0 otherwise	1.00
d4*	Is voting by mail allowed?	1 if d4 = 1; 0 otherwise	1.00
d5*	How many days in advance does the firm send out a notice of general meetings to shareholders?	d5/14	1.00
d6*	Is proxy voting allowed?	1 if d6 = 1; 0 otherwise	1.00

d7	Does the firm disclose a dividend policy?	1/3 if d7 = 1; 0 otherwise	0.33
d8	What is the minimum dividend (as percentage of net profit) according to the dividend policy?	1/3 * d8/100	0.33
d9	Does the firm provide an explanation/rationale for setting dividend at the specified level?	1/3 if 1	0.33

E. DISCLOSURE & TRANSPARENCY

17.00 25%

Does the firm disclose the following information in the disclosure report?

e1	1) Board meeting attendance of individual directors	1 if e1 = 1; 0 otherwise	1.00
e2	2) Board compensation and/or benefits of individual directors	1 if e2 = 1; 0 otherwise	1.00
e3	3) Director shareholdings	1 if e3 = 1; 0 otherwise	1.00
e4	4) Management shareholdings	1 if e4 = 1; 0 otherwise	1.00
e5	5) Related party transactions in details ⁴	1 if e5 = 1; 0 otherwise	1.00
e6	6) Corporate group structure	1 if e6 = 1; 0 otherwise	1.00
e7	7) Groupings of major shareholders who belong to the same family/economic unit	1 if e7 = 1; 0 otherwise	1.00
e8*	Does an investor relations unit exist?	1 if e8 = 1; 0 otherwise	1.00
e9*	Does the firm mention its investor relations activity carried out during the past year?	1 if e9 = 1; 0 otherwise	1.00
e10*	Does company website exist?	1 if e10 = 1; 0 otherwise	1.00

Does company website contain the following information?

e11*	1) Bio of directors	1/5 if e11 = 1; 0 otherwise	0.20
e12*	2) Business operation	1/5 if e12 = 1; 0 otherwise	0.20
e13*	3) Financial statements	1/5 if e13 = 1; 0 otherwise	0.20
e14*	4) Press release	1/5 if e14 = 1; 0 otherwise	0.20
e15*	5) Shareholding structure	1/5 if e15 = 1; 0 otherwise	0.20
e16*	6) Organization structure	1/5 if e16 = 1; 0 otherwise	0.20
e17*	7) Corporate group structure	1/5 if e17 = 1; 0 otherwise	0.20
e18*	8) Annual Report downloadable	1/5 if e18 = 1; 0 otherwise	0.20
e19*	9) Up-to-date information	1/5 if e19 = 1; 0 otherwise	0.20
e20*	10) English version	1/5 if e20 = 1; 0 otherwise	0.20
e21*	Does the firm publish Annual Report in English language (in addition to Thai language)?	1 if e21 = 1; 0 otherwise	1.00
e22*	Does the firm's Annual Report include a section devoted to corporate governance principles and implementations?	1 if e22 = 1; 0 otherwise	1.00
e23	How many times in the last two years has the firm been charged for failures to publish company reports within the specified period? ⁵	3-e23	3.00

OTHER INFORMATION

- h1 Is the Chairman a controlling family member?
- h2 The Chairman's shareholdings (% of total number of shares)
- h3 Is the CEO a controlling family member?
- h4 The CEO's shareholdings (% of total number of shares)
- h5 Is there a foreign national on the board of directors?
- h6 Does the firm have subsidiaries? ⁶
- h7 Does the firm issue corporate bonds?
- h8* Percentage shares classified as "free float" ⁷
- j1 Is the firm a foreign joint venture?
- j2 Foreign partner's shareholdings (% of total number of shares)
- j3 What is the nationality of the joint-venture partner?

Notes:

* Available only for the year 2004; excluded from CGI 2000 calculations.

