

# Enabling the Corporation: Lessons Learned in Governance

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# Topics

- The Importance of Governance
- Organizational Issues in Indonesian Corporations
- Implementing Proper Governance
- Best Practice Model:  
Synergising Governance, Risk Mitigation  
and Audit

# The Importance of Governance

## Recent Findings

# Asia's Governance Challenge

- Corporate governance in Asia has improved, but implanting new forms of behaviour will take time
- Asian countries are enforcing the implementation of Independent Directors and Audit Committees
- Agreement is growing, at least in principle, on what good governance entails, and most countries in the region have adopted explicit governance codes
- Securities laws and the listing requirements of stock exchanges have been strengthened, regulatory authorities have enhanced powers, and the media are more inquisitive and probing

The McKinsey Quarterly, 2004 Number 2

EXHIBIT I

**Asia steps up**

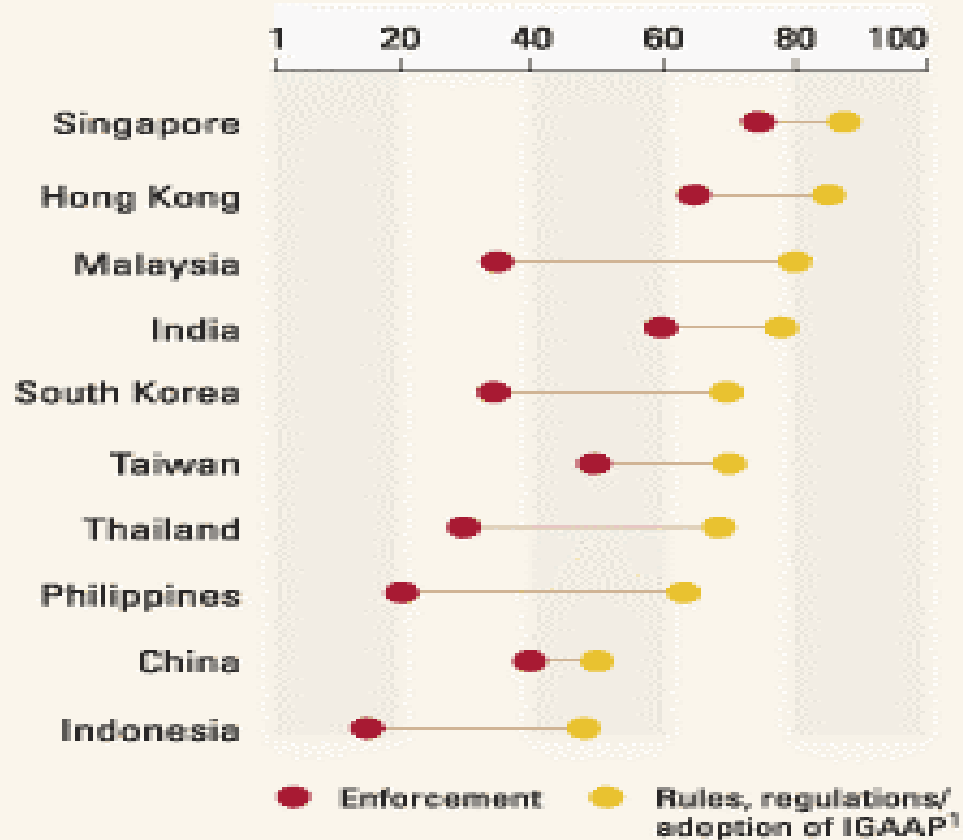
Independent director and audit committee requirements

	1997		2003	
	Independent directors?	Audit committees?	Independent directors?	Audit committees?
China			✓	✓
Hong Kong	✓		✓	✓
India			✓	✓
Indonesia			✓	✓
Malaysia	✓	✓	✓	✓
Philippines			✓	✓
Singapore	✓	✓	✓	✓
South Korea			✓	✓
Taiwan			✓	✓
Thailand			✓	✓

