The Code of Corporate Governance
2012 (Singapore): The Changing Nature and Role of Independent Directors

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ABSTRACT

This paper analyses the amendments to the Singapore Code of Corporate Governance (2012), specifically with respect to the modified definition and role of independent directors. A review of present share ownership structures and their effect on corporate governance practices is provided. The flexibility of a non-mandatory Code of best practice is also acknowledged in the context of international competition between governance systems. A survey is conducted of conventional governance theory and empirical evidence relating to independent directors and their role in the context of concentrated ownership structures. Recent governance theory from the field of behavioural psychology is also reviewed. An assessment is then made of the degree to which the modified provisions implement and accord with the proposals arising from the theoretical and empirical literature. It is contended that the Code in its modified form strikes a good balance between addressing the concerns of those in the investing public whilst not unnecessarily burdening corporate management.

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A INTRODUCTION

In Hong Kong anything not expressly forbidden is permitted, whereas in Singapore anything not expressly permitted is forbidden.¹

These now famous words of Lee Hsien Loong, then Deputy Prime Minister of Singapore, reflect a commonly held view of the Lion State’s approach toward regulation and law and order generally. While acknowledging a note of exaggeration in his statement, Mr Lee stressed the vital role which strict rules and rigorous enforcement has played in developing investor confidence in Singapore as a credible destination for international capital.

Despite this traditionally stringent approach to financial and corporate regulation, the recently revised Corporate Governance Code, which entered into force on 1 July 2012, appears to strike a sensible balance between responding to governance concerns from domestic and international investors whilst not unnecessarily burdening corporate management.²

In conformity with the prevailing school of corporate governance theory over the past half-century, a central role in the governance framework is assigned to the independent director. The 2012 amendments to the Code incorporate specific

¹ Lee Hsien Loong, New Approach to Regulating & Developing Singapore’s Financial Sector, speech presented to the SESDAQ 10th Anniversary, 4 November 1997, p. 27.
provisions altering both the definition of who constitutes an independent director as well as the requisite presence of independent directors in certain situations.

Specifically, the definition of ‘independent director’ is modified to presumptively exclude those who are themselves, or are associated with a 10% shareholder of the firm. As will be discussed in further detail below, this has particular importance in the context of Singapore where concentrated ownership structures have traditionally prevailed. A further modification recommends that independent directors comprise a minimum of half the board where: the Chairman and the CEO is the same person; the Chairman and the CEO are immediate family members; the Chairman is part of the management team or the Chairman is not an independent director. Again, this alteration is of significance given the prevalence of family and nominee dominated boards and the frequency with which the roles of CEO and Chairman are combined.

The purpose of this paper is to consider the role assigned to independent directors under the modifications to the Code as described above, in order to assess their potential effectiveness as an internal governance mechanism. Specific attention will be paid to the Code’s operation with respect to publicly listed corporations, which are required to implement its recommendations on a “comply or explain” basis. Given the high proportion of family-dominated firms currently listed on the Singapore Exchange (SGX), I will provide a detailed

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3 Code (2012), Guideline 2.3.
4 Code (2012), Guideline 2.2.
consideration to how the modified recommendations may impact the governance practices of these firms.

A simple evaluation of the mechanics of these provisions would not however suffice. One must acknowledge that in a rapidly integrating globalised economic environment, domestic jurisdictions compete with one another to attract international sources of finance, and increasingly, listings from foreign-domiciled and multinational corporations. In such a context, the formulation and adoption of a governance system takes on an acute policy objective for a national legislature. On the one hand, there is a definite interest in providing a regulatory regime properly adapted to the corporate landscape and sufficiently stringent to protect against suboptimal management and corporate malfeasance. Without such protections - or the appearance of such protections – the international investing community may not feel confident in directing capital into the market. On the other hand, a legislature seeking to develop its capital markets – as Singapore aggressively is at present – has an interest in creating an environment in which corporate management are not overly burdened by regulation. Both to facilitate continued performance of those firms presently operating as well as to attract further listings from domestic and foreign-based corporations, a regime with sufficient flexibility is desirable.

Thus, from a policy perspective, a balance must be struck between these potentially competing goals. I will, therefore, consider how well the Code,
specifically its modifications concerning the nature and role of independent directors, meets this policy objective. In this regard, comparisons will be drawn to regulatory regimes from other jurisdictions, with particular attention being paid to the UK Corporate Governance Code.\(^5\) In the competitive international corporate environment, the broad acceptance of the UK Code as good governance practice is manifest in the extent to which other jurisdictions, Singapore included, have based their own domestic regulation on the UK model. It is contended that there is significant value in bringing the Singapore Code into line with the UK model, as this provides a signal to the international investing community that the legislature and regulator are proactive in addressing investors’ concerns, and that companies which seek to implement the Code’s recommendations will be subject to rules in accordance with global best practice.

Equally, at a corporate level there is a value in being provided with a Code commanding broad recognition as comporting with global standards. For those SGX listed companies with an investment appetite that demands recourse to international sources of finance, compliance with the Code’s recommendations provides a signal to the investing community that their financial interests will enjoy protection at a level equivalent or superior to their home jurisdiction. It is within this context of increasing convergence between domestic governance standards that the Code must be evaluated.

\(^5\) The Corporate Governance Code 2010 (UK).
Complete global convergence, however, is not necessarily desirable. Were governance reformers in Singapore merely to rigidly transplant mechanisms designed in a foreign context to the local market, it is likely that the result would be poorly adapted to the specific elements which characterise the Singapore corporate landscape. Of particular concern in this regard is the continuing presence of concentrated ownership structures, notably within family-dominated firms, which gives rise to concerns not present in broadly-held corporations which dominate the archetypal Anglo-American system.

It is for this reason that the non-mandatory nature of the Code is of particular value. The modified definition of independent director to exclude those who are, or are associated with, a 10% shareholder, as well as the increased role assigned to independent directors where concentrations of power exist on the board, respond to concerns peculiar to the Singapore corporate context. In implementing the Code on a ‘comply or explain’ basis, corporations can elect to deviate from the recommendations, and maintain current governance practices better suited to their size and financing needs. At present, the evidence suggests that family firms, which tend to be smaller in size and have lower demand for external finance, frequently engage governance mechanisms not in conformity with the Code. Nonetheless, they consistently outperform their non-family equivalents. Rather than imposing a strict regulatory regime which demands immediate compliance with rules which may, in turn, inhibit managerial efficiency, these firms are able to persist with alternative mechanisms provided their
shareholders are satisfied with the explanation tendered in the Annual Report. It is in this regard that the market-mechanism provided by a non-mandatory Code truly exhibits its value.

It must, of course, be recognised that past performance is by no means a guarantee of similar future performance. The potential for poor management and minority oppression, especially given Singapore’s weak market for corporate control, remains a concern. However, the benefit of the Code is that it provides a set of guidelines and recommendations of best practice for directors and shareholders while not mandating immediate compliance with a strict ‘one-size-fits-all’ framework. Nonetheless, its potential to influence the governance practices of small firms over time may be realised if public shareholders begin to demand greater formal or institutional protection of their interests in accordance with its recommendations.

Initially, I will provide an introduction to Singapore’s capital market. Particular attention will be paid to the structure of shareholdings in publicly listed companies and its implications for governance practices at present. This is of significance in determining the potential effect of the Code’s new provisions.

I will then consider the present state-level ambition within Singapore to further develop its equities markets by attracting increased foreign capital and further foreign listings. In the context of the present economic downturn, recognition of
the value of international diversification away from more mature markets in
favour of quickly developing Asian economies provides an opportunity to
Singapore. This adds impetus to the reform movement and supports finding a
balance between providing a regime not so burdensome as to discourage listing
on the SGX, but robust enough to convince foreign investors that Singapore is a
safe location to invest their capital.

I will then provide an overview of the legal and regulatory framework as it exists
at present. This is necessary to understand how the Code operates within the
overall governance regime. Furthermore, I will consider the generally
concentrated shareholding structure of Singapore companies. Paying particular
attention to the prevalence of family-dominated firms, I will discuss what
implications this has for the governance of these companies. In doing so, I
propose that the non-binding nature of the Code is particularly well suited to the
changing nature of the Singapore market. It balances the competing interests of
facilitating continued performance of family firms, many of which at present
employ governance mechanisms better suited to their needs, whilst also
encouraging larger companies to bring their practices into line with international
best practice, thereby increasing their attractiveness to foreign investors.

Following this I will briefly consider the fundamental and relevant governance
theory as it applies to Singapore shareholdings. The purpose of this is to assess
the extent to which the new provisions may comport with and apply these theoretical principles.

I will then review the relevant empirical literature relating to director independence. While it is apparent that no definitive link has yet been established between board independence and firm performance, I will assess how revisions to the Code may respond to explanations proffered as to why the predicted link has yet to be shown. Furthermore, I will consider recent governance theory emerging from the field of behavioural psychology. In doing so, the intent is to consider the degree to which the amendments to the Code, specifically the role it recommends for independent directors, may implement some of the propositions arising from this field.

I will then engage in a close examination of the provisions of the Code relating to independent directors. Specifically, I will discuss those provisions that have been altered to modify the nature and role of independent directors. Based on the material discussed, I will consider the extent to which these respond to the conventional theory, the empirical evidence, the proposals from behavioural theory as well as their potential signalling effect from a policy perspective.

Finally, I will consider the potential for these modifications to increase director ‘busyness’. This may prove to be an unintended side-effect of these alterations, at least in the short-term.
B SINGAPORE: CORPORATE AND MARKET BACKGROUND

I ECONOMIC AND MARKET DEVELOPMENT

The capital markets have played a significant role in the rapid economic development of Singapore. Due its low population, small size and lack of natural resources, the city-state relies heavily on attracting domestic and foreign capital into its financial, manufacturing and commercial industries.⁶

Upon gaining independence in 1965, the Government initiated a series of targeted fiscal spending plans to develop the nation’s manufacturing and financial sectors, and to entice investment from offshore.⁷ The economy quickly matured, and from the early 1990s, the government’s focus shifted to high value-added industries, such as high-tech manufacturing and international business services. Leveraging off its strategically important geographic position and demographic links with India, South East Asia and China, Singapore has sought to position itself as a hub for global finance and a ‘gateway’ for investment into Asia.⁸

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⁶ Singapore has a total landmass of 710 square kms; a population of 5.18m, of which 3.26m are citizens, per 2001 Census figures.
⁷ Phan, Phillip H. and Toru Yoshikawa, Corporate Governance in Singapore: Developments and Prognoses, Research Collection: Lee Kong Chian School of Business 2004, p. 188.
⁸ Phan et al, Note 7, p. 189.
At present, the Singapore Exchange (SGX) has 774 listed companies, with a combined market capitalisation of S$650b (US$469).\(^9\) Over 40% of the companies listed on the SGX originate outside of Singapore, the majority of which come from China. Reflecting the nation’s dominant industry sectors, the index is heavily weighted toward manufacturing (39.5%), services (17.9%) and commerce (14.3%).\(^10\)

II STRUCTURE OF SHAREHOLDING

Notwithstanding Singapore’s pursuit of foreign capital, stock ownership in SGX-listed companies continues to be highly concentrated. An analysis recently conducted by the National University of Singapore’s Centre for Governance, Institutions and Organisations determined that, on average, the top 10 shareholders in publicly listed firms control 74% of the stock.\(^11\) While government-linked firms and large institutional investors constitute a portion of this, the most significant contributor to this concentration is the family firm.

