Introduction

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I The Rise of the Independent Director in the West and Asia

The rise of the independent director in Asia is remarkable. Merely two decades ago, independent directors were oddities in Asia's boardrooms. Today, as this book reveals, they are ubiquitous. Indeed, Asian companies and jurisdictions that lack a significant cadre of independent directors are now seen as outliers – and, more importantly, as being at risk of corporate governance failures. This stands in stark contrast to the 1980s, when Japan's lifetime-employee-dominated boards, which lacked even a scintilla of independence, were the role model for Asia and much admired in the West.[1]

The concept of the independent director and its related model of the 'monitoring board of directors' were, however, not an Asian invention. The concept originated in the United States (US) from the 1970s onwards, as explained by *Baum* in Chapter 1. Today, in their place of origin, the US, the reliance on independent directors as a panacea for various corporate governance ills has reached its zenith. Over the last several decades, the primary legislative and judicial response to almost every major corporate scandal in the US has been to increase the reliance on independent directors. In 2013, in US public companies, 85 per cent of directors were independent, and so-called 'super-majority-boards' with only *one* remaining inside director – normally the CEO – were widespread.[2]

[1] D. W. Puchniak, 'The 2002 Reform of the Management of Large Corporations in Japan: A Race to Somewhere?', *Australian Journal of Asian Law*, 5(1) (2003), 42. See also L. Nottage, 'Japanese Corporate Governance at a Crossroads: Variation in "Varieties of Capitalism"?', *North Carolina Journal of International Law and Commercial Regulation*, 27 (2001), 255; for a general discussion, see H. Baum, 'Emulating Japan?' in H. Baum (ed.), *Japan: Economic Success and Legal System* (De Gruyter, 1997), 1.

[2] U. Velikonja, 'The Political Economy of Board Independence', *North Carolina Law Review*, 92 (2014), 855, 857.

Around 25 years ago, the concept of independent directors was adopted and refined in the United Kingdom (UK). During the 2000s, the UK situation came to mirror that in the US in some respects. About 90 per cent of directors in UK public companies were independent.[3] From the UK, the faith in independent directors further migrated to Continental Europe. Today, no sophisticated European jurisdiction can do without a UK-style 'comply or explain' corporate governance code, which in turn must deal with independent directors in one way or another to be considered credible. Accordingly, the European Model Company Act of 2015 recommends an 'appropriate balance of independent non-executive directors'.[4]

These trends are also reflected on the supranational level. The Organisation for Economic Co-operation and Development (OECD) recommends in its *G20/OECD Principles of Corporate Governance* of 2015 that important tasks should be assigned to independent board members which 'can contribute significantly to the decision-making of the board'.[5] Similarly, the OECD report *Better Policies for Board Nomination in Asia* of 2013 emphasises the importance of independent directors in the nomination (and other) committees in Asian companies.[6]

This is all the more surprising as there is scarce empirical support for the assumption that independent directors are efficient monitors, as *Ringe* shows in Chapter 2. Only fairly recently, in the wake of the Global Financial Crisis of 2008, has the concept of the independent director come under closer and critical scrutiny – but mainly in Europe.[7]

The precipitous rise of independent directors from obscurity to ubiquity in Asia is as such noteworthy. All of Asia's leading economies appear to have transplanted, or at least claim to have transplanted, the concept of the independent director either directly from its US origin or indirectly via the UK model. However, at least at first sight, this rise

3 The number has somewhat decreased since then: see Chapter 1 at IV. 1.
4 European Model Company Act Group, *The European Model Company Act (EMCA) Draft 2015*, Sec. 5, available at http://law.au.dk.
5 *G20/OECD Principles of Corporate Governance* (OECD Publishing, 2015), available at http://dx.doi.org/10.1787/9789264236882-en.
6 *Better Policies for Board Nomination in Asia* (OECD Publishing, 2013), available at http://dx.doi.org/10.1787/9789264204386-en. For a basic overview of some of the rules regarding independent directors in many Asian jurisdictions, see generally, ACGA, 'Rules and Recommendations on the Number of Independent Directors in Asia' (2010), available at www.acga-asia.org/. Special thanks to the ACGA for providing useful information for this chapter and book project.
7 See Chapter 2 at II for a detailed discussion of the growing scepticism of independent directors.

