Corporate Governance in the Philippines and Switzerland — A Comparison of Environment and Practices

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Abstract

This chapter reviews the corporate governance environment of the Philippines and Switzerland by comparing and contrasting the experiences and practices of businesses in these two countries. The comparison between an economically developed country and a developing one provides an insight into the challenges both countries face in the corporate governance experience. The theoretical scope is explored by emphasizing the institutional framework of both countries. Underlying economic measures are also provided placing the context of corporate ownership and board experience. ~~**Text text text text text text text text text text text text text text text text text text text text text text text text text text text**~~

1. Introduction

Our chapter aims to compare corporate governance practices between an emerging market (the Philippines) and a developed market (Switzerland) by highlighting the objectives and challenges of such control mechanisms within distinct institutional contexts. One main goal of corporate governance is to ensure that the owners of the corporation — the shareholders — receive an adequate risk-adjusted return to their investment.

The mechanisms of corporate governance reduce the possibilities of managers to expropriate money from the shareholders by setting rules, monitoring and incentives. The legal system sets boundaries and protects shareholders from illegal behavior. Corporate legal rules typically prevent managers from basic expropriation of shareholders such as stealing and/or~~,~~ tunneling. Corporate governance mechanisms are mostly voluntarily installed devices protecting shareholders. The legal environment --- written legislation and law enforcement --- differs across countries. These differences affect the way ~~how~~ optimal corporate governance structures should be implemented. The requirements of the system of corporate governance practices ~~do~~ also depend on the legal environment. For instance, in countries where ~~the~~ shareholder~~'~~s' money may be used for corruption, other governance mechanisms may be important. The situation is the ~~The~~ same if companies are actively controlled by families.

First of all, we relate the development of both countries to corporate governance and the institutional environment. Then, we briefly describe the historical development of both economies with regard to the economic and legal environment, and the corporate landscape, but also culture and politics. Based on that, we then point out differences in corporate governance practices that might arise because of these country-specific characteristics.

In this context, we show how — because of a differing institutional environment — the ownership structure and the board of directors may vary and how this is related to the structures of ~~the~~ firms. Since corporate governance practices in Switzerland follow predominantly best practice, we stress practices in the Philippines in our comparison. Finally, the chapter will compare and contrast the similarities and differences in both systems.

2. Theoretical Scope

2.1 *Corporate Governance and the Development of Countries*

In general, countries can be divided into two categories according to their economic development: advanced (or developed) countries and emerging (or developing) countries (see IMF, 2012).

In **developed countries**, the basic law generally protects the interests of stakeholders. Basic legal rules protect contractual rights and law is effectively enforced. Legal investor protection is higher than in less developed countries and corporate governance is ~~rather~~ seen as additional (voluntarily) devices ensuring that corporate managers do not ~~misspend~~ waste shareholders' resources. Covenants are protected by debtor rights; criminal law is enforced to reduce corruption, environmental pollution etc. Labor law governs the relationship between employers and employees. Given these basic rules, one main purpose of corporate governance is the agency relationship of trying to ~~to protect~~ shareholder interests ~~which must~~ while 'trusting' that the managers and directors act in the best interest of the corporation ~~which as a general rule is related to shareholder interests~~. This becomes obvious due to the fact that, in developed countries, corporations typically are widely held and the fraction of institutional ownership such as pension funds is substantial.

In **emerging countries**, legal reforms are aimed ~~to~~ at sustaining economic development and trade, e.g., by protecting property rights. Investor protection is less developed and, as a result, corporate ownership is usually concentrated in the hands of a few (e.g. such as a high net-worth individuals and/or~~,~~ families) (see Claessens, Djankov and Lang, 2000). In these countries, illegal economic activities such as corruption and bribery often are prevalent and should be addressed by corporate governance and corporate social responsibility (CSR) which take other stakeholders such as the wider community into account as well.

Corporate governance protects shareholders from firm value-reducing activities of ~~the~~ management. Corporate failures, as a consequence of weak corporate governance, create mistrust and can lead to bad resource allocations. As a result, corporate governance supports economic development by ensuring that investments from investors are not expropriated and~~,~~ economic confidence is assured. ~~therefore becomes~~and This is especially important for ~~the building~~ institutional-building~~up~~ and development of emerging economies, which in turn benefits ~~the~~ society as a whole.

2.2 *A Country's Institutional Framework*

In general, institutions are the outcome of human organizing and interaction. They are normally indigenous structures that are the result of social, economic, historical, judicial, political and religious relationships. Institutionalists study the ways people have structured organizations to have order in a society, to have more efficient economic activity and also to reduce transaction costs and production. Institutions are made up of both "informal constraints" and "formal rules" and are a reflection of socio-economic motives:

> "Institutions provide the incentive structure of an economy; as that structure evolves, it shapes the direction of economic change towards growth, stagnation, or decline." (North 1991: 1)

Similarly, the importance of the institutions of ~~the~~ law and regulation in studies of societies was also expounded by Edelman & Stryker (2005). Laws and enforcement thereof provide institutional legitimacy to the state but also certainty to society. Laws, regulations, government policies and official edicts oil the wheels of commerce by providing boundaries in the field. The absence of these tools is an obstacle to a well-functioning society as social norms are poor substitutes for legitimate social actions. Supporting the importance of the law in economic development also comes from La Porta et al's (1998) study on Law and Finance which tracked the historical evolution of legal development across different jurisdictions.

Altogether, the institutional framework within a country **defines the scope and terms of its corporate governance rulings** because it sets strict rules of investor protection and indirectly influences the configuration of corporate governance at firm level (see Easterbrook and Fischel, 1989). In a series of papers, La Porta et al. (1997, 1998, 2000, 2002) show that lower investor protection is related to weaker financial markets, higher ownership concentration and~~,~~ lower corporate valuation ~~and~~ which affects corporate governance. Transparency

International (2009) underlines the importance of corporate governance to counter corruption and fraud. Wu (2005) detects a positive relationship between good corporate governance and a reduced level of corruption.

