



**GOOD CORPORATE GOVERNANCE: ROLES, DUTIES  
AND RESPOSIBILITIES OF REMUNERATION  
COMMITTEE**

**BY**

**MISS RATCHANIKARN SUWADIST**

**A THESIS SUBMITTED IN PARTIAL FULFILLMENT  
OF THE REQUIREMENTS FOR  
THE DEGREE OF THE DEGREE OF MASTER OF LAWS  
IN BUSINESS LAWS (ENGLISH PROGRAM)  
FACULTY OF LAW  
THAMMASAT UNIVERSITY  
ACADEMIC YEAR 2015  
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THESIS

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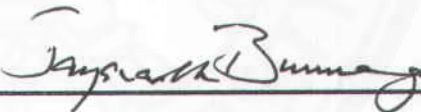
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GOOD CORPORATE GOVERNANCE: ROLES, DUTIES AND  
RESPONSIBILITIES OF REMUNERATION COMMITTEE

was approved as partial fulfillment of the requirements for  
the degree of Master of Laws in Business Laws (English Program)

on August 10, 2016

Chairman



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(Professor Jayavadh Bunnag)

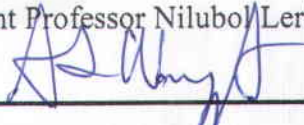
Member and Advisor



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(Assistant Professor Nilubol Lertnuwat, Ph.D.)

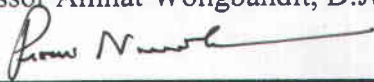
Member



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(Professor Amnat Wongbandit, D.Jur.)

Member



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(Associate Professor Pinai Nanakorn, Ph.D.)

Dean



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(Professor Udom Rathamarit, Docteur en droit)

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|--------------------------------|---|
| Thesis Title                   | GOOD CORPORATE GOVERNANCE:<br>ROLES, DUTIES AND RESPONSIBILITIES OF<br>REMUNERATION COMMITTEE |
| Author                         | Miss Ratchanikarn Suwadist  |
| Degree                         | Master of Laws  |
| Major Field/Faculty/University | Business Law (English Program)<br>Faculty of Law<br>Thammasat University                      |
| Thesis Advisor                 | Assistant Professor Nilubol Lertnuwat, Ph.D.  |
| Academic Years                 | 2015  |

## ABSTRACT

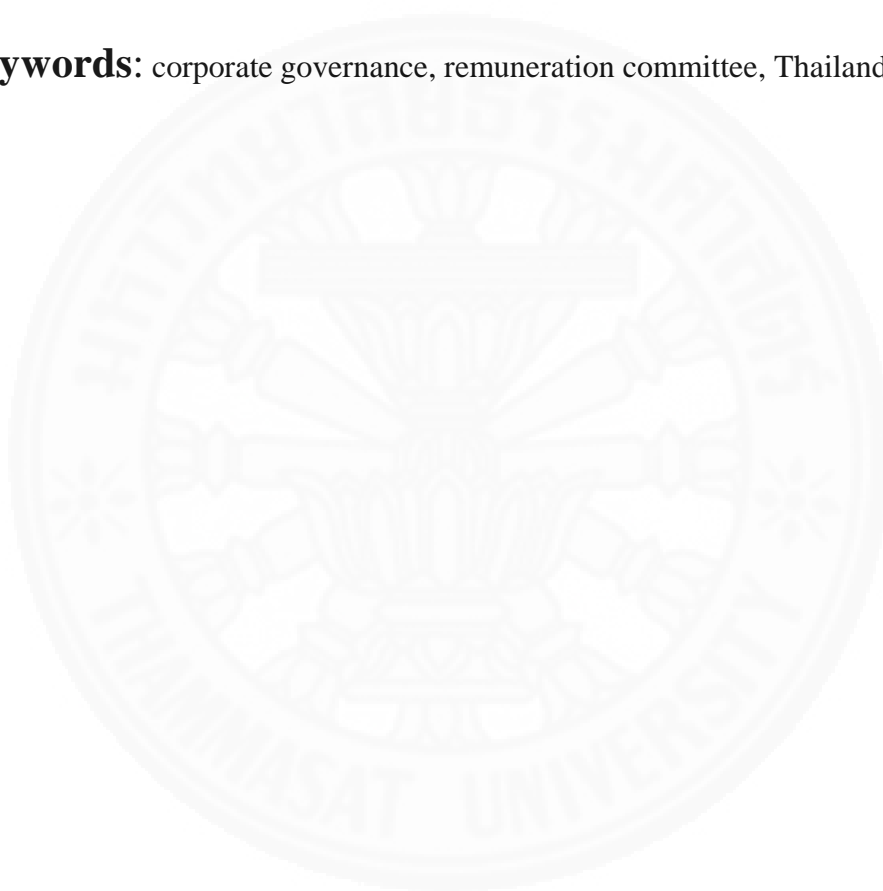
Since 1997, when Thailand's economic crisis was partially caused by poor governance, the Thai capital market has awakened to corporate governance principle improvement. Board of director is expected to act in the best interests of the company and shareholders. Remuneration committees were established to increase board effectiveness. Yet extant laws on their role, duty, and responsibility do not suffice to oblige companies listed on the Stock Exchange of Thailand (SET) to remain in compliance with good corporate governance principles. Public Limited Companies Act, B.E. 2535 (1992) and the Securities and Exchange Act BE 2535 (1992) were studied, along with Securities and Exchange Commission Thailand announcements, The Principle of Good Corporate Governance for Listed Companies 2012, and remuneration committee guidelines. These were compared to the United States corporate governance model, influential in developing international capital markets such as Thailand's.

Results were that some rules, such as remuneration committee structure, shareholder rights and transparency needed improvement to demonstrate good governance in compliance with international standards. Some corporate governance

(2)

recommendations should be retained as already conforming to U.S. regulations and international standards. One such is that executive remuneration determination should be a flexible guideline, complied with individually by each company. However, some U.S. legal provisions are not suitable to be adopted, such as exclusive presence of independent members, and individual executive remuneration disclosure.

**Keywords:** corporate governance, remuneration committee, Thailand



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Furthermore, special thanks go to all of my lecturers at Thammasat University for their inspirational lectures which motivated me to explore some interesting issues concerning good corporate governance. I wish to thank many of my LL.M. 55 friends who regularly encouraged me through the writing process. I also would like to express my thanks to Miss Siriporn Vongsenaaree who helped, supported, and facilitated me during the entire research process.

Last but not least, I would like to dedicate this study to my family, especially to my beloved parents, Narin and Nakarin who encouraged me with love and support through wonderful words to move me forward. It was their love that gave me the strength to carry on and to accomplish my study.

Miss Ratchanikarn Suwadist

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# CHAPTER 1

## INTRODUCTION

### 1.1 Background and problems

The evidence that has emerged about the global economic crises named ‘Tom Yam Kung’ in 1997 and ‘Hamburger’ in 2008 suggests that their cause was the result of poor corporate governance, including concealment and distortion of financial information, and corruption and the misuse of power in the financial markets and individual corporations.<sup>1</sup> The adverse effects of these incidents not only raised a question on the role of directors and whether they functioned to protect the benefits of shareholders, but also led the authorities to actively improve their regulatory frameworks.<sup>2</sup> Due to the expectation of the better economic and financial health of corporations, corporate governance is designed as a mechanism to control the rights and responsibilities of each group of stakeholders in organizations. Its standard is also primarily indicated by transparency.

However, the literature shows that the weaker firms’ corporate governance mechanisms are the greater agency problem they have, since the incongruity between ownership and control is naturally structured in corporations.<sup>3</sup> This characteristic creates an agency relationship in which the company’s managers who directly control the activity act as agents of the principals who are its owners or shareholders, and from this there may arise a conflict of interest.<sup>4</sup> Efficient corporate governance, as a result, is assumed to encourage a board of directors to work as an important monitor of the interests of the shareholders and to reduce the conflict of

---

1 Bob Tricker and Chris Mallin . *Corporate Governance is a Meme*  
<http://corporategovernanceoup.wordpress.com> (accessed August 15<sup>th</sup>, 2015).

2 Simon S.M.H. and Wong Shun Wong. *A study of the relationship between corporate governance structures and the extent of voluntary disclosure*. **Journal of International Accounting, Auditing & Taxation** 10 (2001): 139-156.

3 Core et al. *Corporate governance, chief executive officer compensation, and firm performance*. **Journal of Financial Economics** 51, (1999): 371–406.

4 In legal perspective, a board of director is regarded as the agent of the company not the shareholders.

interest between directors and shareholders.<sup>5</sup> Therefore, corporate governance has been taken into account at both national and international levels by evolving into a form of laws and suggestions, such as the Sarbanes-Oxley Act of 2002 and the Dodd-Frank Wall Street Reform and Consumer Protection Act (2010) in the US, and the Corporate Governance of State-owned Enterprises Guidelines (2005) of the Organization of Economic Cooperation Development (OECD).<sup>6</sup>

While corporate governance is now continually receiving attention, payment of the board of directors is one of the high-ranking concerns because the determination of remuneration reflects the effective performance of corporations, as Warren Buffett said in 2004:

In judging whether Corporate America is serious about reforming itself, CEO pay remains the acid test. To date the results aren't encouraging.<sup>7</sup>

Commonly, the board of directors is categorized into two different groups: directors that are executive directors (hereinafter referred to as executives) and non-executive directors (hereinafter referred to as directors). Compensation packages paid to the boards which are able to attract, retain, and motivate both executives and directors to manage the business should be honest and fair in order to provide maximum benefit to the shareholders. Appropriate remuneration alignment, nevertheless, is not easy owing to the agency problem. The reason is that executives (agents) may pay themselves excessive remuneration in various forms such as salaries, bonuses and stock options, rather than paying as dividends for shareholders

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5 Livia Bonazzi and Sardar M.N. slam. *Agency theory and corporate governance: A study of the effectiveness of board in their monitoring of the CEO*. **Journal of Modeling in Management** 2,1 (2007): 7-23

6 พิภพ อุดร., *ธรรมาภิบาล...พลังขับเคลื่อนสู่ความยั่งยืน*. **วารสารสื่อพลัง** 19,1 (2554): 36-41. (Pipop Udorn. *Good corporate governance...a catalyst for sustainability*. **Power the thought** 19, 1 (2011): 36-41.)

7 Organization for Economic Co-operation and Development. *Corporate Governance and the Financial Crisis*

<http://www.oecd.org/corporate/ca/corporategovernanceprinciples/43056196.pdf> (accessed August 25<sup>th</sup>, 2015)

(principals).<sup>8</sup> Hence, the executive payments higher than the firm's performance would be the result of a lack of productive corporate governance.