appears to merely mirror an international trend – perhaps suggesting that a book on independent directors *in Asia* may be unwarranted. What we suggest does warrant a book, however, is the fact that Asia's independent directors, in a myriad of complex and intriguing ways, as this book demonstrates, are markedly different from what their Anglo-American origins would suggest. As shown by *Puchniak and Kim* in Chapter 3, a comparison of the jurisdiction-specific chapters in this book reveals that *none* of Asia's leading economies have adopted the American concept of the independent director in form and function. To add to the complexity, within Asia, the form and function of 'independent directors' varies, sometimes significantly, from jurisdiction to jurisdiction. This is because the form independent directors take and the function they fulfil are substantially influenced by each jurisdiction's unique shareholder ownership structures, legal origins, types of shareholders, functional substitutes, political economy and cultural norms. In short, the specific details of so-called 'legal transplants' and local context matter – a lot.

These findings are salient in several ways. From a theoretical perspective, as explained by *Puchniak and Kim* in Chapter 3 and elaborated on in Chapter 13 by *Kozuka and Nottage*, the fact that Asia's independent directors depart in form and function so markedly from their places of origin has at least three important implications for comparative corporate law and governance. First, it provides a poignant example of how even in today's globalised world legal transplants are fraught with difficulty and, at least in some cases, may arguably be impossible to achieve in substance at all. Second, it provides a powerful reminder that in spite of the proliferation of common legal terminology and concepts, the global convergence of corporate law and governance may be much further away than is often assumed by the persistent trend in comparative corporate law scholarship to provide grand universal theories to solve the world's corporate governance problems.[8] Third, and perhaps most importantly, the rise of the independent director in Asia illustrates how local context is critically important for accurately understanding corporate law and governance in Asia (and, we suspect, everywhere else).[9] Somewhat

[8] See D. W. Puchniak and H. Baum, 'The Derivative Action in Asia: Some Concluding Observations' in D. W. Puchniak, H. Baum and M. Ewing-Chow (eds.), *The Derivative Action in Asia: A Comparative and Functional Approach* (Cambridge University Press, 2012), 398 ff., for a similar observation regarding the derivative action, another legal transplant in many Asian jurisdictions.

[9] For a similar conclusion see, D. W. Puchniak, 'Multiple Faces of Shareholder Power in Asia: Complexity Revealed' in R. Thomas and J. Hill (eds.), *Shareholder Power* (Edward

surprisingly, Asia has largely (and erroneously) been ignored so far in comparative corporate law in general and particularly with respect to the independent director.

From a practical perspective, it is important to realise that it is a flawed assumption to believe that independent directors in Asia are essentially tantamount in form and function to those in the US or the UK. However, as shown by *Puchniak and Kim* in Chapter 3, the modus operandi of most prominent institutional investors, proxy advisory firms and international financial organisations assumes just that. This is of critical practical importance because enormous faith and fortune hinge on this belief. As highlighted hereafter, the potential consequences of this flawed assumption are magnified by the seismic shift of economic power towards Asia. An accurate understanding of independent directors in Asia, which this book aims to provide, is therefore an issue of both Asian and global consequence.

II Why Asia Matters[10]

The rise of Asian companies, stock exchanges and economies over the last 50 years has been extraordinary and the shift in economic power towards Asia can no longer be ignored.[11]

The first Asian economy to achieve unimaginable economic success was Japan. Starting in the late 1950s, Japan accomplished what Nobel Laureate economist Michael Spence has identified as unthinkable: developing an economy that doubled in size in less than a decade.[12] What makes Japan's accomplishment even more remarkable is that it repeated this feat several times over from the 1960s to the 1980s. As a result, by the late 1980s, Japan's stock market was the largest in the world. Its companies dominated numerous global industries and, by some measures, it was the richest country in the world. Interestingly, however, in the context of this book, Japan accomplished this with a corporate governance system

Elgar, 2015). See also, L. A. Bebchuk and A. Hamdani, 'The Elusive Quest for Global Governance Standards', *University of Pennsylvania Law Review*, 157 (2009), 1263.

