Source: *The Business Times,* p25
Date: 15 May 2018

More can be done despite surge in SGX regulatory action

Investor protection needs to be improved before confidence spirals downwards.

BY MAK YUEN TEEN

THE last two months have been particularly disturbing for minority shareholders in Singapore, with companies such as Midas Holdings, Trek 2000 International and YuuZoo Corporation being investigated by the Commercial Affairs Department (CAD). We also have Noble Group trying to push through a restructuring plan in a rather oppressive manner, after years of questionable accounting practices, generous remuneration for key management and destruction of shareholder value. Then there are companies such as Datapulse Technology, DeClout Limited and Vard Holdings, where minority shareholders have revolted against so-called independent directors, disclosure lapses, ill-considered acquisitions, management entrenchment, contentious shareholder meetings, oppressive treatment of minority shareholders, or various other questionable corporate governance practices.

Last year was not a good year either as we saw new or continuing lapses at companies such as China Sports, DMX Technologies, Emerging Towns & Cities, Epicentre, Fujian Zhengyun, Shanghai Turbo, Universal Resource and Services and Yamada Green.

Having been a keen observer of corporate governance here over the last 20 years, and witnessed other periods where there appear to have been an upsurge of corporate scandals, I believe that we have a serious problem in our market which – if not addressed – will lead to a downward spiral in market confidence and attractiveness of our market for public investors.

ENFORCEMENT OF RULES

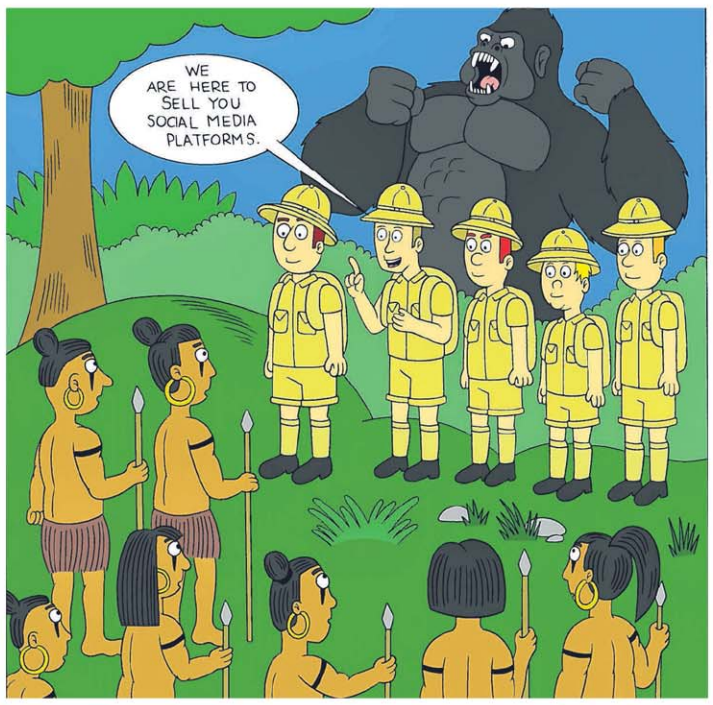
In my view, there are two major causes for this. First, it is well known that we have many foreign companies listed on the Singapore Exchange (SGX) for which we have limited ability to enforce our rules. At its peak in 2010/11, foreign listings made up more than 43 per cent of about 785 issuers listed on SGX. Today, they make up 36 per cent of about 745 issuers listed. A disproportionate number of foreign listings have run into problems and been suspended or delisted. Many operate in countries with a weak rule of law or are incorporated in offshore jurisdictions that are well known for helping companies remain non-transparent. Where certain rules do not apply or regulators are not able enforce them, the risk of misbehaviour increases.

Second, even for domestic companies, there has been little meaningful public enforcement action against companies and directors over the last 10 years – whether it is administrative sanctions such as reprimands by the SGX, or criminal and civil actions by statutory regulators. There are recent signs of a surge in regulatory action but much more needs to be done to arrest what I see as a general decline in market conduct over recent years.

Regulators must also look beyond those who are directly involved in wrongdoing. Enforcement actions against directors, including independent directors, have been particularly rare. It is therefore hardly surprising to find independent directors being beholden to management or controlling shareholders or who do not take their responsibilities seriously. What is worse are some independent directors putting their fingers in the cookie jar, rather than watching over it.

SPIRIT AND SUBSTANCE

Where companies are supposed to observe the spirit and substance of rules, and not just the letter, regulators must be prepared to enforce accordingly. In the recent case of Datapulse Technology, an acquisition was not considered an interested person transaction (IPT) even though the controlling shareholder and the vendor are close business associates. This is because a business associate, no matter how close, is not included in the definition of "associate" under the SGX rules. This seems to go against the spirit of the listing rules, and makes it easy for companies to circumvent.



CARTOON: MAK YUEN TEEN

The Singapore Code on Takeovers and Mergers also emphasises adherence to the spirit of the Code. However, again, the question is whether this is enforced. For example, where a shareholder acquires close to the 30 per cent threshold for a mandatory general offer, is there a review of whether it is a deliberate attempt to circumvent the spirit of the Code or whether there are other concert parties owning shares who – together with the new shareholder – cross the 30 per cent threshold?

