TAIWAN

KEY POINTS

- The financial crisis affected Taiwan less than most other East Asian economies; however, to protect against future shocks, the Government is liberalising markets and reforming the corporate governance regime. Increasingly Taiwan's corporate sector is market driven.

- Corporate governance standards generally are weak. Family controlled businesses, many small and medium sized, dominate the business sector. Minority shareholder rights are limited, little separation exists between owners and managers and institutional investors play a modest role. Also, some conglomerates and the state own many banks, producing connected lending.

- Taiwan's share market is relatively large and liquid but also volatile, reducing its effectiveness as a reliable means of fund raising.

- Eventually, developing share markets and increasing numbers of institutional investors should deepen capital markets; eventually, this will increase corporate scrutiny.

- The Government is improving regulations. In 2001, it strengthened accountant supervision and amended the Company Law, and in 2002, amended the Securities Exchange Law and enacted a Merger and Acquisition Act.

- To further improve corporate governance, authorities have proposed introducing independent directors and enforcing transparency for private companies.

Prior to the financial crisis, Taiwan's relatively closed capital markets, broadly owned corporate sector, deep financial markets and reasonably well developed regulations helped discourage corporates borrowing excessively abroad or locally. In the future, several of these characteristics should promote better corporate governance. In recent years, the Government has kept pace with regional regulatory reforms, continued opening the economy and deregulated key sectors, improving incentives for sound corporate behaviour. However, corporate governance standards remain uneven; for some conglomerates, they have not been a high priority, while others have outstanding international reputations.

CORPORATE SECTOR STRUCTURE

Taiwan's corporate sector is predominantly comprised of family controlled corporates, resembling those of Hong Kong, the Republic of Korea and many South East Asian economies. However, the Taiwan economy is dominated by SMEs, rather than the conglomerates that prevail in the other economies.

Families Predominantly Own Firms

Families control around half of companies listed on the Taiwan Stock Exchange (Claessens, 2000).[1] Typically, owner families fill most board and key management positions. However, unlike many other East Asian economies, corporations rarely cross-hold shares, and many small and medium sized family owned companies list on the share market, dispersing ownership and increasing small outside investor influence (Naughton, 2001).

Deep Capital Markets

Compared with most other East Asian economies, the Taiwan Stock Exchange is reasonably deep relative to GDP, but still quite modest given Taiwan's per capital income levels (Figure 9.1) (Naughton, 1999). About 4 million people from the 22 million population hold broker accounts, and by December 2001, individuals, mainly families, held around half of market capitalisation, and accounted for around 85 per cent of share trade, amongst the highest proportions in the world. Corporations hold a further 20 per cent of share market capitalisation (Figure 9.2).

In 1998, turnover was the world's highest at 323 per cent, and in 2000 turnover remained over 300 per cent; this compares with a typical developed economy's ratio of around 100 per cent (East Asia Analytical Unit, 1999; *The Economist*, 11 August 2001). While a high turnover ensures the market mechanism can provide incentives for good management, it also demonstrates the volatility of the market. Price manipulation also has plagued Taiwan's stock market, for example through the creation of 'shell companies', where a conglomerate targets a particular member company's price, forcing it up through increased leveraging and shifting of group assets (Smith, 2000).

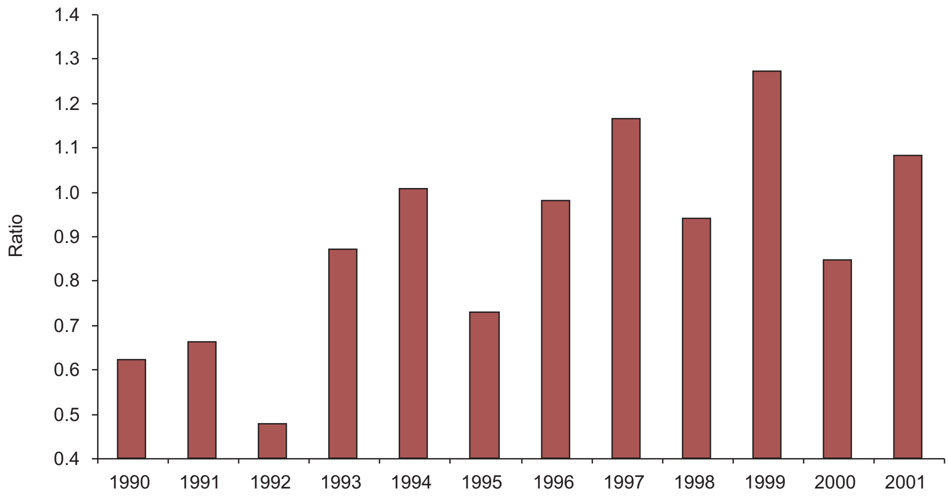
Between 1980 and 2000, the average value of listed companies grew more quickly than unlisted firms, sharply increasing their share of the corporate sector (Naughton, 2001).