Countries with insufficient legal enforcement are observed to have difficulty in attracting external capital (Shleifer and Vishny, 1997). ~~The~~ Furthermore, ~~other way round~~, the importance of an appropriate legal environment is ~~accurately~~ acutely described by Adam Smith ~~(1776)~~:

> "Commerce and manufacturers can seldom flourish long in any state which does not enjoy a regular administration of justice, in which the people do not feel themselves secure in the possession of their property, in which the faith of contracts is not supported by law, and in which the authority of the state is not supposed to be regularly employed in enforcing the payment of debts from all those who are able to pay. Commerce and manufactures, in short, can seldom flourish in any state in which there is not a certain degree of confidence in the justice of government." - Wealth of Nations (1776)

To put it in a nutshell: The institutional environment of a country is **fundamental to its future success and growth**. As Lazonick aptly put it: "History shows, that the driving force of successful capitalist development is not the perfection of the market mechanism but the building of organiz~~s~~ational capacities." (1991: 8) A distinct~~ive~~ view of the role institutions play in economic development was taken by Lin and Nugent (1995). They looked at the reality and struggles of institutions in developing countries. More often than not, developing countries are politically unstable and institutions have to work around this instability.

Institutions influence the **pace and level of economic development**, while economic development can trigger institutional changes (Lin & Nugent 1995: 2303). Institutions in economic development are divided into two types: market and non-market. Market institutions deal directly with contracts, commodity and factor markets. Usually, they are government institutions such as courts, securities commissions (or market regulators), stock exchanges, and economic ministries. Non-market institutions are the firms and communities. Both market and non-market institutions complement each other due to their interconnectedness and interdependency with each other (Lin & Nugent 1995: 2312).

Where there is **underdevelopment**, the most important institutions are "the family, the tribe and the kin group" (Lin & Nugent 1995: 2313). When rich countries undergo economic crises or economically regress, these familiar institutions are rediscovered because they are ~~innate~~fundamental. In developing countries, strong family or kin ties are a safeguard for mutual survival, and insurance against hunger or starvation. (Lin & Nugent 1995: 2317)

3. Comparison of the Philippines and Switzerland

The Philippines is an island archipelago located in South East Asia with a population of 104 million. It is considered a lower middle income country with a nominal gross national income per capita of USD 2,319 in 2012 (CIA, 2013). In recorded history it was a colony for several centuries under Spain and then nearly half a century by the USA. In the period since the end of World War Two, it has suffered various political instabilities with a period of dictatorship under Ferdinand Marcos. (Celoza 1997) The country continues to be erratic politically and economically, not yet achieving the stability that has marked the growth of its neighbo~~u~~rs in the region. It is currently a democracy-in-progress with the most recent presidential elections held in May 2010. Instability in the country has meant a large outflux of its citizens and the economy is reliant on remittances which makes a significant proportion of its GDP (Bayangos & Jansen 2011)

Switzerland is ~~a~~ situated in the midst of Europe with a population of roughly more than 8 million. The country comprises three major language areas (German, French and Italian) and a small Rhateo-Romanic fraction. The country, while not member of the European Union, is highly internationalized~~, which is not lastly~~ with around~~shown by a ~25% foreigners share~~ 25% of the population being non-Swiss citizens. The Swiss economy is relatively successful in international comparison and has a reputation of a so called "safe haven". In 2012, the nominal gross national income per capita was ranked 4th in the world (USD 78,754) (CIA, 2013). Switzerland's position is also ~~owned~~ due to a stable and strong institutional environment: it is one of the most developed economies and has one of the~~ as well as~~ strongest democracies in the world, where the people can have the last word concerning single laws, after government, parliament and~~or~~ other stakeholders. As Switzerland is a country with only few natural resources, ~~we can observe a~~there is a strong emphasis and focus on its intellectual resources such as the high tech industry ~~aiming~~ which aims to develop new innovative products in the fields of e.g. biotech, medical engineering, new materials, greentech etc.

3.1 Institutional Environment

3.1.1 Philippines

Institutional reforms in developing countries with absolute rulers are difficult to verify due to the power struggle that can exist between a president and the bureaucracy (Lin & Nugent 2005: 2338). Typically, the former usually prevails over the latter and a heavily politicized bureaucracy is the result. According to Kay, politicization refers to "… the reaching of decisions on matters within an agency's or program's functional competence through a process that is essentially political and that does not reflect technical and scientific factors in the decision process; and … the taking of specific actions on issues within an agency's or program's competence for the sole purpose of expressing a partisan [or self-interested] political position rather than attempting to reach an objective determination of the issues." (1980:7 in Momani 2004: 900)

Politicization of the bureaucracy in developing countries is a common, albeit problematic, phenomenon (Ilchman & Uphoff 1998: 30-48). Where a working bureaucracy exists, the institutions will have to work around the whims of the incumbent and vice versa. Such a scenario can end up in a catch-22 situation where institutional reforms cannot be initiated at all due to the fear and uncertainty changes might bring to the pre-existing power-political structure. (Lin & Nugent 2005: 2340)

The Philippines is plagued by weak institutions in the aftermath of Marcos' lengthy dictatorship. Democracy has returned to the country but the institutions are not of robust standard with political representation made of oligarchical families. This means government institutions and regulators are frequently politicized. The system of government is modeled after the USA, its former colonial ruler, with a strong executive; however, the legislative and bureaucratic arms are not independent from the executive in practice. ~~In the absence of a strong welfare state, citizens rely on social welfare that may be provided by the company, but most importantly, by the family. This may explain why the family is at the centre of Philippine life.~~

~~Concurrently, when an individual achieves monopolistic political and economic power, the county's institutions suffer in the pursuit of self-interest.~~

> ~~"The weaker the linkage between the ruler's wealth and the growth of national income, the more likely a myopic wealth-maximising ruler bestowed with absolute personal power (e.g. Marcos in the Philippines) might be tempted to eschew property rights in favour of maximum surplus extraction. Rulers may be especially inclined to predatory taxation and other conditions unfavourable to economic growth when threatened." (Lin & Nugent 1995: 2337)~~

