CHAPTER II

OWNERSHIP CONCENTRATION, POLITICALLY CONNECTED FIRMS, AND ACCOUNTING STANDARDS IN THAILAND

2.1 OWNERSHIP CONCENTRATION

Ownership concentration is common among East Asian corporations where one or more family members may have a controlling interest in the firm. This is unlike US and UK based-companies, where shares are commonly held by various parties. Shares in most the listed companies in East Asia are typically concentrated in the hands of a few large shareholders or likely affiliated with a business group which controlled by one family. The concentrated control is achieved through complicated ownership arrangement, i.e. stock pyramids and cross-shareholdings. Fan and Wong (2002) note that corporate share ownership can be viewed as a property rights arrangement through which the owner of the share is entitled to three categories of property rights. First, the owner has the decision right over deploying corporate assets, i.e., the control or voting right. Second, the owner has the right to earn income, i.e., the cash flow right. Third, the owner has the right to transfer the share and the associated control and cash flow rights to another party. The value of the share depends on how well its property rights are enforced. The enforcement of property rights is usually undertaken by both individual owners and the state. In economies where the state does not effectively enforce property rights, enforcement by an individual owner plays a relatively more important role. The structure of share ownership affects the degree to which corporate contracts are enforced because it affects the owners' abilities and incentives to enforce property rights delineated by the contracts.

It is very important for East Asian corporations who hold concentration ownership of a firm to act to ensure that property rights are observed in economies where property rights are not well enforced by the state. Controlling owners obtain the power (through high voting rights) and the incentives (through high cash flow rights) to negotiation and enforcement of corporate contracts with various stakeholders, including minority shareholders, managers, material suppliers, customers, debtholders, and governments. Thus, the various parties in the nexus of corporate contracts share the benefits of trade as a result.

La Porta et al. (1999) investigate the level of ownership concentration by the three largest shareholders of the largest corporations in countries around the world and find that a weak legal and institutional environment (i.e. laws and enforcement) is associated with highly concentrated share ownership in listed companies. The private enforcement of property rights is a probable reason for the concentrated ownership of East Asian corporations, to confront weak legal systems, poor law enforcement, and corruption.

The degree of ownership concentration affects the nature of the contracts, creating an agency problem between managers and outside shareholders. When ownership is diffused to shareholders who are not family related, as is typical in US and UK companies, the agency problem stems from the conflicts of interest between outside shareholders and managers who own an insignificant amount of equity in the firm (Berle and Means, 1932; Jensen and Meckling, 1976). On the other hand, when ownership is concentrated to a level at which an owner obtains effective control of the firm, as is the case in East Asia and most other locations outside the US and the UK,

the nature of the agency problem shifts away from manager-shareholder conflicts to conflict between the controlling owner (who is also the manager) and minority shareholders (Fan and Wong, 2002).

Agency theory considers the relationship between a principal and an agent, where the agent is given decision-making authority that affects the principal's wealth. Although agency theory can be broadly applied with regard to those who are labeled principals and agents, an authentic agency relationship usually refers to the relationship between stockholders of a company (principals) and managers (agents) (Jensen and Meckling, 1976). Problems may arise from such relationships, including problems of motivation and monitoring.

In a firm that is broadly held, the company is owned by many shareholders. Each of the shareholders has only a small portion of the firm's total outstanding shares; hence, none of them has any real power to control the management of the firm. The managers, who make all major decision affecting the firm's profits and value, also have only small portion of the total share. As a result, most of the firm's profits go to shareholders outside the company, who do not have enough power to control the management of firm. Moreover, when owners diversify their wealth over a number of firms, they have less interest in monitoring the operations of firms in which they have financial stake. The influence of the managers over such firms will increase. Therefore, it is more likely that in firms with diffused shareholders, wealth may not be created effectively, because shareholders rarely control the firm or make decisions. Diffuse shareholders may not have enough incentive to invest time and effort heavily in voting as it is unlikely to affect outcomes (Brickley et al., 1988). In addition, as the number of

shareholders increases, it becomes more complicated to organize broadly diffuse ownership interests into an effective monitoring mechanism. Therefore, when ownership is excessively dispersed, corporate assets may be used to benefit managers rather than shareholders.