1 For this purpose, family control is defined as holdings by individual family members and by family controlled corporations using pyramid structures holding 20 per cent or more of a company. Other research suggests families control up to 75 per cent of listed companies (PricewaterhouseCoopers, 2001).

Figure 9.1

Share Market Reasonably Deep

Taiwan's Share Market Capitalisation to GDP Ratio

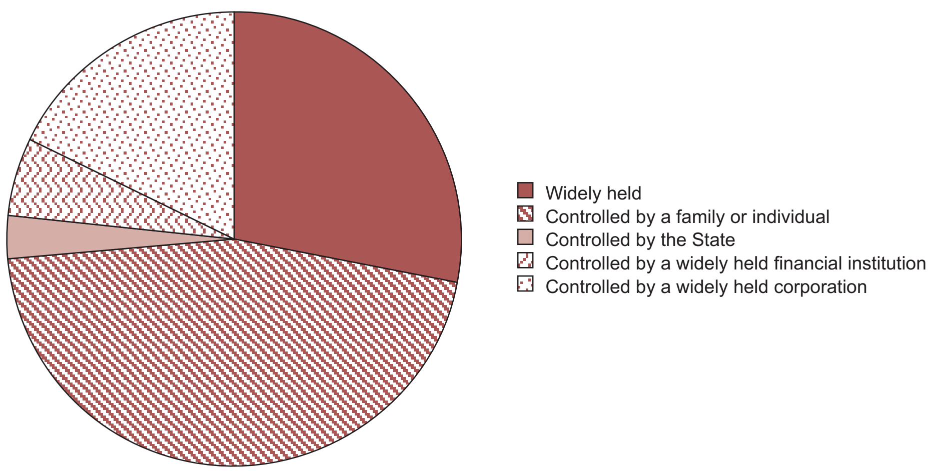


Source: CEIC, 2001.

Figure 9.2

Families Own Large Proportion of Firms

Share of Listed Companies Major Groups Own



Source: Institutional Analysis, 2001.

Despite the stock market's size, its role in enhancing corporate governance is ambiguous. Institutional investors comprise only 5 per cent of share market trading, reducing potential for informed shareholder discipline on family controlled firms. As well, government intervention through the National Stabilisation Fund can move share prices from their fair value, distorting investor signals (PricewaterhouseCoopers, 2001).[2]

Due to families holding shares tightly, business culture norms and poor tender offer rules, merger and acquisition activity is minimal, weakening its role in enforcing good corporate behaviour (Naughton, 2001). In 2000, the only major domestic takeover occurred when Taiwan Semiconductor Manufacturing acquired Worldwide Semiconductor for US$6.4 billion (*Asiamoney*, March 2001).

Banks' entrenched positions and the active sharemarket limits the corporate bond market's scope; it plays only a minor role in influencing corporate behaviour compared to the share market (Naughton, 2001).

Mixed Financing

Taiwan's unique financial sector history creates some differences from other East Asian economies. In the past, small and medium sized enterprises had poor access to the formal banking system, so banks are less important in financing firms in Taiwan than elsewhere in Asia. Small and medium enterprises use informal, curb-side financing mechanisms and increasingly look to the share market. Hence, Taiwan's debt to equity ratios are lower than US ratios. Credit cooperatives, some run by powerful regional political figures, also provide credit to the corporate sector. Some observers estimate their non performing loans comprise around 70 per cent of total loans (*Taipei Times*, www.taipeitimes.com, 3 October 2001).