The importance of good corporate governance has brought about the examination of the possible options in order to make managers act in the best interest of shareholders. These options are the roles of the board of directors and disclosure of financial information. Firstly, the most suitable corporate governance mechanism playing a significant role for remuneration determination is the board of directors including its structure and functions.<sup>9</sup> This has led to the appointment of a remuneration committee (also referred to as a compensation committee) to take full responsibility for the remuneration framework. Its structure is suggested to consist of independent directors in order to monitor management behaviour without conflict of interest<sup>10</sup> and to recommend the remuneration package to the board. Thus, it is anticipated that the remuneration committee will solve the problems occurring in the agency relationship and the absence of good corporate governance. Secondly, the full disclosure of the pay level and compensation policy of companies is another mechanism which is able to promote transparency and accountability, as well as to decrease the risk of excessive remuneration.<sup>11</sup>

In addition to the Asian financial crisis in 1997 and the agency problem, the establishment of an ASEAN Economic Community (AEC) in 2015 is another significant factor impacting the improvement of corporate governance of listed companies in Thailand. Corporate governance must try to be comparable with international standards, which will make the companies ready for competition in ASEAN. In addition, the rise of corporate governance standards not only reflects companies' performance but also increases investors' confidence.

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8 Mohammad Talha. et al. *Corporate governance and directors' remuneration in selected ASEAN countries*. **The journal of applied business research** 25,2 (2009): 31-40.

9 *Id.* at 4

10 *Id.* at 2

11 *Id.* at 7

At ASEAN level, listed companies' corporate governance performance was assessed in 2014 by using the ASEAN Corporate Governance Scorecard. The report showed that Thailand had the highest mean score among the participating countries.<sup>12</sup> Nevertheless, some corporate governance areas should be improved; for example, equitable treatment of shareholders, disclosure and transparency, and board responsibilities, since the average score of these areas had decreased from 2013. The suggestions conform to the Corporate Governance Report of Thai Listed Companies 2015 (CGR), which advised that board responsibilities, one of the corporate governance categories, must be further developed in the corporate governance practices, since its average score is the lowest, as shown in figure 1.1. The suggestion is the disclosure of chief executive officer (CEO) remuneration in both the short-term and long-term, including their performance.

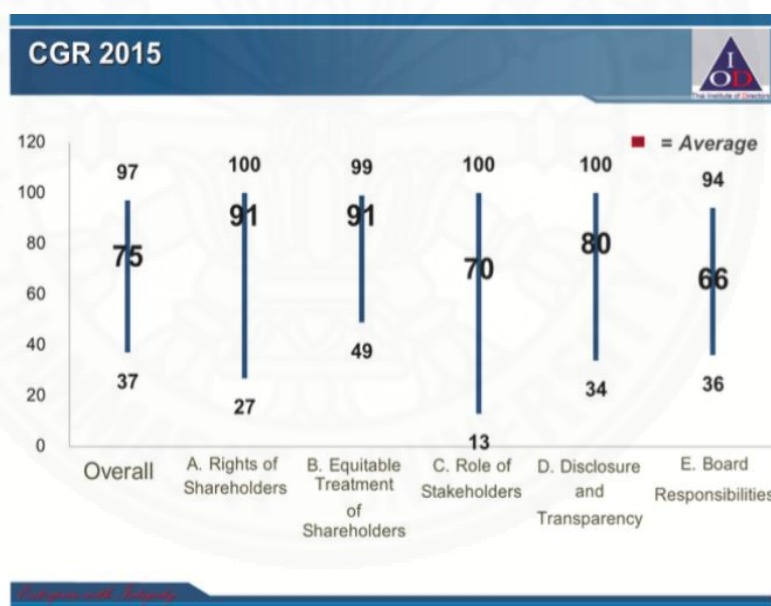


Figure 1.1: The findings in 2015 from a corporate governance assessment of 588 listed companies in the Thai Institute of Directors Association, “Corporate Governance Report of Thai Listed Companies 2015” [http://www.thai-iod.com/imgUpload/file/CGR2015/CGR%202015-result%20Resized\\_.pdf](http://www.thai-iod.com/imgUpload/file/CGR2015/CGR%202015-result%20Resized_.pdf) (accessed 12 March, 2016)

<sup>12</sup> Asian Development Bank. *The ASEAN Corporate Governance Scorecard: Country Reports and Assessments 2013–2014*. (2014)



In the case of remuneration determination, there is only a requirement that a shareholder meeting approves directors' remuneration by a super majority resolution under Section 9 of the Public Company Act B.E. 2535 (1992). The compensation paid for employment of the executive is not subject to the law. At present, there are recommendations and regulations regarding the need for a remuneration committee selected by the board of directors in order to design both the form and the amount of remuneration that should be paid. Generally, the level and make-up of remuneration will be considered by the committee following the principles of good corporate governance for listed companies recommended by The Stock Exchange of Thailand (SET). The expectations of effective remuneration committees have changed markedly, because their duties are to establish transparent remuneration systems related to company performance, to provide value to directors and executives, and to align the interests of all stakeholders.

According to the survey of listed companies in the stock exchange of Thailand, only 64% of listed companies have established remuneration committees,<sup>13</sup> while the promulgated rules and regulations do not specify clear prohibitions and penalties for the board structure, especially independent qualification, duties, and responsibilities.<sup>14</sup> In addition, the remuneration policies among listed companies contain discrepancies because of the lack of practical guidelines to accommodate a uniform remuneration scheme. Most shareholders do not anticipate that the executive

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13 อุษณีย์ สมศิริ, ชณิตา ปิยะพันธุ์พงศ์ ศศิธร มโนทรัพย์ศักดิ์, ณัฐชานันท์ จรัสเชวงพงศ์ และ ณฤดี โรจน กงอยู่. *CG Corner: การกำหนดค่าตอบแทนกรรมการและผู้บริหารระดับสูง*, **Disclosure**

**Focus**, ตุลาคม 2558, 11-13. (Usanee Somsiri, Chanita Piyapunpong, Sasitorn Manosupsuk, Nuchanun Charaschawengpong and Naruedee Rojanakongyoo. *CG Cornor: director and executive compensation determination*, **Disclosure Focus**, October 13<sup>th</sup>, 2015, 11-13.)

14 ฝ่ายพัฒนากฎหมาย สำนักงานคณะกรรมการกฤษฎีกา. *การเพิ่มค่าตอบแทนให้แก่ผู้บริหารในสหรัฐอเมริกา*. ข่าวสารพัฒนากฎหมาย, ลำดับที่ 72, 2 พฤษภาคม 2554, 1-2. (Law Reform Commission, Office of the Council of State. *The increasing of executive compensation in the United States of America*. **Law Reform News**, No. 72, May 2, 2011, 1-2)

remunerations are as expected,<sup>15</sup> such as the following unreasonable executive remuneration packages surveyed in 2013.

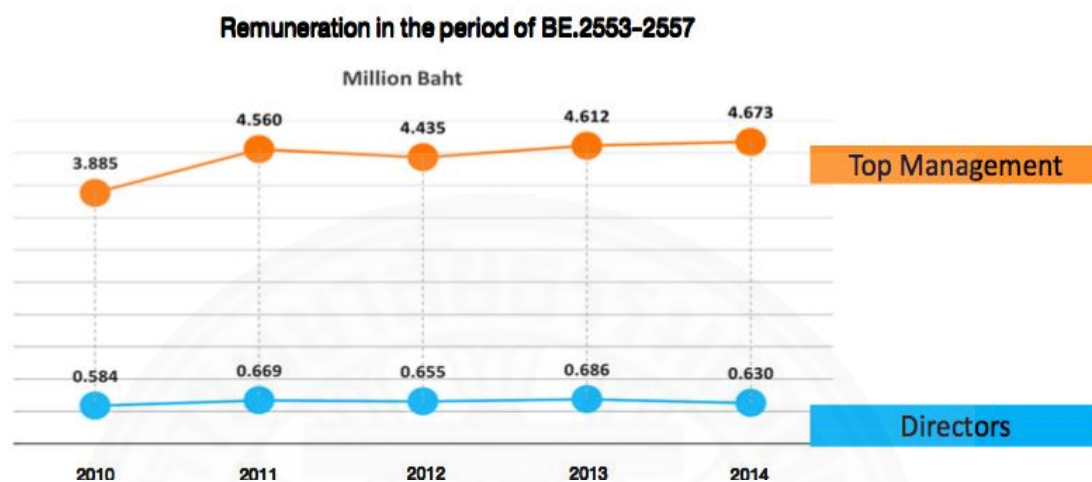


Figure 1.2: Director and executive remuneration in the period of BE 2553-2557 in The Stock Exchange of Thailand (SET), “Thai Directorship 2014,” [http://www.set.or.th/sustainable\\_dev/th/cg/files/2015/Infographic.pdf](http://www.set.or.th/sustainable_dev/th/cg/files/2015/Infographic.pdf) (accessed November 23, 3015).

The diagram shows that the average remuneration of directors in 2014 was less than in 2013 since the whole performance of companies decreased. The executive remuneration, at the same time, increased from the last year.<sup>16</sup> Moreover, the remuneration disclosure of most listed companies has not been established,

<sup>15</sup> *Id.*

<sup>16</sup> ตลาดหลักทรัพย์แห่งประเทศไทย. *สรุปผลสำรวจข้อมูลกรรมการและผู้บริหารของบริษัทจดทะเบียน 2557*, 6. (The Stock Exchange of Thailand, *Directors and executive of listed companies report 2014*, 6.)

[http://www.set.or.th/sustainable\\_dev/th/cg/files/2015/Thai\\_Directorship\\_Survey\\_2014\\_v2.pdf](http://www.set.or.th/sustainable_dev/th/cg/files/2015/Thai_Directorship_Survey_2014_v2.pdf) (accessed November 23<sup>rd</sup>, 3015)

announced and carried out in the same way.<sup>17</sup> This can be explained by the report of SET in 2013, where 96% of listed companies disclosed their remuneration policies and procedures while only 6% disclosed the chief executive officers' remuneration policies, both short-term and long-term.<sup>18</sup> The results reflect that the current practice may not be sufficient to fully meet the transparency and good governance requirements.

## 1.2 Hypothesis

In Thailand, the rules and regulations concerning executive and director remuneration are not sufficient to force the companies listed in the stock exchange to manage and operate in compliance with good corporate governance principles. Hence, the law should establish rules regarding the structure, duties, and responsibilities of the remuneration committee, including remuneration disclosure policy, in an attempt to strengthen the reasonableness and effectiveness of remuneration structure.

