

To lift foreign investment, get a corporate governance certification



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Southeast Asian countries have created a tool to assess companies on governance practices, with important economic benefits.

Countries wishing to increase foreign investment often run up against investor hesitancy with corporate governance practices. The problem is particularly pressing in emerging markets,

which are in greater need of foreign capital and also dogged by governance concerns.

How can companies and investors move past this roadblock? IESE professors [Pietro Bonetti](#) and [Gaizka Ormazabal](#) looked at an initiative by six countries from the Association of Southeast Asian Nations (ASEAN), which created a corporate governance scorecard and subsequent list of top 50 performers. The [research was published](#) in the *Journal of Accounting Research*.

Not prepared by a regulatory agency or rating service, the scorecard and top 50 list are not formal certification. But the independence and rigor of the tool — which involves a two-tiered assessment process by national and regional experts — convert it into a *de facto* certification of corporate governance practices.

The impact of this certification on foreign investment as well as companies is promising, and provides a useful tool for countries exploring ways to attract foreign capital. The study showed that inclusion in the list led to an increase in foreign investment, improved corporate governance practices, lifted stock prices and bolstered accounting performance.

Benefits of the corporate governance certification

Inclusion in the list helped lift foreign holdings in firms. Foreign institutional ownership grew in companies after they were included in the top 50 list. And the increase was significant, particularly considering that foreign investment in the participating countries (except Singapore) was low to begin with.

U.S. institutional investors appeared to be most responsive to inclusion in the top 50 list, followed by foreign mutual funds and foreign banks.

Both primary and secondary markets saw an increase in foreign investment. This is important because it means that certification can help companies to raise new equity capital, and not just that outstanding capital will be shifted to foreign hands.

Inclusion in the list improves corporate governance practices. Beyond changes in investment levels, the study gauged whether inclusion in the top 50 list generated incentives to change companies' governance practices.

To do this, the authors looked at the firms that just missed or just made the top 50, with the

reasoning that companies very close to the threshold were likely to have incentives to strengthen their governance practices. Companies, knowing how much their practices conform with the guidelines of the [ASEAN Corporate Governance Scorecard](#) (ACGS), are likely able to estimate the probability of being included in the list.

Comparing different years, the study found that firms in the vicinity of the threshold exhibited significantly higher increases in their scores compared to firms that were further away from the threshold. Companies saw particularly strong improvements in three of the five criteria they're assessed in: role of stakeholders; disclosure and transparency; and responsibilities of the board.

Inclusion in the list benefits stock prices. Stock prices of firms on the top 50 list rose with the publication of the top 50 list.

Inclusion in the list improves accounting performance. The study also looked at firm profitability in the year after the publication of the list and found that inclusion was associated with higher accounting performance.

Attracting foreign capital and improving corporate governance practices are complex, long-term issues for companies as well as governments. But the study suggests that, in some contexts, creating a rigorous, independent assessment tool can raise foreign investment in publicly listed companies and incentivize changes in corporate governance practices.

About the research

The ASEAN Capital Markets Forum and ranking bodies from each of the six participating ASEAN countries — Indonesia, Malaysia, the Philippines, Singapore, Thailand and Vietnam — provided data for the research. Data on foreign institutional ownership came from the U.S. Securities and Exchange Commission and FactSet/LionShares.

Gaizka Ormazabal discusses more on this research, as well as the accounting challenges for measuring and reporting emissions and intangibles like climate risk, [in this interview](#).

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