Source: Asian Corporate Governance Association

## Toothless tigers?

1 = lowest, 100 = highest



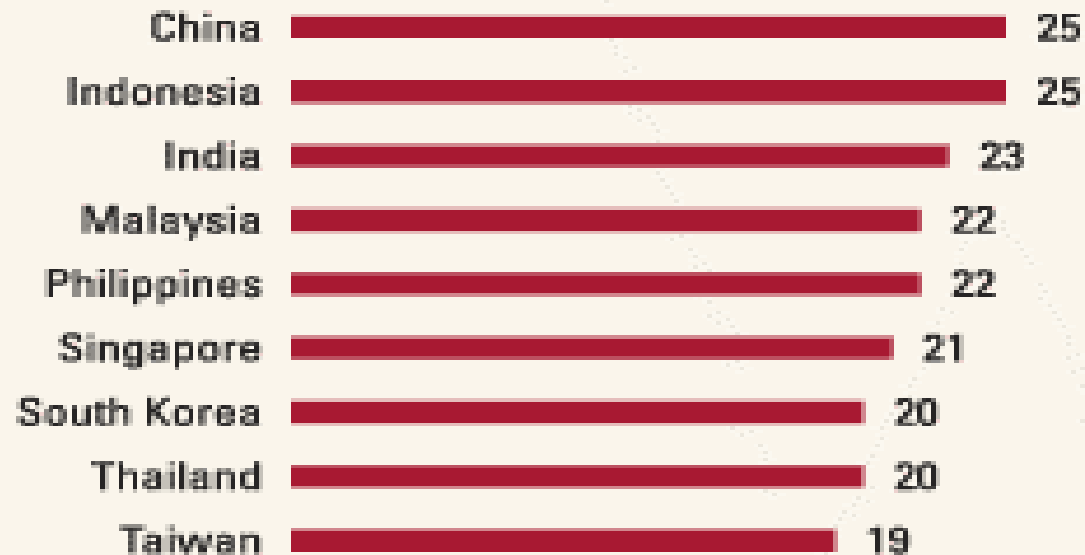
<sup>1</sup> International generally accepted accounting principles.

Source: CG Watch 2003, CLSA Emerging Markets and Asian Corporate Governance Association, April 2003; McKinsey analysis

## EXHIBIT 3

### The governance premium

Average premium investors are willing to pay for well-governed company,<sup>1</sup> 2002, %



<sup>1</sup> Of those investors willing to pay premium.

Source: 2002 McKinsey investor opinion survey

# Market Impact:

Does Good Governance Pay?

LPBN's Shareprice (IDR)





# Market & Business Impact:

## Does Good Governance Pay?

- LPBN, 30 June 2005 performance:
  - Share price increased over 750% in 30mo
  - PER valued slightly higher than market average (13.42)
- Turnaround in financial performance:
  - Over IDR510bn loss in 2003, or over IDR1tn in accumulated losses in 2002 and 2003
  - 2004 net-income after tax IDR893bn
- Market recognition:
  - February 2004 divestment of GOI majority share done at 40% over book value
  - Since May 2004 included in the Morgan Stanley's MSCI Indonesia Index
  - Since July 2004 included in the Jakarta Stock Exchange LQ-45 index
  - September 2005 majority (52.05%) bought by Khazanah at Rp 1,619.11
  - 4Q05 Khazanah issuing a tender offer for the rest of the shares

# Organizational Issues in Indonesian Corporations

# Implications of Dual-Tier Model

- The dual-tier board model (Board of Commissioners & Board of Directors) is believed to:
  - Improve control
  - Separate strategy/policy setting from tactical/operational activities
- In reality, especially in light of the current crisis:
  - Control failed to function properly
  - Management becomes heavily burdened with both operational and governance issues