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The impact of a politicized bureaucracy results in the "primarily loss of confidence in the fairness of government institutions." (Peters & Pierre 2004: 8) In the context of the Philippines, there is a history of politicization in the civil service compounded under the tenure of Marcos. It has been rare for instances of impartiality to occur within the bureaucracy since the end of the dictatorship. In a study of the performance appraisal of the civil service in Singapore, Thailand and the Philippines, Vallance found the Philippine bureaucracy as highly politicized, fundamentally traumatized, and debilitated by a culture of patronage:

> "Under Marcos, the distinction between politics and administration became increasingly blurred as the president appointed undersecretaries from the ranks of elected legislators. Patronage in the civil service became entrenched during the Marcos regime and notions of civil service neutrality were irreparably damaged. Despite President Aquino's vow to 'de-Marcosify' the Philippine civil service (Cariño 1989:214), the trend of politiciz~~s~~ation has continued. Under President Ramos it is estimated that slightly more than half of all senior civil servants in the Philippines are political appointees (Santa Tomas 1995: 272 in Vallance 1999: 82)."

In a comprehensive 2003 report prepared by the World Bank and the ADB for the Government of the Philippines on improving the efficiency of government organiz~~s~~ations, politicisation was singled out as a significant obstacle in the effective functioning of government. The report articulated the main problems of a politicised bureaucracy in the Philippines: its function "too much as an adjunct of the political executive", hierarchical culture, emphasis political influence and patronage, appointments based on patronage rather than merit, and poor salary compensation making some sections prone to graft and corruption (World Bank and ADB 2003: 106-107). To be effective, institutional development requires political will, a relatively de-politicised bureaucracy, and a culture that is willing to be responsive and adapt to the changing needs of the country. Politiciz~~s~~ation of the Philippine bureaucracy hinders the country's performance and frustrates meaningful economic development. (dela Rama 2012) This is a fundamental institutional challenge for the country.

3.1.2 Switzerland

The Swiss confederation was founded on 1 August 1291.[1] In 1499, the country virtually was separated from the Holy Roman Empire. Since then, in spite of various wars and disputes— also among different parts within the country— Switzerland stayed independent, even during World War II.

The institutional system of the country is characterized by a highly developed and deeply rooted democracy, as the Swiss people can decide ~~about~~ on single laws at~~on~~ all levels of the confederation. There is a federal level, a cantonal level (comparable to single federal-~~-~~states) and also a communal authority level. ~~By the way.~~ In addition, Switzerland does not have a capital city as known in virtually all countries of the world; the city of Bern is called the "federal city". The historical independence is elementary for the institutional system of the country.

The Swiss federal government comprises members of all the strongest political parties of the country, and therefore is not only constituted by one political wing. Switzerland does not have a person as a head of state as well as no prime minister; these~~is~~ tasks are~~is~~ jointly fulfilled by the federal government as a whole. On the federal level there are two houses of parliament, both fully elected by the people: First, the national assembly, and second, the Council of States which represents the Swiss cantons. The 26 cantons are ~~reigned by~~have their own governments and parliaments.

The above mentioned history of independence also is a crucial fact for the institutional system of Switzerland in an international perspective. Only in 2002, the Swiss people decided~~s~~ to join the UN. At the same time, it was the first country ever in history, where there was a popular vote about an UN membership. Also, the country is not member of the European Union and the people also refused to join the EU's European Economic Area.

Moreover, the country has an ~~long-term~~ historical, ~~(~~international,~~)~~ humanitarian tradition. A well-known example is the International Red Cross, which ~~has~~ was founded ~~its roots~~ in Switzerland in 1863~~(year of 1863)~~.

Switzerland's institutional environment is strong, democratic and a competitive advantage for the country.

3.1.3 Comparative View

[1] A synopsis of Switzerland's history and development can be found in e.g. Maissen (2012). For the institutional System see Schweizerische Eidgenossenschaft (2012).

Since we are discussing corporate governance in two very distinct countries, it is important to compare differences in the countries' characteristics. For that reason we use figures from the CIA (2013) Factbook about general economic and legal factors. In addition, we used broad indices (and sub-indices) made available by the Heritage Foundation (2013) and Transparency International (2012) to evaluate economic freedom and corruption, transparency, and governance, respectively, in the two countries.

Table 1: CIA Fact Book

	Philippines	Switzerland
Government type	republic	confederation
Legal system	civil law / F~~f~~rench[1]	civil law / G~~g~~erman
Main religion(s)	C~~c~~atholicism	C~~c~~atholicism /P~~p~~rotestantism
Population[2]	103,775,002	7,925,517
GDP[3]	240,700	622,900
Stock Market value[4]	202,300	1,229,000
GDP per capita	2,319	78,594
Stock Market value / GDP	0.84	1.97

Notes: 1 Stulz / Williamson (2003); CIA Factbook describes the legal system in the Philippines as being a mixed legal system of civil, common, Islamic, and customary law. 2 July 2012 est. 3 in Million Dollars, official exchange rate, 2012 est. 4 in Million Dollars, 31 December 2010. Source: CIA (2013): Library, The World Factbook; www.cia.gov.