## 1.3 Objectives

(1) To study the remuneration committee emphasizing:

- The committee's structure
- The committee's responsibilities to approve executive and director remuneration
- The committee's duties and liabilities
- The disclosure relating to remuneration

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17 สุวิสา ทะยะธง. การศึกษาเปรียบเทียบค่าตอบแทนกรรมการของบริษัทจดทะเบียนในตลาดหลักทรัพย์แห่งประเทศไทย ระหว่างปี 2551 ถึง 2553. (วิทยานิพนธ์ปริญญาโทบริหารธุรกิจ, บัณฑิตวิทยาลัย มหาวิทยาลัยเชียงใหม่ บัณฑิตวิทยาลัย, 2554), 134. (Suwisa Tayatong, *Comparative study of directors' remuneration of companies listed on the Stock Exchange of Thailand between 2008 to 2010*, the thesis of Master of Accounting, Chiangmai University, 2001, 134.)

18 *Id.* at 13

(2) To study important legal standards and regulations that govern the remuneration committee in foreign countries, focusing on the American standard.

(3) To study the Thai laws related to executive and directors remuneration and the remuneration committee.

(4) To propose the key rules and practices applicable to the remuneration committee in order to promote its effectiveness.

#### **1.4 Scope of study**

This study will cover the remuneration committee of publicly listed companies including its structures, duties to approve remuneration and disclose compensation information, and responsibilities. The study also examines the legal and regulatory requirements and promulgation of the best practice of the United States of America and compares these to Thailand.

#### **1.5 Methodology**

The thesis methodology is mainly based on documentary research involving the study and analysis of texts and documents as source materials, including domestic and US laws, articles, journals, court decisions, scholars' opinions and internet databases in order to reach the conclusion.

#### **1.6 Expected results**

(1) To understand legal analysis and information with respect to the remuneration committee considering the current environment.

(2) To understand the organization, duties, and responsibilities of the remuneration committee under Thai law and how it forces listed companies to practice in compliance with good governance principles.

(3) To recommend specific practice to increase the effectiveness of listed Thai companies' remuneration committees in determining appropriate remuneration programmes advancing corporate governance goals.



## CHAPTER 2

# CORPORATE GOVERNANCE AND REMUNERATION COMMITTEE

Both corporate governance and remuneration are two areas which have been the subject of attention since the world financial crisis. In order to articulate the roles of the remuneration committee, good corporate governance is considered to reduce the agency problem and increase the value of shareholders and other stakeholders.

### 2.1 Corporate governance

There is no unique definition of corporate governance. The commonly used definition is ‘...the system by which companies are directed and controlled’.<sup>19</sup> The OECD elaborated that corporate governance is a relationship between a company’s management and all stakeholders including a board of directors and shareholders. Corporate governance also provides ‘the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined’.<sup>20</sup>

Corporate governance is designed as a mechanism which decreases the pursuit of self-interest pursuit by the board and increases the firm’s value. Hence, good corporate governance should motivate a board of directors to perform for the best interest of the company and its shareholders, as well as facilitate effective monitoring.<sup>21</sup> The rationale behind this perspective is the consideration of agency theory through the corporation.

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19 Cadbury, Adrian. *Report Of The Committee On The Financial Aspects Of Corporate Governance*. (1992). 16

20 Organization for Economic Co-operation and Development. *OECD Principles of Corporate Governance*. (2004), 11.

21 *Id.*

### 2.1.1 Agency theory

The nature of the corporation is generally defined as the agency relationship – ‘the situations in which one individual (the agent) acts on behalf of another (the principal) and is supposed to advance the principal’s goals’.<sup>22</sup> Furthermore, the principal will authorize the agent to make some decisions on business performance,<sup>23</sup> because corporations are generally managed by a board of directors who are delegated by shareholders.<sup>24</sup> In the eyes of the law, directors are regarded as the agents of the company and work for the company’s benefit.<sup>25</sup> Agency theory argues that these agents, especially the executives, will bear the entire cost of failing to benefit the company only if it is in line with their own best interest.<sup>26</sup> In effect, it can lead to a conflict of interests because the determination made by the agents affects both their own benefit and the interest of the principal.

However, agency problems will be captured by the financial markets and reflected in a company’s share price.<sup>27</sup> The existence of agency costs can be seen as the loss of shareholders’ value when there is a conflict of interest between

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22 Paul Milgrom and John Roberts. **Economics, Organization and Management**. (1993), 170.

23 Jensen, Michael C. and Meckling, William H. *Theory of the firm: managerial behaviour, agency costs and ownership structure*. **Journal of Financial Economics** 3, (1976):305–360.

24 *Executive Compensation, Firm Performance and Corporate Governance: Evidence from the Thai Stock Market*

[http://www.afaanz.org/openconf/2016/modules/request.php?module=oc\\_program&action=view.php&id=84&file=1/84.pdf](http://www.afaanz.org/openconf/2016/modules/request.php?module=oc_program&action=view.php&id=84&file=1/84.pdf) (accessed August 25<sup>th</sup>, 2015)

25 See The Thai Commercial Code Section 1167 states that

“*The relations between the directors, the company and third persons are governed by the provisions of this Code concerning Agency.*” and

The Public Company Section 97 states that

“*The relationship between the directors and the company and the relationship between the company and any third person shall be in accordance with the Civil and Commercial Code in the part on agent.*”

26 Letza, S., Kirkbride, J., Moores, J., Sun, X., and Smallman, C.

*Corporategovernance theorizing: Limits, critics and alternatives*. **International Journal of Law and Management**, 50, 1 (2008): 17-32

27 Patrick, McColgan. *Agency theory and corporate governance: a review of the literature from a UK perspective*.(2011). <http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.202.286&rep=rep1&type=pdf> (accessed June 1<sup>st</sup>, 2016)

executives and shareholders, for example, a compensation system which is insensitive to a company's performance.<sup>28</sup> The divergence of interest between these two parties causes the following four problematic areas:<sup>29</sup>

### 1. Moral Hazard Agency Conflict

The moral hazard problem is likely to arise in a large firm where its size makes the firm's contracting more complex.<sup>30</sup> Thus, shareholders cannot oversee directors' performance effectively due to the lack of information. This situation allows the directors to make inappropriate decisions (from the shareholder's point of view) in order to attempt to make a profit for their own gain.

### 2. Earnings Retention Agency Conflicts

The situation assumes that the executives do not maximize the shareholder benefits since they prefer to retain earnings, whereas shareholders prefer higher returns.<sup>31</sup> The executives benefit from the retention as the firm grows and they have the ability to award themselves a higher level of compensation. The results, at the same time, reduce not only the need for outside funds and external monitoring, but also to pay dividends to shareholders.

### 3. Time Horizon Agency Conflicts

The timing of cash flow may cause a conflict of interest in the agency relationship since the executive may emphasize the company's cash flow only during their employment period. Then, executives, especially those who are approaching their retirement decide to operate short-term projects rather than long-

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28 Nicolette C. Prugsamatz. *Corporate Governance Effects on Firm Value and Stock Market Performance: An Empirical Study of the Stock Exchange of Thailand-100-Index Listed Companies*. <http://www.graduate.au.edu/gsbejournal/5V/Journals/3.pdf> (accessed June 2<sup>nd</sup>, 2016)

29 Patrick, McColgan. *Supra Note 27*.

30 Jensen, Michael C. *The Modern Industrial Revolution, Exit and the Failure of Internal Control Systems*, **Journal of Finance** 48, (1993): 831-880.

31 Jensen, Michael C. *Agency Costs of Free Cash Flow, Corporate Finance and Takeovers*, **American Economic Review** 76 (2), (1986) : 323-329.



term projects in order to reap from this investment and avoid risks that may occur in the term of their employment.<sup>32</sup>

#### 4. Managerial Risk Aversion Conflicts

This problem occurs because of the relationship between risk and return. Shareholders usually accept a high-risk investment which provides high returns, however, executives prefer to make a less risky project decision in order to avoid an event such as bankruptcy which may damage their reputation.<sup>33</sup> The main factor is that an executive remuneration package does not rely on the company's performance but is largely composed of a fixed salary. Thus, there will be no additional advantage from the investment.

In summary, these agency problems arising from the conflict of interest between directors and shareholders in a corporation reflect the poor performance of the executives and directors, including the insufficient disclosure of financial information. The implementation of good corporate governance in a company is required to handle these problems.

#### **2.1.2 Fundamental principles of corporate governance**

To avoid the deficiencies in corporate governance, many institutions have begun citing generally similar versions of best practices in varying degrees of detail.<sup>34</sup> It can be said that there is not an ideal model for corporate governance, in contrast, the model will be developed by a company to cover a specific context, as well as legal and societal factors. Among various frameworks, corporate governance is expected to be an effective expression of the rights and responsibilities of each group of stakeholders in the company. Its basic elements must include the

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<sup>32</sup> *Id.* at 22

<sup>33</sup> *Id.*

<sup>34</sup> McKinsey & Company Thailand, "Strengthening corporate governance practice in Thailand," *Joint report of the Thai institute of Directors and McKinsey & Company Thailand in collaboration with the Stock Exchange of Thailand and the Office of The Securities and Exchange Commission.* (2002), 10.

preservation of the rights of minority shareholders, transparency and responsibility of directors.<sup>35</sup>

In this study, the OECD Principles of Corporate Governance are reviewed, since this has widely become a reference tool for governments, regulations, investors, corporations and stakeholders in both OECD and non-OECD countries. The first OECD Principles of Corporate Governance were revised in 2004 in response to corporate governance developments, focusing the minds of governments on improving their practices. The principles building on the common elements are formulated to adopt the different models that exist and to provide guidance and suggestions for stock exchanges, investors, corporations, and others in developing good corporate governance. The Principles, in summary, contain the following elements:

1. Ensuring the basis for an effective corporate governance framework: The corporate governance framework should be compatible with the law and also promote market transparency and efficiency. In addition, the responsibilities among different authorities should be clearly divided.<sup>36</sup>

2. The rights of shareholders and key ownership: The exercise of shareholders' rights should be protected and facilitated by the corporate governance framework.<sup>37</sup>

3. The equitable treatment of shareholders: All shareholders should have the opportunity to obtain effective redress for violation of their rights.<sup>38</sup>

4. The role of stakeholders in corporate governance: Corporate governance should recognize the rights of stakeholders including promoting the cooperation of stakeholders and the company.<sup>39</sup>

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<sup>35</sup> *Id.*

<sup>36</sup> Organization for Economic Co-operation and Development, *Supra Note 7*, at 17.

<sup>37</sup> *Id.* at 18

<sup>38</sup> *Id.* at 20

<sup>39</sup> *Id.* at 21

5. Disclosure and transparency: Company information concerning the financial statements, performance, ownership, and governance should be timely and accurately disclosed.<sup>40</sup>

6. The responsibility of the board: The strategic guidance of the company should ensure that the board performs its responsibilities effectively.<sup>41</sup>

The OECD corporate governance principles have become an international standard for application in other countries, especially in Thailand.