Government-linked corporations (GLCs) traditionally played an important role in the Singapore economic landscape. The majority of state funds invested in the

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\(^10\) Dieleman, Marleen and Yupana Wiwittanakantang and Shim Jungwook, Drawing a Portrait of Family Firm Governance in Singapore: A Study of SGX-Listed Family Firms, Centre For Governance, Institutions and Organisations, 16 November 2011, p. 8.

\(^11\) Dual-class shares are not permissible under Singapore’s Corporate Law, with the limited exception for Singapore Press Holdings, under the Newspaper and Printing Presses Act 1974 (Singapore), which is permitted to issue a management share. It is, however, permissible to issue ordinary and preference shares. Dieleman, et al, Note 10, p. 10.
Singapore equity markets were channelled through the state’s sovereign wealth fund, Temasek Holdings, wholly owned by the Ministry of Finance. With large block-holdings in GLCs controlled by government entities, the Boards of these companies tended to be staffed by senior civil servants acting as nominee directors. This ownership structure had implications for the governance of these corporations, affecting their commercial objectives, investment horizon, cost of capital and potential for market-based managerial discipline. However, since the 1990s, the state has pursued a sustained privatisation programme, divesting or reducing its position in many of its locally controlled investments, thereby dispersing the equity of former GLCs.

A number of SGX-listed firms today continue to be state-linked or dominated, however this is generally limited to certain large and strategically important corporations, such as Singapore Airlines and SingTel, the national telecom.

While the presence of government ownership and its impact on the governance...
of affected firms is not to be downplayed, this paper will focus more specifically on family-dominated and broadly dispersed ownership structures. The trend away from concentrated ownership in the form of government holdings has not been paralleled by family ownership, which continues to play a significant role amongst listed companies. Furthermore, with the anticipated growth in public listings and capital investment from abroad, the likely direction of shareholding structure amongst Singapore firms will be toward increasingly dispersed ownership. The significance of the amended Code, therefore, will be evaluated against the corporate landscape in its likely future form.

III FAMILY FIRMS

The predominant business structure among Singapore businesses generally, and SGX-listed corporations specifically, is the family firm.\textsuperscript{16} A recent study determined that family firms constitute 52\% of listed companies, and account for approximately 30\% of total market capitalisation in Singapore.\textsuperscript{17} This constitutes 386 of the 743 listed firms covered by the study. While this proportion is slightly reduced from the last comprehensive study of its kind in 2000, it nonetheless represents a continuing significant element in Singapore’s corporate landscape.\textsuperscript{18}

\textsuperscript{16} The classification used by the survey defined ‘family firms’ as “firms owned or influenced by an individual or multiple individuals linked by family ties”. Dieleman et al, Note 10, p. 4.
\textsuperscript{17} Where the classification was altered to exclude founder-run firms with no other family members on the board, these totalled 39\%. Where a minimum requirement of 10\% shareholding among founder and family was applied, the figure was 30\%. Dieleman et al, Note 10, p. iii.
Singapore is by no means unique in this regard, particularly among Asian nations. A 2011 report by Credit Suisse found that family firms were the dominant business structure among the majority of countries in the region, with nations such as Malaysia (62%), Philippines (66%) and Thailand (66%) exhibiting even higher levels of concentration.\textsuperscript{19} Consistent with empirical studies from other jurisdictions, family firms in Singapore also tend to exhibit better performance than non-family firms, averaging a 5% return on assets over the survey period, relative to a 3% average by non-family firms.\textsuperscript{20} However, as has frequently been recognised by empirical literature in the field, this concentration of ownership within the hands of family groups has implications for the nature of governance of such firms.\textsuperscript{21}

Among SGX-listed family firms, the average level of ownership held by the family is 33%, with the largest 10 shareholders controlling 74% of the firm.\textsuperscript{22} While the number of family firms is very high, these companies tend to be smaller in size than non-family firms.\textsuperscript{23} The 2011 National University of Singapore’s study also found that family firms tend to exhibit particular board structures and director characteristics consistently different from their non-family counterparts. Their boards tend to be smaller, having a median of six directors, rather than seven for

\textsuperscript{19} Credit Suisse Emerging Market Research Institute, Asian Family Business Report 2011: Key Trends, Economic Contribution and Performance, p. 3.  
\textsuperscript{20} Dieleman et al, Note 10, p. 4.  
\textsuperscript{21} Khan, Heider A., Corporate Governance: The Limits of the Principal-Agent Approach in Light of the Family-Based Corporate Governance Systems in Asia, Discussion Paper, July 2003, p. 8.  
\textsuperscript{22} Dieleman et al, Note 10, p. iii.  
\textsuperscript{23} Dieleman et al, Note 10, p. 4.
other companies.\textsuperscript{24} Furthermore, family members hold an average of 35% of the board seats and there tend to be fewer non-executive directors, with executive directors making up 42% of the board in family firms as opposed to 30% in non-family companies.\textsuperscript{25}

On average, 80% of executive directors in family firms are family members, and they also often dominate key positions, particularly CEO (90%) and Chairman (82%).\textsuperscript{26} Furthermore, 44% of family firms combine the role of CEO and Chairman in one person, compared to only 16% of non-family firms.\textsuperscript{27} This is in spite of the Code’s recommendation that these two roles should, \textit{in principle}, be held by different persons.\textsuperscript{28} Thus, while family members do not necessarily constitute a majority of the board, they nonetheless often command significant control over the firm.

While board committees generally include a high proportion of ‘independent’ directors, family members tend to be well represented in the nominating committee.\textsuperscript{29} This is, again, of significance, given the family’s resultant ability to influence the selection and appointment of future directors and managers. The tenure of directors in family firms is significantly different, averaging 11 years in duration, as opposed to 7 years in non-family firms. Of those directors who are

\begin{itemize}
\item Dieleman et al, Note 10, p. 9.
\item Dieleman et al, Note 10, p. 9-10.
\item Dieleman et al, Note 10, p. 10.
\item Dieleman et al, Note 10, p. 11.
\item Code (2012), Guideline 3.1.
\item Family representation in board committees: remuneration committee (8%); audit committee (6%); nomination committee (19%). Dieleman et al, Note 10, p. 12.
\end{itemize}
themselves family members the average tenure is 19 years. This no doubt brings some benefits in the form of stability and long-term relationships between management and stakeholder groups as well as ensuring directors possess in-depth knowledge of the firm and its business operations. It does, however, also heighten the risks associated with managerial entrenchment and insufficiency of independence, which will be discussed in further detail below.

A final, and intangible, element which should not be neglected is the role that family values, and specifically, ‘traditional Asian family values’, play in the corporate governance and business operations of family firms in Singapore. As Shalabh Mittal, the Managing Director and CEO of Mercator Lines (Singapore) has acknowledged, Asian families place great importance on the commitment and loyalty of family members, rather than individualistic aspirations. Of benefit to the firm, this may encourage directors and managers to take a longer-term investment horizon and inspire genuine commitment among employees and stakeholder groups. The potential downside, of course, is that in such a context, directors and managers may be less inclined to challenge the prevailing strategic direction or decisions of key members, as the social costs of breaking from the family consensus are high.

31 Dieleman et al, Note 10, p. 16.
32 Dieleman et al, Note 10, p. 16.
IV OVERALL CORPORATE GOVERNANCE IMPLICATIONS

The generally concentrated nature of shareholdings in SGX-listed companies has governance implications for the approximately 4,000 registered corporate directors in Singapore. On average, Singapore companies tend to have less independent directors and more often combine the roles of CEO and Chairman, than other comparable jurisdictions. From a study comparing a selection of publicly listed firms in the UK, Hong Kong, Australia and Singapore, it was found that 57% of Singapore companies do not combine CEO and Chairman, compared to over 80% in Australia and the UK. Furthermore, Singapore boards comprised an average of 55% independent directors, compared to 61% in the UK and 76% in Australia. It is also noteworthy that boards of directors in Singapore met an average of 5 times per year, compared to 8 in the UK and 11 in Australia.

Given the generally high concentration of block-holdings, the practice of engaging nominee directors is very common. Whether they are members of a controlling family or representatives elected by reason of their association with a majority shareholder, the presence of nominee directors potentially gives rise to conflicts of interest. A tension may arise between the nominee’s legal and ethical

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34 Teen, Mak Yuen and Daphne Teo, A Comparison of Boards of Big Firms across Four Countries, p. 2.
35 Teen et al, Note 34, p. 2.
36 Teen et al, Note 34, p. 2.
37 Phan, Note 7, p. 190.
duty to represent the shareholders as a whole, as owners of the company, and their interest in representing the block-holders who are responsible for their appointment. This tension has been recognised as inherent to concentrated ownership structures, giving rise to a ‘principal-principal’ problem, a deviation from the archetypal ‘principal-agent’ problem encountered in broadly-held companies.\(^{38}\) Thus, in the context of concentrated ownership, the role of the independent director is different from that where ownership is diffuse, as is typically exhibited in the Anglo-American world. While the statutory and fiduciary duties of a director in such circumstances are not technically altered, they necessarily take on a different focus to reflect the potential threat to minority interests posed by the presence of a controlling shareholder.

Prior to the 2012 amendments to the Code, the definition of ‘independent director’ did not specifically exclude those who were, or were associated with 10% shareholders. A complaint frequently voiced by shareholder groups was that many nominally ‘independent’ directors were not sufficiently independent from majority or controlling shareholders, undermining their credibility as a truly objectively voice capable of advocating the interests of the minority. This will be discussed in further detail below.

Finally, it must also be acknowledged that Singapore generally exhibits a weak market for corporate control. The combined effect of concentrated ownership structures, strong family and government shareholdings, and generally less clear

\(^{38}\) La Porta et al, Note 14.
rules regarding takeovers, diminish the potentially regulating role that market forces can play in disciplining management.\textsuperscript{39} The importance, therefore, of formal corporate governance mechanisms, such as truly effective independent directors, is thus heightened.