10 A significant portion of the section was based on Puchniak, 'Multiple Faces of Shareholder Power in Asia' which can be consulted for detailed citations and additional sources.

11 For a political analysis of the power shift towards Asia, see G. Rachman, *Easternization: War and Peace in the Asian Century* (The Bodley Head, 2016).

12 D. H. Brady and M. Spence, 'The Ingredients of Growth', *Stanford Social Innovation Review*, available at ssir.org.

that was almost entirely devoid of independent directors. In fact, Japan's lifetime-employee-dominated boards – in which independent directors were almost non-existent – were a hallmark of its world-leading companies, capital markets and economy. Notwithstanding the burst of the economic bubble in 1990 and the infamous ensuing two 'lost decades', Japan has maintained its status as one of the world's three largest economies.

Japan's outstanding economic success provided a model for other Asian countries. Starting from the 1960s, Asia's so-called 'tiger economies' each followed in Japan's footsteps by building economies that doubled in size in under a decade. All of these repeated this feat several times over in the decades that followed. As a result, by the late 1990s, Asia's tigers all had developed economies, which produced companies and capital markets that were competitive with (and, in some cases, superior to) those in the West. Moreover, in the 1990s, Singapore and then Hong Kong overtook Japan in terms of Gross Domestic Product (GDP) per capita, with the other Asian tigers following their lead.

Importantly, in the context of this book, as in Japan, the economic success in these economies was largely accomplished *without* the aid of independent directors. Rather, and in so far distinct from Japan, these successful Asian economies were built on a foundation of companies controlled by large-block family and/or state controlling shareholders, whose dominance over corporate governance appeared to be the key to their extraordinary economic development.[13]

Although the Asian Financial Crisis (Crisis) from 1997 to 1999 rocked the foundation of Asia's tiger economies, one of the greatest untold stories of Asia's economic rise is what has occurred in its tiger economies in the 15 years *following* the Crisis. During this time, Singapore has led the way by continuing its phenomenal growth, which has catapulted it to now having a GDP per person that is double Japan's and, indeed, higher than any G7 country. It is also recently ranked as having the world's best economy, topping global charts in terms of economic competitiveness. In a similar vein, the GDP per person in Hong Kong now exceeds Japan and the United States, and its stock exchange has led the world in initial public offerings in five of the past eight years.[14] Moreover, Taiwan's GDP per person now exceeds Japan's, and Korea now has a GDP per person roughly equivalent to Japan's and most developed Western countries. In

[13] See the comparative analysis in Chapter 3 at III.
[14] 'Hong Kong Exchanges and Clearing: Down Market?', *The Economist*, 24 June 2017, available at www.economist.com.

the process, all of the tiger economies have produced world-leading companies in myriad industries.[15]

Last, but certainly not least, China and India are in the midst of their own economic growth miracles and, with over two billion people, have already transformed themselves into the world's most important engines for economic growth. Just two decades ago, Chinese companies were virtually non-existent on the global stage. Today, China has more Fortune Global 500 Companies than any other country in the world aside from the United States.[16] In this regard, merely two decades ago, China's stock exchanges were in their infancy. Today, they are poised to challenge the Western stock exchanges for global supremacy. After struggling to keep up with China, India now appears to be possibly the next rising star of Asia. Its economy, capital markets and companies have more recently risen from obscurity to being a focal point for international investors. Indeed, India now is one of the ten largest economies in the world and is projected to be in the top five by the end of this decade. Further, attention should be accorded to the increasingly tight integration within the Asian economies, which are presently underpinned by an ever-growing number of multilateral, regional and bilateral investment treaties, including the launch of the ASEAN Economic Community (AEC) in 2016.[17]

In sum, the net result of the last half century of Asia's economic development is clear: the West's domination of the world economy is in all likelihood phasing out. By 2020, three of the world's four largest economies will be in Asia (China (1), Japan (3) and India (4)). In 2010, Asian stock exchanges captured 66 per cent of the capital raised globally through initial public offerings, up from 12 per cent in 1999. In 2013, for the first time, there were more Fortune Global 500 Companies in Asia than in either North America or Europe (see Table 1.1).[18]