PREVENTIVE MEASURES

While more vigorous enforcement actions by regulators are important, they are often too late to save investors from losses. Prevention is always better than cure. More pre-emptive steps therefore also need to be taken.

First, more must be done to improve the quality of listings. Caveat emptor does not mean "anything goes". Yes, this is easier said than done when SGX is facing global competition in attracting listings, but admitting poor-quality listings will just create more problems downstream. In this regard, there is a need to watch out for companies with questionable business models proposing to list here; companies listed here that have already destroyed considerable shareholder value by spinning off part of their business to take minority investors for a further ride; and mainboard companies dodging the SGX watch list by downgrading to Catalist. Market players, such as sponsors, must be held more accountable as their own bottom line may cause them to focus more on quantity than quality.

GREATER INVESTOR VIGILANCE

Second, minority investors themselves should pay more attention to the business models of the companies that they invest in, and to warning signs and red flags. Take the case of a "social media/e-commerce" (or whatever they want to call it) company here. When my students who are extremely savvy with social media have never heard of the company and mistake it for a popular drink here, but the company claims to be able to sell its products through franchisees in many "exotic" emerging markets, one should be very sceptical. That company had more red flags than China on National Day.

In the case of an S-chip that recently got into a huge mess, various lapses had started to emerge in February this year. However, there were also earlier warning signs last year. The company issued six responses to queries from SGX (in the few years before that, it had received no SGX queries). The then CEO and executive chairman were replaced as legal representatives for four wholly owned subsidiaries in China – to reduce their travel and in the case of the former CEO, "health reasons" was also cited. Three of these four subsidiaries are now named in litigation or have been served letters of demand, having apparently entered into loan, financing or guarantee agreements. In Chinese companies, legal representatives and custody of the company seals are very important.

In February this year, another company responded to an extensive list of queries from SGX relating to discrepancies in its circular for an acquisition that is an interested person transaction, with various questions also raised about the acquisition. That same month, a financial controller left another company following a succession of earlier departures of financial controllers. A procession of financial controllers or chief financial officers resigning is often a sign of financial irregularities or aggressive accounting, regardless of how the company may try to spin it.

ALERTING PUBLIC INVESTORS

However, more can perhaps be done to alert public investors. For instance, the financial statements of a company that is now under CAD investigation had received a disclaimer of opinion from the auditors for three successive years. This begs the question as to whether trading should have been suspended or the company should have been placed on a watch list. A disclaimer of opinion means that the financial statements cannot be relied upon, and successive disclaimers can be just as bad or worse than a company making successive years of losses. Existing shareholders may be unhappy if a share is suspended because they cannot exit, but there is also the issue of the interest of potential investors who may unwittingly invest in a lemon.

An initiative that I am currently working on with others in identifying early warning signs and red flags, based on an analysis of companies that have been caught in scandals and those that have not, can also hopefully make a difference. The idea is to create a tool that tells investors when to run – or at least to start warming up.

REVIEWING INVESTOR PROTECTION

Finally, the authorities could consider setting up a committee to specifically examine how to enhance investor protection in Singapore. This committee can consider how to improve the minority investors' ability in enforcing their rights. A few years ago, a former CEO of the SGX suggested some form of arbitration body to help resolve disputes involving minority shareholders. Such a body could be an answer to the lack of a contingency fee-based class action system in Singapore which generally makes shareholder action impractical. It may also be useful to consider the possibility of introducing some form of contingency fee arrangement for legal action, perhaps based on the UK model. I do not believe that all shareholder disputes can be resolved "in the boardroom" so to speak, or through shareholder dialogue sessions.

Other issues that could be looked at include those mentioned above, such as a watch list for companies with serious red flags – and companies using their resources to frustrate the requisitioning or calling of meetings by shareholders; minority shareholders' access to advice about their rights; access to shareholder contacts to facilitate communications among minority shareholders; misuse of private placements to frustrate minority shareholders; the conduct of shareholder meetings where critical issues such as delisting are decided; and barriers to shareholder rights and participation when shares are held in nominee accounts. We would not be able to address all minority shareholders' woes but we should try to reduce the disadvantages that they currently face against the Goliaths in the market, often well supported by their army of advisers.

The possibility of allowing minority shareholders to elect at least some independent directors or putting "voting caps" on controlling shareholders when electing independent directors could also be considered (minority election of independent directors and voting caps are already practised in some jurisdictions). Again, consider the case of Datapulse, which has 10,000 shareholders. At its recent EGM, excluding the shares of the controlling shareholder who owns 29 per cent and even if we disregard the shares of the opposing requisitioning shareholder who owns 16 per cent, 55 per cent of the remaining shares actually voted to remove the current directors and appoint the proposed directors (and also rejected the diversification plan). However, the current directors remain entrenched with no independent director having a mandate from the minority shareholders and look set to push through their diversification plan. A 29 per cent shareholder being able to elect 100 per cent of the directors just does not seem right.

If minority investors continue to perceive the playing field as grossly unfair or continue to see their investment go up in smoke, they will lose interest in investing in companies here. That can only hurt liquidity and valuations, making SGX a truly unattractive place for companies to list. We should look seriously into improving investor protection here before it is too late.

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