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CORPORATE GOVERNANCE IN SINGAPORE: EXPLORING THE CONCEPT OF DIRECTOR INDEPENDENCE IN THE LIGHT OF GLOBAL CORPORATE GOVERNANCE PRINCIPLES

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ABSTRACT

Director independence is a major institutional element of corporate governance. In Singapore, the Code of Corporate Governance 2012 ("Singapore Code") has introduced several major changes to the concept of independent directors. The expanded definition of independence, which requires independent directors to be independent from both management and shareholders holding 10% of the company's shares, could affect the availability of independent directors in Singapore. While the definition of independence is well-elaborated, Singapore's rules do not provide clarity on the role of independent directors; nor do the expectations of the role appear to have changed to take the expanded definition into account. This paper suggests that the Singapore Code should advocate that independent directors exercise vigilance on behalf of minority shareholders and play a proactive role in risk management. Relevant comparisons are made with the requirements in the United States and United Kingdom, and other global corporate governance principles.

Keywords: Corporate governance, Independent directors, Code of Corporate Governance

INTRODUCTION

In a recent study analysing corporate governance requirements and degrees of enforceability across 25 global markets, Singapore ranked first in the Asia-Pacific region, and third overall behind the United States and United Kingdom (KPMG and ACCA, 2014). Singapore first implemented the Code of Corporate Governance in 2001. The concept of independent directors was introduced by it as a mechanism to improve board accountability and objectivity, and has since been widely embraced by listed companies in Singapore. In 2012, the corporate governance framework in Singapore underwent extensive review, resulting in key amendments in the revised Code of Corporate Governance 2012 ("Singapore Code") relating to various aspects including director independence, board composition, directors' training, remuneration matters, risk management, and shareholders' rights and responsibilities. The changes to the concept of director independence in the Singapore Code were implemented with the aim of bringing an objective and independent element to board decision-making relating to corporate affairs.

Against the backdrop of Singapore's reputation for good corporate governance, a recent slew of corporate governance issues arising in Singapore Post Limited, a major listed company providing postal services, is a good reminder that the safeguards against board governance in Singapore may not be sufficient. The director at the centre of Singapore Post Limited's corporate governance problems was then its lead independent director, who misbehaved under the watch of its then independent board chairman (Tan, 2016). The events stirred up corporate governance concerns in the business community and media, and resulted in the scrutiny of Singapore's independent directors. This suggests the need to re-examine the concept of director independence in Singapore.

This paper focuses on the definition and role of an independent director in Singapore. It is widely recognised that director independence in the context of corporate governance has

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long been a subjective trait that is not easy to measure. The approach towards director independence depends on several factors, including board structures, company ownership structure, and corporate culture. It is therefore no surprise that the concept of director independence varies from jurisdiction to jurisdiction. Relevant comparisons are made with the corporate governance regime in the United States and United Kingdom, and the possible rationale and consequences of major differences are discussed. The concept of director independence in the G20/OECD Principles of Corporate Governance ("OECD Principles") and the ICGN Global Governance Principles ("ICGN Principles) is also examined.

Under the expanded definition of director independence in Singapore, independent directors are required not only to be independent from management, but also to be independent from shareholders with an interest in 10% or more of the total voting shares in the company (Code of Corporate Governance, 2012). The expansion brings the definition of independence closer to that of the United Kingdom, but departs from the definition of independence in the United States. The modification is crucial because it may mean that the independent directors are changing their core function from monitoring management on behalf of dispersed shareholders to monitoring controlling shareholders on behalf of minority shareholders (Puchniak and Lan, 2016). Although the expanded definition of independence purports to improve board objectivity and effectiveness, it poses potential implications and obstacles for listed companies in Singapore. These issues are examined in this paper.

Independent directors in Singapore have generally been seen as acting as overseers, checking and balancing the acts of the board and management of the company. Despite the clarity provided by the expanded definition of independence, the rules in Singapore have yet to prescribe the role of independent directors; nor do expectations of the role appear to have changed to take into account the expanded definition of independence. This paper suggests that, in the light of the expanded definition of independence, as well as the unique corporate culture and the predominance of concentrated ownership structure in local companies, the Singapore Code should advocate that independent directors exercise vigilance on behalf of minority shareholders in contexts such as self-dealing transactions and other conflict-of-interests situations, and play a proactive role in risk management to mitigate the risk of fraud, bribery and corruption.