### 2.1.3 Corporate governance of listed companies in Thailand

The concept of corporate governance has been gaining popularity in Thailand since the 1997 financial crisis revealed the ineffective governance system, including poor protection of minority shareholders and weak information disclosure standards.<sup>42</sup> The lessons learned from this crisis have forced the Thai government to develop corporate governance and disclosure standards. At the same time, most Thai listed companies have markedly reformed governance mechanisms so that they will retain investors' confidence and raise themselves to the international standards.<sup>43</sup>

#### 2.1.3.1 The regulatory evolution of corporate governance

The regular corporate governance amendment in Thailand covers the following professional organizations:

1. The Securities and Exchange Commission (SEC)
2. The Stock Exchange of Thailand (SET)
3. The Thai Institute of Directors (IOD)

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40 *Id.* at 22

41 *Id.* at 24

42 Nam, Sang-woo and Nam, Il-Chong. **Corporate governance in Asia: recent evidence from Indonesia, Republic of Korea, Malaysia, and Thailand** (2004).

43 Australian-Thai Chamber of Commerce. *Business brief: Corporate Governance in Thailand*. **Advance** (2014): 6

In the aftermath of the 1997 economic crisis, Thailand learned lessons from the weak corporate governance performance. Most Thai listed companies that were reviewed found that their corporate governance practices did not meet the international standards and expectations. One of the causes was the company environment, which was mainly family-owned at the time of the crisis.<sup>44</sup> The over-investment decided upon by family and related-party shareholders who were the controlling shareholders dispossessed the minority shareholders' wealth.

Shortly after the crucial time, the SET established the 'Code of Best Practice for Directors' in 1999, because it was realized that the board of directors' role was the main mechanism for good corporate governance practices.<sup>45</sup> In addition, good corporate governance awareness became part of the national agenda within five years, and the Prime Minister named 2002 as 'The Year of Good Corporate Governance'. In terms of the stock exchange, SET introduced '15 Principles of Good Corporate Governance', including transparency and information disclosure, internal control and risk management, shareholder rights and equitable treatment, stakeholder rights, roles and responsibilities of the board of directors, and business ethics.

In 2006, the principles were firstly revised in order to become comprehensive and comparable to OECD principles and World Bank recommendations. Thai listed firms were encouraged to follow up these principles until ASEAN membership began. The principles were modified again in order to be compatible with the ASEAN Corporate Governance Scorecard criteria, which is provided to assess whether or not the corporate governance performance of the companies in ASEAN capital markets meet the international best practice.

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44 Thai Institute of Directors Association. **Review of corporation governance in Asia: Corporate governance in Thailand.** (2004).

45 Prasan Trairatworakul, *Challenges of good governance: Accountability and the rule of law*, speech given at The Asian Economic Crisis and Corporate Governance meeting, (1999) <http://wb-cu.car.chula.ac.th/papers/corpgov/cg072.htm>. (accessed February 14<sup>th</sup>, 2016).

The continual collaboration of these associations has developed and launched an effort to baseline corporate governance practices for listed companies. The timeline of regulatory evaluation can be concluded as shown in Figure 3.

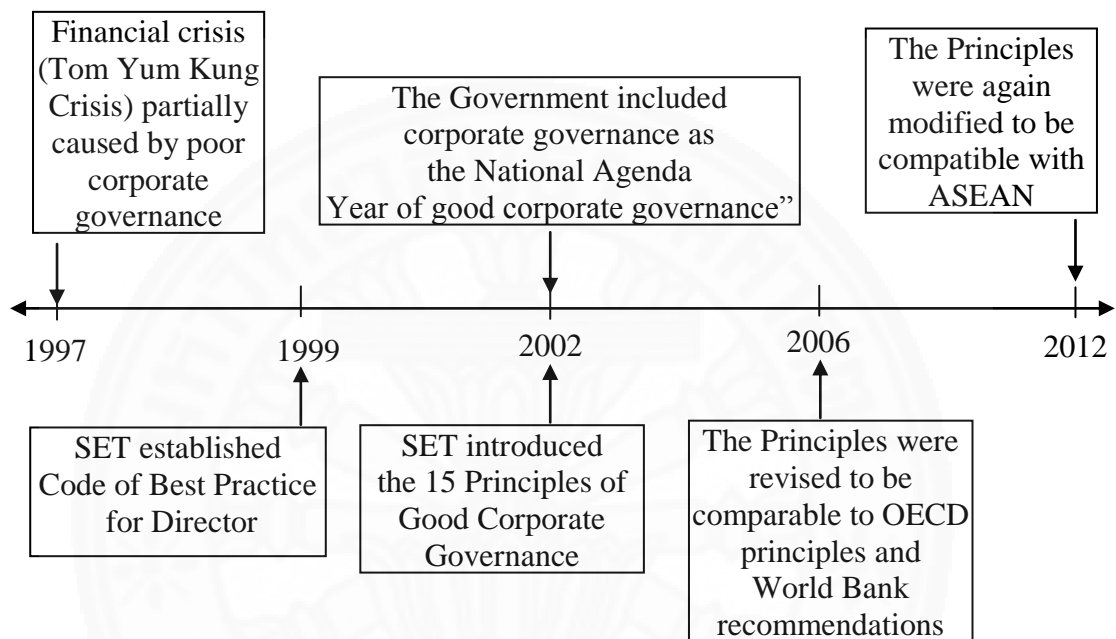


Figure 2.1: Thai corporate governance evolution adopted from OECD, ‘Session 5: The role of Stock Exchanges in Promoting Corporate Governance in Asia—ten years from now?’ (Asian roundtable on corporate governance 10-year anniversary, Manila, Philippines, September, 9-10 2009).

### 2.1.3.2 The principles of corporate governance for Thai listed companies

SET launched the final revised governance guidelines named ‘The Principles of Good Corporate Governance for Listed Companies 2012’ which presents five categories of corporate governance as follows:

1. The rights of shareholders: Shareholders control the company and make decisions on corporate change through the board of directors, thus, the company should encourage them to exercise their rights.<sup>46</sup>

2. Equitable treatment of shareholders: All shareholders should be treated equally and fairly even if they are a minority whose rights have been violated.<sup>47</sup>

3. Role of stakeholders: The mechanism promoting the collaboration of the firm and its stakeholders should be created to increase wealth, financial stability and sustainability.<sup>48</sup>

4. Disclosure and transparency: The board of directors should disclose the company’s important information through easy-to-access channels. It should also ensure that the said information is accurate, correct and transparent.<sup>49</sup>

5. Responsibilities of the board: The board of directors is an important factor which should perform corporate governance for the best interests of the company. Moreover, it should be accountable to shareholders and independent of management.<sup>50</sup>

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46 The Stock Exchange of Thailand. **The Principles of Good Corporate Governance for Listed Companies 2012**. (2012), 60.

47 *Id.* at 68

48 *Id.* at 74

49 *Id.* at 80

50 *Id.* at 88

The principles established by SET have attempted to support listed companies strengthen their corporate governance systems, as stated in the introduction:

SET continuously supported listed firms to establish their CG systems, and expects all listed companies' boards and management teams to develop their systems to be comparable with international standards, benefitting the companies themselves, the Thai capital market and the sustainable development of the Thai economy.<sup>51</sup>

## 2.2 Remuneration committee

In the context of a corporation, shareholders do not directly manage, but appoint directors as the representatives of the company to oversee the corporation. A board of directors has evolved as part of the market solution to the problem of contracting within organizations,<sup>52</sup> because it not only performs to maximize the wealth of its firm, but also exercises its responsibilities for the best benefits of shareholders.

In comparative terms, the different board structures are based on the type of governing body, broadly categorized as follows:<sup>53</sup>

1. The unitary system: The governing body is comprised of a single board.
2. The two-tier system: The governing body is comprised of two separate boards, a supervisory board and a management board.

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51 *Id.* at 2

52 Hermalin, B. and M. Weisbach. *The Effects of Board Composition and Direct Incentives on Firm Performance*, **Financial Management**, 20. (1991): 101-112.

53 Miguel A. Mendez. *Corporate governance; a US / EU comparison - course outline*.<http://foster.uw.edu/wp-content/uploads/2014/12/MiguelMendezFinal.pdf> (accessed June 1<sup>st</sup>, 2016)

The unitary board<sup>54</sup> is emphasized in this study since it is commonly found in most countries, including the United States<sup>55</sup> and Thailand.<sup>56</sup> Under this system, there is only one board that is responsible for the company's operations to outsiders.<sup>57</sup> The board, hence, plays the important roles of monitoring managers, evaluating management, and ensuring the managers' performance. Even though the advantage of this model is that the board's functions theoretically permit the separation of decision-management from decision-control,<sup>58</sup> it may not be able to effectively oversee the power of management.<sup>59</sup> As a result, the board may set up various committees to carry out some its duties, to provide effective checks and balance mechanisms and to handle serious problems, such as setting executive compensation, which is a significant device for reducing the agency problem arising from the corporation's management. Nevertheless, the board of directors still retains its responsibility to oversee the performance of these committees. One of several committees appointed by the board is the remuneration committee. The sample unitary structure of a board of directors is shown below:

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54 The "Unitary" board will also be referred to interchangeably throughout this study as "One-tier" board or "single-tier" board.

55 Miguel A. Mendez. *Supra Note 53*.

56 Piman Limpaphayom and J. Thamas Connelly. *Review of Corporate Governance in Asia: Corporate Governance in Thailand*. <http://ssrn.com/abstract=965300> (access May 29<sup>th</sup>, 2016)

57 The Securities and Exchange Commission. *Part I Overview of the Current Situation*. [www.sec.or.th/EN/Documents/Information/part%20I-V.doc](http://www.sec.or.th/EN/Documents/Information/part%20I-V.doc) (access May 29<sup>th</sup>, 2016)

58 Lauren A. Burnhill. *Overview: The US Governance Model* [https://centerforfinancialinclusionblog.files.wordpress.com/2013/02/us\\_and\\_european\\_governance\\_model\\_presentation.pdf](https://centerforfinancialinclusionblog.files.wordpress.com/2013/02/us_and_european_governance_model_presentation.pdf) (accessed June 1<sup>st</sup>, 2016 )