This remarkable development is what makes the examination of the independent director in Asia so timely, important and interesting. For the purposes of this book, we concentrate on Asia's seven most important and

[15] Puchniak, 'Multiple Faces of Shareholder Power in Asia'.
[16] *Ibid*.
[17] See, for example, V. Bath and L. Nottage, 'Asian Investment and the Growth of Regional Investment Agreements' in C. Antons (ed.), *Routledge Handbook of Asian Law* (Routledge, 2017); M. Kawai and G. Wignaraja (eds.), *Asia's Free Trade Agreements: How Is Business Responding?* (Edward Elgar, 2011).
[18] Puchniak, 'Multiple Faces of Shareholder Power in Asia'.

Table I.1 Economic and Corporate Governance Developments Across Asia

Jurisdictions	Total population (million), 2015	Nominal GDP (million USD) and world ranking, 2015	GDP per capita based on Purchasing Power Parity (IntD),[a] 2015	Mar of li com USI
Japan	127.0	4,123,258 (3)	37,321	4,89
South Korea	50.6	1,377,873 (11)	34,549	1,23
China	1,371.2	10,866,444 (2)	14,238	8,18
Taiwan[d]	23.5	523,006 (–)	46,833	
Hong Kong	7.3	309,929 (33)	56,719	3,18
Singapore	5.5	292,739 (37)	85,208	63
India	1,311.1	2,073,543 (7)	6,088	1,51

[a] The data in this column is denominated in International Dollars (IntD), where 'an int country a comparable amount of goods and services a US dollar would buy in the US'. Se Dollar"', available at datahelpdesk.worldbank.org.

[b] Data for this and the preceding two columns is from the World Bank Databank, availab umn has been rounded up to the nearest third decimal place.

[c] N. A. Chakra et al., 'Doing Business 2016: Measuring Regulatory Quality and Efficienc doingbusiness.org.

[d] Data for Taiwan for the first three columns is taken from the International Monetary Fu available at www.imf.org. No data on Taiwan is available for the 'market capitalisation of is comparable to the other jurisdictions.

dynamic economies out of Asia's more than 45 countries: China, Hong Kong, India, Japan, Singapore, South Korea and Taiwan. Collectively, these seven jurisdictions account for approximately 80 per cent of Asia's economic output and are home to its nine largest stock exchanges.[19] After the United States, China and Japan are, respectively, the world's second and third largest economies and, India and South Korea are, respectively, the third and fourth largest economies in Asia. Hong Kong, Singapore and Taiwan regularly rank among the most competitive and dynamic economies in the world.[20]

In addition, these jurisdictions represent the most populous and economically influential economies in the region. They also are diverse in terms of stages of development, competitiveness, capital markets and the extent to which independent directors have been encouraged or required – although independent directors have been on the rise in all seven jurisdictions. These jurisdictions involve a variety of legal traditions, so this variable can also be brought into the picture in comparing and assessing the regional evolution and impact of independent directors. They also display interesting variability in terms of the structure and type of shareholders – although concentrated shareholding, family firms and state-owned enterprises are prominent. Additionally, Australia is included as a separate chapter in this book for comparative reasons, as it has extensive economic relations throughout Asia, and its jurists have longstanding links with the common law countries in Asia.

III The Independent Director Defined

Before proceeding any further, for the purpose of this book, there is a critical conceptual point that must be clarified: who qualifies as an 'independent director'?[21] At first blush, the answer to this question appears intuitively simple: an independent director is a person on a company's board who is not dependent on *someone* or *something* related to the company. A comparative analysis, however, quickly shows that no universal

[19] D. W. Puchniak, 'The Complexity of Derivative Actions in Asia: An Inconvenient Truth' in D. W. Puchniak, H. Baum and M. Ewing-Chow (eds.), *The Derivative Action in Asia: A Comparative and Functional Approach* (Cambridge University Press, 2012), 98.

[20] *Ibid*., 98.