# The Indonesian Board Model

- Dual-tier model quite often deemed obsolete, and not amenable to current crisis-solving movements:
  - Board of Commissioners: collective, no individual responsibilities
  - Board of Directors: collegial, quite normal in an executive environment
- In companies trying to restructure or revamp themselves, this model is quite often a burden, mainly due to difficulties in synchronizing tasks and efforts in both tiers

# Transformations in Private Firms

- With time, “entrepreneurial” private companies became more “structured”
- The real entrepreneurs in the company moved from the management positions to the board of commissioners
- These commissioners have extensive knowledge of the business, often better than the management themselves
- Executives hired to manage have difficulties in carrying out their tasks

# State-Owned Enterprises

- Increasingly, SOEs became more professional and entrepreneurial, although:
  - Most of commissioners are bureaucrats or members of the armed-forces, without sufficient knowledge about the business, much less about how to perform control
  - Often, senior bureaucrats serve as commissioners in companies they are supposed to regulate
- More professionals from the private world are hired to manage SOE. They do however, run into extra risks since business failures in SOEs increasingly regarded as corruption of people's money.

# Implementing Proper Governance

# Implementing Good Governance

- Relevant references and metrics are needed, preferably at world-class best practice levels
- Compliance assessment by an independent party with recognized capabilities to perform the task
- Transparency, accountability and good decision making require proper information support, which is often insufficient due to poor management of the company's knowledge repository



# General Challenges

- The overall system tends to be “regulatory driven” rather than “ethics driven”:
  - Regulations generally affect us at the corporate levels
  - Ethics pertain more to individuals
- Governance and management tend to be “compliance driven” rather than “voluntary based”:
  - Voluntary conformity is needed to complement regulatory compliance
- Regulations alone can not cover all possibilities, good corporate governance and professional ethics are needed
- Most corporations still do not recognize the (almost) direct financial impact of good governance