59 The Securities and Exchange Commission. *Supra Note 57*.



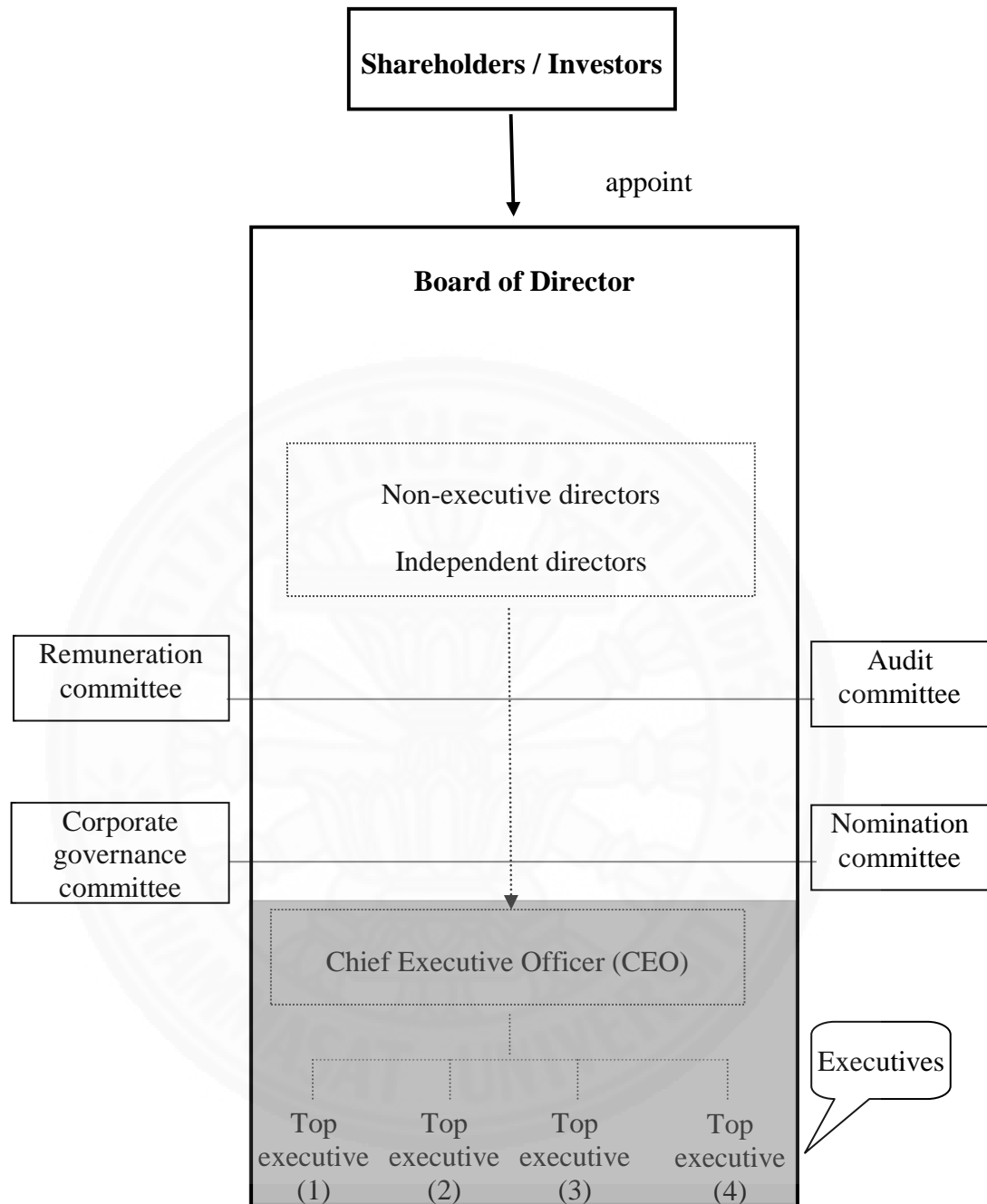


Figure 2.2: The sample structure of a board of director in the listed companies adapted from the Securities and Exchange commission, *Directors' handbook Vol.1: Roles, duties and responsibilities of directors and board of directors*, Bangkok: Thai Institute of Directors, 2007, 18-20.

The remuneration committee is regarded as the representatives of the board of directors. It carries out the primary role of assisting the board in its responsibilities for considering and recommending an effective remuneration policy for all employee levels. The committee must ensure that the executives, directors and prescribed officers are paid fairly in accordance with the long-term interest of the company. The remuneration report must also be provided accurately and completely so that shareholders are able to inspect it and protect their interests.<sup>60</sup> Thus, the process with regard to remuneration matters shall be done in compliance with good corporate governance practices.

### **2.2.1 Remuneration determination**

Remuneration is designed to pay for performance, services or employment of directors on the board of the company. The remuneration determination should be sufficient to encourage those who are the crucial mechanisms driving the company to be successful to remain with the company for a long period.

#### **2.2.1.1 The forms of remuneration**

Most remuneration packages are paid in elements of both monetary and non-monetary forms. A package generally takes the form of three parts as follows:

##### **1. Fundamental remuneration**

1.1 Basic salary is paid monthly, quarterly or annually in accordance with qualifications, responsibility, and risk taken for an appointed position.<sup>61</sup> The level of payment is considered by role, skills and the contribution of

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<sup>60</sup> Institute of directors Southern Africa, *Remuneration committee forum*, 6. [http://c.ymcdn.com/sites/www.iodsa.co.za/resource/collection/57F28684-0FFA-4C469AD9EBE3A3DFB101/Position\\_Paper\\_1\\_A\\_framework\\_for\\_remuneration\\_committees.pdf](http://c.ymcdn.com/sites/www.iodsa.co.za/resource/collection/57F28684-0FFA-4C469AD9EBE3A3DFB101/Position_Paper_1_A_framework_for_remuneration_committees.pdf) (accessed July 20, 2015).

<sup>61</sup> Suwisa Tayatong., *Supra Note 17*, at 17.

each director. Some directors receive an additional fee for the position of committee chairmanship held.

1.2 Meeting allowances is a fee paid to each director based on a per-board of directors meeting. Sometimes, a director may receive an additional attendance fee if he participates in a committee meeting. This may be set at a lower or the same level. The amount of the meeting allowance, however, is designed to be a reasonable and sufficient level in order to provide fairness for the director's time.<sup>62</sup>

## 2. Intensive remuneration

2.1 Accounting-based bonus measure covers each director's performance, providing an improved mechanism for aligning a manager's interests with the shareholders of the company.

2.2 Employee stock option plan (ESOPs) is offered to motivate directors and executives to work by providing the opportunity to buy the shares of company stock at a fixed price during a specified period of time.<sup>63</sup>

2.3 Stock appreciation rights (SARs) is the right to receive an amount equal to the appreciation in value of company stock over a certain price during a specified period of time.<sup>64</sup>

## 3. Benefits

Provident fund set up voluntarily between employer and employee consisting of money given by both parties. It is regarded as remuneration since it not only enables employees to save for their retirement, but also helps them by adding to the fund.<sup>65</sup> In addition, compensation is normally reimbursed in the form of

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<sup>62</sup> Thai Institute of Director Association. *Director compensation best practice*. (2006).

<sup>63</sup> Wachtell, et al, *Remuneration committee guide*  
[http://www2.deloitte.com/content/dam/Deloitte/za/Documents/governance-risk-compliance/ZA\\_Compensation\\_Committee\\_Guide\\_02062015.pdf](http://www2.deloitte.com/content/dam/Deloitte/za/Documents/governance-risk-compliance/ZA_Compensation_Committee_Guide_02062015.pdf) (accessed August 25<sup>th</sup>, 2015), 28.

<sup>64</sup> *Id.* at 29

<sup>65</sup> Securities and Exchange Commission, "Thai provident fund"  
[http://www.thaipvd.com/content\\_en.php?content\\_id=00307](http://www.thaipvd.com/content_en.php?content_id=00307) (accessed August 15<sup>th</sup>, 2015).

other benefits, such as life insurance or private health insurance, as well as services such as personal travel, a company car, fuel, office service, and continuing director education.

According to the survey in 2014 by SET, the remuneration paid to the boards of Thai listed companies was reported in two groups as executive director remuneration and director remuneration. The first three pay forms paid to executives are basic salary, bonus, provident fund and a combination of these, while non-executive directors commonly received basic salary, meeting allowance, bonus and a combination.<sup>66</sup> The percentage of monetary remuneration disclosed by listed companies was observed and reported as shown in the diagram below:

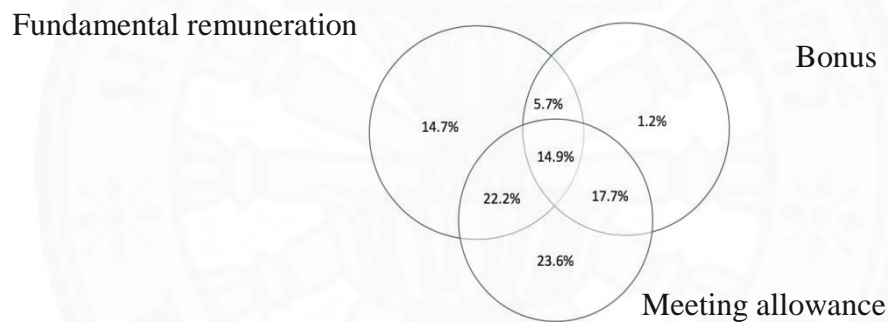


Figure 2.3: The first three forms of director remuneration of Thai listed companies in 2014, adapted from SET, “Thai Directorship 2014,”

[http://www.set.or.th/sustainable\\_dev/th/cg/files/2015/Infographic.pdf](http://www.set.or.th/sustainable_dev/th/cg/files/2015/Infographic.pdf)

(accessed November 23, 3015).

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<sup>66</sup> The Stock Exchange of Thailand's., *Supra Note 16*.

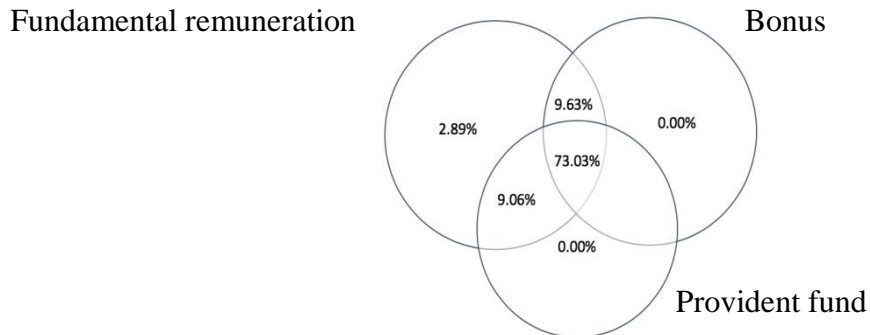


Figure 2.4: the first three forms of executive remuneration of Thai listed companies in 2014 adapted from SET, “Directors and executive of listed companies report 2014,” 8. [http://www.set.or.th/sustainable\\_dev/th/cg/files/2015/Thai\\_Directorship\\_Survey\\_2014\\_v2.pdf](http://www.set.or.th/sustainable_dev/th/cg/files/2015/Thai_Directorship_Survey_2014_v2.pdf) (accessed November 23, 2015)

### 2.2.1.2 The problems of remuneration determination

At present, firms are under pressure to provide not only reasonable remuneration, but also sufficient payment to attract and retain both talented directors and executives. Remuneration determination, at the same time, should be adopted in the corporate governance process. In this study, the problems of remuneration determination examined in a large amount of literature<sup>67</sup> mentioned two issues:

#### 1. Arm’s length bargaining contract

The board is directly entrusted by shareholders with the executive remuneration determination, nevertheless, it would be difficult to design an acceptable package without involving the executives. Thus, the executive team practically tries to exercise a negotiation process in order to solve this problem.<sup>68</sup>

<sup>67</sup> Bebchuk, Lucian A. and Fried, Jesse. M.. **Pay without performance: the unfulfilled promise of executive compensation.** (2004)

<sup>68</sup> Fisher, Roger. et al. **Getting To Yes: Negotiating Agreement Without Giving In,** (1992).