However, increasingly conglomerate and government owned banks are involved in non-commercial, connected lending, raising non performing loan levels.[3] For example, a cement and petrochemical conglomerate owns Chinatrust Commercial Bank, and Pan Asia Bank was caught up in the troubled Everfortune Group (East Asia Analytical Unit, 1999).

MARKET PRESSURES INCREASING

Over the last decade, the Government has gradually opened the financial and corporate sector to international competition and investment and privatised government owned banks; eventually this should improve capital market vigilance and corporate discipline. In recent years, large internationally integrated firms, like Acer and Taiwan Semiconductor Manufacturing, have boosted their corporate governance standards to access international financial markets. However, as in the rest of East Asia, smaller family owned firms still are less convinced of the benefits of good corporate governance.

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2 This fund, created in 2000, smooths large fluctuations in the Taipei market resulting from excessive speculation and over-reaction to non-economic factors, such as the reaction to a presidential election (OECD, 2000).

3 Non performing loans rose through the late 1990s, forcing authorities to consider funding their removal from bank balance sheets (PricewaterhouseCoopers, 2001).

FINANCE MARKETS

New regulations, bank restructuring and privatisation and increasing foreign participation eventually should strengthen capital market development and tighten firms' investment strategies.

Capital Markets

Taiwan's previously government dominated banking system restricted lending to the dynamic small and medium enterprise sector, encouraging the informal financial sector, and eventually, the share market. Deepening capital markets should foster better market discipline. In 2000, 80 firms listed for the first time, Taiwan's largest annual increase so far. In 2000, the Securities Exchange Commission launched the Taiwan Innovation Growing Entrepreneurs program, TIGER, with more relaxed listing rules to promote listing for smaller, particularly high technology firms on the over the counter market. In 2001, authorities lifted restrictions on foreign shareholdings; consequently, foreign shareholdings should rise from 8 per cent of market capitalisation in 2000 (Naughton, 2001). The newly amended Company Law prohibits cross-shareholding among affiliates, possibly further increasing share ownership dispersion (PricewaterhouseCoopers, 2001). Despite these developments, to maintain founding family control, many large and viable companies choose not to list, instead raising finance through internal sources, bank finance and the informal market (Naughton, 1999; East Asia Analytical Unit, 1999).

In 2001, draft Company Law amendments eased regulations on firms merging and shedding non-core business units, potentially encouraging merger and acquisition activity (*Taipei Times*, www.taipeitimes.com, 27 October 2001). In 2002, authorities also enacted the Merger and Acquisition Act, and amended the Securities Exchange Law, the Fair Trade Law and some tax rules to increase merger and acquisition activity (PricewaterhouseCoopers, 2001).

Bond markets

Since 1999, significant new government enterprise and foreign institution bond issues have helped the bond market flourish. Issues should continue to increase in 2002, as the 2001 draft Company Law amendments simplified the regulation of small companies' bond issues (*Taipei Times*, www.taipeitimes.com, 27 October 2001). In future, corporate bond markets could contribute to improved corporate governance (Naughton, 2001).

Since the financial crisis, the Ministry of Finance has strengthened direct finance markets, including improving securities dealer supervision, enacting the Securities and Futures Investors Protection Act and amending the Securities Exchange Law (PricewaterhouseCoopers, 2001).

Institutional Investors Should Expand

Taiwan's institutional investor community has been small, but recent developments should encourage its growth; if it became more active, the large share market could better realise its potential to influence firm behaviour. Since 2000, banks can invest up to 40 per cent of their paid-up capital, less cumulative losses, in securities, including in insurance and other finance-related firms. This should increase the number of institutional investors (PricewaterhouseCoopers, 2001). Also, the four large public pension funds increasingly allocate funds to outside managers; the latter could manage 20 to 30 per cent of public pension funds by 2005 (*Taipei Times*, www.taipeitimes.com, 15 October 2001).[4] Authorities also relaxed restrictions limiting Employee Pension Fund investments in private enterprises. These trends should develop private institutional investment and reduce political pressure on public pension funds to intervene in the stock market.