V   SINGAPORE: “THE GATEWAY TO ASIA”

Singapore has consistently been considered one of the safer and more profitable destination for equity investment amongst emerging markets. While other South East Asian nations share similarly formulated corporate governance frameworks, it is noted that Singapore companies have a consistently better record of corporate governance practice and less instances of management malfeasance. Teen \textit{et al} attribute this, in part, to the higher proportion of the population holding shares who constitute a politically empowered and legally aware middle class, less tolerant of infringements into their property rights.\textsuperscript{40} Similarly, La Porta \textit{et al} proposed that the governance standards of Singapore are supported by a generally strong rule of law in the island nation. Using proxies such as the ease of doing business, efficiency of the legal system, corruption, risk of contract repudiation and expropriation, Singapore compared favourably not only by Asian standards but also amongst countries from the Common Law tradition, the grouping generally providing the strongest protection of investors' rights.\textsuperscript{41}

\textsuperscript{39} Phan, Note 7, p 188.
\textsuperscript{40} Teen \textit{et al}, Note 34, p. 3.
\textsuperscript{41} Efficiency of judicial system: Singapore (10); Australia (10); UK (10); Malaysia (9). Rule of law: Singapore (8.57); Australia (10); UK (8.57); Malaysia (6.78). Corruption: Singapore (8.22);
Nonetheless, increasing global interconnectedness between domestic financial markets and the desire to attract foreign capital into the Singapore equity markets has spurred a concentrated effort to bring governance standards into line with international best practice. This reform effort appears to be supported by financial and corporate professionals in Asia. A survey of 176 senior finance executives in China, Hong Kong, Singapore and Malaysia noted that, in contrast to many of their compatriots from the US and Europe, they see the value in increased regulation in certain areas of their own economies.\textsuperscript{42} 59\% of respondents believed that regulation was enhancing value while only 22\% suggested that it hindered growth.\textsuperscript{43} These results confirm previous surveys of institutional investors who, whilst acknowledging that corporate governance standards were generally strong in Singapore, nonetheless believed that improvements were needed.\textsuperscript{44} 86\% believed that Singapore companies had higher standards than other Asian nations, however 95\% stated that changes needed to be made to bring standards into line with global best practice. Of specific importance was highlighted the increasing demand for truly independent

\textsuperscript{42} ACCA/CFO Asia Research Service, A Critical Connection: Making the Link Between Regulation and Shareholder Value, reported in Church, John, Waiting on the regulatory platform, 16 January 2008, p. 1.
\textsuperscript{43} Church, Note 42, p. 2.
\textsuperscript{44} Quah, Michelle, Corporate governance a key consideration of Singapore investors: survey, Business Times Singapore, 4 May 2005, p. 2.
directors, and the creation of a pool of professional, properly educated, independent directors in Singapore.\textsuperscript{45}

As has often been the case with corporate governance reform movements, momentum for change was partially incited in reaction to highly publicised corporate governance failures.\textsuperscript{46} A series of governance scandals rocked the Singapore market between 2004 and 2006. A number of senior executives of China Aviation Oil (Singapore) were charged with serial corporate malfeasance after the company was forced to seek court protection having lost US$550m investing in oil derivatives.\textsuperscript{47} In other high profile cases, three employees of the Government of Singapore Investment Corporation (GSIC) were fined for insider trading in Japanese shares, and in April 2004 the former finance manager of Asia Pacific Breweries was jailed for 42 years for “cheating German and Japanese banks”.\textsuperscript{48} In each of these cases, the role of the independent directors in failing in their duty to adequately monitor management was highlighted as contributing to the outcome. During the consultation phase for the last reform of the Code, in 2005, calls came from those within the industry to tighten the definition of ‘independent director’ to exclude those associated with major shareholders. Ultimately, however, this was rejected. This failure to take the initiative at this

\textsuperscript{45} Teen et al, Note 34, p. 2.

\textsuperscript{46} The US Securities and Exchanges Act was enacted in the aftermath of a series of corporate governance scandals in the 1930s, creating the Securities and Exchanges Commission (SEC) and requiring all listed firms to be subject to external auditing. Within Asia, most countries designed or revised their corporate governance frameworks immediately following the Asian Financial Crisis of 1997.

\textsuperscript{47} Quah, Note 44, p. 2.

\textsuperscript{48} Quah, Note 44, p. 2.
stage was lamented by Jamie Allen, Secretary-General of the Asian Corporate Governance Association, who noted:

the more we talk to directors in Singapore, the more it appears that a lot of those directors are not pulling their weight; they are not putting in the time required…[and] a lot of the independent directors are not as independent as you would expect.\(^49\)

Fully 82% of respondents to a 2005 survey of investors advocated a stricter definition of ‘independent director’.\(^50\)

It is against this backdrop that the signalling value of reform to the Code becomes apparent. From a national perspective, tightening of the Code’s provisions to bring them into conformity with international standards sends a message to the global investing community that Singapore’s market is subject to rigorous regulatory standards. From a corporate point of view, in complying with the Code’s recommendations, a company seeking to access foreign capital to fund their investments can justifiably claim that their governance mechanisms are in line with international best practice.

\(^{49}\) Jamie Allen, quoted in Lloyd-Smith, Jake, Does Singapore need a corporate sling?, ACCA Publications, 10 January 2006, p. 2.
\(^{50}\) Quah, Note 44, p. 1.
C THE SINGAPORE CORPORATE GOVERNANCE FRAMEWORK

I LEGISLATIVE AND REGULATORY ENVIRONMENT

To properly comprehend the role that the Code plays within the Singapore corporate landscape, it is necessary to first understand where it fits within the nation’s regulatory framework. From an institutional standpoint, Singapore generally comports with the traditional Anglo-American style system. Its legacy as a British colony ensured Singapore maintained a common law legal system.

Under s 157A(1) of the Companies Act 1967 (Singapore), the business affairs of a corporation are managed by, or under the direction of a unitary board of directors. A director is under general statutory duties to, “act honestly and use reasonable diligence in the discharge of his duties” and not to make improper use of corporate information to gain an advantage for himself or another or to cause a detriment to the company. As a fiduciary, a director is also subject to duties owed to the company under common law, to act bona fide in what they consider to be the best interests of the company. Directors owe a duty of loyalty to the company, and are therefore obliged not to place themselves in a

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51 Companies Act 1967 (Singapore), s 157A(1).
52 Companies Act 1967 (Singapore), s 157(1) and (2).
53 The statutory duties are explicitly stated to be in addition to, and not in derogation of, any other written or rule of law relating to the duties of a company director of officer. Companies Act 1967 (Singapore), s 157(4).
position where their duty to the company may conflict with their own interests.\textsuperscript{54} In addition, directors must exercise their powers of management for a ‘proper purpose’.\textsuperscript{55} Finally, most of the rights of a shareholder are specified in the company Articles of Association, which is mandatory to adopt upon incorporation. While it is permissible for a company to issue shares with different dividend and voting rights, s 64 of the \textit{Companies Act} requires all ordinary shares to carry one vote per share.\textsuperscript{56}

Complementary to the Corporate Governance Code, which will be discussed below, is the Directors’ Code of Professional Conduct (2009) (‘CPC’), published by the Institute of Directors (Singapore).\textsuperscript{57} This non-mandatory set of industry practices is intended to provide guidance to corporate directors on acting honestly, with due care and diligence, and ensuring disclosure of all potential conflicts of interest. Being an industry-produced guideline, CPC is non-enforceable and has no punishment mechanism.

Singapore shares many of the institutional aspects of the market-based Anglo-American system. However, the general concentration of ownership and predominance of family and government block-holdings undermines the potentially disciplinary effect of the market for corporate control. In these

\textsuperscript{54} Chew Kong Huat v Ricwil (Singapore) Pte Ltd [2000] 1 SLR 385.
\textsuperscript{55} Howard Smith Ltd v Ampol Petroleum Ltd [1974] AC 821.
\textsuperscript{56} The single exception to this principle, as noted above, is the issue of a management share issued by a newspaper company under the Newspaper and Printing Presses Act 1974 (Singapore).
\textsuperscript{57} Code of Conduct (2009), Institute of Directors, Singapore.
circumstances, the role of independent directors within the governance framework is elevated in importance and modified in focus given the high prevalence of nominee and family-affiliated directors.

II THE CORPORATE GOVERNANCE CODE: “COMPLY OR EXPLAIN”

Publicly listed companies in Singapore are required to comply with the Singapore Exchange Listing Rules and the Listing Manual. These rules govern, *inter alia*, requirements relating to disclosure of information and takeover procedures. Furthermore, the Listing Rules also require listed companies to implement the recommendations of the Code of Corporate Governance, on a ‘comply or explain’ basis. The non-mandatory ‘comply or explain’ principle was modelled on the UK Code of Corporate Governance, which provides companies the flexibility to deviate from the Code’s recommendations where they deem it to be in the corporation’s interests.\(^{58}\) By requiring companies to identify where they have deviated and provide an explanation to their shareholders, it is intended that their corporate governance practices will be subjected to market forces, wherein a shareholder not satisfied with their explanation or alternate arrangement can exercise their right to sell their share.

The benefit to this model is that it allows companies to tailor their corporate governance practices to the specific needs of their business, given its size, operations and other unique characteristics. In providing a set of general principles and recommended guidelines, management are given guidance in the

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\(^{58}\) The Corporate Governance Code 2010 (UK).
form of a best practice manual, and shareholders are provided with a set of criteria against which to assess a company’s governance standards.

The non-mandatory nature of the Code is particularly well suited to the evolving nature of the Singapore market. As has been noted above, a significant number of listed firms continue to be owned or dominated by family groups. As was also noted, family firms have proven to consistently outperform the average listed company by a significant margin on a return on assets basis. These firms tend to be smaller in size and less internationally connected. Therefore their limited capital requirements reduce the need to access financial markets either domestically or internationally. Enforcing a strict, mandatory set of principals by which all companies must abide could potentially stifle the strong performance of those smaller firms whose alternate governance practices may be better suited to their size, shareholder structure and strategic needs. The efficiency loss in decision-making caused by overly burdensome monitoring costs may outweigh any potential benefit gained from increased minority shareholder protection.

Allowing these companies to deviate from the Code’s recommendations may therefore be beneficial, at least in the short term. Past performance is certainly no guarantee that future performance will follow the same course, though as Kahneman and Tversky have shown, this naïve belief is a trap that frequently ensnares investors and human beings generally.\(^\text{59}\)

Merely because family firms

have exhibited superior performance does not necessarily justify the continuing threat to minority shareholders’ rights of expropriation or prejudice posed by overweening majority shareholder representation on the board. The potential for this to occur will be discussed in further detail below. However, by providing a non-mandatory guideline to best practice, minority shareholders who feel that their rights are not adequately protected by the present governance mechanisms can engage their voting rights to agitate in favour of compliance, or in the more likely scenario, exercise their right of exit. In this way, the market mechanism may ultimately induce conformity with the Code among these firms also.