Moreover, in a widely held firm, coalition among managers could be used to strengthen their ability to devise policies and procedures that develop information systems that limit the potential power of owners, thereby ensuring managerial control, leading to the potential misuse of power. Hence, in a widely held firm, agents are more likely to influence both management and control decisions, whereas principals or their representatives are less effective in their monitoring role (Tosi and Gomez-Meiji, 1989). There are no countervailing forces to keep agents in check. Executives of firms with widespread shareholders have an advantage over executives of firms with concentrated shareholders because dispersed shareholders are more likely to evaluate organizational performance based on reporting earnings, which are subject to managerial manipulation (DeAngelo, 1988).

In contrast to widely held firms, firms with concentrated ownership generally have large shareholders that own a substantial amount of the firm's total outstanding shares. Such large shareholders have a significant financial investment in the firm and are interested in increasing the value of their holdings. Shareholders with a large number of shares can leverage their voting power and affect strategic decision making (Hansen and Hill, 1991; Wright et al., 1996). Large shareholders can monitor firm performance and management behavior in order to protect their investment (Alchain and Demetz, 1972). It is also suggested that only large shareholders have the economic

rationalization to scrutinize management or firm performance closely (Shleifer and Vishny, 1986). In addition, large shareholders are likely to support decisions that are shareholder-motivated (Holderness and Sheehan, 1985; Mikkelson and Ruback, 1991). Thus, in a firm with concentrated ownership, shareholders are likely to have sufficient power to protect their interests and actively monitor the firm's performance. Large shareholders can use their voting power to make necessary changes more easily than shareholders in widely-held firms.

Concentrated-ownership firms are typically composed of active shareholders, and the quality of monitoring is high. This adds constraints that inhibit self-serving behavior by managers (McConnell and Servaes; 1990). Large shareholders also put stress on management to improve performance. In such firms, managers may hesitate to adopt self-serving, unprofitable strategies for fear of being discovered and the possible loss of employment (Jame and Soref, 1981; Kroll et al., 1993). As a result, large shareholders help increase the firm's value by preventing managers from behaving opportunistically (Shleifer and Vishny, 1986).

On the negative side, concentrated ownership can harm corporate value especially when large shareholders are also involved in the management team (La Porta et al., 1999). The general practice of hiring close or related family members and putting them into managerial positions as top executives or company directors not only affects the decisions of managers but also shields them from being realistically monitored and closely controlled by corporate governance mechanisms. The power to control corporations gives large shareholders the ability to use corporate assets for their own interests while minority shareholders and creditors bear the costs. Such activities

include: consuming perquisites, providing jobs to family members and paying them excessive salaries, giving preferences to companies they privately own, and setting dividend policy according to their investment and consumption plans.

Large shareholders may override the interest of minority holders (La Porta et al., 2000; Shleifer and Vishny, 1997). Jog and Tulup (1996) and Rao and Lee-Sing (1996) find that the effect of concentration of share ownership on firm performance is negligible.

2.2 OWNERSHIP CONCENTRATION IN THAILAND

Like that of other East Asian countries, ownership structures in Thailand tend to be highly concentrated amongst family members. La Porta et al. (1998) find that the average percentage of common shares owned by the three largest shareholders in each of the ten largest Thai listed firms is estimated at around 47 percent. Khanthavit et al. (2003) study corporate ownership in Thailand after the East Asian financial crisis (1997). They compare post-crisis ownership structures with ownership structures before the crisis (1996) to address the effects of the economic downturn on ownership. The results reveal that the post-crisis ownership structure shows a decline in the role of families in controlling publicly traded firms. In 1996, approximately the average level of family owned shares is 51.14 percent, higher than 45.65 percent in 2000[5]. The controlling families are replaced mainly by foreign investors and domestic financial institutions. Controlling shareholders appear to have used less complicated shareholdings, in the forms of pyramidal structures and cross-shareholdings, to

[5] Gilson (2001) notes that many firms in East Asia have been actively restructuring activities which includes selling of some of the affiliates/subsidiaries in order to save the core business. More severely, the controlling shareholders might be forced to sell off their shares and /or issue new equity to raise more funds to keep their main business alive.

enhance their control after the crisis. Direct ownership is seen to be have been used most often in Thai public firms during the pre- and post-crisis years. In 2000, in approximately 78.04 percent of the firms used simple direct shareholding, compared to 76.53 percent in 1996[6]. This study has considered the possibility that high ownership are negatively associated with accounting conservatism.