1. According to the SET and the SEC, a director is defined as being "independent" if he/she meets the following qualifications:

- 1) Holding shares not more than 5 per cent of paid-up capital of the company, affiliated company, associated company or related company, which shall be inclusive of the shares held by "related persons". Related persons mean to include persons who have relationship with or are related to the company to the extent that they cannot perform their duties independently or in a flexible manner such as supplier, customer, creditor, debtor or person who has business relation that is material, etc.
- 2) Being a director who does not take part in the management of the company, affiliated company, associated company, related company or majority shareholder of the company.
- 3) Not being an employee, staff member or advisor who receives a regular salary from the company, affiliated company, associated company, related company or majority shareholder of the company; for example, the Chief Executive Officer of the company may not be a member of the Audit Committee because he is directly responsible for the management etc. In addition, he/she must have no direct or indirect benefit or interest in finance and management of the company, affiliated company, associated company or majority shareholder of the company.
- 4) Being a director who has no benefit or interest of the said nature during the period of 1 year before his appointment as a member of the Audit Committee except where the Board of Directors has carefully considered that such previous benefit or interest does not affect the performance of duties and the giving of independent opinions. In addition, he/she must not be a related person or a close relative of any management member or majority shareholder of the company.
- 5) Being a director whom is not appointed as a representative to safeguard interests of the company's directors, majority shareholders or shareholders who are related to the company's majority shareholders.
- 6) Being capable of performing duties, giving opinions or reporting the results of performance of work according to the duties delegated by the Board of Directors free and clear of the control of the management or the majority shareholders of the company including related persons or close relatives of the said persons.

2. The SEC and the SET strongly recommend that all directors of listed companies attend at least one directors training course offered by the Thai Institute of Directors Association (Thai IOD) to acquire formal knowledge about their role and responsibilities as well as to develop skills necessary for them to lawfully and effectively perform

their board functions. The Thai IOD's main training courses include the 5 ½ -day Director Certification Program (DCP) and the one-day Director Accreditation Program (DAP). More information can be obtained at the Thai IOD's website: <http://www.thai-iod.com/eng/>

3. To answer this question, I considered law enforcement actions in form of both criminal prosecutions and administrative sanctions by the SEC. A company is given a value of 1 under this question if it appears that during the last two years, director(s), management, or other insider(s) of the company was engaged in an unlawful business regarding takeover procedures, insider trading, dissemination of information, or failed to exercise his/her duties with care and honesty in order to preserve the interest of the company.

4. The SET rules require that if a listed company intends to enter into any transaction with connected persons, the listed company has to comply with the prescribed procedures. For example, if the volume of the connected transaction is not material, the listed company must disclose details of such transaction to the public. But if the volume of the transaction is substantial, the resolution from shareholders meeting must be obtained before entering into such transaction. Information that needs to be disclosed in case of connected transactions includes date when decision is made, relevant parties, explanation regarding the nature of asset or services being transacted, a total value and criteria used in determining the transaction total value, name, titles and shareholding in the listed company of connected persons, opinions of the board of directors concerning the decision to enter the transaction, and opinions of the audit committee that may be different from those of the board of directors, etc.

According to the SET, "connected person" is defined as follows:

(1) the management, major shareholders, controlling persons or persons to be nominated as the management or controlling persons of a listed company or a subsidiary company including related persons and close relatives of such persons.

(2) any juristic person having a major shareholder or a controlling person as the following persons of a listed company or a subsidiary: (a) the management (b) major shareholder (c) controlling person (d) person to be nominated as the management or a controlling person, and (e) related persons and close relatives of persons from (a) to (d).

(3) any person whose behavior can be indicated as an acting person or under a major influence of persons from (1) to (2) when making decision, determining policy, handling management or operation; or other persons the Exchange deems as having the same manner.

5. Failure to file required reports to the SET is considered a criminal violation. Documents required by the Thai public company law to be disclosed by listed company within a specified period are, for example, annual report, audited financial statements, reviewed quarterly reports, and report on the change in beneficial ownership of the company.

6. Under the accounting standards on consolidation of financial statements used in Thailand, the term "subsidiary" is defined as an entity that the parent company holds more than 50% of the total shares of the entity. It should be noted that, companies that are controlled or indirectly held by the parent company are not considered subsidiaries under this definition.

7. The "freefloat" of a listed security is the proportion of shares available for purchase in the market by investors. In principal, it is that part of shares not held by strategic shareholders and not held as treasury stock. The Research Department of the SEC defines strategic shareholders and estimates the free float under a set of guidelines. Strategic shareholders are defined as holders of shares for the purpose of company management or for business strategy. The following shareholders are considered as strategic shareholders:

- 1) Government, state-owned enterprises, and government agencies
- 2) Board members, managers or officials on the top four positions ranking down from the manager, including their related persons
- 3) Shareholders that hold shares in the proportion of more than 5%, with exception to the following groups of shareholders: securities companies, life-insurance companies, insurance companies, mutual funds, and contractual saving funds
- 4) Shareholders who have controlling power of the company
- 5) Shareholders whose shares are subjected to silent period

APPENDIX B: Construction of Ownership Variables

Data on equity ownership for individual firms is obtained mainly from the SET database, which provides a list of all shareholders owning at least 0.5 percent of a listed company. I classify these major shareholders into four main groups: 1) Thai family-business group, 2) Thai non-family-business investors, 3) Thai government, and 4) foreign investors. Each group is further divided into subcategories as illustrated in Table 5.