The literature claimed that ‘managers use their power to get boards to pay them more than they would receive if there were an arm’s length negotiation’.<sup>69</sup>

Moreover, such a decision is presumed to be a business judgement made by directors, which generally is deferred by courts, as the Delaware Supreme Court wrote: ‘The size and structure of executive compensation are inherently matters of judgement’.<sup>70</sup>

The question is whether or not a remuneration package made by negotiation maximizes the shareholders’ interests, since it may seem to be more one-sided than at arm’s length.<sup>71</sup> Hence, the remuneration committee is expected to bargain for reasonable and acceptable remuneration terms that are acceptable to both the executives and to other stakeholders. Moreover, outside consultants and shareholders shall be involved in the negotiation process.

## 2. Pay without performance

Executives who are non-independent directors have specific roles to operate the business, hence, they desire the appropriate remuneration in return for their work. An effective remuneration arrangement is suggested to cover three areas: decreasing agency cost, improving company’s performance and increasing shareholders’ value.<sup>72</sup> The compensation contract is assumed as the monitoring cost where the shareholders pay to measure, monitor and control executives’ behaviour.<sup>73</sup> Pay for performance, respectively, has long been suggested by most economists to be an efficient remuneration contract.

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69 Bebchuk, Lucian Arye, et al. *Managerial power and rent extraction in the design of executive compensation*, **University of Chicago Law Review**, 69(3), (2002): 751-846.

70 Steven Balsem, **An introduction of Executive compensation** (2002), 175

71 Schwab, Stewart J. and Thomas, Randall. S. *An empirical analysis of CEO employment contracts: What do top executives bargain for?*, **Washington and Lee Law Review**, 63(1), (2006): 231-270.

72 Mirrlees, James.A. *The optimal structure of incentives and authority within the organization*, **The Bell journal of economics**, 7 (1976): 105-131

73 Patrick, McColgan. *Supra Note 27*.

There is an additional suggestion based on factors used to design the executive compensation level of the Institutional Shareholders Services. This is that companies should apply ‘Total Shareholder Returns’ (TSR), which refers to: ‘the difference between rate of stock price (appreciation/depreciation) plus the dividends’. At the same time, it offers two main approaches<sup>74</sup> as follows:

1. Peer Group Alignment: The total executives’ pay, the total pay of shareholders and company performance shall be compared to a group of companies that are reasonably similar in terms of industry profile, size, and market capitalization.<sup>75</sup>

2. Absolute Alignment: The level of executive pay is compared over the period of a year with the increase or decrease of the total shareholders returns for the same period so as to make it comparable.<sup>76</sup>

The above-mentioned problems have been observed and examined as the impact of remuneration determination. They are also partially discussed in Chapter 4.

### 2.2.2 The corporate governance roles of the remuneration committee

Since the establishment of a remuneration committee demonstrates the awareness of the value of the specialist, it must play a key role in deciding the policy and levels of director and executive remuneration by implementing good corporate governance. This study considers the remuneration committee with regard to the corporate governance principles provided by SET as follows:

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74 พิกพ อุดร. ผลตอบแทนผู้บริหารภายใต้หลักธรรมาภิบาลต้นแบบจากสหรัฐอเมริกาผู้ระดับนานาชาติ, วารสารสื่อพลัง (2012): 34-29 (Pipop Udorn. *Executive compensation according to good governance: from a US model to a global level. Power The Thought*. 2,3 (2555): 34-29)

75 Carol, Bowie. **Evaluating Pay for Performance Alignment ISS’ Quantitative and Qualitative Approach**. (2004).

76 Pipop Udorn. *Supra Note 74*.

### 1. Equitable treatment of shareholders<sup>77</sup>

The transparent nomination of a remuneration committee is credible to the outside world. Moreover, the specific qualities of its members raise the shareholders' confidence that it is able to approve matters concerning remuneration without conflict of interest and bias. Its own qualifications will ensure that any decisions made by the committee shall be to the advantage of the company.

From the same perspectives, an effective board of directors should separate the problems of decision management and decisions on control. If executives are able to dominate the board, the separation will be difficult and may affect shareholders. As a result, the board should retain an outside independent director holding a managerial position.<sup>78</sup> It is believed that a large number of independent directors can separate these functions because their reputation, concern and equity stake provides them with sufficient incentive to do so. Moreover, the literature suggests further positive roles for independent directors that include disciplining poor performance, reducing top management's ability to block a takeover bid, determining the proportion of managerial compensation that is equity based, and reducing managerial opportunism in granting executive stock options, among others.<sup>79</sup>

### 2. Disclosure and transparency<sup>80</sup>

Important company information, sufficiently reported to the shareholders or public, improves the stakeholders' participation and monitoring. The disclosure includes both financial and non-financial information with correct and accurate reporting, for instance a remuneration policy for the board members and key executives.<sup>81</sup> This information is of concern to shareholders because they are interested in the link between remuneration and company performance. Moreover, the disclosure expectation is higher, so that investors can assess the costs and benefits of

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77 The Stock Exchange of Thailand. *Supra Note* 46 at 68.

78 Fama, E.F. and M.C. Jensen. *Separation of Ownership and Control*. **Journal of Law and Economics** 88 (2), (1983): 301-325.

79 Patrick, McColgan. *Supra Note* 27.

80 The Stock Exchange of Thailand. *Supra Note* 46 at 80.

81 *Id.* at 22



remuneration plans and the contribution of incentive schemes, such as stock option schemes, to company performance. At the same time, the statements provided through easy-to-access channels that are fair and trustworthy promote the company's transparency.

### 3. Responsibilities of the board<sup>82</sup>

The remuneration committee has responsibilities imposed by law, the board of directors, the articles of association or the resolutions of the meeting of shareholders. Since the committee is a group of directors who have specific tasks in the compensation area, they must act on a fully informed basis, in good faith, with due care, and in the best interest of all stakeholders. In addition, they must align top executive and board of director remuneration with the long-term interests of the company and its shareholders.<sup>83</sup> The shareholders, at the same time, are encouraged by the good corporate governance principles to:

[B]e able to make their views known on the remuneration policy for board members and key executives. The equity component of compensation schemes for board members and employees should be subject to shareholder approval<sup>84</sup>

If the committee performs any responsibilities accordance with the law and ethical standards, it can ensure that any decisions are made by the committee for the best interests of the company and all shareholders.

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82 *Id.* at 88

83 The Organization for Economic Co-operation and Development. *Supra Note 20.*

84 *Id.* at 18

### CHAPTER 3

## THE UNITED STATES OF AMERICA LAWS IN RELEVANCE TO THE REMUNERATION COMMITTEE

The focus on the legal and regulatory requirements and promulgation of the best practice of the US is considered as the appropriate and comparable source because the US is one of the countries, ‘that have some features of the best corporate governance systems in the world’.<sup>85</sup> The US corporate governance model enormously impacts the corporate development of the rest of the world, including Thailand where the corporate governance standard has been influenced by Anglo-American corporate reforms.<sup>86</sup> In addition, the recent drastic corporate reform which has brought a new comprehension to corporate development<sup>87</sup> is the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act (hereinafter referred to as the Dodd-Frank Act). The Dodd-Frank Act is considered to be strong medicine, because it imposes obligations, especially on executive remuneration and disclosure issues, with respect to good corporate governance<sup>88</sup> as stated in the pretext:

To promote the financial stability of the United States by improving accountability and transparency in the financial system, to end too big to fail, to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes.<sup>89</sup>

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85 Hleifer, A. and R. Vishny. *A Survey of Corporate Governance*, **The Journal of Finance**, (1997): 737-7

86 Akira Suehiro and Natenapha Wailerdsak, *Family Business in Thailand Its Management, Governance, and Future Challenges Asean*, **Economic Bulletin** 21,1 (2004): 81-93

87 Yuwa Wel, **Comparative corporate governance: a Chinese perspective** (2003).

88 Pipop Udorn. *Supra Note 75*.

89 Dodd-Frank Wall Street Reform and Consumer protection Act [hereinafter referred to the “Dodd-Frank Act”]: 1

The US Securities and Exchange Commission actively adopted its rules in order to reach the objective which ‘is to promote the long-term sustainability of the US financial system’.<sup>90</sup> The enforcement of the Dodd-Frank Act reflects not only the change of executive remuneration design in the US, but also the positive effects in an area of corporate governance with regard to the remuneration committee, including its structure and qualifications, on listed companies in the world. Another mirror of the emphasis on corporate governance improvement in the US is the large proportion of research on remuneration committees, remuneration determination and policy.<sup>91</sup>

According to the long and solid development of corporate governance in the US, this chapter takes into account whether or not the Thai laws and regulations in relevance to corporate governance and remuneration committees are expected to resemble those of the US.

### 3.1 US corporation context

Although the board structure of the US corporation generally resembles that of the Thai,<sup>92</sup> there is a significant distinction between these two countries, which is the ownership structure. In the US listed firms, dispersed ownership is prevalent.<sup>93</sup> Its characteristic is that, ‘there is no individual or group with either the voting power or the incentive to exercise control and enforce profit maximization’.<sup>94</sup> Without the

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90 Mary Jo White. *Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act*. <https://www.sec.gov/spotlight/dodd-frank.shtml> (accessed June 2<sup>nd</sup>, 2015)

91 Kin-Wai Lee. *Compensation Committee and executive compensation in Asia*, **International Journal of Business**, 19, 3. (2014): 213-236.

92 The board structure of both Thai and US corporations are called “the unitary board” which a single board of directors, comprising executive and non-executive directors (NEDs).

93 Kurt A. Desender, *The relationship between the ownership structure and the role of the board*. [http://www.business.illinois.edu/Working\\_Papers/papers/09-0105.pdf](http://www.business.illinois.edu/Working_Papers/papers/09-0105.pdf) (accessed June 2<sup>nd</sup>, 2016)

94 Leech and Leahy. *Ownership structure, control type classifications and the performance of large British companies*, **Economic Journal**, (1992): 1418-1437

voting power, the incentives to perform direct monitoring are lacking.<sup>95</sup> Moreover, the effect of dispersed ownership is that, ‘when the shareholders are too dispersed to enforce value maximization, corporate assets may be deployed to benefit managers rather than shareholders’.<sup>96</sup> Thus, the use of a board of directors and its sub-committee is a corporate governance mechanism reducing the conflict of interest between those dispersed shareholders and hired managers who are unaccountable to outsiders.