CORPORATE GOVERNANCE CONCERNS

It is widely recognised that the structure of corporate ownership within an economy is a primary determinant of a country's corporate governance system (Solomon, 2013). Ownership structures are diverse across countries, with dispersed ownership being more common in listed firms in the United States and the United Kingdom, compared to countries in Asia where concentrated ownership is more prevalent (Hopt, 2011; Stijn et al., 2000; La Porta et al., 1999). The varying governance approaches based on ownership structures across different jurisdictions are expressly acknowledged in the OCED Principles, which state that "[t]he variety of board structures, ownership patterns and practices in different countries will thus require different approaches to the issue of board objectivity" (OECD, 2015, p. 58). Among the various approaches to bolster board objectivity is the use of independent directors, which has become a cornerstone of the modern corporate governance landscape. Generally, independent directors are crucial for enhancing board effectiveness and providing a source of confidence to investors in the strength of the governance of the company (Clarke, 2007). Independent directors have increasingly been crucial in helping to attain a balance of power within the company board and providing an independent view on corporate strategy and affairs (Solomon, 2013).

Governance Concerns Arising from a Dispersed Ownership Structure

The defining characteristic of a dispersed ownership structure is the separation of ownership and control (Berle and Means, 1932). Under the agency theory, managers make the day-to-day business decisions on behalf of the dispersed shareholders as agents, and are responsible for advancing the shareholders' best interests (Jensen and Meckling, 1976). Jensen and Meckling (1976) however assert that the underlying assumption under the agency theory is that in the absence of oversight, management could be tempted to use corporate resources in its own perceived self-interest. The central governance concern in a dispersed ownership structure is therefore the significant agency problems between management and shareholders, arising from the shareholders' lack of incentive to supervise management due to their dispersed ownership (Solomon, 2013). This agency problem presents shareholders with the need to monitor company management.

There are various approaches towards corporate governance which improve accountability, thereby allowing shareholders to monitor management and resolve agency problems in a dispersed ownership structure. Such approaches include the board of directors, disclosure and transparency, internal controls and risk management, audit functions, institutional investors, regulations, and a market for corporate control (Solomon, 2013). The board of directors, in the context of agency concerns, is an intermediary representing shareholder interests vis-à-vis management, curtailing management's ability to extract private benefits or act in a suboptimal way with respect to shareholder interests" (Nili, 2016, p. 6). The board of directors serves as a check on management, and would presumably perform its role more effectively if its members were independent from and not financially beholden in some way to management. The concept of independent directors thus originated in a dispersed ownership structure to strengthen the monitoring role of the board (Gordon, 2007).

Corporate Governance in the United States

The American economy has traditionally been dominated by publicly-held companies with widely dispersed shareholders (Hopt, 2011). The principal governance concern is the potential for overreaching by management, and independent directors in a dispersed ownership structure strengthen control over management and address conflicts of interests between managers and shareholders (Solomon, 2013). The concept of independent directors originated from the notion of disinterested directors under common law, whereby directors who have an interest in any transaction or proposed transaction are barred from voting on such matters (Karmel, 2013). In the aftermath of the financial scandals in 2001, the United States Securities and Exchange Commission incorporated the requirements of independent directors into the Sarbanes-Oxley Act of 2002. The subsequent 2008 financial crisis led to further legislative requirements on independent directors in the Dodd-Frank Wall Street Reform and Consumer Protection Act. Under the stock exchange regulations, domestic listed companies, except for controlled companies (i.e. those where a single shareholder or a group of shareholders holds 50% or more of voting shares), are required to have a majority of independent directors (Weil, Gotshal and Manges LLP, 2014; NYSE Listed Company Manual, Section 303A.01; NASDAQ Stock Market, Rule 5605(b)).