[21] See Chapter 1 at I. 3 and Chapter 2 at III. 2 for an extensive discussion of the complex issue; see also D. C. Clarke, 'Three Concepts of the Independent Director', *Delaware Journal of Corporate Law*, 32 (2007), 73.

definition of 'independence' exists. Regulatory standards across countries generally employ various definitions using different combinations of criteria according to what the jurisdiction's legislature or other governing body regarded as imperative in the particular context.[22] The lack of a shared understanding comes as no surprise if one considers the fact that independent directors exist within boards that have a multiplicity and diversity of functions.[23] These will vary depending on the particular agency problems that are most acute in a given jurisdiction's unique corporate governance environment.[24] In other words, the context in which independent directors operate in each jurisdiction is highly path dependent.[25]

However, as explained by *Puchniak and Kim* in Chapter 3, leading corporate governance advisory firms, entire areas of comparative corporate governance research and prominent organisations (e.g., the World Bank) have often assumed that there is a singular definition of independence – most often based on the American concept of the independent director. In this respect, we depart from this approach for the reasons given above and in the individual chapters that follow.

Independence is not an end in itself, but instead, constructed to serve a pre-defined goal. If the main task assigned to the independent directors is to monitor management as a solution to the classic agency conflict between managers and dispersed shareholders as owners, independence from the entrenched Chief Executive Officer (CEO) of the stereotypical US Berle-Means corporation seems to be the most important criterion. If, on the other hand, the primary function of such directors is to protect minority shareholders against a controlling blockholder in an archetypical Continental European or most Asian companies, independence from the latter will be the decisive characteristic.

[22] For a general discussion, see, for example, P. L. Davies and K. J. Hopt, 'Boards in Europe: Accountability and Convergence', *American Journal of Comparative Law*, 61 (2013), 301, 317 ff.

[23] For the purpose of this book, we only deal with public listed companies and non-financial companies.

[24] See, for example, R. B. Adams, B. E. Hermalin and M. S. Weisbach, 'The Role of Directors in Corporate Governance: A Conceptual Framework and Survey', *Journal of Economic Literature*, 48 (2010), 58.

[25] For an up-to-date overview of different corporate governance arrangements in major economies, see, for example, K. J. Hopt, 'Comparative Corporate Governance: The State of the Art and International Regulation', *American Journal of Comparative Law*, 59 (2011), 1.

As such, for the purpose of this book, we suggest the following working definition: an independent director is a non-executive outside director who is not in some way affiliated with management, a major shareholder and/or the company in a way that compromises his or her independence. However, merely having independence from management (but not the controlling shareholder) will satisfy the requirements for being described as an 'independent director' in the context of this book. To do otherwise would be to exclude the American concept of the independent director. This would not make sense as conventional (yet erroneous) wisdom suggests the American definition has become the global standard. As empirically proven by *Puchniak and Lan* in Chapter 9, this is clearly not the case as the vast majority of countries around the world have not adopted the American definition of the independent director. As in Asia, these countries have defined independence as being independent from management *and* significant shareholders.

IV Organisation of the Book

The *first part* of the book is made up of three general chapters. The first two deal with the origins, the theoretical foundations and the economic efficiency of the concept of the independent director. The third presents the comparative and theoretical findings of the jurisdictional chapters and develops a taxonomy of independent directors in Asia.

Chapter 1 provides a historical and comparative analysis of the rise of the concept of the independent director in, first, the US and later on, the UK. The corporate board as a management organ in the modern sense sprung to life in the seventeenth century. When joint-stock companies flourished in the UK during the eighteenth and nineteenth centuries and attracted an ever-increasing number of average citizens as investors, managerial powers started to shift gradually from the boards in their entirety to professional managers acting as executive directors – the classical corporate agency conflict arose. In the first half of the twentieth century, a managerialist model of corporate governance dominated both economies. It was not until the 1970s that the concept of the independent director and the related model of the 'monitoring board' first appeared in the US. Today, as mentioned above, the reliance on independent directors has reached its zenith in the US. In the early 1990s, the concept of independent directors was adopted and refined in the UK. From there it migrated to Continental Europe. The reluctant acceptance and only gradual implementation of this legal transplant in Germany is taken as