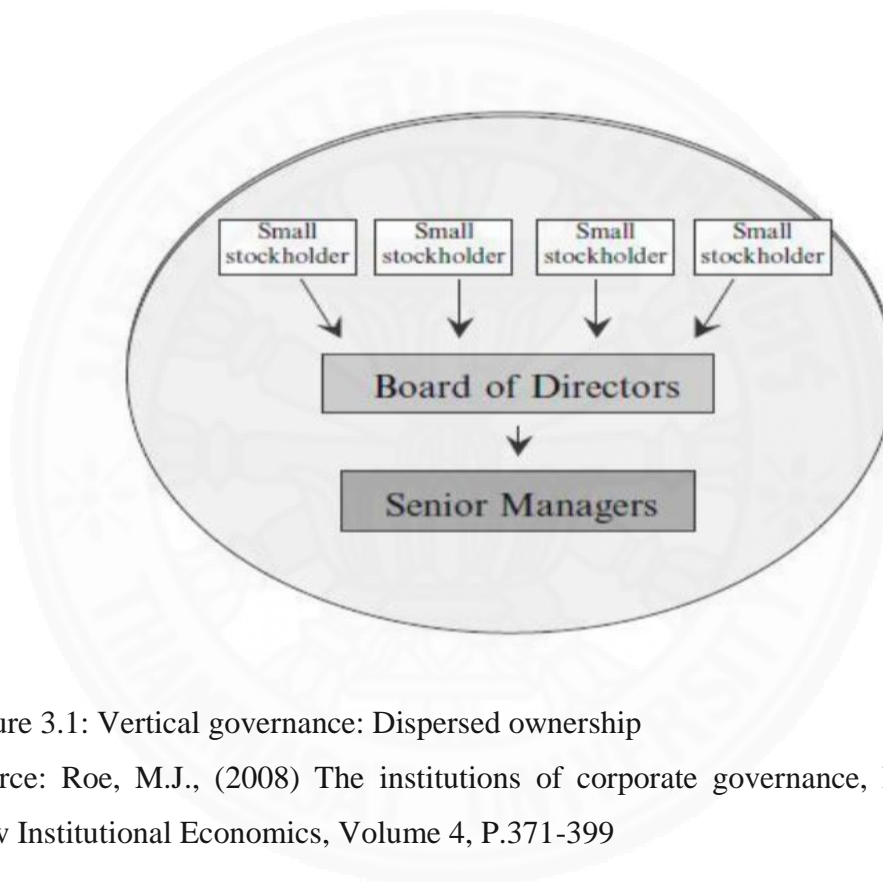


Figure 3.1: Vertical governance: Dispersed ownership

Source: Roe, M.J., (2008) The institutions of corporate governance, Handbook of New Institutional Economics, Volume 4, P.371-399

<sup>95</sup> Miguel A. Mendez *Corporate governance; a US / EU comparison - course outline*. <http://foster.uw.edu/wp-content/uploads/2014/12/MiguelMendezFinal.pdf> (accessed January 25,2016)

<sup>96</sup> Morck, R., Shleifer, A., Vishny, R., *Management ownership and market valuation: an empirical analysis*, **Journal of Financial Economics**, (1988): 293–315

### 3.2 Legal framework

The main sources of law enforcing the list companies (also referred to as ‘issuer’<sup>97</sup> identified in the Securities Exchange Act) is the Securities Exchange Act 1934, which has been adopted by the applicable federal laws. The Act also appoints the Securities and Exchange Commission (SEC) in order to specify additional rules and requirements to direct national securities exchange<sup>98</sup> and to prohibit the listing of any equity security of a company.<sup>99</sup> Moreover, the exchanges shall add listing standards to conduct their own listed companies.

A remuneration committee is fulfilled by the board of directors in order to effectively advance the company’s corporate governance concerning the determination of remuneration. As listed companies in the US, the committee’s performance and relevant practices approved by the board of the company shall abide by the regulations imposed through the federal legislation, implementing rules and stock exchange listing standards.

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97 The Securities Exchange Act [hereinafter referred to “the Exchange Act”] Section 3(8) provides that

*“(8) The term “issuer” means any person who issues or pro-poses to issue any security; except that with respect to certificates of deposit for securities, voting-trust certificates, or collateral- trust certificates, or with respect to certificates of interest or shares in an unincorporated investment trust not having a board of directors or of the fixed, restricted management, or unit type, the term “issuer” means the person or persons performing the acts and assuming the duties of depositor or manager pursuant to the provisions of the trust or other agreement or instrument under which such securities are issued; and except that with respect to equipment-trust certificates or like securities, the term issuer means the person by whom the equipment or property is, or is to be, used.”*

98 *Id.* Section 6

99 *Id.* Section 10C(a) and (f)

In this study, the regulations related to the remuneration committee are considered as follows:

1. The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (hereinafter referred to as the Dodd-Frank Act)
2. The Securities Exchange Act of 1934 (hereinafter referred to as the Exchange Act)
3. The rules of the US Securities and Exchange Commission (hereinafter referred to as US SEC Rules)

Furthermore, the corporate governance listing standards of the New York Stock Exchange (NYSE), which is the world's largest stock exchange, the so-called New York Stock Exchange Listed Company Manual with regard to consideration of the practical terms.

### **3.3 Remuneration committee establishment requirement**

Neither the Exchange Act nor US SEC rules requires listed companies to set up a remuneration committee. It is upon stock exchanges to state such requirement in their listing standards. NYSE is one of the capital markets requiring its listed companies to establish a remuneration committee.<sup>100</sup>

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100 New York Stock Exchange Listed Company Manual [hereinafter referred to "NYSE Listed Company Manual"] Section 303A.05 (a)

### 3.4 Remuneration committee composition

The remuneration committee consists of directors who are delegated the power from the board to consider remuneration matters. The committee may additionally select a remuneration consultant, legal counsel or other adviser,<sup>101</sup> so that the committee shall be guided by reasonable advice in making decisions. According to the Dodd-Frank Act and the related SEC rules, the requirements of both committee members and its consultants for independent assessments are the particular concerns.

#### 3.4.1 Remuneration committee members

Each remuneration committee member is required by the Exchange Act to be both the member of the board and independent.<sup>102</sup> The independence is not defined by laws, nevertheless, the Exchange Act as amended by the Dodd-Frank Act, enforces the exchanges to qualify the term independent director by considering these following relevant factors specified in Section 10C(a)(3):

[S]hall require that, in determining the definition of the term independence the national securities exchanges and the national securities associations shall consider relevant factors, including:

- (A) the source of compensation of a member of the board of directors of an issuer, including any consulting, advisory, or other compensatory fee paid by the issuer to such member of the board of directors; and
- (B) whether a member of the board of directors of an issuer is affiliated with the issuer, a subsidiary of the issuer, or an affiliate of a subsidiary of the issuer.

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101 The Exchange Act, Section 10C(b)(1) imposes that

*“The compensation committee of an issuer may only select a compensation consultant, legal counsel, or other adviser to the compensation committee ”*

102 *Id.* Section 10C(a)(2)



Even though the Exchange Act does not directly state the limitations, it can be said that the Act requires the exchanges to develop additional independence requirements specific to members of a remuneration committee.<sup>103</sup>

As the current practice, the NYSE imposes that the company must have a remuneration committee consisting of entirely independent directors whose qualification meets the specific requirements.<sup>104</sup> The exchange also applies its own test conforming to those relevant factors without further standards as specified in Section 303A.02(a)(ii).<sup>105</sup> NYSE generally looks to ensure that the directors have not been employees of the company, had a business relationship (other than stock ownership) with the company or a familial relationship with employees of the company.<sup>106</sup>

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103 Skadden et al., *2015 Compensation Committee Handbook*  
[https://www.skadden.com/sites/default/files/2015\\_remuneration\\_Committee\\_Handbook\\_111814b.pdf](https://www.skadden.com/sites/default/files/2015_remuneration_Committee_Handbook_111814b.pdf) (accessed July 17, 2015).

104 NYSE Listed Company Manual Section 303A.05 (a)

105 *Id.* Section 303A.02(a)(ii)

*“In order to tighten the definition of independent director for purposes of these standards:*

*(ii) In addition, in affirmatively determining the independence of any director who will serve on the compensation committee of the listed company's board of directors, the board of directors must consider all factors specifically relevant to determining whether a director has a relationship to the listed company which is material to that director's ability to be independent from management in connection with the duties of a compensation committee member, including, but not limited to:*

*(A) the source of compensation of such director, including any consulting, advisory or other compensatory fee paid by the listed company to such director; and*

*(B) whether such director is affiliated with the listed company, a subsidiary of the listed company or an affiliate of a subsidiary of the listed company.”*

106 Doreen E. Lilienfeld. *Say-on-pay, the golden parachute, and other executive compensation*. <http://www.shearman.com/~media/Files/NewsInsights/Publications/2016/04/Inside-the-Minds.pdf> (accessed February 14<sup>th</sup>, 2016).



### 3.4.2 Remuneration committee consultants and other advisers

Listed companies are authorized by law to retain a compensation consultant, legal counsel, or other adviser<sup>107</sup> in order to guide their view on the optimal remuneration and on other peer company comparison.<sup>108</sup> Compensation consultants and other advisers shall be qualified by specific independence factors identified by the US SEC, which are required to meet the basic factors according to Section 10(b) (2) of the Exchange Act including:

- (A) the provision of other services to the issuer by the person that employs the compensation consultant, legal counsel, or other adviser;
- (B) the amount of fees received from the issuer by the person that employs the compensation consultant, legal counsel, or other adviser, as a percentage of the total revenue of the person that employs the compensation consultant, legal counsel, or other adviser;
- (C) the policies and procedures of the person that employs the compensation consultant, legal counsel, or other adviser that are designed to prevent conflicts of interest;
- (D) any business or personal relationship of the compensation consultant, legal counsel, or other adviser with a member of the compensation committee; and
- (E) any stock of the issuer owned by the compensation consultant, legal counsel, or other adviser.<sup>109</sup>

In the case of a remuneration consultant's independent criteria, the US SEC does not issue regulations beyond the specific factors stated by law. With reference to the NYSE listing standard, the work of a compensation consultant obtained by a remuneration committee shall be directly appointed, compensated, and monitored by the committee.<sup>110</sup> The standards not only follow up the relevant factors stated by the Exchange Act, but also specify further determination related to that consultant's independence to consider any business or personal relationship.<sup>111</sup>

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107 The Exchange Act Section 10C(b)(1)

108 Skadden et al., *Supra Note* 103.

109 The Exchange Act Section 10C(b)(2)

110 NYSE Listed Company Manual Section 303A.05(C)(ii)

111 *Id.* Section 303A.05(C)(v)(F)

### 3.5 Remuneration committee's responsibilities

The responsibilities of the remuneration committee are commonly outlined in the committee's charter approved by the board of directors, which comply with the requirements specified by law and address the company's particular needs and circumstances. They should reflect the requirements imposed by the securities exchanges, some of which are the result of the Dodd-Frank Act, applicable US SEC regulations and other legal limitations.<sup>112</sup>

There is no fixed charter regarding the remuneration committee's responsibilities. The minimum responsibility requirements, according to the NYSE listing standards, must include:

1) to examine and approve CEO compensation with relevance to corporate governance objectives and evaluate CEO performance in order to determine and decide the compensation level;

2) to provide recommendations regarding to non-CEO executive officer compensation, and incentive-compensation and equity-based plans to the board of directors; and

3) prepare the disclosure required by Item 407(e)(5) of Regulation S-K<sup>113</sup>

In the case of director remuneration responsibility, this may be assigned by the board to the remuneration committee.<sup>114</sup>

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112 Skadden et al.,*Supra Note* 103.

