Thoughts on the Survey on Corporate Governance among Mongolian Listed Companies

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1. Foreword

The survey by questionnaire on corporate governance among companies listed on the Mongolian Stock Exchange was carried out in June 2011. It was a collaborative work between the Social System Institute of Chuo Gakuin University and a study group of the National University of Mongolia. The high response rate of companies to the questionnaire, 71%, was the result perhaps of its being supported by the Financial Regulatory Commission. Based on data mainly from this survey, I would like to point out and to consider some problems in corporate governance of listed companies in Mongolia.

2. Types of Listed Companies and Features of the Market

From the survey, we could identify two types of companies, large and small, among listed companies. According to data on corporate scale by employees, there are 45 firms (46.9%) with less than 50 employees and five firms (5.2%) with more than 1001 employees, pointing to the coexistence of two greatly differing corporate scales among listed companies.

In the First Section of the Tokyo Stock Exchange, there are large-scale companies, while in other markets, such as Jasdaq and Mothers, shares of medium or small sized firms are traded. The Mongol Stock Exchange combines the characteristics of these two markets into one.

3. Ownership Structure of Listed Companies

We also discovered interesting and important facts from the survey data regarding the owners and ownership structure of listed companies.

(1) There were 78 firms in which government owned no shares (83.9% of respondents), and a majority of responding firms showed a shift from nationalized firms to private ownership, indicating an advance in privatization of listed companies. The rate of share holdings by government in listed companies in China is declining due to the reform of non-circulated shares, but in one third of listed companies more than 20% of shares are still held by government. These trends suggest that privatization is advancing among Mongolian listed firms more than among listed firms in China.

(2) While the companies in which government owned no shares made up the majority of respondents, 10% responded that they are nationalized companies in which government owned most of their shares. Of these, 1 company (1.1%) responded that government owned 71-80% of their shares, and 8 companies (8.6%) responded that government owned more than 81% of their shares. These nationalized firms are large enterprises with ample amounts of capital.

(3) As to ownership of the responding companies, firms whose founders or their families

owned more than 31% of the shares accounted for 50%. This means that about half of listed companies are owned by founders or their families, and thus share the characteristics of a family business.

4. Relations Between Management and Ownership

As to the question whether founders and their families were active in management or not, responses showed that in most firms the founder or their families participated in and performed management duties. The likely background to this is that the founder-executives bought nationalized enterprises with the intention of maintaining and developing them as businesses, not as investments. Alternatively, there might also have been entrepreneurs with creative business plans who continued to manage their business after founding it. In any case, as the capital providers, or shareholders, continue in the role of executives, they can be considered owner-managers.

5. Problems Regarding the Functions of Shareholders Meetings and Board of Directors Meetings

(1) Functions of shareholders meetings

The Mongolian Stock Exchange released the following data regarding shareholders meetings of listed companies.[1)]

	2009	2010
Number of listed companies	358	336
Companies that announced shareholders meetings	166	159
Companies that submitted balance sheets	133	151
Companies that distributed materials of shareholders meetings	8	6

Companies that announced shareholders meetings accounted for 166 firms among 358 listed companies in 2009 and 159 among 336 listed companies in 2010, or only 47% of listed companies. Companies that submitted balance sheets accounted for 44.8%, below half of total listed companies, with 133 firms making submissions in 2009 and 151 in 2010. Companies that distributed materials of shareholders meetings were extremely rare, with only six firms doing so. These data show that shareholders meetings and management are not operating according to standard procedures in some companies.

(2) Structure of boards of directors

Most of the respondents to the questionnaire reported having nine directors, accounting for 81 firms (84.4%). 73 firms (78.5%) reported having non-executive directors and 55 firms (59.1%) reported having independent directors. As the number of non-executive directors made up the majority of nine member boards, this structure of board of directors is similar to the model of

corporate governance in England and America.

(3) Meetings and management of board of directors

74.5 percent of responding companies answered that they have rules or codes concerning a board of directors, but 24 companies (25.5%) answered that they did not have such rules or codes. As one fourth of responding companies do not have rules or codes regarding the holding, proceedings and management of boards of directors, their institutionalization is a matter of immediate concern.