At the other end of the spectrum, larger listed companies with the desire to access global financial markets will be more likely to comply with the Code’s recommendations. In doing so, they can send a message to foreign and domestic investors alike that their governance mechanisms are in conformity with international best practice, and thus they can be relied upon to protect their shareholders’ interests.

III GENERAL REVISIONS IN THE 2012 CORPORATE GOVERNANCE CODE

The Corporate Governance Code was first recommended by the Committee of Corporate Governance in 2001. The Code was subject to review and a revised Code was issued in 2005. The latest revision to the Code was drafted by the Corporate Governance Council, which engaged in a period of public consultation
between June and July 2011. During the consultation period a total of 75 submissions were received from academics, legal and accounting professionals and corporate practitioners. The final version of the Code was accepted by the Monetary Authority of Singapore (MAS) in May 2012, and has been implemented with effect from 1 July 2012. The MAS has, however, provided for a transition period, over which affected companies may amend their corporate governance practices to comply with the Code’s revised provisions.60

The major revisions to the Code were in three broad areas, namely: board composition and director independence; remuneration practice and disclosure; and risk management. Other minor changes to the Code constituted slight tightening of rules to make certain recommendations more forceful or explicit. For example, Guideline 1.2, which formerly read, “all directors must objectively take decisions in the interests of the company,” was altered to state, “all directors must objectively discharge their duties and responsibilities at all times as fiduciaries in the interests of the company.”61

Furthermore, certain specific recommendations were made in response to concerns among the investing community as well as empirical studies about multiple directorships and director ‘busyness’. In this regard, Guideline 4.4 was amended to include the statement, “[t]he Board should determine the maximum number of listed company board

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60 Significantly, changes to the composition of the board pursuant to Guideline 2.2, are to be made at the AGM following the end of the financial year commencing on or after 1 May 2016.  
61 Code (2012), Guideline 1.2.
representations which any director may hold, and disclose this in the company’s Annual Report.  

Significant amendments have also been made in the areas of director training, the appointment of alternate directors, remuneration practice and disclosure. The 2005 Code already recommended that incoming and incumbent directors should receive appropriate training regarding the duties of directors as well as specialised training in the fields of accounting, legal and industry-specific knowledge. The new Code, however, explicitly obliges the company to both arrange and fund all such training programmes, and to disclose the nature of the training provided in their Annual Reports. This alteration places a greater onus on the company to actively facilitate the necessary training of directors, and provides the ability for shareholders to assess their performance in this regard by requiring disclosure thereof.

It is also of note that remuneration practices are recommended to be aligned with the long-term interests and risk policies of the company. With regard to the level and mix of executive directors’ remuneration, the amended Code explicitly states that performance-related remuneration should be aligned with the long-term success of the company, and “should take account of the risk policies of the company, be symmetric with risk outcomes and be sensitive to the time horizon

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64 Code (2012), Guideline 1.6.
of risks. These alterations can be seen as a response to the general movement in corporate governance internationally away from remuneration practices which reward excessive risk taking and short-term incentivisation of management. Whilst Singapore has not experienced the same ‘ratcheting up’ of officer’s pay to the levels experienced in jurisdictions such as the US and UK, such a provision reflects a general concern to avoid rewarding the wrong types of behaviour from corporate insiders.

While many of the amendments are of importance, the focus of this paper is on the nature of independent directors and the specific roles assigned to them under the Code. A number of amendments from the 2005 Code were of significance in this regard. Before addressing them specifically, a survey of the empirical literature as well as recent theory from behavioural psychology regarding the importance and function of independent directors will provide a yardstick by which to assess the amended Code’s potential.

D GOVERNANCE THEORY AND EMPIRICAL “SUPPORT”

I GOVERNANCE THEORY: THE INDEPENDENT DIRECTOR AND FIRM PERFORMANCE

The independent director, as an internal mechanism of corporate governance, has steadily gained favour over the course of the past half-century. In the US, for

example, the number of independent directors on the boards of public companies increased from approximately 25% in 1950, to 75% in 2005. The classical rationale behind including independent and objective individuals in the management of a company and monitoring of its executives is to counteract the conventional agency problem. Within the corporate governance context, the principal-agent problem was first identified by Adam Smith in 1776, who stated the problem as follows:

The directors of [joint stock] companies, however, being the managers rather of other people’s money than their own, it cannot well be expected, that they should watch over it with the same anxious vigilance [as owners]…Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company.

In response to this problem, the independent director was intended to act as an internal control system. By placing independent persons within the boardroom and charging them with the duty to direct the business affairs of the company and monitor the decisions of executive management, it was expected that managerial opportunism could be curbed and poor performance identified early and acted upon by disciplining, hiring and firing management.

As an internal corporate governance mechanism, independent directors are expected to impose less agency costs on the company than more rigid external and legal alternatives. Rational economic theorists proposed that independent directors are properly incentivised to act as effective monitors. According to the reputation theory, as identified by Fama and Jensen, it is in the personal interests of directors to develop reputations as expert monitors, in order that they maintain their presently held directorships and potentially gain further board positions in future. Thus, they should be motivated to conduct their monitoring role in a rigorous manner.

History, however, shows that the inclusion and increasing reliance upon independent directors has not been the ‘silver bullet’ to prevent wayward or under-performing management from negatively affecting corporate performance, and prejudicing the rights and interests of shareholders.

As Michael C. Jensen conceded in his Presidential Address to the American Finance Association in 1993:

> the problems with corporate internal control systems start with the board of directors. The board, at the apex of the internal control system, has the final responsibility for the functioning of the firm. Most importantly, it sets the rules of the game for the

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CEO. The job of the board is to hire, fire, and compensate the 
CEO, and to provide high-level counsel. Few boards in the past 
decades have done this job well in the absence of external 
crisis. This is particularly unfortunate given that the very 
purpose of the internal control mechanism is to provide an early 
warning system to put the organization on track before 
difficulties reach a crisis stage. The reasons for the failure of the 
board are not completely understood... 

II EMPIRICAL LITERATURE: BOARD INDEPENDENCE AND FIRM 
PERFORMANCE

A great deal of empirical literature has sought to identify a relationship between 
board composition, specifically the proportion of independent directors, and firm 
performance. To date, however, no consistent link has been shown.

In a review of various studies, encompassing different proxies for the 
performance of US public companies, Hermalin and Weisbach found no 
correlation between the balance of inside and outside directors and overall firm 
performance. They did, however, find that the overall number of directors on a 
board negatively correlates with firm performance, and that boards with fewer 

69 Jensen, Michael C., Presidential Address: The Modern Industrial Revolution, Exit and the 
70 A good survey of various empirical approaches is provided in, Bhagat, Sanjai and Bernard 
Black, The Uncertain Relationship Between Board Composition and Firm Performance, Business 
71 Hermalin, Benjamin E and Michael S Weisbach, Boards of Directors as an Endogenously 
Determine Institution: A Survey of the Economic Literature, Federal Reserve Bank of New York 
and more outside directors make better, or at least different, decisions with respect to poison pills, acquisitions, executive compensation and CEO replacement.\textsuperscript{72}

In other studies, insignificant relationships were shown between accounting measures of firm performance and the ratio of outside to inside directors on the board.\textsuperscript{73} In an attempt to better measure the value added from intangible factors like corporate governance, Hermalin and Weisbach used \textit{Tobin's Q} as a measure of performance, again finding no relationship.\textsuperscript{74} Bhagat and Black looked to the long-term stock market and accounting performance of firms, once again showing no consistent relationship to the makeup of the board.\textsuperscript{75} In the most extreme of cases, by some measures the proportion of independent directors on the board was found to negatively correlate with firm performance.\textsuperscript{76}

Other empirical studies sought to find a link between board composition and specific events. In an analysis of US publicly traded companies, Weisbach found that boards which comprise at least 60% independent directors are significantly more likely to fire a poorly performing CEO.\textsuperscript{77} Furthermore, unexpected stock returns were found on days following the announcement of CEO resignation or resignation.

\textsuperscript{72} Hermalin et al, Note 71, p. 8.
\textsuperscript{74} Hermalin, Benjamin E. and Michael S Weisbach, The Effects of Board Composition and Direct Incentives on Firm Performance, Financial Management 1991, Volume 20, No 4, p. 101-112.
\textsuperscript{75} Bhagat, Sanjai and Bernard Black, Board Independence and Long-Term Firm Performance, Unpublished Paper, February 2000, p. 11.
\textsuperscript{76} Hermalin et al, Note 71, p. 8.
removal, which, the author posited, reflected the view that directors increased firm value by removing bad management. Similarly, studies by Kang and Sorensen and Hermelin and Weisbach found that CEO departure after poor performance correlated with the number of independent directors, as well as with the existence of a non-executive Chairman. Morck, Schleifer and Vishny also found that CEOs are less likely to be replaced following poor performance where they concurrently serve as CEO and Chairman. In another study of US-listed companies by Beasley, firms found to have committed fraud tended to have fewer independent directors than the median of firms in the sample.

III AUDIT COMMITTEE INDEPENDENCE AND FIRM PERFORMANCE

Other studies have looked to the composition of board committees, particularly the audit committee, seeking again to find a relationship between committee independence and firm performance. The prevailing school of thought suggests that the especially important role of monitoring the financial reports of the company requires persons independent from management who can be trusted to objectively and honestly review the company’s financial position. Specifically, this should remove the risk of conflicts of interest arising between executive directors whose bonus compensation may be related to corporate earnings. This

conventional belief is so strongly held that in some jurisdictions, such as the US, it is mandated by statute that the audit committee of publicly traded companies be entirely staffed by independent directors.  

Again, however, the predicted relationship is not shown to be present by the empirical literature. Romano conducted a thorough survey of four separate studies seeking to identify the anticipated link between audit committee composition and firm performance. Each study used a set of different measures as proxies for performance, including accounting, market, productivity of long-term assets and investment strategies. Despite the use of differing measures as well as data from multiple jurisdictions, no relationship was shown to exist.