Corporate Governance in the United Kingdom

The typical ownership structure in the United Kingdom is similarly dispersed (Hopt, 2011). The concept of independent directors was taken first to the United Kingdom via the Cadbury Report in 1992. After the reporting scandals in 2001, the requirements on independent directors were strengthened via the Higgs Report in 2003. Under the UK Corporate Governance Code (2012), the board should include an appropriate combination of executive and non-executive directors (and in particular, independent non-executive directors) such that no individual or small group of individuals can dominate the board's decision-making. Except for smaller companies (i.e. below the FTSE 350 throughout the year immediately prior to the reporting year), at least half the board, excluding the chairman, should be comprised of non-executive directors determined by the board to be independent (UK Corporate Governance Code, 2012). Pursuant to the UK Corporate Governance Code (2012), a smaller company should have at least two independent non-executive directors.

Governance Concerns Arising from a Concentrated Ownership Structure

In a concentrated ownership structure, the presence of controlling shareholders gives rise to different corporate governance issues (Bebchuk and Hamdani, 2009). Urtiaga and Saez (2012) report that controlling shareholders generally have both the incentives and the power to monitor management, and they usually wield control over the board. As a result of the low level of separation of ownership and control, there can be abuses of power. The problem in a concentrated ownership structure is the potential expropriation of the minority shareholders by the controlling shareholders through self-dealing and related party transactions (Urtiaga and Saez, 2012). Minority shareholders also may not be able to obtain requisite information on the company's operations. Opaque financial transactions and misuse of corporate funds are potential problems in a concentrated ownership structure (Solomon, 2013). The goal of corporate governance is therefore to monitor the corporate behaviour of the controlling shareholders and reduce the potential expropriation of minority shareholders. In a concentrated ownership structure, the independent director could similarly perform a monitoring role, but focusing on the controlling shareholders rather than on the management (Bebchuk and Hamdani, 2009).

Corporate Governance in Singapore

The landscape in Singapore is vastly different, with concentrated-ownership companies being prevalent among the state's listed companies. Tan (2011, p. 29) reported that "corporate ownership is highly concentrated, and mainly owned by families, groups of families or interest groups and the Singapore government." According to a recent empirical study, up to 60.8% of listed companies in Singapore can be classified as family-controlled (Dieleman et al., 2013). Empirical evidence suggested that family members collectively hold large controlling blocks of shares in family-controlled companies, which results in such companies having extremely concentrated shareholder structures (Dieleman et al., 2013). The highly concentrated-ownership structure among family-controlled companies can give rise to the agency problem of expropriation of minority shareholders by the controlling shareholders.

In Singapore, the concept of independent directors was introduced in 2001 with the aim of improving board accountability and objectivity, and as a way of preventing corporate mismanagement. Principle 2 of the Singapore Code provides that "[t]here should be a strong and independent element on the board that is able to exercise objective judgement on corporate affairs independently." To demonstrate this, independent directors should make up at least one-third of the board, but this percentage is increased to at least half of the board where the chairman of the board and the chief executive officer is the same person or are immediate family members, or the chairman is part of the management team or not independent (Code of Corporate Governance, 2012, Principle 2; Yip and Tan, 2013). Furthermore, the issuer's board must have at least two non-executive directors who are independent and free from any material business or financial connection with the issuer (SGX Listing Mainboard Rules, Rule 210(5)(c)).

DEFINITION OF DIRECTOR INDEPENDENCE

Different countries define independence differently. The OECD Principles do not provide an exact definition of independence and recognise varying approaches towards defining independence for board members. According to the OECD Principles, "in many instances, objectivity requires that a sufficient number of board members not be employed by the company or its affiliates and not be closely related to the company or its management through significant economic, family or other ties" (OECD, 2015, p. 58). Under this definition of independence, shareholding would not bar a director from attaining an independent status. The OECD Principles further provide that "in other instances, independence from controlling shareholders will need to be emphasised, in particular if the ex-ante rights of minority shareholders are weak and opportunities to obtain redress are limited" (OECD, 2015, p. 58). This definition would prevent an independent director from having a connection with shareholders. In addition, the ICGN Principles set forth a list of criteria that would compromise the independence of a director (ICGN, 2014). Importantly, a director's independence is compromised if he is a "significant shareholder of the company, or an officer of, or otherwise associated with, a significant shareholder of the company" (ICGN, 2014, p. 10). No further elaboration is provided on what constitutes a "significant shareholder".