The simple controlling ownership structure in Figure 1 shows an example of direct shareholder ownership by the Asavabhokhin family in Land and House Public Co., Ltd. ("LH"). LH is a largest real estate company listed on the SET and owned directly by the Asavabhokhin family which is also the founder of the firm. The Asavabhokhin family controls 21.46 percent of the firm's votes and Mayland Corporation Limited controls 5.86 percent. Mayland Corporation Limited is controlled by Asavabhokhin family.

The next case (shown in Figure 2) is an example of controlling ownership by direct and indirect ownership. Charoen Pokphand Foods Public Co., Ltd. ("CPF") is a leading manufacturer of prepared animal feeds and is listed in the SET. CPF is controlled by a Charoen Pokphand Holding Co., Ltd. and Charoen Pokphand Group Co., Ltd., with 20.12 percent and 15.06 percent of total shares, respectively. Charoen Pokphand Holding is wholly owned by Charoen Pokphand Group Co., Ltd. which is controlled by the Chearvanont Family.

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[6] Wiwattanakantang (2001) also notes that simple ownership structures are typically employed; pyramid and cross-shareholding arrangements are less than one-fourth of the sample.

หอสมุดกลาง ศูนย์วิทยทรัพยากร
จุฬาลงกรณ์มหาวิทยาลัย

Shin Corporation (shown in Figure 3) is owned directly by the Shinawatra family who is also the founder of the firm. The Shinawatra family controls 49.67 percent of the firm's votes. Shin Corporation and its subsidiaries and associates (together "the Shin Corp Group") are principally engaged in the satellite, internet, telecommunications, media and advertising, low-fare airline and consumer finance business. The Group renders satellite transponder and related services and operates a television channel. In addition, the Group also provides and operates an internet service provider and content producer, advertising services and publishes telephone directories, cellular telephone equipment, nationwide cellular network services, data transmission services, a low-fare airline and consumer finance business. The Shin Corp Group has obtained concessions from government agencies, in Thailand and other countries, to provide satellites and transponder services, to be an Internet Service Provider, to act as a television broadcaster, and to provide telecommunication services in the Laos PDR and Cellular Telephone Systems in Thailand and Cambodia, etc. The periods of the concessions range from 10-35 years.

2.3 POLITICALLY CONNECTED FIRMS

The nexus between business and government has been a topic of intense public debate and academic research alike. Faccio (2006) documents that political leaders use their power to grant favors to connected firms, which benefits the firms, and that firms can gain an economic advantage from maintaining close relationships with politicians. She studies over 20,000 listed companies with political connections from 47 countries. She finds a significant increase in corporate value when those involved in business enter politics.

As emphasized by Shleifer and Vishny (1994), politicians themselves will extract at least some part of the rents generated by connections. Corporate value will be enhanced only when the marginal benefits of the connections outweigh their marginal costs. Fisman (2001) concludes that, in Indonesia, a sizeable percentage of well-connected firms' value comes from political connections. In particular, he compares the returns across firms with differing degrees of political exposure at the time of rumors of Indonesian President Suharto's worsening health. Around that time stock prices of firms closely connected with Suharto dropped more than the prices of less well connected firms.

Prior studies have examined political connections in specific circumstances and/or in specific countries. For example, US researchers have examined the role of connections created by contributions to electoral campaigns. For example, Roberts (1990) focuses on the wealth effect of Senator Henry Jackson's death on companies that made contributions to his campaign, as well as on firms contributing to the campaign of his successor, Senator Nunn. Campaign contributions and interest groups are also the focus of studies by Kroszner and Stratmann (1998). Non-US studies generally look at connections generated by means other than campaign contributions. In a study based in Canada, Morck et al. (2000) discuss the political influence of dominant business families. Johnson and Mitton (2003) analyze political connections in Malaysia, considering connected firms whose officers or major shareholders are affiliated to top government officials. They examine the impact of the Asian financial crisis in Malaysia on government subsidies to politically favored firms. Of the estimated $60 billion loss in market value for politically connected family firms from July 1997 to August 1998, roughly 9 percent can be attributed to the fall in the value of

their connection. Firing the Deputy Prime Minister and imposing capital controls in September 1998 primarily benefit firms with strong ties to Prime Minister Mahathir. Of the estimated $5 billion gain in market value for Mahathir-connected firms during September 1998, approximately 32 percent is due to the increase in the value of their connections.