Romano also surveyed 16 further studies which sought to identify the predicted relationship between audit committee composition and the probability of financial statement misconduct. Again, various measures were engaged, including abnormal accruals of financial misstatement, financial statement restatements and fraud, SEC actions, third-party or contract fraud allegations, and stock market responses to unexpected earnings. Of the 16 studies, 10 did not find that complete independence of the audit committee increased firm performance

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81 Sarbanes-Oxley Act 2002 (US), s 301.
83 Romano, Note 82, p. 1531-1532.
in the conventional sense, nor with respect to reduced financial statement irregularities, and one showed inconsistent results across different measures. Furthermore, there was not even a consistent finding that audit committees with a majority of independent directors performed better in this regard.\textsuperscript{84}

IV EXPLANATIONS: WHY ARE THE PREDICTED RELATIONSHIPS OFTEN NOT FOUND?

Various theories have been proposed to explain why the relationships predicted between board composition, audit committee composition and firm performance have not been found. Hermalin and Weisbach have suggested that the composition of a board and firm performance are endogenous, performance being both a result of the actions of previous directors, as well as potentially influencing the nature of directors who are subsequently selected.\textsuperscript{85} Holmstrom has challenged the validity of the conventional reputation theory.\textsuperscript{86} Rather than a reputation as an effective monitor, Holmstrom proposes that the \textit{appearance} of being an effective monitor is really what is of value to a director. Furthermore, the reputation amongst CEOs as being generally compliant and not challenging managerial authority may actually be of greater value to a potential director seeking endorsement from management as a nominee.

\textsuperscript{84} Romano, Note 82, p. 1532.
\textsuperscript{85} Hermalin et al, Note 74, p. 953.
A further theory, suggests that, at present, many nominally ‘independent’
directors are not truly independent from management or from substantial
shareholders, undermining the objectivity and disinterestedness which are
supposed to inform the exercise of their duties. This was specifically adverted to
in the context of Singapore in the above statement from Jamie Allen.\footnote{Allen, quoted in Lloyd-Smith, Note 49.} Clearly,
for an ‘independent’ director to provide objectivity and a frank assessment of
managerial decisions, genuine independence is desired.

The manner of appointment may also operate to undermine the true objectivity of
independent directors. Shivdasani and Yermack looked for a relationship
between the level of CEO involvement in the selection process and the
appointment of independent directors.\footnote{Shivdasani, Anil and David Yermack, CEO Involvement in the Selection of New Board
Members: An Empirical Analysis, Journal of Finance 1999, Volume 54, p. 1829-1853.} As predicted, the higher the level of CEO
involvement in the selection process, the lower the number of independent
directors subsequently appointed.\footnote{Shivdasani et al, Note 88, p. 1832.} Furthermore, their study also found that, of
those directors who were appointed and designated as ‘independent’, many often
had some form of financial tie to either the firm or the CEO himself.\footnote{Shivdasani et al, Note 88, p. 1832.} As Morck
has pointed out, even in the absence of a direct financial tie, it is conceivable that
an ‘independent’ appointee may feel a sense of obligation to the CEO who was
responsible for their appointment, manifesting itself in a reflexive desire to repay the favour.\textsuperscript{91}

An analysis will follow of the alterations to the definition of independent director, provided for in the new Code. It is predicted that these changes may go some way to closing the gap between legal independence and genuine independence.

\textbf{V THE ROLE OF INDEPENDENT DIRECTORS IN THE CONTEXT OF CONCENTRATED OWNERSHIP}

As was noted above, the generally concentrated nature of shareholdings as well as the prevalence of family and government ownership structures, combine to create a relatively weak market for corporate control in Singapore. In jurisdictions where share ownership is diffuse and takeover rules facilitative, the threat of replacement following hostile takeover has frequently been shown to act as an effective mechanism to enforce discipline upon management.\textsuperscript{92} Empirical studies have found a relationship between firms receiving takeover bids and subsequent improved firm performance.\textsuperscript{93} Shareholders in the Singapore equity markets cannot rely on this market mechanism of corporate governance, and thus, the importance of other monitoring institutions, such as independent directors, is heightened.


High concentration of ownership, however, also alters the nature of the agency problem, and therefore necessarily also alters the role of independent directors. Where large blocks of the ordinary voting stock in a company are held by an individual shareholder, or a group of shareholders acting in concert, they are able to exercise their membership rights to elect members to the board. These nominee directors are thus able to act as monitors over management from within. Thus, where a majority shareholder exists, the incentive and capacity to effectively monitor management overlap, and the majority shareholder (generally as represented by his nominee) is best positioned to provide this monitoring function. There is a consequent reduction in the agency costs associated with the conventional principal-agent problem.

The benefits accruing to firms with concentrated ownership structures are magnified when the majority shareholding represents a family, as is often the case in Singapore. A significant body of empirical research has shown that family owned and controlled firms tend to exhibit superior business performance to non-family firms. As was noted above, the overlap of owner and manager responsibilities in family firms ensures that they do not suffer from the same agency costs born by broadly held firms. As the statistics relating to board structures in Singapore above show, families tend to be well represented on the

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boards of such firms. In this situation, there is less scope for managerial opportunism. Furthermore, family ownership often also provides stability and continuity in the ownership and management of the business. Where shareholders are less concerned with short-term results, managers are able to implement long-term investment strategies, often resulting in increased long-term value for the firm.

Anecdotally, family firms are often said to enjoy other benefits. The importance of maintaining the family’s reputation may encourage a greater focus on producing products or services of a higher quality. The stability of family control over long periods enables management to develop and foster strong relationships with suppliers, customers and other stakeholder groups, resulting in reduced transaction costs. Furthermore, it is often noted that family-run firms are better able to inspire genuine commitment from their employees, rather than mere obedience. Again, this can reduce transaction and monitoring costs, and may even act as a substitute for higher remuneration.

VI GOVERNANCE THEORY: THE PRINCIPAL-PRINCIPAL PROBLEM

While concentrated ownership structures generally, and family-dominated firms specifically, enjoy the abovementioned advantages, it is recognised that a different form of governance problem may arise in this context, identified as the
principal-principal problem. In this situation, large shareholders can potentially seek to use their dominant position on the board, either personally or through their nominees, to further their own interests at the expense of minority shareholders. Among Singapore companies, dual class board structures are common, wherein nominee directors and director/managers have the ability to exercise their powers in a way that prejudices the rights of the minority. This gives rise to the risk of self-dealing or minority expropriation by controlling shareholders. This may take the form of shareholder loans, related party transactions, loans to directors who are themselves members of the controlling family, ownership dilution through new stock issue, and dealings with related parties on a less than arms-length basis.

Equally, the mechanisms of managerial discipline are weakened in this context. Phan et al propose that this is the most significant impediment to Singapore enjoying the strength of corporate governance of other Anglo-American jurisdictions. Of particular concern in the context of family firms, managerial entrenchment can take place, wherein family members establish themselves in key management and board positions. This can lead to a situation in which a member who is no longer suited to the role because of, for example, the changing nature of the business, nonetheless maintains their position due to the social and structural influence of the family within the board. Furthermore, by

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95 La Porta et al, Note 41.
97 Phan et al, Note 7, p. 12.
occupying key positions and exerting influence through the nominating committee, families may limit the selection pool for management and board nominations to family members or associated persons. This may lead to suboptimal selections being made on the basis of loyalty to the family, rather than relevant experience or business expertise.

The abovementioned statistics regarding typical board structures of SGX-listed family firms confirm the potential for such a situation to arise. Of particular note in this regard, family firms have a family member as CEO in 90% of cases, as Chairman in 82% of cases and a single person occupying both positions concurrently in 44% of cases.\(^9\) This is further evidenced by the high level of representation of family members in nominating committees and the tenure of directors, averaging 11 years generally in family firms (compared to 7 years in non-family firms), and 19 years for directors who are themselves family members.\(^9\)

In this context, therefore, the role of the independent director is not, so much, to prevent managerial opportunism at the expense of the shareholders. Rather, it is to prevent the majority shareholders from exercising their dominant position within management and on the board, at the expense of the minority shareholders. The legal duties of an independent director, as a fiduciary, are no different. Urtiaga et al, however, propose that the primary focus of their

\(^9\) Dieleman et al, Note 10, p. 4.
\(^9\) Dieleman et al, Note 10, p. 4.
monitoring function must necessarily be on preventing conflicts of interest of controlling shareholders and the risk of expropriation, and should be stated as such, to provide independent directors with a clear mandate and definition of legal status.\textsuperscript{100} Kevin Kwok, a senior accounting practitioner in Singapore, has identified that this special role for independent directors is particularly critical where the interests of management, the company and shareholders may diverge, specifically with regards to executive remuneration, succession planning, change of corporate control, auditing and evaluation of board performance.\textsuperscript{101}

The benefits of an effective independent element within family firms has been identified in the theory and is supported by some empirical evidence. In a study of over 80 family-owned companies in the US being run by a third or later generation, Ward found that the success and continued existence of these firms was most strongly correlated with the presence of an active and outside, non-family-controlled, board.\textsuperscript{102} There are a number of potential benefits that truly independent directors can bring to a family-dominated firm. Engaging persons from outside of the family may increase the breadth and depth of business and industry specific skill brought into the firm, as well as broaden the firm’s network. This is of particular value as a firm matures through the business life cycle and the skills required of directors and management change. Outside directors are more likely to challenge prevailing family opinions and provide greater discipline

\textsuperscript{100} Urtiaga et al, Note 92, p. 14-15.  
to decision-making. Their presence may also encourage concentration on important core functions of strategy and oversight, rather than allowing board meetings to be disrupted by family and non-business related issues. Furthermore, where contrasting views or factions arise within the family, the presence of an independent director can provide a ‘buffer’ and an impartial third party who can objectively arbitrate the issue.\textsuperscript{103}

Despite the benefits which independent directors can potentially bring to such organizations, it is apparent that their value has not yet been fully appreciated by Singapore listed family and tightly-controlled firms. At a corporate governance roundtable in 2011, it was noted that many closely-held firms merely engaged independent directors because they were obliged to by the listing rules.\textsuperscript{104} A commonly expressed concern was that independent directors might turn out to be unflinchingly oppositional to the controlling shareholder. It was also noted that some companies intentionally engaged independent directors whose values were similar to those of the controlling shareholder. Often this meant selecting former executive directors from other companies who shared the view that managerial autonomy should not generally be interfered with by non-executive directors.

The amendments to the Code, as discussed below, should go some way to increasing the role of truly independent directors on company boards. Perhaps

\textsuperscript{103} IFC SME Toolkit, p. 3.
\textsuperscript{104} Deloitte Whitepaper, Note 33, p. A7.
over the course of time the value brought to companies by reason of their presence may come to be more widely appreciated.

E BEHAVIOURAL RESEARCH: CAN TRULY INDEPENDENT DIRECTORS IMPROVE FIRM PERFORMANCE?

