

# Financial System Arrangement, Corporate Governance and Financial Crisis in East Asia Countries\*

Kemin Wang

Business School of Jilin University

**[摘 要]** 本文主要考察了东亚国家的金融制度安排、公司治理结构和金融危机的相关性。本文认为，在有关金融危机问题的研究中，最重要的思路是把金融制度安排与公司治理结构的关系引入其中。尽管公司治理结构的理论与实践似乎在告诉我们一个事实，股权和债权的相对集中将有利于对管理者的监督及对投资者的保护，然而需强调的是这一利好的事实却依赖于有效的金融制度安排，而绝不是所谓的“政府政策和利益导向型”安排。本文的主要结论是，东亚国家的“政府导向型”金融制度安排，使其金融机构和企业 在政府的庇护下，长期从事“道德风险”活动，从而在创造“经济奇迹”的同时也制造了“金融泡沫”，并最终导致金融危机的爆发。

**[关键词]** 金融制度安排 公司治理结构 金融危机

---

\* The Final Research Results Supported by the KFAS International Scholar Exchange Fellowship program, 2001-2002.

## **Abstract**

In this report, we investigate Financial System Arrangement, Corporate Governance and Financial Crisis of East Asian Countries. We argue that the most important thinking way is to introduce the relationship between financial system arrangement and corporate governance into the study of financial crisis. Though the theory and practice of corporate governance have told us that the relevant concentration of ownership will be benefit to supervision of managers and protection of investors. We should stress that whether this arrangement is success will depend on efficient financial system arrangement, rather than so called ‘government policy and interest conducted style’ arrangement. Our opinion is financial system arrangement oriented government in East Asian countries have made financial institutions and firms engage in long term Moral Hazard activities with the shelter of government, so “Economy Miracle” and “Financial Bubble” were made in same time, and finally result in break out of financial crisis.

**Key words:** Financial System Arrangement, Corporate Governance, Financial Crisis.

### **1. Introduction**

Since 1980s, under background of finance liberalization and globalization, the purpose of financial system arrangement has taken place profound transform. Many countries have reformed the conductive

and supervisory regulation of financial system extensively, loosed the control of credit and interest rate as possibly, and loosed the limits of market entrance and the activity of financial institutes. Especially, as for developed western countries, while they loosed supervision, they also take more care of financial system security and protect investors' interest and take it as the guiding principle of financial system arrangement. It has been tested by practice, in the environment of financial market development and transformation, while faced the moral risk of financial system and bad gamble activities, financial system arrangement of both macroeconomic style and resource allocation style, which conducted by government' macro-policy and interest, is gradually lose its efficiency. So the reasonable chose is structure style, organizations style and protect style financial system arrangement since this can resolve the risk and income distribution problems among investors, managers and other stakeholders by financial supervision to improve the governance of financial institution and firm organization.

From the review of theories, the relationship between financial system arrangement and corporate governance has experienced many changes, and the understanding of several relevant theories to it has not gotten consistent. According to financial intermediation theory, financial intermediation system has a very important meaning to the information screen and behavior supervision of corporate managers while there exist

information asymmetry (Akerlof, 1970). Further more, this effective system arrangement will help to improve relationship between banks and firms, and impel firm to engage in effective investment activities, then reduce moral risk (Colin Mayer, 1988). Capital structure theory argues that equity/debt mechanism can reduce agency cost by effecting and controlling corporate managers' behaviors (Harris, Raviv and Stulz, 1988). Agency theory address the roles of directorate and large shareholders to supervise corporate managers, proxy right competition and takeover, and the roles of public accountants and audit information disclosure system, in the meantime. Capital structure theory also argue the roles of corporate debt restriction and incentive contract, especially the roles of large debtor system to control corporate managers' behaviors should not be neglected (Shleifer and Vishny, 1997). Ownership structure theory argues that ownership concentrate not only increase the roles of legal protect to investors, but also can improve the incentive of shareholders gather information and supervise managers, then avoid conventional 'free ride' problem (Shleifer and Vishny, 1999). Since 1990s, through structure, organization and protect style financial system arrangement, several developed western countries have got success in aspect of improving corporate governance, supervising managers effectively and protecting investors. For example, in the past of 10 years, American capital market structure has occur profound changes,