2.4 POLITICAL CONNECTED IN THAILAND

Bunkanwanicha and Wiwattanakantang (2006) explain that, after the absolute monarchy was abolished in 1932, Thai politics was dominated for half a century by a military and bureaucratic elites. Civilian governments slowly gained greater authority, but were typically short-lived and unstable. In 1988, General Chatichai Choonhavan assumed office as the country's first democratically elected prime minister in more than a decade. Unfortunately, this government was overthrown by a military coup in February 1991. In the following ten years, Thailand was ruled by four elected governments, namely the governments of Prime Ministers Chuan Leekpai (September 1992 to May 1995), Banharn Silpa-Archa (July 1995 to September 1996), General Chavalit Yongchaiyudh (November 1996 to November 1997), and Chuan Leekpai (November 1997 to February 2001). As their parliamentary majorities consisted of around a half-dozen parties, all governments rested upon multiparty coalition arrangements. Changes in the alliances between political parties occurred very often, resulting in very frequent cabinet reshuffles. Therefore, all governments were shaky; and indeed all collapsed when key coalition partner deserted them (see Appendix A for more details).

Bunkanwanicha and Wiwattanakantang (2006) also note that a big change in Thai politics occurred when political reforms resulted in a new constitution in 1997. The principal aim of the new constitution was to create a stable democratic system with checks and balances. Under the new constitution, the House of Representatives was made up of 500 members (MPs). Out of the 500 MPs, 400 were elected on a constituency basis and 100 MPs were chosen from "party lists" drawn up by each party. The number of votes obtained by each party determined how many from the party list become MPs. The MPs served for a four-year term. The constitution also mandated that the prime minister must be an elected MP.

The first general election under the 1997 constitution was held on January 6, 2001. The Thai Rak Thai Party (TRT), a new party established in 1998 by a group of tycoons, won 248 out of 500 seats of the House of Representatives. By absorbing several smaller parties, the TRT managed to obtain an absolute majority in the lower house. Accordingly, Thaksin Shinawatra, the TRT leader, became Prime Minister on February 9, 2001. Thaksin Sinawatra's administration was re-elected in the February 2005 election. This government was the first civilian government to complete a full four-year term. This administration was also unique in that the prime minister and many of the cabinet members were either the founders of big business empires or belonged to the families who owned extensive businesses. Before Thaksin became the Prime Minister, he was appointed as Foreign Minister for three months from November 1994 to February 1995.

The political power of Thaksin Sinawatra's administration was shaky for the first half-year due to the serious corruption charges against Prime Minister Thaksin that began in late 2000. Thaksin was accused of concealing assets while serving in top office in 1997, an alleged violation of the 1997 constitution. Thaksin stood trial under the newly established Constitutional Court and, had he been found guilty, he would have had to have stepped down and been expelled from holding public office for five years. However, he was declared innocent in August 2001.

2.5 CONTROLLING OWNERSHIP AND POLITICALLY CONNECTED FIRMS IN THAILAND

Shin Corporation ("Shin Corp") is a telecommunication conglomerate that – through a portfolio of over 20 subsidiaries, associates, related companies and joint ventures ("Shin Corp Group"), owns and obtains concessions from government agencies, in Thailand and other counties, to provide satellites and transponder services, to be an Internet Service Provider, to act as a television broadcaster and to provide telecommunication services in the Laos PDR and Cellular Telephone System in Thailand and Cambodia, etc. The period of the concessions ranges from 10-35 years.