# Risk Management in a Good Governance Context

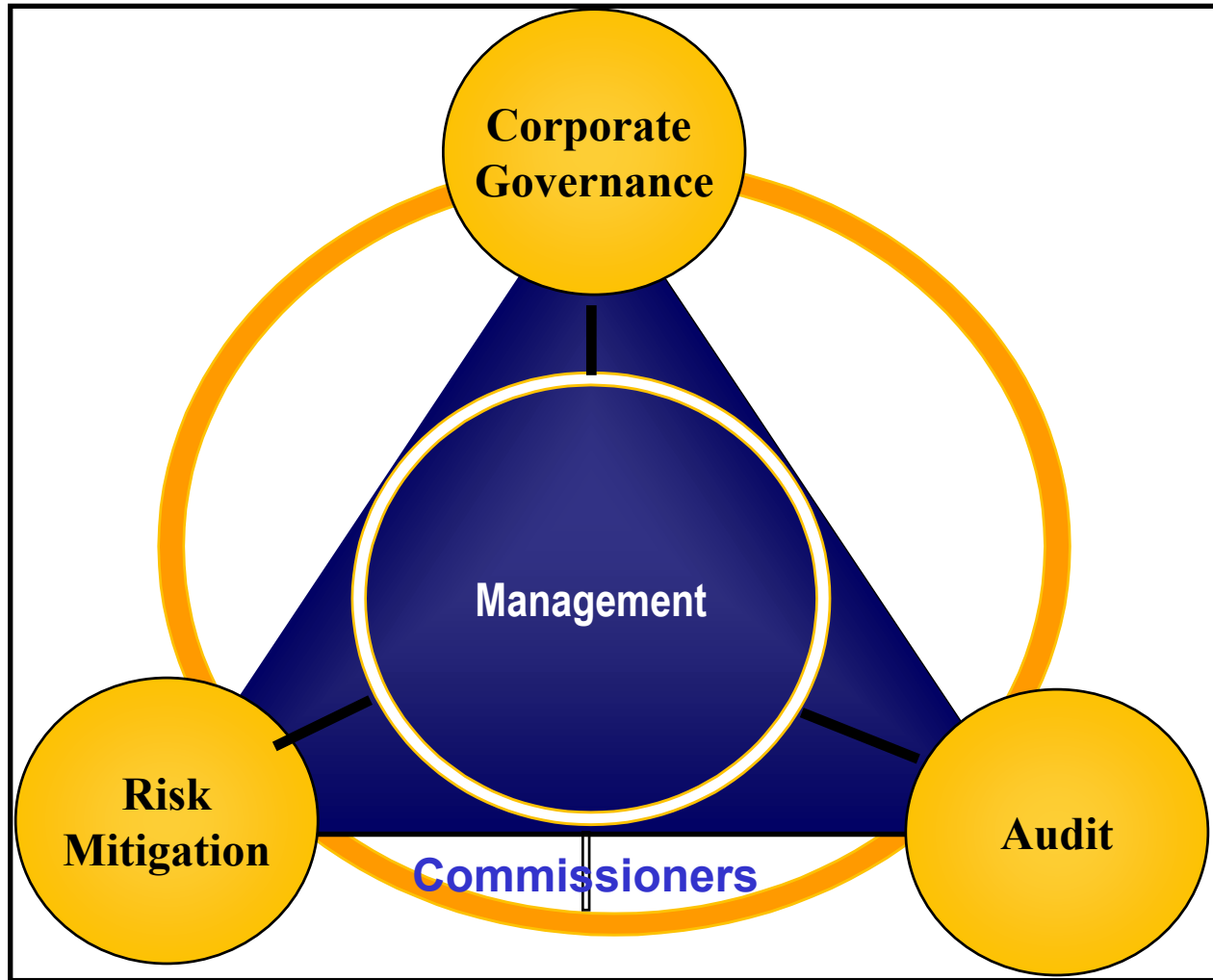
- In addition to good design and operationalization of a corporate governance structure, main key performance indicators are:
  - Timely mark-to-market valuation of its books
  - Proper handling of risk and its disclosure by the management
- The most important adage is:  
“Transparency loses its meaning without information”
  - Information to be disclosed need to be readily available in the bank’s information system
  - Ad hoc solutions will lack the repeatability necessary in a sustainable risk management context
  - While banks may be familiar with audit frameworks, risk and the information about it are new