The 2000 *Financial Institutions Merger Law* and 2001 *Financial Holding Company Law* allow for financial institutions to merge or form holding companies, potentially increasing institutional investors' influence, diversity and scale (PricewaterhouseCoopers, 2001).[5] Taiwan's domestic based mutual funds industry also is large, although it does not yet actively manage its investments.

In 2000, authorities removed the 50 per cent cap on foreigners owning individual listed companies.[6] Also, officially approved qualified foreign institutional investors including large banks, insurance companies, securities firms and mutual funds, can undertake portfolio investment (*Asia Times*, www.atimes.com, 15 December 2000). In 2000, the world's second largest management company, UBS of Switzerland, acquired a majority stake in a local fund provider. Increasingly, foreign investors discuss corporate governance issues with management (Asian Corporate Governance Forum, 2000). However, individual foreign investors can only invest up to US$5 million in portfolio investment and non-qualifying foreign companies can only invest up to US$50 million (*Asia Times*, www.atimes.com, 15 December 2000). Hence, Taiwan still has one of the most restricted investment regimes in East Asia.

Nevertheless, reflecting recent liberalisation, domestic and foreign institutional investors' share in market trading has increased from a low base (Figure 9.3).

ADVISING TAIWAN'S SMALL INVESTORS

As small investors drive close to 90 per cent of share trading in Taiwan, many new firms are tapping this market, offering investment advice on stocks and corporate company information. For example in 2000, Peter Kurz, formerly head of research at Merrill Lynch in Taipei and well-known for frequent television appearances and his Mandarin and Taiwanese language skills, established www.mrtaiwan.com, catering for both small and institutional investors. The firm's 40 employees focus on Taiwan's large and liquid share market, especially its retail investors as foreign securities companies are less interested in these shares.

Source: *Taipei Times*, www.taipeitimes.com, 16 June 2001.

4 In July 2000, the Civil Servant Pension Fund outsourced NT$15 billion and the Postal Savings Fund outsourced NT$20 billion to nine local fund managers. The Labour Pension Fund will outsource 5 per cent of funds to private asset managers by early 2002 (*Taipei Times*, www.taipeitimes.com, 15 October 2001).

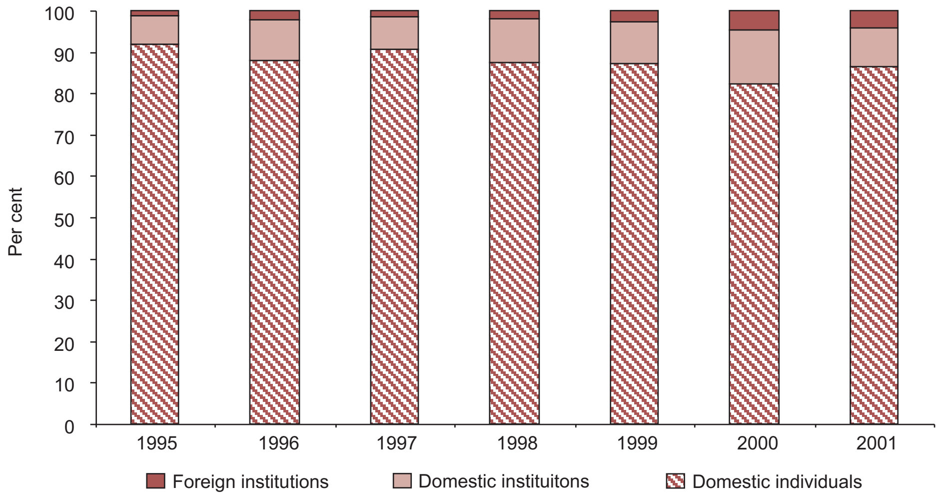
5 Holding companies now can enjoy tax and other benefits, although authorities will monitor their activities closely (PricewaterhouseCoopers, 2001).

6 In 1999, authorities capped foreign ownership at 50 per cent, up from 30 per cent for all foreign investors and 15 per cent for a single foreign investor.

Figure 9.3

Institutional Investors More Prominent

Share of Trading by Major Group, 1995-2001



Source: CEIC, 2002.