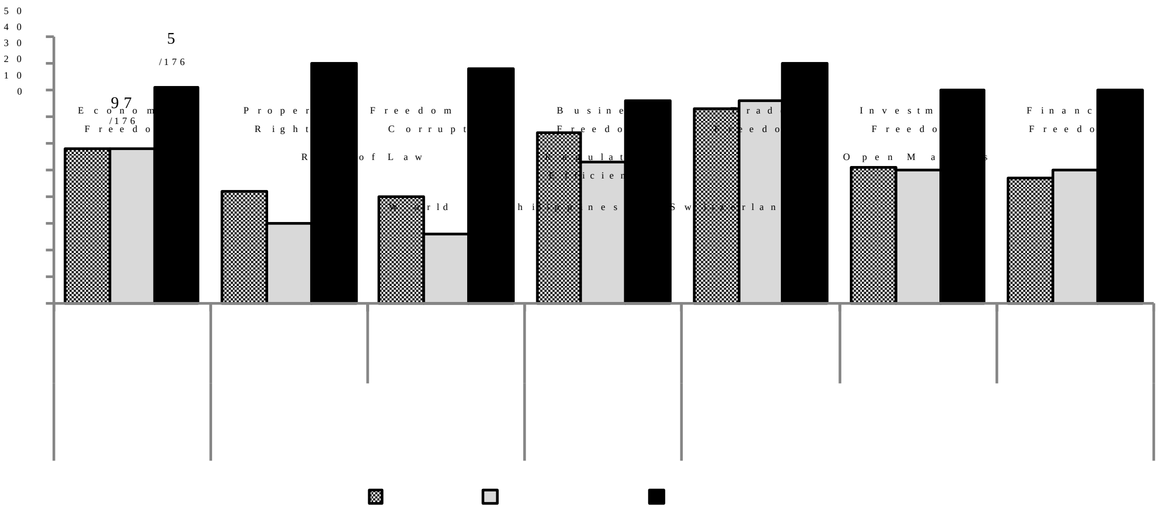
Table 1 shows significant differences between the two countries in economic terms. The Philippines is the 12th largest country in terms of population and has over 100 m~~M~~illion inhabitants. Switzerland with its roughly 8 m~~M~~illion people is only ranked 95th from 239 countries. However, gross domestic product (GDP) is higher in Switzerland than in the Philippines which translate into an almost 34 times lower GDP per capita.

It is ~~interesting~~ interesting to note~~ts~~ the comparison of the size of the respective stock markets. The stocks listed on the Philippine Stock Exchange are worth 202 Billion US Dollars in 2010 while the figure of the SIX Swiss Exchange is 1,229 Billion US Dollars. The ratio of market value of publicly traded shares to GDP is 0.84 in the Philippines and 1.97 in Switzerland. However, the stock market is relatively important in Switzerland ~~also thanks~~due to some multinational~~very large~~ companies such as Nestlé, Novartis, Roche and~~or~~ UBS. In comparison, the ratios are 1.09 in the United States, 0.42 in Germany, and 0.57 in China.[2] Hence, the importance of the stock exchange also in the Philippines is relatively high suggesting that the legal environment and corporate governance are important factors.

To compare the Philippines and Switzerland, we ~~want to take a look~~also looked at the so-called "Index of Economic Freedom", developed by the Heritage Foundation.

[2] Ratios: United States: 17,140,000 (market value of publicly traded shares in 2010) / 15,650,000 (GDP in 2012). Germany: 1,430,000 / 3,367,000. China: 4,763,000 / 8,250,000.

Figure 1: Index of Economic Freedom



Notes: Source: Heritage Foundation (2013): Index of Economic Freedom; www.heritage.org

It becomes obvious that Switzerland has a degree of economic freedom above the world's average. Switzerland has one of the strongest systems for enforcing property rights, whereas the Philippines is below other countries in this context. This also holds account in terms of business freedom and investment freedom. However, the trade freedom and financial freedom of the Philippines shows clear signs of an upswing in that country's development ~~of the developing country.~~.

~~In a further step,~~Furthermore, we also looked ~~take a look at the~~ three factors of corruption, transparency and governance to compare the institutional system of the two countries.

Table 2: Corruption, Transparency, and Governance

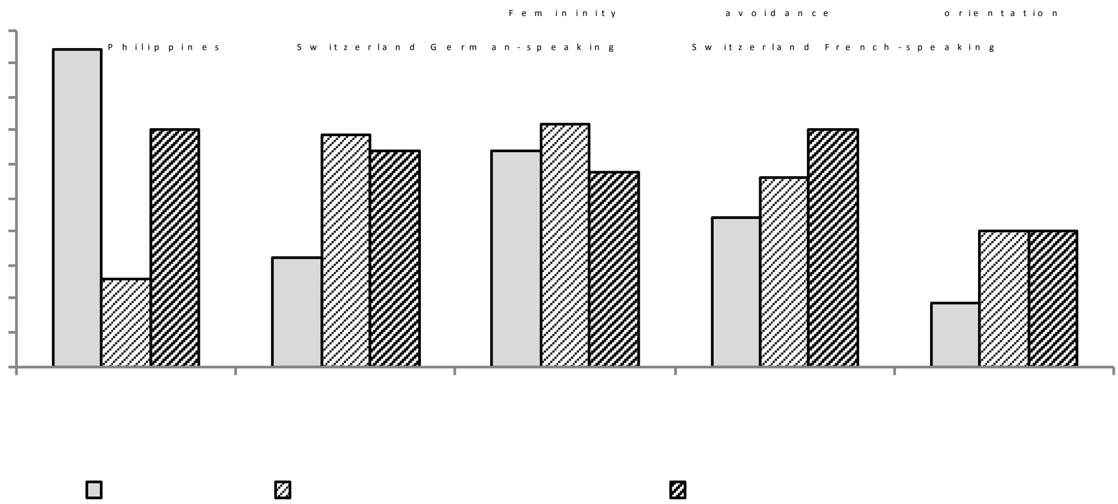
		Philippines	Switzerland	World
Corruption Perceptions Index (2012)	Rank	105 /176	6 /176	
	Score	34 /100	86 /100	43 /100
Control of Corruption (2010)	Percentile rank	22%	96%	
	Score	(-0.8)	(2.1)	(1.3)
Bribe Payers Index (2011)	Rank	n.a.	1 /28	
	Score (max 10)	n.a.	8.8	7.9
Financial Secrecy Index (2011)	Rank	33 /71	1 /71	
	Score	(254)	(1879)	(350)
Press Freedom Index (2011-2012)	Rank	140 /179	8 /179	
	Score	(65)	(-6)	(39)
Rule of Law (2010)	Percentile rank	35%	96%	
	Score	(-0.5)	(1.8)	(0)
Judicial Independence (2011-2012)	Rank	102 /142	5 /142	
	Score (max 7)	(2.9)	(6.4)	(4)

Notes: Source Transparency International (2012): Corruption Perceptions Index 2012; www.transparency.org

The Corruption Perceptions Index ranks Switzerland on the 6th and the Philippines on the 105th position from 176 countries surveyed (see Transparency International, 2012). Accordingly, the control of corruption differs significantly between the two countries (Philippines 22%; Switzerland 96%). The differences and relative positions of the Philippines and Switzerland are unaltered with respect to financial secrecy, press freedom, rule of law and judicial independence.

