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Good corporate governance pays: The case of Micro-Mechanics

MM is a role model for small firms seeking to grow and be successful, but larger companies can also learn a lot from it about the spirit of good governance. **BY MAK YUEN TEEN**

THE latest volume 10 of the annual *Corporate Governance Case Studies* published by CPA Australia which I edit has a case study called *Micro-Mechanics: The Little Giant in Corporate Governance.*

Micro-Mechanics (MM) has consistently been one of the best governed and most transparent companies listed on SGX, punching well above its weight. It listed on the then Sesdaq in 2003 before moving to the Mainboard in 2008. It won the most transparent company award for Sesdaq companies in 2005, followed by a corporate governance award in 2006, both organised by the Securities Investors Association (Singapore) under its Investors' Choice Awards.

I was co-chair of the Singapore Corporate Governance Awards (SCGA) when it became one of the first Sesdaq companies to win the award since its launch in 2003, as no Sesdaq company won in the initial years.

During my terms on the selection committees for the chief financial officer (CFO) and investors relations awards under the Singapore Corporate Awards, the latter as chair, the CFO of MM, Chow Kam Wing, won the CFO of the Year Award for Sesdaq companies, and the company won several awards for investor relations (and continued to win numerous awards including for the best board).

Award winners can be bad actors, winning through carefully curated corporate governance disclosures that impress judges and assessors, but not MM. Chow said: "Literally, we do not strive to maintain a high level of corporate governance. We are just humbly doing the right things as a listed company, whether today or the next 10 years. We just put ourselves in the shareholders' shoes – what they want from a company they have invested in." Humility is a good trait and I have never felt that MM lobbied to win awards like some do.

The corporate governance section of the company's annual report shows how it thoughtfully applies the provisions of the Singapore Code of Corporate Governance (SCCG) rather than "cutting and pasting" from corporate governance statements of other companies.

Examples include its approach to board composition and diversity, succession, continuing education of directors, search and nomination process for directors, criteria and process for assessing director independence, the "9-year rule" for independent directors, and "busyness" of directors. In several areas, it sets a higher bar than the SCCG. For instance, no MM director can serve on more than four listed boards in total.

It does not comply with all provisions in the SCCG or what are considered as "best practices" but through the corporate governance statements and informal discussions I have had with the company, I can understand why.

BOARD PRACTICES

In its annual report, MM discloses that it identifies potential candidates for independent directors through third parties which it specifically identifies, such as the Singapore Institute of Directors, and through its own directors.

It separates the chairman and chief executive officer (CEO) roles, with a female independent chairman, Sumitri Menon. One of the other two independent directors is also a female.

MM's CFO has equal authority on the board for a substantial check and balance in decisions. CEO Christopher Reid Borch (above) feels that the CFO should be able to speak his mind on the board.

While Menon has served as an independent director for 18 years, it has a policy of renewal for other independent directors. MM believes that the chairman may need to stay for a longer period to ensure a balance of power and checks and balance, as the longer tenure equips the chairman with more knowledge and stature.

It agrees that other independent directors should not serve more than nine years. At its latest AGM held on Oct 29, 2021, Menon's continuation as an independent director was approved by 99.47 per cent of "independent shareholders" for the second-tier vote.

Chow also shared why he was appointed to the board even though it may be inconsistent with "best practice" to have three executive directors, including the CFO, on a six-member board. He said the board came to the view that having the CFO merely as a subordinate of the CEO was insufficient and the CFO should have equal authority on the board to provide a substantial check and balance in decisions. The CEO, Christopher Reid Borch, also felt that the CFO should be able to speak his mind on the board.

One does get the sense that the three executive directors do not operate in a hierarchy but more as equals with complementary expertise. The annual report has an "Executive Management Report" signed off by the three executive directors, rather than the usual CEO Report. MM provides the e-mail address of every director, unlike most other companies that do not make it easy for shareholders to contact directors, especially the independent directors.

REMUNERATION PRACTICES

The current remuneration amounts of the three executive directors, including the chief operating officer (COO), Low Ming Wah, are disclosed in a band from S$750,000 to S$1,000,000. It has been in this range since FY2017. Between FY2015 and FY2016, it was in the range of S$500,000-S$750,000, and before that it was S$250,000-S$500,000.