I THE GENERALISED AGENCY PROBLEM IN SOCIAL PSYCHOLOGY

The failure of empirical analyses to identify the predicted link between board independence and firm performance, as discussed above, has seen the emergence of enquiries into the corporate governance conundrum from different scientific fields. In a series of working papers from the National Bureau of Economic Research, Randall Morck has sought to apply principles from behavioural psychology to relationships within the corporate boardroom context.\(^\text{105}\)

Morck’s conceptual starting point is the generalised agency relationship, wherein any person from whom loyalty is expected is an agent, whilst the principal is the person to whom that loyalty is owed.\(^\text{106}\) Proceeding from this concept, we can interpret the generalised agency problem as when an agent exhibits non-optimal loyalty to the principal, whether that be too little loyalty or too much. However, rather than focusing on the traditional agency problem confronted in economics

\(^{106}\) Morck, Note 105, p. 3.
literature, as between shareholder and manager, Morck applies the concept to the relationship between a director, as agent, and the CEO to whom the director feels a sense of loyalty, as principal. The hypothesis is that, in such a relationship, the agent’s sense of loyalty may lead him to display excessive obedience to the principal. This excessive obedience undermines his ability to act consistently with his own reasoning and in accordance with his legal and ethical obligations to the shareholder as statutory principal.

The foundation for this generalised theory of agency can be found in Stanley Milgram’s series of social psychology experiments conducted during the 1960s and 1970s.\textsuperscript{107} The experiment, in its basic form, involved a series of subjects drawn from the general populace of New Haven, Connecticut, who responded to an advertisement to be payed for participating in psychology experiments. Each subject is told they are to assist the experimenter in a study of “the effects of punishment on learning and memory.”\textsuperscript{108} A professional actor (the ‘learner’) has wires attached to him, which lead to a box falsely depicting electric switches labelled with a range of different voltages, as well as terms such as “slight”, “very strong” and “danger severe”. As the ‘experimenter’ (also an actor) poses a series of questions to the ‘learner’, the subject is instructed to trigger the switches applying an electric shock to the ‘learner’ for each question answered incorrectly, with the voltage increasing for each further incorrect response. The ‘learner’

\textsuperscript{108} Milgram (1963), Note 107, p. 372.
protests to this treatment, growing increasingly impassioned as the voltage level is raised.

The experiment in this form was repeated using various different subject groups and the results were consistent. To the point at which the ‘learner’ demanded to be released (up to 135 volts), 100% of subjects were willing to apply the shocks as directed. At this point, 20% no longer obeyed. As the voltage is increased, 80% of subjects continued to apply the shocks until the ‘learner’ began to scream (285 volts). Slightly over 65% of subjects continued to apply the shocks up to 450 volts, even as the ‘learner’s’ protests became increasingly vehement.\footnote{Milgram (1974), Note 107, p. 188.}

Following the experiments, Milgram interviewed his subjects in an attempt to understand their behaviour. In response to his enquiries, it was commonly stated that feelings of “duty”, “loyalty” and a sense of “doing what was expected of them” drove their actions.\footnote{Milgram (1974), Note 107, p. 7.} Nonetheless, when he asked for a moral judgement of what his subjects thought to be the correct course of action, they consistently identified disobedience to their instructor’s commands as the proper behaviour.\footnote{Morck, Note 91, p. 6.}

From his observation of this behaviour Milgram deduced that his subjects experienced an \textit{agentic shift}. While they do not abandon their personal moral reasoning, it takes on a different focus in certain circumstances. Their sense of
loyalty to perceived authority overrides the moral sentiment toward the results of their personal actions. As Milgram stated, “[the subject’s] moral concern now shifts to a consideration of how well he is living up to the expectations that the authority has of him.”¹¹² As Morck points out, this represents a shift from the teleological, or consequentialist, decision-making framework, to a de-ontological, duty-based framework.¹¹³

While it is well beyond the scope of this paper to consider the cause of such behaviour, it is interesting to note that Milgram proposed this may be the result of an innate pleasure or satisfaction that human beings gain from displaying obedience to perceived authority figures. The genetic basis, he proposed, may derive from the behaviour of pre- and early-human hunter gatherers, whose chances of survival were significantly advantaged over biologically similar species, if they fell into line behind a tribal chief or alpha male.¹¹⁴

II THE AGENTIC SHIFT IN THE BOARDROOM

As was noted above, Morck contends that corporate boardroom dynamics may be affected by this second agency problem, wherein a director, as agent, subordinates his actions to the judgement of the CEO, as principal. Non-executive directors may feel a natural sense of obligation toward the CEO and executives who are generally heavily involved in their appointment. In the

¹¹³ Morck, Note 105, p. 7.
conventional division of responsibilities, the day-to-day business and strategic management of the firm are performed by executive managers, whilst non-executives act as monitors, who approve or disapprove of the executives’ proposals. This may also give rise to feelings of loyalty toward those responsible for the firm’s management, who are expected to be acting on the best information available. Faced with the authority status and perceived power and expertise of the CEO, a director may subordinate his legal and ethical duty to act in the interests of shareholders, to his innate desire to exhibit loyalty to the CEO.

In the boardroom context, the agency cost is that incurred as a result of the director displaying excessive loyalty to the CEO, rather than engaging their own reasoning in the manner they are otherwise obliged. The subordination of their decision-making to that of the CEO renders the director’s actions a failure to properly exercise his duty to the shareholders. The prediction, therefore, is that because suboptimal decisions of the CEO will be approved without independent analysis of their value, firm performance will suffer. This theory may draw some support from empirical analyses, such as that of Adams et al., which have found a correlation between the power of CEOs and increased variability in firm performance.¹¹⁵

Milgram performed a number of variations of his basic experiment in an attempt to learn more about how his subjects' behaviour was being affected. One such variation involved three ‘testers’: the first, who was actually an actor, read the question out; the second, also an actor, indicated whether the ‘learner’ answered the question correctly, whilst the third, the true subject, was charged with initiating the electric shock.\(^\text{116}\) During the course of the experiment as the voltage was increased, at first, the first ‘tester’ took objection to the experiment and left. The true subject, at this point, was instructed by the psychologist to both ask the questions and apply the shocks as before. As the voltage increased further, the second ‘tester’ also objected and refused to continue. The psychologist again instructed the subject to continue with the procedure.\(^\text{117}\) When the experiment was performed with the above variation, the proportion of those who continue to apply the electric shocks reduced significantly as those around them expressed their objections to the experiment. Milgram concluded that the dissenting voices of the true subject’s perceived peers acted to break the pattern of excessive obedience to the authority figure.

Morck recognised that the role of the ‘dissenting peer’ could be played by a truly independent director in the boardroom context, expressing objections or

\(^{116}\) Morck, Note 105, p. 12-13.

\(^{117}\) Morck, Note 105, p. 13.
genuinely challenging the CEO. Proactive peers, in the form of genuinely independent directors, could break the spell a powerful or charismatic CEO has over the board, and encourage them to be more active in questioning and challenging the status quo.

As to why the presence of independent directors on boards has yet to be shown to correlate with improved firm performance, Morck also acknowledges the present lack of *genuine* independence in many instances. Under this logic, until the proper classification and enforcement of ‘independence’ is established, the predicted benefit of the dissenting peer will not develop and the disciplining effect on management will not be shown. The lack of genuine independence has been recognised in many jurisdictions as an issue which undermines the effective functioning of independent directors as an internal governance mechanism. The Higgs Report in 2003 found that almost 50% of directors of UK publicly listed companies, who had been classified by their boards as ‘independent’ had been recruited by the CEO through personal contacts or friendships, and only 4% had been subjected to a formal interview for the position. In such circumstances, it is highly likely that these ‘independent’ directors will feel a sense of obligation to the CEO and management responsible for their position.

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119 Morck, Note 105, p. 15.
120 Higgs, Derek, Review of the Role and Effectiveness of Non-Executive Directors, January 2003, p. 16-18.
IV  DIRUPTING EXCESSIVE LOYALTY: CONFLICTING AUTHORITY FIGURES

A further variant to Milgram’s experiment proved to result in consistently different behaviour. In this situation, there were two psychologists present during the experiment, both of similar age and height. As the voltage being applied to the ‘learner’ reached a certain point, one of the psychologists began to argue with the other, protesting that it was not necessary to increase the voltage any further. The other rejected these complaints and continued to instruct the true subject that the experiment is to be conducted as originally planned.\textsuperscript{121} The effect of this staged conflict was telling. In all cases, the subject ceased to apply the shocks when the first psychologist voiced his objection. From this Milgram concluded that conflict between rival authority figures operated to displace or reduce the subject’s sense of obedience sufficiently for his personal rational decision-making to take over.

Again, Morck identified an application for the boardroom context. The rival authority figure can be represented by the presence of a Chairman who is not concurrently the CEO. Alternately, or in addition to this, the appointment of a lead independent director charged with convening the independent directors, could equally displace the naïve obedience to the CEO.\textsuperscript{122} It appears that the value of such rival authority figures has gained some acceptance in jurisdictions such as the UK, where the \textit{Corporate Governance Code} (2010) obliges companies to

\textsuperscript{121} Morck, Note 105, p. 14.
\textsuperscript{122} Morck, Note 105, p. 15.
have a separate CEO and Chairman as well as to appoint a senior independent
director.\textsuperscript{123}

V DISRUPTING EXCESSIVE LOYALTY: PROXIMITY FROM AUTHORITY

In yet another variation of Milgram’s experiment, the instructor was removed from
the laboratory. The ‘teacher’ (the true subject of the experiment) and the ‘learner’
(the actor), now received instructions via the telephone. When the experiments
were conducted in this manner, the obedience of the ‘teachers’ fell by
approximately one-third. Furthermore, a significant number of participants
administered lower shocks than that which they were supposed to and in some
instances participants actually lied to their instructors when asked whether they
were delivering shocks of the requested level. Tellingly, this disobedient
behaviour was halted as soon as the experimenter returned to the laboratory,
and the original levels of compliance were again exhibited.\textsuperscript{124}

It is also worthy of note that proximity to the ‘learner’ receiving the abuse, as
where experiments were conducted in which the subject physically applied the
‘learner’s’ hands to the electrode, only reduced obedience slightly. Proximity to
the instructor showed a far more significant relationship to compliance.\textsuperscript{125}

Milgram thus concluded that the physical presence of the authority figure
significantly increases obedient behaviour.