57 firms (60.0%) responded that they held board of directors meetings one to four times a year; the next most frequent response was five to ten times a year, for 29 firms (30.5%). Considering that the functions of boards of directors are making decisions on policy and monitoring and supervising execution of decisions, it seems that the board of directors in some companies are not functioning adequately, as they only hold meetings one to four times a year.

(4) Problems of compensation to directors

The survey made clear the following: 47 firms (49.5%) paid salaries or compensation to directors, and 48 firms (50.5%) did not. In the cases where companies paid compensation to directors, the forms of compensation were 1) shares (30 firms, 62.5%), 2) salary (18 firms, 37.5%), 3) bonus (2 firms, 4.2%), 4) others (10 firms, 20.8%). The first problem with these forms of compensation is that the bonus was the least frequent form. As bonuses are paid out of profits to the executive, and only two firms paid executive bonuses, the responses suggest that profits may not be sufficient to pay a bonus, or executive bonuses are not yet established practice in Mongolia. The second problem is that as most compensation to directors was made in the form of shares, the practice of stock options may be widespread in Mongolia. The third problem is that 48 firms (50.5%) didn't pay compensation to directors. The following reasons may account for this: 1) as there are large numbers of non-executive directors, they might be understood as an honorary post, 2) among responding companies, large numbers of founders or their families assumed the position of director, perhaps making the practice of non-compensated directorships for owner managers widespread. As compensations are considered incentives for the activities of directors, it is necessary to make reforms in this regard.

6. Issues and Prospects —from the viewpoint of corporate governance—

(1) Necessity of multiple and different viewpoints

It should be pointed out that as there are two types of firms listed on the Mongolian Stock Exchange, medium or small-scale firms and large-scale firms, the Mongolian Stock Exchange consists of markets of different natures.

Markets such as “Jasdaq” or “Mothers” in Japan, the “Board of Founded Enterprise” in China, and “Nasdaq” in the U.S.A, offer support to emerging firms, and thus are of a different character from markets oriented to large-sized enterprises. When two different types of enterprises coexist in a single market, of course, compound and pluralistic regulations to address them must be devised. In the case of Mongolia, it’s necessary to take measures to protect investors, while at the same time they must promote the increase of circulated shares through

reform of non-circulated shares for large nationalized enterprises. In relation to this, regulations on the ratio of shareholding by specific large shareholders need to be introduced into listing requirements.

At the same time, it is necessary to support and take measures to promote the supply of capital for new emerging concerns. For example, in the case of listing examinations it is important to lay stress on business plans for the future rather than short-term profit conditions.

(2) Codification of rules and compliance

While it goes without saying that shareholders and board of directors meetings play important roles as corporate organs, data on actual conditions of shareholder and board of directors meetings indicate an immediate need to institute rules regarding their holding, proceedings and management. It is important to hold shareholders and board of directors meetings, to circulate materials, to record proceedings and to manage them, according to instituted rules.

(3) Deciding and codifying management policy and philosophy

In answer to the question,"Has your company codified its management policy and philosophy?" 50 firms (54.3%) answered "Yes" and 26 firms (28.3%) answered that "It's under consideration." These responses indicate without a doubt a trend towards independent management and a will to establish corporate policy on their own after privatization. Likewise, as to an ethical code, 34% of firms answered that it has been codified and 37% of firms answered that it had not been. The fact that a third of responding companies (34%) had already codified their ethical codes only a few years since privatization, and, furthermore, that 29.3% had it under consideration, indicate a corporate posture of seeking to strengthen their self-regulatory capability through the setting of ethical codes. As to the contents of management policies, philosophies and ethical values, it would be of great interest to learn what philosophies and ethical values Mongolian listed companies emphasize, as Asian enterprises.[2)]

Notes:

1) Mongolian Stock Exchange, Annual report, 2010.p.9.
2) According to"Mongolia in World Competitiveness, 2010", Economic Policy and Competitiveness Research Center 2011, comparative data on management practices in 15 countries including Korea, Russia, Singapore, Malaysia, Thailand, Bulgaria, et al, show that Mongolia is ranked 13th in ethical practice, 8th in social responsibility, and 11th in effectiveness of management supervision. In contrast to these low rankings, it should be noted that Mongolia ranked relatively high in managerial entrepreneurship, at 3rd place, and innovative capacity of firms to generate new products, at 6th.