Bank Restructuring

Ongoing privatisation, increasing foreigners' presence and crisis induced restructuring force banks and corporates to compete more for funds. Since 1991, the authorities have licensed domestic private sector banks and privatised government owned banks. However, compared to many other East Asian economies, crisis induced restructuring had a limited impact on traditional bank-client relations. Most Taiwanese conglomerates have maintained their links with group banks, despite public injections into several banks. However, eventual sales of the Government's newly acquired bank equity eventually may weaken links between banks and their business groups' owners.

More important for bank and corporate behaviour are new reforms limiting bank ownership concentration and related party lending. October 2000 amendments to the Banking Law capped corporate or individual stakes in a bank at 25 per cent.[7] It also limited bank lending to affiliated business groups to 40 per cent of the bank's net worth (PricewaterhouseCoopers, 2001).

7 However, approved holding companies' stakes may exceed this.

PRODUCT MARKETS

Taiwan's many small and medium enterprises already compete vigorously and many export efficiently. Liberalised trade and investment regimes increasingly expose them to global competition, tightening discipline on managers to use investors' funds wisely.

Trade Reforms

Over the late 1990s, Taiwan's average nominal tariff rate fell from over 10 per cent to around 8 per cent, increasing competition for local corporates (East Asia Analytical Unit, 2000). However, substantial tariffs remain on processed food products, automotive parts and passenger vehicles. Trade licensing and import permit restrictions affect several sectors, including pharmaceuticals and agricultural products like sugar and rice.

Foreign Direct Investment

During the late 1990s, anticipating Taiwan's WTO entry the Government relaxed foreign direct investment regulations, including removing restrictions on foreign banks. Authorities now restrict direct investments only in strategic and national interest sectors, including some utilities. In November 2001, Taiwan also lifted a formal 50-year ban on local companies directly investing in China, though in fact local companies had invested on the mainland for many years. Authorities also will simplify procedures for investment projects under US$20 million (*South China Morning Post*, www.scmp.com, 8 November 2001). With Taiwan's WTO entry, several remaining restrictions, including on medical services, should end (*Taipei Times*, www.taipeitimes.com, 7 November 2001).

REGIONAL COMPETITION SPURS MERGERS

While still uncommon, increasing regional competition recently drove several local companies to merge to boost efficiency and potentially, shareholder profits. In March 2001, two medium sized domestic appliance firms, Teco Electric and Machinery and Samco Corp, announced their merger to better respond to strong competition from Korean and Chinese mainland firms. In the same month, in a US$1 billion deal, United Microelectronics and Acer merged their monitor manufacturing subsidiaries, creating AU Optronics, the world's second largest flat panel display screen producer. In May 2001, United Microelectronics announced a US$300 million deal merging its four printed circuit board affiliates into Unimicron Technology Corp.

Source: *Far East Economic Review*, www.feer.com, 16 June 2001.

Government Ownership and Deregulation

For over five decades, the Government was a major investor in Taiwan's financial, heavy industry and infrastructure sectors, but this is changing. Now, except in some banks and utilities and the energy sector, its role in the corporate sector is relatively limited (*Far Eastern Economic Review*, www.feer.com, 11 February 1999). Authorities continue to privatise government owned enterprises and introduce competition in telecommunications, power generation, oil refining and distribution, however progress has slowed due to stock market weakness and volatility. However, the loss-making China Shipbuilding Corporation remains government owned, and may become Taiwan's first bankrupt government owned enterprise (*South China Morning Post*, www.scmp.com, 7 May 2001).

REGULATIONS STRENGTHENING

Taiwan's regulatory framework is mature and broadly enforced.[8] However, the Ministry of Finance is strengthening supervision of accountants and amending the *Securities and Futures Investors Protection Act* and the *Securities and Exchange Law*. The Securities and Futures Commission supervises and enforces standards.

TRANSPARENCY

Listed companies generally disclose more information than non-listed companies, which often lack effective reporting facilities. However, leading local companies increasingly recognise providing sound information attracts lower cost share capital.