diversified institutional investor increase quickly, CEO of several famous corporations have been dismissed under pressure of institutional investors, American investor capitalism is replacing American manager capitalism. In fact, the relative competition power of American firms and relative growth of American economy have made the advantage of American financial system arrangement appeared.

My opinion is the relationship between financial system arrangement and corporate governance should serve to the supervisory degree and the protective extent to managers, and these two aspects just is weak of financial system arrangement in the Asia ‘post developed’ countries. In fact, financial system arrangement oriented government in Asia ‘post developed’ countries have made financial institutions and firms engage in long term moral risk activities with the shelter of government, so “economy miracle” and “financial bubble” were made in same time, and finally result in break out of financial crisis.

After Asia financial crisis, economists summarize the common ground in crisis countries as followed: one is to carry out substantially fixed exchange rate system, second is to carry out quickly finance liberalization policy with unsound financial supervision system. So a great many of foreign capital flow into domestic firms by bank, and most foreign debt is short term debt, government only vouch for long term foreign debt, then shield financial institutions and firms engage in high

risk investment activities. Just as Chinese scholar Zhang Weiyong(1999) pointed out that moral risk activities, which rooted from information asymmetry, have created financial bubble. Diamond-Dybvig (1999) argues that there exists multi-Nashi equilibrium in economy, economic entity can not forecast which equilibrium will happen, imperfect information result in break out of financial crisis.

I am strongly argues that the most important thinking way is to introduce the relationship between financial system arrangement and corporate governance into the study of financial crisis. Though the theory and practice of corporate governance have told us that the relevant concentration of ownership will be benefit to supervision of managers and protection of investors. I should stress that whether this arrangement is success will depend on efficient financial system arrangement, rather than so called ‘government policy and interest conducted style’ arrangement. It has been tested by practice that financial system arrangement oriented government has made banks, which guaranteed by government, become ‘bureaucratic financing firm’ and ‘bureaucratic institutional investor’. Insurance fund, pension fund and investment fund gradually become ‘bureaucratic short term interest groups’, and especially with the condition of extreme unsound corporate law, will result in ‘proxy right seek rent’, corruption, and rampant expropriate of investor interest.

Look into 21 century, firms in Asia 'post developed' countries need large-scale acquisition reconstruction to foster kernel competition, but more important is through reform financial system arrangement and improve corporate governance, then to develop debt credit culture and capital credit culture and enhance control of managers and protection of investors. China, Korea and other Asia countries have similar financial system, how to learn from western' successful experiment, to meet this challenge, is a common century task faced us.

...

#### References

Allen, Franklin, and Douglas Gale, 1999, Comparing Financial Systems, Cambridge: MIT Press, forthcoming.

Aoki, Masahiko and Hugh Patrick, 1993, The Japanese Main Bank System: Its Relevance for Developing and Transforming Economies, New York: Oxford University Press.

Bebchuk, Lucian, 1999, "The Rent Protection Theory of Corporate Ownership and Control, Law School, manuscript.

Claessens, Stjin, Simeon Djankov, and Larry H.P. Lang, 1999, The Separation of Ownership and Control in East Asian Corporations, World Bank, manuscript.

Coffee, John C. Jr., 1998, The Future as History: The Prospects for Global Convergence in Corporate Governance and its Implications,

Columbia Law School Working Paper 144.

Carlin, Wendy, and Colin Mayer, 1998, Finance, Investment and Growth, University College, manuscript.

Shleifer, Andrei and Vishny, Robert, 1997, "A survey of Corporate Governance." *Journal of Finance*, 737-83.