To determine whether an individual or corporation belongs to a Thai family-business group, I consult a publication titled *Thai Business Groups: A Unique Guide to Who Owns What* (Brooker Group, 2002) which provides comprehensive business and personal profiles of the 150 largest business families in Thailand. Additional information is collected from Department of Business Development, Ministry of Commerce for use in identifying ultimate owners of Thai non-listed corporations that are shareholders of listed companies in the sample.

Following Wiwattanakantang (2000), I describe a company as having a controlling shareholder if the largest shareholder(s) holds more than 25 percent of the firm's shares directly or indirectly.³ There were 43 companies in which a single foreign investor held more than 25 percent of the total shares; 36 of those companies were foreign multinational corporations. The family-business-group and the state-enterprise dummies have a value of 1 if a company is controlled by a family and by the Thai government, respectively; 0 otherwise. In 2004, about 47 percent of the sample companies were controlled by family business groups and 7 percent by the Thai Government.

The ownership pattern of Thai non-financial listed companies by type of the largest shareholder is presented in Table B2 below. The evidence is consistent overall with a survey of Thai ownership structure in 1996 by Wiwattanakantang (2000). Thai family business groups held the largest stake in more than 70 percent of the non-financial firms in the Thai stock market before the Asian crisis of 1997. However, this pattern has been changing over time as the family business groups either have given up their control to other types of investors or de-listed their companies from the stock market.

³ As noted in Wiwattanakantang (2001), under the Public Limited Companies Act, at or above 25 percent shareholdings, a shareholder has sufficient voting rights to do the following: 1) nullify any corporate decisions, 2) demand to inspect the business operation and the financial condition of the company, as well as the conduct of the board, 3) call an extraordinary general meetings at any time, and 4) submit a notion to the court demanding for the dissolution of a company if s/he believes that further company operations will bring only losses, and that the company has no chance of recovery. Since deviation from one-share-one-vote rule is not allowed in Thailand, voting rights are proportional to the number of shares owned by a shareholder.

Table B1: Summary Statistics of Shareholdings by Type of Shareholders, 2004

Type of Shareholders	Mean Shareholdings (N = 350)	Std. Dev.	Min	Max
Thai family business group	33.9	26.7	0.0	99.0
<i>individuals</i>	18.1	22.0	0.0	93.8
<i>corporations</i>	15.8	22.1	0.0	99.0
Thai Government	5.6	15.7	0.0	94.2
<i>State/State enterprises</i>	4.0	12.8	0.0	94.2
<i>Crown Property Bureau</i>	1.6	8.7	0.0	80.5
Other Thai investors	21.5	20.2	0.0	97.9
<i>individuals</i>	13.3	15.7	0.0	87.8
<i>corporations</i>	5.4	12.5	0.0	97.9
<i>banks</i>	0.6	3.0	0.0	35.8
<i>non-bank financial institutions</i>	2.0	3.5	0.0	25.0
<i>unidentified¹</i>	0.2	0.7	0.0	7.6
Foreign investors	16.1	19.9	0.0	88.4
<i>individuals</i>	1.4	4.4	0.0	40.0
<i>corporations</i>	7.8	16.1	0.0	75.0
<i>banks</i>	2.6	6.4	0.0	72.2
<i>non-bank financial institutions</i>	4.2	8.9	0.0	80.4
<i>government</i>	0.1	1.1	0.0	15.5
Unidentified¹	0.0	0.3	0.0	3.1

Notes: ¹ Shareholdings under this category is unidentifiable because the shares were held under the Thailand Securities Depository Co., Ltd as a nominee for Thai or foreign investors.