Financial Reporting

Corporations follow a disclosure based system of reporting.[9] Annually, bi-annually and quarterly, listed companies publicly release and register their audited and certified financial reports with the Securities and Futures Commission. Annual general meetings approve annual reports. In non-public companies with paid in capital over NT$30 million, an accountant must audit financial statements. Public companies report consolidated accounts and related party transactions (PricewaterhouseCoopers, 2001). Each month, public companies must report to the Securities and Futures Commission changes in shareholdings of people with more than 10 per cent of total shares in a listed company. In August 2000, the commission brought the *Rules Governing Information Reporting by Traded Companies* more into line with international standards.

If a company fails to comply with a reporting standard, it is liable for an administrative fine; providing false information is a criminal act under the *Securities Exchange Law* (PricewaterhouseCoopers, 2001). Listed company compliance generally exceeds private company compliance.

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8 Eric Tsai, Carly Johnson, Vicky Chang and Nina Ta, all of Puhua and Associates, correspondent law firm to PricewaterhouseCoopers Taipei, contributed to this section.

9 The Company Law generally governs the corporate reporting duties of non-public companies and the Securities and Exchange Law governs listed companies.

Accounting Standards

Accounting standards generally follow United States standards, except those for reporting impaired assets and employee benefits other than pensions (Banko, 1999). The Ministry of Finance recognises standards determined by the Accounting Research and Development Foundation, an independent accounting standards board. In 2000, new standards covered disclosure of segment liabilities and cash flow statements. Furthermore, the National Federation of Certified Public Accountants can launch proceedings against accountants failing to comply with standards, improving enforcement (PricewaterhouseCoopers, 2001).

Auditing

Auditing standards also generally follow United States standards. Company law generally requires annual financial statements, and the *Securities and Exchange Law* further requires audit or certification of financial statements for public companies. Audits must follow the *Statement of Auditing Standards and Regulations for Auditing and Certification of Financial Statements by Certified Practising Accountants* (PricewaterhouseCoopers, 2001).

Two or more certified public accountants must jointly audit and certify a public company's financial reports, upon application and approval from the Securities and Exchange Commission. Since 2000, the Securities and Futures Commission has been able to appoint, where necessary, a certified public accountant or other professional to examine a company's financial condition and related documents (PricewaterhouseCoopers, 2001). In February 2000, authorities increased certified public accountants' inspection responsibilities.[10] Public companies now place more importance on internal audits in satisfying shareholder concerns at annual general meetings. However, non-listed companies are less concerned.

MINORITY SHAREHOLDERS' RIGHTS

Despite laws granting shareholders various rights, shareholder activism is limited and minority shareholders' positions generally are weak.

Listing Rules

Listing rules generally are similar to those elsewhere in East Asia. However, reflecting flagging corporate profits, in 2000, regulators eased registration requirements for listing, reduced over-the-counter stock exchange listing requirements and shortened the review period to increase capital on offer (PricewaterhouseCoopers, 2001).

[10] Certified public accountants and auditors' assistants must pursue further education and strictly comply with professional ethics.

Under the Securities and Exchange Law, companies violating provisions can face administrative and criminal penalties; the Taiwan Stock Exchange Commission may suspend trading in, or delist, a firm's stock in the public interest. In 1999-2000, it delisted several firms, including Hung Fu Construction for not honouring its cheques payable (PricewaterhouseCoopers, 2001).

Representation

Shareholder rights are typical of the region. The chairperson of the board convenes shareholder meetings annually. In the event the chairperson fails to do so, under the *Company Law*, shareholders with more than 3 per cent of issued shares may request the supervisor to convene a shareholder meeting. One-share one-vote allows a simple majority of votes representing more than 50 per cent of total equity to pass resolutions. With the exception of persons engaged in trust business, shareholders may appoint proxies, although a single shareholder cannot represent more than 3 per cent of the stock. Election, though not removal, of directors is based on a mandatory cumulative voting mechanism (PricewaterhouseCoopers, 2001).

Shareholders elect the board of directors and the board appoints at least one non-executive director.[11] Shareholders also must appoint a supervisor, who can inspect the company's financial conditions and audit the financial statements the board proposes and submits to the annual meeting (PricewaterhouseCoopers, 2001).