According to Hofstede (1980), culture is a set of shared values that separate one group of people from another. While it is difficult to assess a country's culture and hence its values, we use characterizations provided by Geert Hofstede (http://geert-hofstede.com) to approximate culture in both countries and make general comparisons.

Figure 2: National cultural dimensions



Notes: Source Hofstede (2013): National cultural dimensions, geert-hofstede.com

Power-~~-~~distance measures bias towards hierarchical structures. Filipinos and Swiss French ~~rather~~ are inclined to accept hierarchical structures where people accept their position within a society. In contrast, Swiss Germans are more egalitarian and prefer decentralization. Both language groups in Switzerland are equally individualistic and value self-responsibility. In the Philippines, belonging to a group (e.g., family), loyalty, and responsibility for each other is important. ~~In what concerns~~In terms of ~~-~~the role of competition in a society, there are low differences between the countries. In both countries, people value success more than the quality of lif~~v~~e. Filipinos do not value the avoidance of uncertainty in contrast to the Swiss who are rules-orientated with strong regard for ~~such as~~ precision or punctuality. In the Philippines practice comes before principles and there is a higher tolerance of crossing the norm. Both countries share a short-term orientation which translates into traditions (?), the urge to quick success and a low propensity to save.

Because there are significant differences on the economic, legal, and societal level, it is very interesting to note the ~~how~~ corporate governance responses to these differences.

3.2 *Corporate Governance Practices*

3.2.1 In General

Corporate governance practices aim to reduce agency costs which accrue from the conflict of interests between shareholders and managers. A variety of mechanisms protects shareholders from managerial misbehavio~~u~~r, ensures that shareholders' interests are respected and thereby mitigates the so-called principal-agent problem. Good corporate governance reduces the likelihood of bad management decisions. On the one hand, lower risk leads to lower costs of capital. On the other hand, investment solely into positive net present value projects leads to higher free cash flows. Both effects have a positive impact on firm performance. In addition, a CSR strategy takes also other stakeholders into account. For instance, risk management, which is also a board task, has to consider corporate actions that may negatively affect society; ~~and which~~ this in turn lead to reputational costs. Recommendations for corporate governance practices or reforms have to account for a country's institutional environment and firm-specific characteristics.

Even though corporate governance is important, its form and implementation are largely left to the discretion of the firms and can be formulated differently across countries. This flexibility and the fact that one unique corporate governance system does not exist is probably one of the reasons why the topic has grew in interest in the ~~last~~ recent years. The corporate scandals in the United States and Europe ~~in~~ at the beginning of the 21st century have led to debates about corporate governance in ~~the~~ society. People, especially in developed countries, are typically invested into stocks or pension funds and are thereby materially dependent ~~that~~ on corporations that generate high returns.

Countries providing weak legal investor protection and firms with poor corporate governance tend to have difficulty obtaining financial resources (Shleifer and Vishny, 1997). Empirical studies have documented a positive relationship between strong corporate governance and firm value (see e.g., La Porta, Lopez-de-Silanes, Shleifer, and Vishny, 2002; Gompers, Ishii, and Metrick, 2003).

The effectiveness of corporate governance devices such as the board of directors, large shareholders, the market for corporate control, the capital structure, executive compensation, and, not least, competition at various firm levels is affected by a country's institutional framework.

Additionally, CSR stresses ~~the fact that~~ wrong managerial behaviour may financially or non-financially affect a variety of stakeholders. CSR becomes especially important if the state is not able to maintain a basic legal system that protects stakeholder interests and ensures that corporations are held liable for their potential misbehavio~~u~~r. The legal environment in emerging countries is typically less developed than in advanced countries and therefore responsibility for all stakeholders becomes especially important for corporations doing business in such environments.

Philippines

To understand corporate governance practices in the Philippines, the context in which these practices occur must take into account the pre-existing business-economic condition: the Philippines is a developing country with underdeveloped institutions, a small private sector controlled by a few families, a large public sector with a sometime predatory state.

The first corporate governance code was introduced in the Philippines in 2002[3], in the wake of the region-wide reform backed by the IMF, World Bank and Asian Development Bank after the East Asian Crisis of 1997. Parts of the code look at board governance, shareholder rights and disclosure. The code is overseen by the Securities and Exchange Commission (SEC). Corporations are expected to follow the code but due to resource issues, the code suffers from mandatory regulatory enforcement. Blue-chip companies tend to subscribe to the intentions of the code in order to assure foreign investor confidence. The board governance element codifies the introduction and existence of independent directors. However, this has been difficult to implement due to the largely family-controlled insider boards of the major corporations of the country. Nevertheless, unlike companies in developed countries, excessive managerial remuneration is not an issue.

Corporations in the country by and large have engaged in stakeholder relationships ~~especially~~ given the wide gulf between the haves and have-nots in the country – there is an inherent obligation on the former to contribute to the community and address issues of poverty. Programs of CSR are well established in the country such as providing infrastructure (e.g. work-sanctioned days off to build homes for the poor), and scholarships for students who are socio-economically disadvantaged.

The analogy of the Philippine corporation as an extended family takes a far more significant and socially embedded function in society. ~~The relationship between an employer and employee in the Philippines is far more socially embedded~~. As religion is an important part of the society, large companies have their own chapels and places of worship. In shopping malls, masses ~~were~~ are conducted daily. Work ~~stopped~~ stops for the conduct of daily masses and prayers in-house at 9am, 12pm and 3pm. Social clubs ~~were also formed in~~ exist in companies ~~with~~ such as dance, photography, or~~and~~ art~~ competitions and~~ clubs. The relationship between an employer and employee in the Philippines is far more socially embedded than in other countries – the employment contract extends to a social contract with a strong emphasis on loyalty and reciprocity.