United States

The definition of independence in the United States requires that the independent directors be independent from the management. Specifically, the definition focuses on the absence of financial and family ties between directors and the company. The rules in the NYSE Listed Company Manual and NASDAQ Stock Market contain specific prerequisites for director independence, explicitly prohibiting directors from being considered independent if they were employees of the company, received compensation over a certain threshold other than as a director fee, had ties to the company's auditor, or had business or compensation interlocks with the company above a certain threshold. Crucially, the definition of independence does not consider the relationship with controlling and significant shareholders. As the governance concern is independence from management, ownership of even a significant amount of the company's shares, by itself, is not a bar to a finding of director independence (NYSE Listed Company Manual, Section 303A.01; NASDAQ Stock Market, Rule 5605(b)).

The definition of independence currently does not consider social and professional ties with the company and its management, although those ties may in reality affect the independence of directors. There are, however, case law developments in the United States suggesting that the definition of independence may become broader in future (Khanna and Mathew, 2010). In *re Oracle Corp. Derivative Litigation,*[2] it was held that personal and social relationships are relevant to determining director independence. Although the decision was made within the context of claims of independence for a special litigation committee at issue, it begs the question of whether a workable definition of independence could exist that might capture social and personal relationships (Tung, 2011). Currently, the requirements for independence described in *Oracle* have yet to be incorporated into the stock exchange regulations, which have mainly focused on directors' financial and family ties to the company. However, in the light of *Oracle*, it remains to be seen whether formal independence without social independence is adequate under the current definition of independence to assure the effectiveness of independent directors.

United Kingdom

The definition of independence in the United Kingdom is more comprehensive than in the United States, as it requires independent directors to be independent from both management and significant shareholders. The 1992 Cadbury Report, which first introduced the notion of independent directors in the United Kingdom, required independence only from management. In the wake of the financial scandals in 2001, the Higgs Report in 2003 recommended the expansion of the definition of independence, and this was reflected in the revised UK Corporate Governance Code. The impetus for the expanded definition of independence was to address the fact that it was "not just relationships or circumstances that would affect the director's

[2] (2003) 824 A.2d 917 (Del. Ch.).

objectivity, but also those that could appear to do so" (Higgs Report, 2003, p. 36). The expanded definition of independence also makes clear that "receiving additional remuneration beyond the director's fee compromises an individual's independence" (Higgs Report, 2003, p. 36). Non-executive directors should also not allow the objectivity of their judgment be affected by the income derived from their role or shareholding (Higgs Report, 2003).

Singapore

In 2012, the Singapore Code was revised to require,[3] among other changes, independent directors to have independence from shareholders holding 10%[4] or more of the company's shares, and not just independence from management (as had been the case under the previous definition). Under the expanded definition, a director is deemed to not be independent if he is "a director who is a 10% shareholder or an immediate family member of a 10% shareholder of the company, or a director who is or has been directly associated with a 10% shareholder of the company, in the current or immediate past financial year" (Code of Corporate Governance, 2012, p. 5). A director will be considered "directly associated" with a 10% shareholder only "when the director is accustomed or under an obligation, whether formal or informal, to act in accordance with the directions, instructions or wishes of the 10% shareholder in relation to the corporate affairs of the corporation" (Code of Corporate Governance, 2012, p. 5). The expanded definition of independence appears to be in line with the concentrated ownership structure that predominates listed companies in Singapore, as it now covers relationships with controlling shareholders.

While the expansion brings the definition in Singapore closer to that of the United Kingdom, it poses potential implications and obstacles for listed companies as a result of the requirements linking shareholding and director independence. Firstly, the expanded definition of independence could reduce the availability of independent directors for listed companies in Singapore. Given Singapore's relatively close-knit business community and the prevalence of family-controlled firms, major shareholders are often disinclined to select directors who would challenge management, albeit constructively, preferring instead to bring in independent directors who would work harmoniously with them. It is therefore common to have friends of the major shareholders sitting on the board of such companies as independent directors, to minimise excessive challenging from outsiders. Under the expanded definition, these individuals may lose their independent status if they are considered directly associated with the major shareholders. Secondly, the requirement of linking "10% shareholders" and director independence could be unduly conservative. It raises the question of whether a shareholder holding 10% of the company's shares could sufficiently influence the governance of the company concerned.