Shin Corp was founded by Mr. Thaksin Shinawatra in the 1980s. After the January 2001 elections, when Thaksin was elected Prime Minister and his Thai Rak Thai party ("TRT") was swept into power, Thaksin resigned from his positions in the Shin Corp Group and transferred his shareholdings to other Shinawatra family members. Specifically, after Thaksin became Prime Minister in 2001, the three largest shareholders in Shin Corp were the Prime Minister's daughter (Ms. Pintongta Shinawatra), the Prime Minister's son (Mr. Phantongtae Shinawatra) and the Prime

Minister's brother-in-law (Mr. Bhanapot Damapong). Interesting, Mr. Damapong also served as Chairman of Shin Corp's Board of Directors (The Nation, January 26, 2003).

After Thaksin and the TRT party came to political power in January 2001, Shin Corp continued to earn substantial revenues under its various government concession contracts. Shin Corp's concession revenues and its resulting net profit increased very substantially from 2001, when Thaksin became Prime Minister, through 2003. In January 2003, the Thai Ministry of Finance, with the support of the Prime Minister, changed the existing revenue sharing formula for mobile telecommunications concessions and permitted telecom concessionaries (such as Shin Corp) to deduct part of their concession fees to be paid as excise tax. During 2003, the stock market value of the five listed companies in the Shin Corp Group almost tripled (The Nation, January 26, 2003).

Many observers both inside and outside Thailand have expressed the view that Shin Corp experienced rapid economic growth as a result of the policies and decisions of the government. After Thaksin became Prime Minister on February 17, 2001 (see the history Thai cabinet from 1992-2006 in Appendix A), As described in Figure 4, Panel A, the market capitalization of the three main Shin listed companies (Shin Corporation, Advanced Info Service and Shin Satellite) multiplied almost three times in terms of market capitalization from Baht 155.9 billion as of December 31, 2000 to Baht 461.6 billion as of December 31, 2005[7]. As shown in Figure 4, Panel B, total assets and shareholders' equity as of December 31, 2005 of Shin Corporation and

[7] The market capitalization of Shin Corporation, Advance Info Service and Shin Satellite decreased from Baht 461.6 billion as of December 31, 2005 to Baht 319.4 billion as of December 31, 2006 when Shinawatra Family sold its ownership in Shin Corp Group to Temasek Holding of Singapore in January 23, 2006.

subsidiaries multiplied 1.2 times and 1.6 times, respectively, compared to total assets and shareholders' equity as of December 31, 2000. Among its main competitors, United Communication Public Company Limited ("Ucom's") capitalization has stayed roughly flat. The Shin Corp Group's success in overcoming competition, maintaining market leadership, and managing the threats of liberalization resulted in the group's two main listed companies (Shin Corporation and Advanced Info Service) soaring ahead of the market in 2003.

According to Imai (2006), the media, another institution essential to keep an eye on corruption, is also suspected to be under the influence of powerful politicians connected to Thai family businesses. The most notable example is the former Prime Minister Thaksin's family controlled 53 percent of the independent television station, *iTV*. After Thaksin's family bought *iTV* in 2000, many reporters were sacked and the station withheld advertisements from newspapers critical of Thaksin.

Anecdotal evidence suggests that skeptics might be right. For example, the television station owned by former Prime Minister Thaksin benefited from the government decision to cut license fees. In addition, the airport authority approved a discount on airport fees for Thai Air Asia, an airline in which the Shin Corporation held 50 percent of outstanding shares. In another instance, a company owned by the deputy leader of the ruling Thai Rak Thai Party secured massive debt write-off from the state-owned asset management company. These decisions made by the Thai Government resulted in the law being violated, and they generated suspicious that certain business indirectly benefited from their political connections.

The Thai Rak Thai party (TRT) won again in the 2005 elections. Toward the end of 2005, anti-Thaksin groups grew larger in number and held increasing numbers of protests. Despite some successes, Thaksin was alleged of various wrongdoings, including having absolute power, corruption, conflict of interest, lese-majeste, violation of human rights and using inappropriate populist policies to win over the rural poor (The Nation, February 8, 2006). After a deal to sell Shin Corporation to Tamasek Holdings of Singapore without paying tax because it was sold in the Stock Exchange of Thailand, there were massive demonstrations, especially in Bangkok, against Thaksin (The Nation, February 8, 2006).