[3] See SEC (2002) http://www.sec.gov.ph/laws/memorandumcircular/CY%202002/sec-memo-2,s2002.html

Switzerland

Until ~~today~~ recently, Swiss corporation law is relatively flexible concerning corporate governance-related rules and leaves much freedom to ~~the~~ firms. The law prescribes directors to act in the best interest of the corporation. The *Swiss Code of Best Practice for Corporate Governance (SCBP)* consists of unbinding recommendations. These recommendations focus on shareholder interests as is customary in Anglo-Saxon countries. However, in contrast to the typical dispersion of ownership prevalent at U.S. companies, many Swiss firms are controlled by large shareholders, notably families and private individuals. Hence, a corporate governance strategy is also affected by the values advocated by these dominant shareholders (see Gantenbein and Volonté, 2012a).

Since Switzerland is host to many large multinational firms, international corporate governance standards have been adopted without being imposed by Swiss law. For instance, most firms have installed an audit, compensation, and nomination committee. In addition, their international orientation gives them special responsibilities when dealing in different parts of the world, especially in emerging markets. Swiss law does not stipulate a CSR strategy, however, particularly those firms operating in emerging markets have introduced codes of conduct (e.g., Syngenta), maintain educational or health care programs for people in emerging markets (e.g., Nestlé and Novartis).

3.2.2 Corporate Ownership

Corporate governance mitigates problems arising from the separation of ownership and control. If the owner is also the manager ~~herself~~ (e.g.~~i.e.~~ sole-proprietorship) there are no conflicts of interest~~s~~ because the principal and the agent are the one and the same,~~is~~ and thus requires no specific corporate governance mechanisms. In contrast, modern corporations with capital-intensive production processes as prevalent in modern economies are frequently financed by capital markets. ~~In~~ As a consequence, many economic actors provide finance, and ownership is typically separated from control which potentially leads to agency costs. Hence, agency costs do also depend on how ownership is linked to control. If ownership and control largely overlap, as is often the case with family-controlled firms, agency costs should be lower.

~~The v~~Voting right is the most important legal right to shareholders as legal owners of the corporation (Shleifer and Vishny, 1997). Therefore, the ownership structure is the most frequently discussed corporate governance device (see Aguilera and Jackson, 2010). ~~The agency~~ Agency costs accrue from a principal-agent conflict when ownership and control are ~~being~~ separated.

In many countries, corporations are held by controlling families or individual shareholders. On~~e~~ the one hand, their control allows them to monitor more effectively the management and agency costs potentially decrease (see Shleifer and Vishny, 1986). On the other hand, they may also influence corporate policies for their own private benefits of control creating a principal-principal agency problem. Such private benefits are difficult to measure and include influence over the firm's resources, prestige or perquisites (Fama and Jensen, 1983; Dyck and Zingales, 2004). In this situation, the protection of minority shareholders' interests becomes especially crucial.

Shleifer and Vishny (1997) argue that the conflict between controlling and minority shareholders is stronger than the classical conflict between managers and shareholders in many countries. This is especially the case if controlling positions are based on a deviation of voting rights from cash flow rights such as dual class equity structures (see Masulis, Wang, and Xie, 2009; Gompers, Ishii, and Metrick, 2010). In Asia, but also in Continental Europe such structures are common and typically negatively related with firm value (see La Porta, Lopez-de-Silanes, and Shleifer, 1999; Claessens, Djankov, and Lang, 2000; Faccio and Lang, 2002; Volonté and Zaby, 2012). In contrast, Li, Nguyen, Pham and Wei (2011) indicate that large foreign shareholders have a positive effect on firms in emerging markets and Kim, Eppler-Kim, Kim and Byun (2010) show that higher levels of corporate governance attract foreign investors.

In addition, in emerging markets, firms often belong to business groups which are ~~often~~ typically owned by families connecting multiple member firms through direct, pyramidal, and/or cross-holding structures which enhance control (see Masulis, Pham, and Zein, 2011). This corporate structure ~~does also face~~has its own problems. Korean chaebol-affiliated firms, for instance, ~~depict~~ have lower shareholder values than other firms (see Ferris, Kim, and Kitsabunnarat, 2003). The lower valuation is associated with~~to~~ typical problems of diversified firms, the "diversification discount" caused, e.g., by subsidizing weak branches of the group.

Philippines

In developing countries, ownership is highly concentrated. Ownership concentration is a manifestation of economic control (see Berle & Means 1933, Sales 1979 for classifications of control). In the ground-breaking study by Claessens, Djankov and Lang (2000) of 2,980 East Asian listed corporations, ~~they~~ the authors found more than two-thirds of firms are controlled by a single shareholder. In the Philippines, the top 15 families control 55% of corporate assets, and 46% of the GDP.

According to the 2002 World Development Report, there is a link between high concentrated corporate ownership and the efficacy of legal protection in countries. That is, “concentrated ownership tends to substitute for weak legal protections” (2001:58). This view complements and supports resource dependence theory and the resource based view of the firm in developing countries: where there is an unstable political environment, the conglomerate form is the preferred method of organising. Investors in weak institutional environments also place a premium on firms who are part of conglomerates due to the perception that “concentrated ownership delivers great benefits when those owners in control have appropriate incentives and when owners outside the firm have more leverage” (World Bank 2001: 58).