THE ROLE OF INDEPENDENT DIRECTORS

The OECD Principles provide that "independent directors can contribute significantly to the decision-making of the board and bring an objective view to the evaluation of the performance of the board and management" (OECD, 2015, p. 58). Independent directors can also play an important role in areas "where the interests of management, the company and its shareholders

[3] The revised Singapore Code took effect in respect of annual reports relating to financial years commencing from 1 November 2012, with the exception of changes needed to comply with the requirement for independent directors to make up at least half of the boards in specified circumstances. Such changes are to be made at the annual general meetings following the end of the financial years commencing on or after 1 May 2016.

[4] An "independent" director is "one who has no relationship with the company, its related corporations, its 10% shareholders or its officers that could interfere, or be reasonably perceived to interfere, with the exercise of the director's independent business judgement with a view to the best interests of the company"; a "10% shareholder" is defined as "a person who has an interest … in not less than 10% of the total votes attached to all the voting shares in the company"; and "voting shares" exclude treasury shares (Code of Corporate Governance, 2012, p. 4-5).

may diverge, such as executive remuneration, succession planning, changes of corporate control, take-over defences, large acquisitions and the audit function" (OECD, 2015, p. 58). The OECD Principles also recognise the importance of having independent directors review and monitor related party transactions. For significant transactions, a committee of independent directors should be established to vet and approve the transaction. The committee should review significant related party transactions to ensure fairness and reasonableness (OECD, 2015).

United States

The primary role of independent directors in the United States is to monitor management on behalf of dispersed shareholders who are hindered by collective action problems from monitoring management themselves (Gordon, 2007). This is consistent with the definition of independence that requires an independent director to be independent from management. To facilitate oversight of the management, the independent directors have relevant powers in the audit committee, including the hiring, overseeing and firing of outside auditors (Clarke, 2007). They also have a role in the vetting of conflict-of-interest transactions, which are reviewed by the courts under the heightened standard of the entire fairness test unless the transactions are approved by independent directors (Ferrarini and Filippelli, 2014; Fairfax, 2010). Furthermore, the independent directors have a role regarding shareholders' derivative actions, since they may prevent shareholders from bringing those actions or may terminate such derivative actions (Fairfax, 2010).

United Kingdom

Similarly, independent directors in the United Kingdom play an important monitoring role in overcoming the agency problems inherent in companies with a dispersed ownership structure. The Walker Review (2009) highlighted the need for independent directors to constructively challenge executives more substantially before strategic decisions are made. Independent directors, particularly in the banking sector, need to challenge executives on issues of risk, risk management and related strategy. They should also play a crucial role in monitoring excess risks taken on by the company.

Singapore

The Existing Role of Independent Directors

Theoretically, the role of independent directors in concentrated ownership companies is to a large extent different from that in dispersed ownership companies. In a concentrated ownership structure, independent directors are not needed to monitor management, since the former are already actively monitored by the controlling shareholders. The role of independent directors is therefore to reduce potential expropriation of the minority and address conflicts among controlling and minority shareholders.

Independent directors in Singapore are generally regarded as crucial in providing an oversight and monitoring role for the board and management (SID, 2007). SID (2007) elaborated that the primary role of an independent director is "not to protect the interest of minority shareholders, but to act as a check and balance on the acts of the board and management of the company". SID (2007) also recognises that "the independent director is not merely the guardian of the minority shareholders, nor is he only to focus on related party transactions involving a listed company, its management or major shareholder." SID (2007) acknowledges that the indirect role played by the independent director seems to promote the best interest of minority shareholders, but in fact promotes the interest of *all* shareholders. In essence, the primary role of independent directors in Singapore is not to monitor the controlling shareholders but to monitor the board and management. This does not appear to match the governance concerns arising from concentrated-ownership companies predominant in Singapore, nor is it compatible with the expanded definition of independence in the Singapore, which requires independence from both management and 10% shareholders.

Redefining the Role of Independent Directors

To address the mismatch outlined above, this paper suggests that, in the light of the expanded definition of independence, the unique corporate culture and the predominance of concentrated ownership structure, the Singapore Code[5] should advocate that independent directors exercise vigilance on behalf of minority shareholders and play a proactive role in risk management.