\textsuperscript{123} The Corporate Governance Code 2010 (UK), A.1.2 and A.2.1.
\textsuperscript{124} Morck, Note 105, p. 11-12.
\textsuperscript{125} Morck, Note 105, p. 11-12.
Morck saw the analogy in the corporate context. Directors of a corporation are far closer in proximity on a regular basis to the CEO and, if one exists, to a controlling shareholder. Public shareholders, on the other hand, are a “relatively remote abstraction.”\textsuperscript{126} In such circumstances, the sense of loyalty to the perceived authority figures is likely to trump their legal and ethical duties of loyalty to public shareholders, whose presence is generally felt only at annual general meetings.\textsuperscript{127}

As a means of harnessing the disruptive effect of increased proximity, Morck advocates regulations mandating meetings of directors absent the CEO or controlling shareholder, as well as staffing key board committees with only independent directors.\textsuperscript{128} Again, the efficacy of these measures is contingent upon the directors who are designated as ‘independent directors’ being \textit{truly} independent.

\textsuperscript{126} Morck, Note 105, p. 12.  
\textsuperscript{127} Morck, Note 91, p. 9.  
\textsuperscript{128} Morck, Note 105, p. 12.
INDEPENDENT DIRECTORS IN THE CODE

THE “INDEPENDENCE” OF INDEPENDENT DIRECTORS

10% Shareholders

Principle 2 establishes the fundamental proposition that Boards should have a “strong and independent element…which is able to exercise its objective judgement on corporate affairs independently, in particular from Management and 10% shareholders. [emphasis added]” The 2012 Code differs from its predecessor in specifying that independence should also exist from 10% shareholders. The Code defines a “10%” shareholder as

a person who has an interest or interests in one or more voting shares in the company and the total votes attached to that share, or those shares, is not less than the 10% of the total votes attached to all the voting shares in the company.

Guideline 2.3 goes on to define an independent director as one who has:

no relationship with the company, its related corporations, its
10% shareholders or its officers that could interfere, or reasonably be perceived to interfere, with the existence of the

130 Code (2012), Footnote 2.
director’s independent business judgement with a view to the best interests of the company. [emphasis added]¹³¹

The Guideline sets out a non-exhaustive list of relationships, which, if shown to exist, give rise to a presumption that a director is not independent. Included in this list as an amendment from the previous Code is a director who is himself a 10% shareholder in the company, or has a family member who is a 10% shareholder, and a director who has been “directly associated with a 10% shareholder of the company, in the current or immediate past financial year.”¹³² This brings the Singapore Code into line with the UK Code’s definition of ‘independent’, the original version of which the Singapore Code was based on.¹³³ The fact of its exclusion from previous versions in Singapore may suggest a resistance amongst corporate boards affected by the definition, who, given their high prevalence, would constitute a powerful lobby group.

These amendments are of significance, given the aforementioned presence of concentrated ownerships, particularly amongst family firms, and the frequent engagement of nominee directors. By tightening the definition to presumptively exclude 10% shareholders, or their family and associates, this greatly increases the likelihood that directors appointed to provide the independent and objective viewpoint envisioned for them in the Code, will actually bring an independent mind to their task of monitoring and disciplining management.

¹³¹ Code (2012), Guideline 2.3.
¹³² Code (2012), Guideline 2.3 (e) and (f).
¹³³ The Corporate Governance Code 2010 (UK), B.1.1.
2 Former service providers

The new Code also provides greater clarity as to the types of commercial relationships with external organizations which may undermine a director’s independence. The 2005 Code included in its list of presumptive non-independence, relationships with any “for-profit business organization to which the company or any of its subsidiaries made, or from which the company or any of its subsidiaries received, significant payments in the current or immediate past financial year.” The amended Code seeks to provide greater clarification as to the types of commercial relationships which may fall into this category, by stating, “…material services (which may include auditing, banking, consulting and legal services)…”

A proper interpretation of the 2005 provision should, no doubt, have included the types of services specifically listed in the amended Code. Nonetheless, in keeping with the intention of the Code to act as a ‘best practice’ model, by specifically listing types of services which should be considered to fall into this category, both corporate directors and shareholders are given greater guidance by which to assess the governance policies of the firm.

134 Code (2005), Guideline 2.3(d).
135 Code (2012), Guideline 2.3(d).
Again, this is an area of importance, given the frequency of board appointments of persons who formerly acted as external legal, accounting or consulting advisors. The potential for such a prior relationship to undermine the independence of such persons is clear. Firstly, there is an existing relationship with the incumbent directors and managers of the firm which may inhibit their ability to objectively monitor them. Secondly, there exists the potential for these persons to effectively be required to assess the value of strategic policies or investment decisions which they themselves were involved in making. Finally, from a policy perspective, this provision may also prove valuable in encouraging companies to look to a broader pool of potential independent directors, bringing not just the benefits of greater independence but potentially providing a broader set of expertise and experience to the role.

3 Particularly rigorous review

In accordance with Principle 4, the nominating committee is responsible for making recommendations to the board regarding, *inter alia*, the appointment and re-appointment of directors.\(^{136}\) The amended Guideline 4.2 includes among important issues to be considered during the review process, “the composition and progressive renewal of the board.”\(^{137}\) By explicitly referring to “progressive renewal”, it appears the drafters seek to draw a nominating committee’s attention to the potential for entrenchment of directors over extended periods. The

\(^{136}\) Code (2012), Principle 4; Guideline 4.2(d).

\(^{137}\) Code (2012), Guideline 4.2.
problems associated with director entrenchment, have been discussed above at length. This is of particular importance in the case of directors designated by the board as ‘independent’, given the potential for their objective judgement to be eroded through natural socialising pressures over the course of time on the board.

In determining whether a director is ‘independent’, the newly included Guideline 2.4 states that any director who has served on the Board for a period exceeding 9 years, “should be subject to particularly rigorous review.” This provision will potentially affect a significant group. A 2011 survey by the Institute of Directors (Singapore) found that over 25% of directors of publicly listed companies had served for a period of 9 years or more. Socialising processes and concern regarding ‘collegiality’ among board members have long been recognised as potentially giving rise to ‘groupthink’, undermining a nominally independent director’s ability to engage truly independent judgement. Other jurisdictions have included more stringent guidelines. The UK Code recommends particularly rigorous review after 6 years, while the Malaysian Code mandates that any director serving beyond 9 years can no longer be deemed independent. Nonetheless, the inclusion of this recommendation in the Singapore Code should alert board and nominating committee members to these risks when assessing a

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138 Code (2012), Guideline 2.4.
139 Unattributed, More independent directors needed under proposed code revision, Channel News Asia, 14 September 2011, p. 2.
141 The Corporate Governance Code 2010 (UK), B.2.3; Code on Corporate Governance 2012 (Malaysia), Recommendation 3.2.
director’s independence. Furthermore, it should encourage them to be particularly vigilant in determining independence, given they will have to justify their decision to shareholders in the Annual Report.\footnote{142 Code (2012), Guideline 4.3.}

The insufficiency of independence of directors was acknowledged as an issue of concern by regulators and practitioners prior to the amendments. The empirical literature, as discussed above, also highlights the importance of ‘independent directors’ being \textit{truly} independent. Genuine independence is a necessary precondition to each of Morck’s behavioural based-proposals. These amendments should, therefore, raise the independent credentials of boards which seek to comply with the Code’s recommendations.

II THE POSITION AND PRESENCE OF INDEPENDENT DIRECTORS

Guideline 2.1 recommends that independent directors should make up at least one-third of the board.\footnote{143 Code (2012), Guideline 2.1.} However, the newly included Guideline 2.2 strengthens the presence of independent directors in certain circumstances, recommending that they make up at least \textit{half} the board where:

\begin{enumerate}
\item the Chairman and the CEO is the same person;
\item the Chairman and CEO are immediate family members;
\item the Chairman is part of the management team; or
\end{enumerate}
These recommendations respond to concerns expressed about a general lack of independent representation on boards and specifically to the situation in Singapore where many boards are dominated by members of the same family. With regard to family firms, the 2011 NUS study found that 35% of all board seats were held by family members, 80% of executive directors were family members and the key roles of CEO and Chair were almost always held by family members and often combined.\textsuperscript{145}

Given this new recommendation, it appears that the overwhelming majority of family firms – which constitute 52% of publicly listed companies – will be required to have no less than half of the board classified as independent, if they wish to comply with the Code. The effect of this provision, when combined with the aforementioned tightening of the definition of ‘independent’, should operate to significantly enhance the presence of directors who are truly independent from the controlling family. The increased presence of these persons not beholden to the dominant family or shareholders should diminish the opportunity for majority shareholders to act to the detriment of the minority. The larger group of independent directors can act as an effective counterweight to the interests of majority holders, as represented through family members or nominees on the board.

\textsuperscript{144} Code (2012), Guideline 2.2.  
\textsuperscript{145} Dieleman et al, Note 10, p. 4.
board, in situations where their interests may conflict with that of the company as a whole.

These recommendations may also provide the disruption to reflexive obedience as envisioned by Morck. An individual director’s more genuinely independent nature should increase their likelihood of challenging the prevailing sentiment. The presence of these individuals, particularly in their heightened numbers, may enable them to play the role of the dissenting peer, whose voiced objection may disrupt the agentic shift, and thus encourage those around them to voice dissent themselves.

III CONFLICTING AUTHORITY FIGURES

Separation of the key roles of CEO and Chairman has long been identified in corporate governance literature as beneficial to the effective monitoring of managerial activity. Though there are competing schools of thought on the matter, advocates of separation argue that permitting a single person to occupy both positions concurrently is, in the words of an Economist journalist, “the corporate equivalent of a schoolboy marking his own exam papers.”

Nonetheless, the extent to which such a separation has been applied by individual companies and enforced by regulators differs significantly between jurisdictions. As at 2010, 59% of S&P 500 companies still combined the two roles

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146 Proponents of the ‘stewardship’ theory highlight the value accruing to the company by reason of increased decision-making efficiency where the roles are concurrently held by a single individual; Unattributed, The Shackled Boss, Economist, 21 January 2012, p. 67.
within a single individual.\textsuperscript{147} At the other end of the spectrum, a 2009 study found that 80\% of companies in Europe had separated the roles of CEO and Chairman.\textsuperscript{148} It appears, however, that separation is finding greater acceptance internationally. A survey conducted by Booz\&Co of the world's 2,500 largest companies, found that the proportion of incoming CEOs who also held the role of Chairman fell from 48\% in 2002 to less than 12\% in 2009.\textsuperscript{149}

In keeping with the prevailing movement toward separation, the Singapore Code recommends that the Chairman and CEO should \textit{in principle} be separate persons.\textsuperscript{150} It is interesting to note that the language used is less forceful than that of the UK Code, upon which it was based, which states, “the roles of Chairman and Chief Executive Officer \textit{should not} be exercised by the same individual.” [emphasis added]\textsuperscript{151} Regardless, it is apparent from the abovementioned statistics that many publicly listed companies, particularly family firms, elect to deviate from this recommendation.