The other side to this is that the treatment of minority shareholders is a pressing corporate governance issue in countries with concentrated ownership. Even where the prevalence of business groups is a private response to weak government institutions, the concentration of wealth in a few people, families or groups is a “formidable barrier to policy reform” and could negatively affect “the evolution of the legal and other institutional frameworks for corporate governance and the manner in which economic activity is conducted.” (Claessens et al 2000: 110). Concentration of ownership in the private sector of the Philippines and most of East Asia is manifested in the widespread corporate form of family-owned business groups or conglomerates (Granovetter 2001: 69-70)~~. Granovetter’s definition of business groups is applied here.~~

> ~~“One can consider as business groups those collections of firms bound together in some formal and/or informal ways, characterised by an ‘intermediate’ level of binding… they are the outcome of investments by a single family or small number of allied families who, once having acquired the component companies, keep them together as a coherent group among which personnel and resources may be shifted as needed. Yet the individual companies continue to keep some separate identity.” (2001: 69-70)~~

Family-owned business groups dominate the private sector landscape of the country with the Ayala Group and SM Group as prime exemplars. However, this corporate form is not unusual as ~~these corporate forms~~ business group structure dominate across the East Asian region with Japanese keiretsus and Korean chaebols (as the previous section mentioned) being prime examples of this type of private sector ~~organis~~organizing~~ations~~.

Another perspective on their dominance can be situated from the resource based view of the firm (Penrose 1959, 2010), which posits the firm as a collection of productive resources (2010: 21-23, 58-77). ~~In the 1980s, the rise of resource-based perspectives in strategic planning saw a more extensive exploration of this view of the firm. (Penrose in Pitelis 2010: xxxv, Wernerfelt 1984, Porter 1980, 1985)~~

The relevance of the resource-based view of the firm for business groups in developing countries was highlighted in Guillen’s (2000) seminal work on business groups.~~Mauro Gillen’s seminal work, Business Groups in Emerging Economies: A Resource-Based View (2000)~~. The resource based view of business groups provides reasons for their affiliated firms to be widespread and dominate across a diversity of industries (2000: 368-369) and their advantages over foreign competitors (2000:376) due in large part to “asymmetric trade and investment conditions.” (2000: 368)

However, unlike the institutional view of business groups ~~the resource based view of the firm does not see business groups “as substitutes for markets that fail, but rather, as an organisational form in competition against foreign MNES, and non-diversified firms lacking the capability to enter multiple industries.” (2000: 376) That is,~~ the resource-~~ ~~based view gives business groups a superior advantage to others due to their conglomerate structure and allowing a sharing and cross-over of resources between companies within a business group. However, this view of the business group as highly protectionist may overlook some of the historical reasons for their establishment, growth and persistence. The other side to the resource-based view of a business group in a developing country is where the internal resources of a firm interact with the external environment. Indeed, the resource-based view of the firm is closely related and complements the resource dependence theory perspective.

For Philippine business groups, the internal resource-based view of the firm poses the following question: how are resources administered (or protected) within a predatory state environment?

Under the dictatorship of ~~President Ferdinand~~ Marcos, there were moves by the President to expropriate businesses owned by conglomerates and transfer them to his cronies. Where majority ownership in a firm was below 50%, the firm was more prone to being taken over by the President’s cronies. Seeing these~~is move~~actions by the President, the strategy adopted by some of the family-owned business groups was to attract a foreign investor to take a minority interest in a business to offset the political risk of expropriation. The raison d'être being if Marcos expropriated the business, a foreign government would intervene and put pressure on Marcos not to expropriate the business. There was a belief that a foreign government would interfere to defend the ownership stake of the foreign shareholder.

~~Thus, cultivating relationships with foreign investors was one way to offset the bulwark of the state. This allowed business groups to diversify and apply its resources to ensure the survival of commercial operations during a period of instability. At the nadir of the Marcos dictatorship, for one business group, an owner's contacts in foreign governments that carried influence in the country were used to pressure the dictator not to expropriate that well-connected owner's company's assets. This was indicative of the fear and paranoia in the private sector. From this perspective, a business group used every possible resource to ensure the continued existence of the firm.~~

A resource-based view of the firm justifies the continued dominance of family business groups in ~~unstable,~~ developing economies - in effect, should a fickle government come into power with the view of expropriating company assets, the business groups are big and diversified enough to survive such a political move. This is one reason why the ownership strategy of business groups in developing countries such as the Philippines, is to ensure majority control is consistent and an explanation for their reluctance to relinquish majority ownership. A long-term view of the firm with majority control was far more important than a valuation discount in the short-term. In the Philippines, minority ownership made~~kes~~ a firm vulnerable to state-backed expropriation as what happened with the brewery San Miguel Corporation during Marcos' dictatorship.

~~The conglomerate structure of business groups in the Philippine private sector as the best form of organising is best understood through the lens of the resource dependence perspective. Resource dependence theory deals with the "ecology of the organisation" and this perspective seeks to understand how these entities are managed and controlled as "[o]rganisations are inescapably bound up with the conditions of their environment." (Pfeffer & Salancik 1978: 1)~~

The business group structure is a deliberate response to the external pressures of an organisation. The idea of organisational survival "to acquire and maintain resources" (1978: 2) has manifested itself with the conglomerate structure or group affiliation in order to withstand the political turmoil of the country and provide a bulwark against a predatory state.

Switzerland

In modern industrialized economies such as Switzerland, large complex corporations user their competitive advantage in producing innovative goods and providing high quality services. These types of firms are typically financed by equity investors. In Switzerland, 60 percent of all exchange-listed companies are controlled by shareholders owning over 20 percent of voting rights. While these firms are smaller in size on average, there are also large firms that are controlled by shareholders. For instance, Roche and Richemont are majority-controlled by families. However, both firms are exhibiting a dual-class equity structure which discriminates minority shareholders in their voting rights (see Volonté and Zaby, 2012).

[This is a short section compared to the Philippines! Why don't you talk about remuneration especially the recent reforms?]

3.2.3 Boards

Board of directors are an essential factor in corporate governance. Corporate directors are delegates of, and elected by, shareholders to represent them and lead the company. They have the duty to act in the best interest of the corporation which, in general, is equal to looking after shareholder interests. This implies that its primary responsibility, upon which its legitimacy rests, is to reduce agency costs. The directors' responsibility is monitoring and advising the management board which is charged with the daily operational business and therefore board composition and structure is an important issue in corporate governance.

Major topics in this respect include CEO duality, the independence of board members from managers (especially the CEO), and the busyness of directors etc. The board is regularly blamed if corporations fail for not having protected shareholder interests, colluding with management, and for being too passive in general.