The Singapore Code should explicitly make clear that independent directors play a role in exercising vigilance on behalf of minority shareholders in contexts such as self-dealing transactions involving the controlling shareholder and the company, as well as other conflict-of-interest situations. One might initially question the need for such enhanced monitoring function. It has been argued that the family-controlled companies in Singapore are indirectly prevented from extracting private benefits of control because the effectiveness of Singapore's corporate regulators and the strong emphasis in Singapore family corporate culture appear to be important substitutes for the monitoring of controlling shareholders by independent directors (Puchniak and Lan, 2016). However, there have been specific local cases of expropriation of minority shareholders in Singapore, including *Raffles Town Club Pte Ltd v Lim Eng Hock Peter*[6] and *Lim Swee Khiang v Borden Co (Pte) Ltd*.[7] An empirical study has shown that self-dealing transactions are in fact common in family-controlled companies (Tan, 2011). These circumstances make clear that enhancing the monitoring role of independent directors to exercise vigilance on behalf of minority shareholders can provide a useful additional check on private benefits of control, and this role ought to be made explicit in the Singapore Code. Moreover, an enhanced monitoring function assigned to independent directors in alignment with the expanded definition of independence in Singapore could boost Singapore's reputation as a beacon of corporate governance.

In particular, the role of independent directors should focus on vetting and approving self-dealing transactions and other conflict-of-interest situations. Currently, Rule 917 of SGX Listing Mainboard Rules requires a statement by the audit committee regarding whether it takes the view that the self-dealing transaction at issue (called an "interested person transaction" under the SGX Listing Mainboard Rules) has been carried out on normal commercial terms, and is not prejudicial to the interests of the issuer and its minority shareholders. Under the Singapore Code, Guideline 12.1, the audit committee should comprise of at least three directors, the majority of whom should be independent. Importantly, the audit committee is able to discharge its obligation by obtaining an opinion from an independent financial adviser and relying on the value assessment made by such an adviser (SGX Listing Mainboard Rules, Rule 917(4)(ii)). It is submitted that these current requirements do not reach a level sufficient for an independent director to effectively monitor controlling shareholders to prevent the potential expropriation of minority shareholders. Tasking independent directors with the vetting of self-dealing and other conflict-of-interest transactions could be effective in deterring the private benefits of control and the expropriation of the minority.

Increasingly, shareholders are also demanding higher expectations of how companies undertake risk management to keep risks at an acceptable level. In this regard, the Singapore Code should explicitly provide that independent directors also play a role in reviewing the risk

[5] While compliance with the Singapore Code is not mandatory under the "comply-or-explain" regime adopted in Singapore, listed companies are required to disclose in their annual report any deviation from the Singapore Code and
provide an appropriate explanation for such deviation. This effectively provides an impetus for listed companies to redefine the role of their independent directors.

[6] (2010) SGHC 163.

[7] (2006) 4 SLR(R) 745.

management framework put in place by the company to mitigate the risk of fraud, bribery and corruption. They are expected to engage in proactive steps rather than assuming that no corporate misconduct can happen. Such steps can include conducting the necessary due diligence and background checks on entities transacting with the company, stepping up awareness of risk management within the company, and ensuring compliance with the applicable laws. The independent directors are expected to constructively challenge and ask questions, and raise the appropriate red flags at the right time.

CONCLUSION

The concept of independent directors in Singapore is both a challenging and controversial area. While the definition of independence in Singapore is now well-elaborated, listed companies face potential implications and obstacles as a result of the expanded definition. Notwithstanding the clearer definition of independence, the rules in Singapore have yet to prescribe the role of independent directors. Independent directors are generally regarded as crucial as overseers, monitoring the acts of the board and management for the company. But such a role appears not to match the governance concerns arising from concentrated-ownership companies predominant in Singapore, and the expanded definition of independence in the Singapore which requires independence from both management and 10% shareholders. To address the agency problems of expropriation of minority shareholders that could be prevalent in a concentrated ownership structure, the Singapore Code should advocate that independent directors exercise vigilance on behalf of minority shareholders and also play a proactive role in risk management.

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