COMPANIES RECOGNISE THE VALUE OF GOOD GOVERNANCE

Anecdotal evidence suggests leading corporations seeking international finance are raising their corporate governance standards. For example, Taiwan's largest computer manufacturer and exporter, Acer, appointed a new non-executive board director; it also discloses financial information, the company strategy and new alliances on its Internet site. Listed companies, Giga-Byte Technology and Gordon Auto Body Parts, also have outside directors and outside supervisors. Other companies trying to take the lead in corporate governance include Taiwan Semiconductor Manufacturing and United Microelectronics.

Source: PricewaterhouseCoopers, 2001.

Board Structure and Duties

Company directors and high level managers have a duty of care as good administrators, and shareholders must approve transactions benefiting directors. Although directors do not have to be trained, those in the insurance, securities and trust management sectors need some qualifications (PricewaterhouseCoopers, 2001).

11 Directors no longer need to be shareholders of the company.

If directors breach their duties, the *Company Law* provides for basic shareholder derivative actions.[12] However, the law does not clarify the criteria for the courts to uphold a derivative action, increasing the risk it will fail; this deters shareholder activism. Moreover, recent *Company Law* amendments do not provide statutory backing to the business judgement rule, a cornerstone of the Australian and US corporate governance systems, which provides statutory backing to the decision-making power of directors of a company (PricewaterhouseCoopers, 2001).

CREDITORS' RIGHTS

Bankruptcy Laws

Taiwan's bankruptcy law is underdeveloped; at present no dedicated court deals with bankruptcy although one is planned (*Taipei Times*, www.taipeitimes.com, 19 October 2001). Parties seek to avoid face-losing situations, also weakening enforcement. Often, legal counsels assisting in bankruptcy matters lack financial knowledge and experience in preparing restructuring plans, and a single judge can hear more than 100 different cases a month (*Taipei Times*, www.taipeitimes.com, 19 October 2001). Consequently, voluntary debt restructuring often works better.

Several company post crisis reorganisations revealed laws treating secured creditors need strengthening, as some deny creditors' enforcement procedures. Consequently, regulators amended the Company Law's reorganisation statutory procedure. This helped the 1999 reorganisation of Tung Lung Metal Industry under a successful insolvency workout (PricewaterhouseCoopers, 2001). Despite this amendment, additional reforms are needed. Courts still take up to 270 days to approve a company's application to reorganise, compared with the international standard of 60 days, and often appoint the insolvent firm's manager as its receiver, disadvantaging creditors (*Taipei Times*, www.taipeitimes.com, 19 October 2001).

Bank Supervision

In the early 1990s, industry deregulation significantly boosted bank numbers, increasing the need for adequate supervision. In particular, many conglomerates used liberalisation to create their own new banks, in some cases compromising lending standards (Smith, 2000). The Central Bank of China, a government owned bank, performs regulatory and central bank functions, auditing banks and financial institutions under the Banking Law. During the crisis, connected lending was behind the collapse of three out of the four financial institutions to fail in 1998 (Smith, 2000). In October 2000, penalties for violating the *Banking Law* increased with longer prison terms and higher fines (PricewaterhouseCoopers, 2001). In 2001, the Government proposed the Financial Supervisory Board Organisation Law which seeks to create the independent Financial Supervisory Board to execute financial regulatory policy (*Taipei Times*, www.taipeitimes.com, 27 March 2001). According to the proposal, the new board may order any financial institution to assist in investigating fraud or other criminal activities, imposing fines on financial institutions failing to comply.

12 The amended *Company Law* lowers the threshold shareholding for these actions from 5 to 3 per cent.

IMPLICATIONS

With a corporate sector dominated by family companies and previously by government owned enterprises, Taiwan's corporate governance was not strong. Since the financial crisis, the Government has sought to strengthen corporate governance and related regulations to insulate Taiwan from potential contagion. On-going goods and service trade liberalisation increases pressure on domestic managers. Opening up of the financial and corporate sectors to foreign investors, on-going institutional investment and prudential regulations reforms also should promote more vigorous financial markets which eventually should increase discipline for corporates. Post crisis, authorities also addressed several corporate and bankruptcy law deficiencies, although board independence and minority shareholder protection, especially in family companies are still inadequate. Nevertheless, reforms underway and anticipated should eventually help Taiwan make the transition to a rules based business model.

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