Philippines

Consensus-building is a fundamental feature of Philippine boards – a dysfunctional board rarely works and a conflicted board has a flow-on effect to the rest of the organisation. The role and nature of the relationship between the CEO and Chairman is pivotal in the board. If the CEO and Chair roles are unified, this is commonly referred to as CEO duality and power is heavily concentrated:

> "The power of the chairman added to the power of the chief executive presents a formidable combination." (Cadbury 2002: 110)

CEO duality may lead to what Finkelstein and D'Aveni point out its double-edged sword: "forcing boards to choose between the contradictory objectives of unity of command and [CEO] entrenchment avoidance." (1994: 1080). When the roles are separated, the Chairman must decide whether they are an executive or non-executive chair. For UK and Australian corporations, there is a requirement to explain why or why not the roles of Chair and CEO are united. The premise behind this requirement is that concentration of power with a CEO that has both roles may prevent objective decision-making ~~to the detriment of the company~~ and may overburden the person with responsibility to the detriment of the company. (Cadbury 2002: 110) ~~As Cadbury points out:~~

> ~~"The separation of the two roles builds in a check and a balance. Chairmen are responsible for ensuring that their boards take account of the interests of the shareholders and that they carry out their supervisory functions conscientiously. Chairmen, who are also chief executives, have to be scrupulously clear in their own minds when they are acting as the one and when as the other, as they move between the two roles. It can be done and it is done, but it is less demanding on all concerned to divide the roles rather than the individual. When someone who holds both positions is determined on a course of action, which perhaps entails high risks for the company, who is to challenge their judgement?" (2002: 110)~~

For Philippine corporations, the roles are normally combined. Or if they are separated, then the two individuals come from the same ownership interests or from the same business family typically with a ~~father~~founder generation-~~son~~ son/daughter combination. This duality is a reflection of the business being an extension of the family with the family's "identity or reputation" intricately linked to the business. (Gersick et al 1997: 37) This also reinforces the need for control by the family owners and a signal to the stock market the family's enduring interest.

With regards to board membership, most companies have the requisite board committees. The SEC Code also requires two independent directors. Their introduction to a family-insider and controlled board has been a revolutionary element in Philippine corporate governance. Unlike Anglo-American countries where the majority of company boards have independent directors reflecting the highly-dispersed ownership, Asian company boards have strong reluctance to have independent directors on their board. This is not only the case in the Philippines but also in other countries of the region such as Japan, Hong Kong and South Korea where a majority of the company board membership are made of executive, and not independent, directors.

Switzerland

~~The S~~Swiss corporation law imposes corporate directors the duty to act in the best interest of the company. SCBP states that shareholders' interests should be met, however, it consists only of recommendations, also in what ~~concerns~~ is the best ~~the~~ configuration of the board. Nevertheless, Swiss boards orientate themselves by these recommendations and best practices ~~on~~ at the international level. For instance, the roles of the CEO and the chairman are separated in 87 percent of all firms (see Volonté, 2012).

The flexibility of the Swiss law manifests in the use of board system used by the companies. Swiss boards can either be one-tiered or two-tiered. One-tier boards such as in Anglo-Saxon countries or France can consist of executive (e.g., CEO) as well as non-executive directors, while two-tier boards strictly separate the management board from the board of directors such as in Germany. Volonté (2012) shows that culture is likely to affect the decision which board system to choose: boards in Swiss-French areas and in Roman Catholic cantons are more likely to be one-tiered and thus more hierarchical; Swiss-German boards and boards in Protestant cantons are more likely to be two-tiered where powers are strictly separated. Both structures correspond to values attributed to those four cultural groups and to the two language regions' closest neighbours (France and Germany).

Since many Swiss companies are big multinational players, international standards of corporate governance do also affect the board membership of directors. Most boards are composed by internationally experienced directors. About a quarter of all directors are foreigners and almost half of all board members have been working abroad. In addition, other business experiences of directors are high too: 50 percent of all directors have served or serve as CEO, 59 percent have financial experience, and 56 percent depict industrial experience (see Gantenbein and Volonté, 2012b).

Some companies do also explicitly address CSR. In such a setting boards are likely to introduce ethical standards, codes of conduct an install specific board such as committees that govern compliance with CSR (see Gantenbein and Volonté, 2012a).

4. Discussion and Conclusion

The role of the government in developing countries is a pivotal one. The absence of government cannot be filled by the private sector alone as the latter does not have the legitimacy and isn't sufficiently capable - ideologically and operationally otherwise – to completely discharge its stakeholder responsibilities to fulfil wider community expectations. Functional government, rather than a functional private sector, is overwhelmingly far more important for a developing country than a dysfunctional government.

The government sets rules via its legal system that encourages economic activity. For instance, the enforcement of property rights is crucial for doing business and a source of competitive advantage.

This chapter has shown how important the institutional environment is for the strength of a country's corporate governance system and private sector development. In emerging countries such as the Philippines where politicised government institutions still dominate, regulatory enforcement of existing laws and codes become problematic. The private sector is asked to take on some of the public roles that government is unable to fulfil. This filters down to the way the companies and boards react to unstable political situations and how corporate governance reform is shaped and continues to be shaped by the existing private sector environment.

~~[In emerging countries… ..the Philippines]~~

In developing countries, such basic rules are factual and the legal system is increasingly improved to guarantee minority shareholders protection and other corporate governance-related rules. Improving corporate governance has been argued to enhance capital allocation and is thereby beneficial for the whole society.

In Switzerland, the law provides basic rules to protect shareholders (e.g., duty of care of directors) and stakeholders (e.g., labour law), however, corporate governance-related rules are until now relatively unspecific. Many corporations influenced by the unbinding SCBP and their international orientation standards have adapted international standards of corporate governance.

This chapter showed that corporate governance in the Philippines and Switzerland has been shaped by their respective histories, institutions and ownership structure. The practice of corporate governance continues to be an important element in attracting and assuring investor confidence. The experiences of companies in these two countries show the diversity of experience but also the global nature of corporate governance reforms.

[End]

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