Table B2: Identification of the Largest Shareholder, 1996, 2000, and 2004

Type of Shareholder	1996		2000		2004	
	No. of firms	%	No. of firms	%	No. of firms	%
Total	353	100.00	311	100.00	350	100.00
Thai family business group	264	74.79	216	69.45	220	62.86
Thai Government	18	5.10	19	6.11	29	8.29
State/State enterprises	11	3.12	12	3.86	20	5.71
Crown Property Bureaus	7	1.98	7	2.25	9	2.57
Other Thai investors:	31	8.78	23	7.40	46	13.14
<i>individuals</i>	7	1.98	5	1.61	16	4.57
<i>corporations</i>	21	5.95	14	4.50	25	7.14
<i>financial institutions</i>	3	0.85	4	1.29	5	1.43
Foreign investors:	40	11.33	50	16.08	52	14.86
<i>individuals</i>	3	0.85	0	0.00	1	0.29
<i>corporations</i>	31	8.78	36	11.58	42	12.00
<i>financial institutions</i>	6	1.70	14	4.50	9	2.57
Unidentified investors	0	0.00	3	0.96	3	0.86

APPENDIX C: The Three Lists of the Foreign Business Act of 1999.

List 1

The businesses not permitted for aliens to operate due to special reasons:

- (1) Newspaper business, radio broadcasting or television station business
- (2) Rice farming, farming or gardening.
- (3) Animal farming
- (4) Forestry and wood fabrication from natural forest
- (5) Fishery for marine animals in Thai waters and within Thailand specific economic zones.
- (6) Extraction of Thai herbs.
- (7) Trading and auctioning Thai antiques or national historical objects.
- (8) Making or casting Buddha images and monk alms bowls.
- (9) Land trading

List 2

The businesses related to the national safety or security or affecting arts and culture, tradition, folk handicraft or natural resource and environment.

Group 1: The businesses related to the national safety or security

- (1) Production, selling, repairing and maintenance of:
 - (a) Fire arms, ammunition, gun powder, explosives.
 - (b) Accessories of firearms, ammunition, and explosive
 - (c) Armaments, ships, aircrafts or military vehicles.
 - (d) Equipment or components, all categories of war materials.
- (2) Domestic land, waterway or air transportation, including domestic airline business.

Group 2 : The businesses affecting arts and culture, traditional and folk handicraft:

- (1) Trading antiques or art objects being Thai arts and handicraft.
- (2) Production of carved wood.
- (3) Silkworm farming, production of Thai silk yarn, weaving Thai silk or Thai silk pattern printing.
- (4) Production of Thai musical instruments.
- (5) Production of goldware, silverware, nielloware, bronzeware or lacquerware.
- (6) Production of crockery of Thai arts and culture.

Group 3: The businesses affecting natural resources or environment:

- (1) Manufacturing sugar from sugarcane;
- (2) Salt farming, including underground salt;
- (3) Rock salt mining;
- (4) Mining, including rock blasting or crushing;
- (5) Wood fabrication for furniture and utensil production

List 3

The business which Thai national are not yet ready to compete with foreigners:

- (1) Rice milling and flour production from rice and farm produce
- (2) Fishery, specifically marine animal culture.
- (3) Forestry from forestation.
- (4) Production of plywood, veneer board, chipboard or hardboard.

- (5) Production of lime.
- (6) Accounting service business.
- (7) Legal service business.
- (8) Architecture service business.
- (9) Engineering service business.
- (10) Construction, except for:
 - (a) Construction rendering basic services to the public in public utilities or transport requiring special tools, machinery, technology or construction expertise having the foreigners' minimum capital of 500 million Baht or more.
 - (b) Other categories of construction as prescribed by the ministerial regulations.
- (11) Broker or agent business, except:
 - (a) Being broker or agent for underwriting securities or services connected with future trading of commodities of financing instruments or securities.
 - (b) Being broker or agent for trading or procuring goods or services necessary for production or rendering services amongst affiliated enterprises.
 - (c) Being broker or agent for trading, purchasing or distributing or seeking both domestic and foreign markets for selling domestically manufactured or imported goods in the manner of international business operations having the foreigners' minimum capital 100 million Baht or more.
 - (d) Being broker or agent of other category as prescribed by the ministerial regulations.
- (12) Auction, except:
 - (a) Auction in the manner of international bidding not being the auction of antiques, historical artifacts or art objects which are Thai works of arts, handicraft or antiques or having the historical value.
 - (b) Other categories of auction as prescribed by the ministerial regulations.
- (13) Internal trade connected with native products or produce not yet prohibited by law.
- (14) Retailing all categories of goods having the total minimum capital less than 100 million Baht or having the minimum capital of each shop less than 20 million Baht.
- (15) Wholesaling all categories of goods having minimum capital of each shop less than million Bath.
- (16) Advertising business.
- (17) Hotel business, except for hotel management service
- (18) Guided tour.
- (19) Selling food or beverages.
- (20) Plan cultivation and propagation business.
- (21) Other categories of service business except that prescribed in the ministerial regulations