Deviation from this recommendation is explicitly accounted for in the Code, whereupon it is recommended that an independent director should be appointed to act as lead independent director.\textsuperscript{152} The duties of the lead independent director are to provide an alternate contact point to shareholders, and to organise

\begin{itemize}
  \item \textsuperscript{147} Unattributed, The Shackled Boss, Economist, 21 January 2012, p. 67.
  \item \textsuperscript{149} Favaro, Ken, Karlsson, Per-Ola and Gary Neilson, CEO Succession Report, Booz\&Co, 2011, p. 7.
  \item \textsuperscript{150} Code (2012), Guideline 3.1.
  \item \textsuperscript{151} The Corporate Governance Code 2010 (UK), A.2.1.
  \item \textsuperscript{152} Code (2012), Guideline 3.3.
\end{itemize}
and lead the independent directors in meetings absent the executives. The 2012 Code has broadened the range of situations in which a lead independent director’s appointment is recommended and strengthened the forcefulness of the recommendation. The 2005 Code recommended appointment where the chairman and the CEO: is the same person; are related by close family ties; or, where they are both part of the executive management team. The amended Code extends the recommendation also to situations where the Chairman is not an independent director. This alteration can again provide an elevated role for an independent director who takes a position of leadership within the governance team, to potentially provide a counterweight to the executives and CEO.

Furthermore, where the 2005 Code stated, companies may appoint a lead independent director in the situations listed above, the amended Code states that every company should appoint a lead independent director. While this may appear a minor alteration in language, one must keep in mind the non-binding nature of the Code as a model of best practice. Its intent is not to bind corporations to abide by regulatory diktat, but rather, to provide a series of principles and guidelines by which corporate directors and shareholders can assess the practices of their own firms. Its normative influence, therefore, may well be increased even through apparently minor alterations in language if the effect is to convince shareholders to agitate in favour or compliance.

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153 Code (2012), Guidelines 3.3 and 3.4.
154 Code (2005), Commentary 3.3.
155 Code (2012), Guideline 3.3.
The presence of a separate and independent individual from the CEO, either in the form of a Chairman or lead independent director, may operate to provide the conflicting authority figure envisioned by Morck. Provided this separate authority is truly independent and active in voicing objections or alternative opinions to the CEO, they may function as the rival authority which proved so effective in Milgram’s experiments at disrupting the *agentic shift*. Where directors are presented with competing authorities, it is likely that the individual will reengage his own reasoning process, and be, thereby, less prone to naively supporting sub-optimal decisions made by a powerful or charismatic CEO.

IV PROXIMITY: SEPARATE MEETINGS OF INDEPENDENT DIRECTORS; AUDIT COMMITTEES STAFFED BY INDEPENDENT DIRECTORS

In accordance with Guideline 3.4, it is recommended that the independent directors meet periodically, led by the lead independent director, and without the presence of the other directors.\textsuperscript{157} Similarly, Guideline 2.8 recommends that the non-executive directors meet regularly without the presence of management.\textsuperscript{158} No doubt, the rationale behind convening these meetings is to provide a forum in which those whose primary function is to monitor the management and assess their decisions can discuss matters and potentially voice concerns or criticism without fear of offence, censure or retribution.

\textsuperscript{157} Code (2012), Guideline 3.4.
\textsuperscript{158} Code (2012), Guideline 2.8.
In accordance with Morck’s proposals, such fora may benefit from the proximity from authority that Milgram’s experiments proved to be effective in reducing the reflexive obedience of his subjects to their instructors. When physically removed from their perceived authority figures - the CEO and executives - directors should be less likely to subordinate their own rational decision-making processes in favour of exhibiting loyalty. With respect to meetings of independent directors, the potential for this phenomenon to take place is heightened, given both the presence of the truly independent rival authority figure, in the lead independent director, as well as the more genuinely independent nature of the directors themselves, thanks to the refined definition. If this recommendation is acted upon it could prove particularly useful in the context of family firms. This would effectively constitute a meeting of at least half of the directors, all of whom have no association with the family or major shareholders. The opportunity to have full and frank discussions regarding corporate matters in this format should encourage superior decision-making and reduce the potential for minority interests to be neglected.

It is interesting to note, however, that the Singapore Code does not actively encourage the same level of independence from the audit committee. Guideline 12.1 is substantially the same in effect as its predecessor.\(^{159}\) It is recommended that the audit committee comprise a minimum of three directors, all non-executive directors, but only a majority of whom, including the audit committee

chairman, should be independent.\textsuperscript{160} The UK Code, on the other hand, recommends that all members of the audit committee should be independent.\textsuperscript{161} In the US, the \textit{Sarbanes-Oxley Act 2002} (US) mandates that audit committees of all publicly listed firms must be staffed entirely by independent directors.\textsuperscript{162} As was noted above, the conventional theory suggests that independent audit committees are desirable as members whose compensation is not linked to firm profits are less likely to intentionally misstate earnings. This anticipated relationship between committee composition and audit failure was not found in the empirical literature.\textsuperscript{163}

Despite the lack of empirical evidence showing the value of complete audit committee independence, it is surprising that Singapore would not adopt an equivalent provision to that of the US and UK. Given the non-mandatory nature of the Code, a recommendation of this type would not unnecessarily burden those companies who, for good reason, chose not to completely staff an audit committee with independent directors. However, for the Monetary Authority of Singapore, which is responsible for approving the Code, to have failed to accord with prevailing sentiment toward audit committee independence, may represent a missed opportunity to send a stronger signal to the international investing community that Singapore is serious about protecting shareholders from audit failure.

\footnotesize{\textsuperscript{160} Code (2012), Guideline 12.1.  
\textsuperscript{161} The Corporate Governance Code 2010 (UK), C.3.1.  
\textsuperscript{162} Sarbanes-Oxley Act 2002 (US), s 301.  
\textsuperscript{163} Romano, Note 82, p. 1529-30.}
G  DIRECTOR “BUSINESS”

The modification to the definition of independent director, combined with the heightened level of involvement of directors designated as such, will have a significant impact on the Singapore corporate landscape. A 2011 survey of over 700 Singapore listed companies found that approximately 8 in 10 will need to find more independent directors if they wish to comply with the amended Code.\textsuperscript{164} The same survey found that over 25\% of directors in these companies had served for longer than 9 years.\textsuperscript{165} Those from this group who are designated as ‘independent’ will be subjected to “particularly rigorous review” in their future assessments of independence. Depending on the vigour with which these reviews are conducted, this may further increase the demand for new independent directors.

It has been acknowledged that there presently exists a relatively small pool of qualified independent directors in Singapore. The significant increase in demand for such persons may result in an increased prevalence of individuals holding multiple directorships concurrently, at least in the short term. This is ironic given the amended Guideline 4.4 appears to be specifically formulated to avoid the problems associated with director ‘busyness’.\textsuperscript{166} The provision recommends that the nominating committee pay special attention to a director’s ability to dedicate

\textsuperscript{164} Unattributed, Note 139, p. 1.
\textsuperscript{165} Unattributed, Note 139, p. 1.
\textsuperscript{166} Code (2012), Guideline 4.4.
sufficient time to the role, in light of any other board representation commitments.
Furthermore, the board should determine a maximum number of listed company board positions which any of its directors may hold.\textsuperscript{167}

To assuage any fears of excessive director ‘busyness’, John Lim of the Institute of Directors (Singapore), noted that, presently, 84% of directors sit on only one board. Thus if each were to take a second board position, the pool would be increased by 84%. He also stressed that this may provide the advantage of broader corporate experience to each directorship as well as making these directors less beholden to any individual firm.\textsuperscript{168} Regardless, it appears that in the longer run, more qualified independent directors will need to be found in Singapore, given both the increased demand per company, and growing popularity of the SGX as a platform for listing.

\textbf{H CONCLUSION}

Relative to developing economies and mature markets alike, Singapore has consistently offered a strong regulatory environment and rigorous enforcement of shareholder protections. The alterations to the Code should inspire greater confidence in a system which already exhibits generally good governance standards. The strengthened requirements relating to director independence respond directly to concerns expressed by those in the investing community and

\textsuperscript{167} Code (2012), Guideline 4.4.  
\textsuperscript{168} Unattributed, Note 139, p 1.
appear well calibrated to comport with empirical and theoretical literature in the field.

Nonetheless, there remains the concern that continued deviation from the Code enables firms to operate in a manner which does not accord adequate protection to the rights of minorities. Were this to continue, the result would no doubt be to discourage increased minority participation in share ownership.

Given the presently high level of deviation from the provisions, particularly amongst smaller family-dominated firms, it is clear that there is not yet widespread acceptance of all aspects of the Code's recommendations. The non-mandatory nature of the Code ensures that companies that wish to pursue their present non-conforming course of action are legally permitted to do so. The evidence at present suggests that family firms, whose governance practices will be most affected by the alterations regarding 10% shareholders and minimum independent representation, also tend to be smaller in size. With less need to access larger sources of external financing, it is likely that they will experience less immediate pressure to modify their practices in accordance with the Code’s recommendations.

At the other end of the spectrum, larger or faster growing companies with financing requirements demanding greater recourse to institutional investors and foreign sources of capital will feel greater pressure to comply with the Code. With
the increasing role of wealth managers and institutional investment into the Singapore equities market, shareholders of this size have both the incentive and the leverage to demand greater protection of their interests. They are therefore more likely and more able to agitate in favour of complete compliance with the Code’s amended recommendations.

Thus, the short-term effect of the modifications may be to further separate listed firms into complying and non-complying groupings divided by their size and capital requirements. However, the normative impact of the Code is not to be overlooked. The market effect of the “comply or explain” principle may nonetheless begin to be felt by smaller companies. The heightened disclosure requirements also present in the amended Code play an important role in this regard. As broader acceptance of the Code’s guidelines evolves, minority shareholders are likely to become more active in demanding that their interests are protected to an equivalent level to that which other corporations on the market provide.

The rapid economic development of Singapore since gaining independence has been greatly facilitated by its dynamic yet secure capital markets. The traditionally stringent approach to regulation established the country’s corporate sector as a credible repository for equity investment. The flexibility provided by the Code in its amended form further buttresses the SGX’s desirability as a platform for public listing. As the nation’s founding Prime Minister, Lee Kwan
Yew, aptly boasted from the capital in 1965, “over 100 years ago this was a mud-flat, swamp. Today this is a modern city. Ten years from now, this will be a metropolis. Never fear.” The rate at which the nation’s capital markets are attracting the attention of the international investing community, encouraged by genuine governance reform, suggests this optimism about Singapore's future is equally valid today.

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169 Lee Kuan Yew, Founding Prime Minister of the Republic of Singapore, 12 September 1965.
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K  CASE LIST