One can perhaps quibble that the company does not disclose these in exact amounts. However, with cumulative dividends since its listing in 2003 amounting to about five times the original share price, total return since its IPO of more than 20 times including dividends, and a market capitalisation that has increased from about S$100 million in 2007 to about S$450 million today, even Grinch would not begrudge management of the remuneration amounts. The exact remuneration of each individual non-executive director is disclosed.

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While various family members hold shares in the company, MM should not be mistaken for a family company practising nepotism.

The founder's eldest son, Kyle Borch, joined the US subsidiary of MM in 2018 as a manufacturing engineer. He is no slouch, having a Bachelor of Science degree in Physics and Math from the University of California Los Angeles and a Masters degree in Mechanical Engineering and Engineering Management from the University of Southern California.

His role is non-managerial and his total remuneration for the most recent financial year is just S$131,000. In many family companies, one may need to add a zero, and perhaps multiply by some factor, for the remuneration of an immediate family member of the founder.

With the founder and his family controlling about half the shares of the company, they can easily enrich themselves at the expense of minority shareholders should they choose to.

However, they have been very responsible when it comes to remuneration and appointment of family members, while paying generous and increasing dividends that benefit all shareholders. They clearly understand that if the company does well, they will be amply rewarded through their large stakes in the company.

TRANSPARENCY COMES FIRST

It is no surprise that MM has won many transparency and investor relations awards. It commits to responding to questions raised by investors and analysts within three working days. Since its listing, MM has been queried just once, which it addressed promptly.

Under the risk-based approach to quarterly reporting, MM was no longer required to report quarterly. But the MM board decided unanimously to continue with it, believing that transparency and accountability to shareholders, and other benefits, outweigh the time and costs involved.

MM does hold its AGM during the peak period in October, in the last three days of the month. However, this is justified because it announces its first quarter results before the AGM, either on the same day or the day before –within a month of the end of the first quarter. This allows the company to discuss not only the full-year results but also the latest first quarter results at the AGM. In contrast, most companies which had been practising quarterly reporting announce first-quarter results after the AGM and avoid discussing the latest outlook with shareholders at the AGM.

BUSINESS CONTINUITY PLANNING

Although MM did not suffer major losses during the severe acute respiratory syndrome (Sars) outbreak in 2003, it was a wake-up call regarding the importance of business continuity planning (BCP). In 2008, it invested S$3 million to implement enterprise resource planning (ERP), a Web-based platform to enable employees to access company information and input data. It phased out desktops and equipped employees with laptops for working from home. Had this not been done, the company would have suffered greatly with the Covid-19 pandemic. BCP also means having backup plans for its manufacturing operations. The company has five factories in Asia and the US and decided that most of its factories should manufacture similar products, have standardised machinery and consistent standard operating procedures.

The exception is its California factory, where the products are completely different and the risk is exacerbated by its location in an earthquake-prone area. The company had considered a proposal by a consultant to build a back-up factory but decided that it does not pass the cost-benefit test. It discloses this potential risk in its annual reports to keep investors and stakeholders informed.

In 2018, MM established a pandemic response plan (PRP) as part of its BCP, two years before the Covid-19 pandemic. Annual training equipped employees with a comprehensive understanding of individual roles and duties in the event of a disaster, drawing from cases of past pandemics such as Sars and Middle East respiratory syndrome (Mers). MM was one of the first companies to be allowed to re-open its manufacturing operations in China after the lockdown in 2020.

A MODEL FOR OTHER COMPANIES

MM is a role model for small companies seeking to grow and be successful in the long term, but larger companies can also learn a lot from it about the spirit of good governance.

I am often asked about evidence showing that good corporate governance pays. It is difficult to empirically prove a relationship between good corporate governance and success of a company for many reasons, including the challenge of measuring the substance of corporate governance. It is much easier to find examples of companies that have been ruined by poor corporate governance.

MM is a compelling case study that demonstrates that good corporate governance does pay, and corporate governance and performance go hand in hand.

■ The writer is professor (practice) of accounting at the NUS Business School and a corporate governance advocate. He is not a shareholder and has no affiliation with Micro-Mechanics. The views in this article are his personal views.