# Best Practice Model: Synergising Governance, Risk Mitigation and Audit

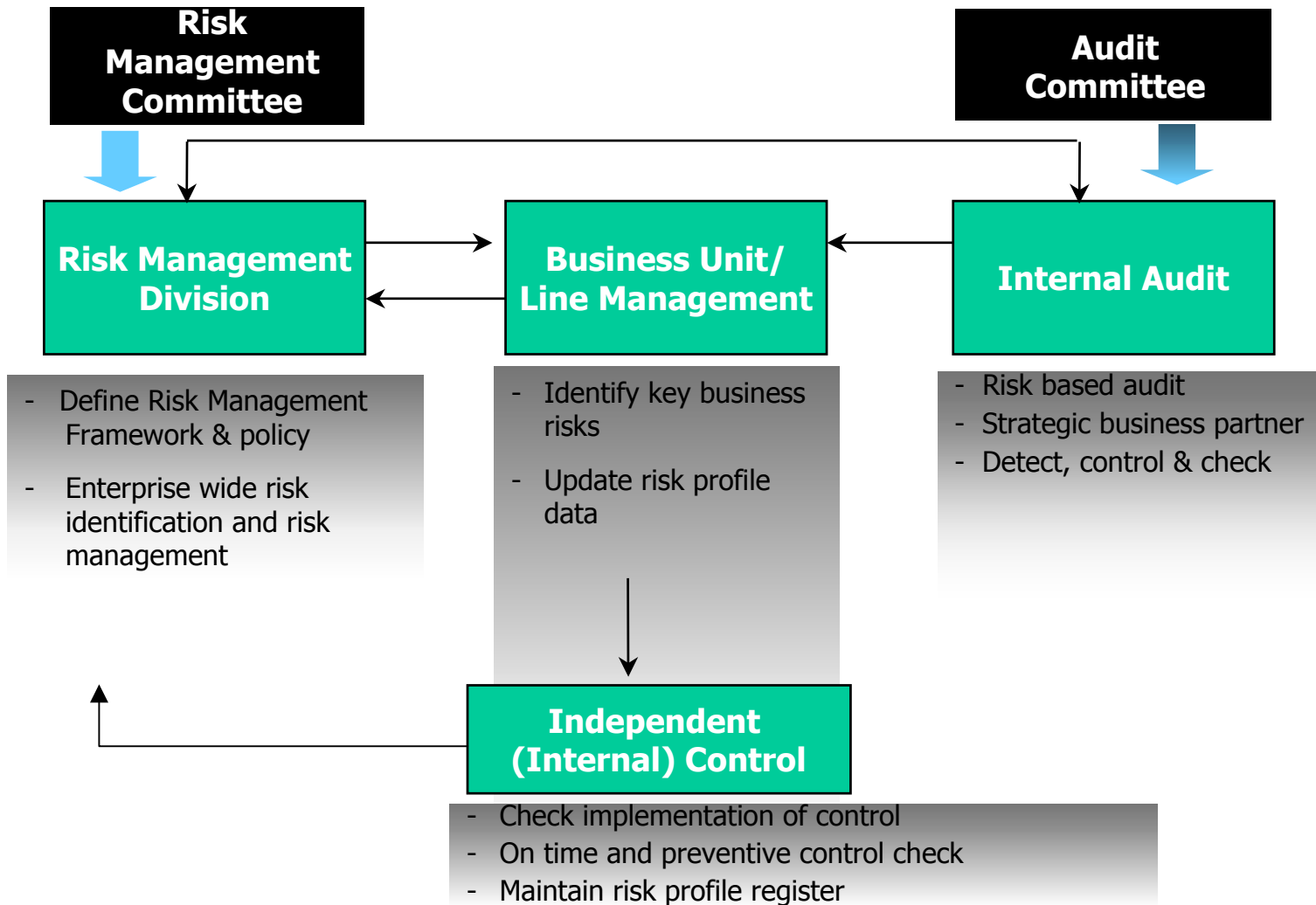
# Governance in Dual-Tier Boards

- The single-tier model is moving towards “quasi dual-tier” model:
  - Separate Chairman from CEO function
  - Or, while Chairman & CEO may remain as one person, and additional “Lead Director” will take over chairmanship wherever necessary
- The dual-tier model is moving towards “quasi single-tier” model:
  - Chairman still separate from CEO, but CEO will attend (and most likely drive) most BoC meetings
  - Commissioners are given individual responsibilities through formation of standing committees

# Quasi Single-Tier Board Structure



# A Possible Framework



# Preventing & Detecting Breaches

- Identified risk-profiles will help focus control and audit:
  - Proper division of tasks among risk management, control and internal audit
  - Top management “hands-on” action on audit reports
- Build-up of a knowledge-base:
  - A well documented fault-event database is urgently required, with emphasis on governance breach cases
  - This enables controllers and auditors to quickly detect possible acts of governance breach
  - It also serves historic precedence information to help determine follow-up actions, including punishments
- Managed sharing of these knowledge-bases:
  - Organizations need to develop a shared knowledge-base so that benefits can be realized on a national level

# Conclusion

- Improvement of corporate governance will be increasingly important, both within a company, and on a “macro” level affecting the companies market values
- Within a more global economy, good governance will help support a bank’s business role and importance
- The main motivating factors behind good governance are:
  - Investors and creditors
  - Society at large
  - Government and regulators
  - The bank itself (including its internal stakeholders)
- It is important for a bank to formalize its corporate governance platform into its management, operations and administration



# Enabling the Corporation: Lessons Learned in Governance

*Thank You*