In response, Thaksin dissolved the House of Representatives on February 24, 2006 and called an election. The election was held on April 2, 2006. Other major political parties boycotted the election and did not send members to contest it. As a result, the parliament did not initially achieve the complete 500 members necessary to function. On May 8, 2006 the Constitutional Court ruled to invalidate the April elections and scheduled new elections for October 2006. However on September 19, 2006 the military seized power in bloodless coup. Thaksin was overthrown and the October 2006 election was cancelled[8].

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[8] The coup took place on Tuesday 19 September 2006, when the Royal Thai Army staged a coup against the government of caretaker Prime Minister Thaksin Shinawatra. The coup, which was Thailand's first in fifteen years, followed a year-long political crisis involving Thaksin and political opponents and occurred less than a month before nation-wide House elections were originally scheduled to be held.

2.6 THAI ACCOUNTING STANDARDS

Thai Accounting Standards (TAS) and the Thai Auditing Standards are authorized by two professional organizations, the Institute of Certified Accountants and Auditors of Thailand (ICAAT) and the Board of Supervision of Auditing Practice (BSAP).

ICAAT was established in 1948 as "The Institute of Certified Accountants of Thailand", an independent professional accounting organization[9]. The main objectives of the institute were to establish Thai accounting and auditing standards, and to promote, disseminate, and exchange accounting knowledge.

Before the 1997 crisis, TAS were based on either US Generally Accepted Accounting Principles (US GAAP), IAS or local criteria, as ICAAT believed appropriate for the country. However, firms' financial statements were criticized as rarely complying fully with the national or international standards upon which they were based. Users of this information did not receive early warning signals about deteriorating financial conditions and were therefore unable to make timely adjustments. The lack of internationally acceptable practice in accounting was one cause of the poor disclosure and transparency that contributed to the 1997 crisis. In 1998, ICAAT promoted TAS as consistent with, or similar to IAS. However, in 1999, ICAAT issued ICAAT Announcement No.010/2540-2542, "Policy of Setting Thai Accounting Standards" so that IAS is now the main guideline for setting Thai Accounting Standards. If an issue is not covered by the international standards, US

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[9] On January 29, 2005, the ICAAT member unanimously voted to register the cessation of its operation and transferred all ICAAT's assets to the Federation of Accounting Professions (FAP). ICAAT was the standard-setting body for both accounting and auditing, but with no legal authority or powers of enforcements. FAP is established under Accounting Profession Act B.E. 2547 as a self-regulating, standard-setting body.

GAAP is considered the guideline. TAS compared to International Financial Reporting Standards (IFRS) are described in Appendix B.

The new law concerning accounting practice or the so-called "Accounting Profession Act B.E. 2547" became effective on October 23, 2004 and the Federation of Accounting Professionals (FAP) is established in January 2005 to assume the responsibilities of the ICAAT. The newly established Federation of Accounting Professionals (FAP) and the Accounting Professional Oversight Board (APOB) are the offspring of the new legislation. The FAP is designed to act as a governing body with responsibilities such as licensing, registration, and drafting of conduct principles, while the APOB is the one who supervises the Federation's business and endorses Thai accounting standards. The law reflects that giant leap forward in efforts to enhance the quality of financial reporting.

In general, firms can recognize losses in a more timely fashion by choosing to implement accounting policies that slow down the recognition of gains while speeding up the recognition of losses, such as contingent liabilities, lower of cost or net realizable value, allowance for doubtful accounts, and impairment of assets. Contingent liabilities represent yet another area in which firms can demonstrate more timely loss recognition. It is often the case that while a liability's exact amount cannot be determined, the maximum amount is well defined (e.g., fines for environmental pollution), in which case adopting a policy to recognize the maximum liability would clearly represent timely accounting for losses. Basically, conservatism is embedded in Generally Accepted Accounting Principles through practices such as lower-of-cost-or-market accounting for inventories and the use of write-downs and write-off for long-lived assets. However, the recognition rules for assets impairment provide for

discretion and judgement by managers. For instance, IAS 36 does not require that long-lived assets be evaluated for impairment every period, but rather that an entity shall assess at the end of each reporting period whether there is any indication that an assets may be impaired. If any indication exists, the entity shall estimate the recoverable amount of the assets (see IAS 36, paragraph 9). If managers have different incentive, they are likely to make different judgements.