113 NYSE Listed Company Manual Section 303A.05(b)(i)

114 Skadden et al.,*Supra Note* 103.

### 3.5.1 Director remuneration

The director remuneration programme and level are generally subject to shareholder meetings of the whole board of directors, otherwise they may fall within the duties assigned by the board to the remuneration committee or another committee of the board, or the remuneration committee (or such other committee) may make recommendations to the board.<sup>115</sup> Even so, there is a distinction between director fees and executive remuneration, ‘executives are paid remuneration in consideration for their full time employment with the company. Director fees are not remunerated in the same way, but rather an honorarium that is paid to directors for their contributions to the company’.<sup>116</sup> Most of the considerations in the context of executive compensation are applied to the determination of director compensation as well.

Under NYSE listing rule Section 303A.09, the listed companies are required to have guidelines with regard to director compensation. The guidelines should include:

- (1) General principles for determining the form and amount of director compensation;
- (2) The independence of directors when their fee exceeds what is customary;
- (3) The conflict of interest as to whether a director is affiliated, or enters into consulting contracts with (or provides other indirect forms of compensation to) a director;
- (4) The evaluation of each of these matters when determining the form and amount of director compensation, and the independence of a director.

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115 Skadden et al., *Supra Note 103*, at 8

116 Kala Anandarajah, *Non-Executive Director Remuneration - A Quick Review Of Where It Stands*. [http://www.sid.org.sg/web\\_publications/articles\\_detail/35](http://www.sid.org.sg/web_publications/articles_detail/35) (accessed March 1<sup>st</sup>, 2016)

Even if the director remuneration responsibilities are not required to be delegated to any particular committee, such as a remuneration committee, it is recommended by the exchange's listing standards to assign such responsibilities.<sup>117</sup> The reason is that the remuneration plan determined must be approved by the directors who may directly benefit from that proposed plan and this is not protected by a court, as noted in the business judgment topic.

### 3.5.2 Executive remuneration

Executive remuneration is another interesting provision specified by the Dodd-Frank Act, since it has been well-received at international level and is likely to be adopted. Executive remuneration shall be recommended by the remuneration committee to the full board of directors.<sup>118</sup> Furthermore, it needs to include these important requirements, ie say on pay, pay for performance and clawback.

#### 1. Say on pay

According to the Dodd-Frank Act, Section 951 adds new Section 14A(a)(2) to the Exchange Act authorizing the shareholders that:

[N]ot less frequently than once every 6 years, a proxy or consent or authorization for an annual or other meeting of the shareholders for which the proxy solicitation rules of the Commission require compensation disclosure shall include a separate resolution subject to shareholder vote to approve the compensation of executive.<sup>119</sup>

The Act also specifies that this non-binding vote shall be made a resolution on how often they would like to be presented: every year, every other year, or once every three years.<sup>120</sup>

This advisory vote is known as 'say on pay vote', where the shareholders who are regarded as owners of the company have a direct signal to

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117 Wachtell, et al, *Supra Note* 63, at 79.

118 *Id.*

119 The Exchange Act Section 14 A(a)(1)

120 *Id.* Section 14 A(a)(2)

approve any type of compensation of executives who are regarded as employees working for the owners.<sup>121</sup> The authority of shareholders on executive remuneration approval does not only increase transparency, but also the company's disclosure obligations.<sup>122</sup> In addition, shareholders are allowed to vote on how frequently to hold the say on pay vote, which is also a non-binding vote.

## 2. Pay for performance

In accordance with Section 953(a), the executives' remuneration determination shall not be paid as they please, since annual proxy statements have to present the relationship between compensation and performance. The company is required to report 'information that shows the relationship between executive compensation actually paid and the financial performance of the issuer, taking into account any change in the value of the shares of stock and dividends of the issuer and any distributions'.<sup>123</sup>

As the pay level depends on the performance of the company, it can be said that the executives will gain higher pay only when they can create higher benefits to the shareholders. There are additional regulations emphasizing the importance of 'pay for performance', which is the deduction of tax. With respect to Section 162(m) of the Internal Revenue Code, performance-based compensation is the exception of the \$1 million deduction limitation on certain employees in public companies.<sup>124</sup> The deduction shall not apply to compensation

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121 Pipop U., *Supra Note 74*.

122 New York country lawyers' association. *Investor Protection of Dodd-Frank Act and enhanced professionalism*, presented at New York country lawyers' association March 25<sup>th</sup>, 2014.

123 The Dodd-Frank Act, Section 953(a) specifies that

*"(a) Disclosure of pay versus of performance- Section 14 of the Securities Exchange Act of 1934 (15 U.S.C. 78n), as amended by this title, is amended by adding at the end "*

124 The Internal Revenue Code Section 162(m) states that

*"(1) In general*

*In the case of any publicly held corporation, no deduction shall be allowed under this chapter for applicable employee remuneration with respect to any*

considered in relation to a company's performance by meeting the following requirements:

- (1) the compensation is determined by the remuneration committee,
- (2) there is shareholder approval before payment, and
- (3) there is certification of the remuneration committee before payment.<sup>125</sup>

### 3. Recovery of erroneously awarded remuneration policy

With respect to Section 954, listed companies are required by the Act to implement a policy known as 'clawback' that:

[I]n the event that the issuer is required to prepare an accounting restatement due to the material noncompliance of the issuer with any financial reporting requirement under the securities laws, the issuer will recover from any current or former executive officer of the issuer who received incentive based compensation (including stock options awarded as compensation) during the 3-year period preceding the date on

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*covered employee to the extent that the amount of such remuneration for the taxable year with respect to such employee exceeds \$1,000,000.*

*(2) Publicly held corporation*

*For purposes of this subsection, the term publicly held corporation means any corporation issuing any class of common equity securities required to be registered under section 12 of the Securities Exchange Act of 1934."*

125 *Id.* Section 162(m)(4)(C) states that

*"Other performance-based compensation*

*The term applicable employee remuneration shall not include any remuneration payable solely on account of the attainment of one or more performance goals, but only if—*

- (i) the performance goals are determined by a compensation committee of the board of directors of the taxpayer which is comprised solely of 2 or more outside directors,*
- (ii) the material terms under which the remuneration is to be paid, including the performance goals, are disclosed to shareholders and approved by a majority of the vote in a separate shareholder vote before the payment of such remuneration, and*
- (iii) before any payment of such remuneration, the compensation committee referred to in clause (i) certifies that the performance goals and any other material terms were in fact satisfied".*

which the issuer is required to prepare an accounting restatement, based on the erroneous data, in excess of what would have been paid to the executive officer under the accounting restatement.<sup>126</sup>

The obligation to clawback requires the duty to exclusively recover incentive-based compensation (including stock options) from current and former executives who are paid based on improper financial statements or a material non-compliance with any financial reporting requirement under the SEC Rules during the prior three years after the year in which the errors were made in the report. The amount of recovery is calculated based upon the correct amount after the restated amount is subtracted from the excess amount paid. This policy does not only encourage executives who certify the statement to perform with more caution, but also prevents window dressing accounting aimed at short-term profit.<sup>127</sup>

### 3.6 Disclosure

The disclosure requirements in Regulation S-K and Regulation S-X provided by the US SEC consider ways to improve the disclosure regime for the benefit of both companies and investors.<sup>128</sup> A remuneration committee of a listed company is obliged to improve their disclosure policy to meet not only the requirements stated by law, but also the good corporate governance standard. A remuneration committee that reports sufficient information through public disclosure contributes to increased transparency. The following section sets out the primary components of remuneration disclosure required each year

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126 The Dodd-Frank Act Section. 954 specifies that

*“The Securities Exchange Act of 1934 is amended by inserting after section 10C, as added by section 952”*

127 Pipop U., *Supra Note 74*.

128 The U.S. Securities and Exchange Commission. *Disclosure effectiveness*. <http://www.sec.gov/spotlight/disclosure-effectiveness.shtml> (accessed March 1<sup>st</sup>, 2016)



### 3.6.1 Compensation committee governance

The corporate governance of a remuneration committee requires disclosure by describing the scope of the committee's authority, the roles of any compensation consultants, and the company's process of remuneration design. Listed companies are responsible for completing the Remuneration Committee Governance Form 8-K on a current basis in order to notify the shareholders.<sup>129</sup> Nevertheless, if listed companies do not set up a remuneration committee, they shall state the basis for the view of the board that it is appropriate for the company not to have such a committee and identify the participant who considers executive and director compensation.<sup>130</sup> The presentation of the committee governance includes:

1. The election of a director relating to the independence standards containing specific requirements for the remuneration committee of the board<sup>131</sup>

2. The total number of meetings held by remuneration committees

3. The remuneration committee's charter (if any)<sup>132</sup>

4. The scope of the remuneration committee's authority<sup>133</sup>

5. The additional description if the committee delegates its authority and to whom

- 5.1 Any roles of executives in determining or recommending the amount or form of executive and director compensation<sup>134</sup> and

- 5.2 Any roles of compensation consultants in determining or recommending the amount or form of executive and director compensation with additional fees<sup>135</sup> and their independence<sup>136</sup>

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129 Edward M. W., *Frequently asked questions about FORM 8 – K*, <http://media.mofo.com/files/Uploads/Images/FAQ-Form-8-K.pdf> (accessed June 2, 2015)

130 The Securities and Exchange Commission's rules §229.407 (e)(1)

131 *Id.* §229.407 (a)

132 *Id.* §229.407 (e)(2)

133 *Id.* §229.407 (e)(3)(i)(A)

134 *Id.* §229.407 (e)(3)(i)(B)(ii)

135 *Id.* §229.407 (e)(3)(i)(B)(ii) also states additional description as :



6. The existence of conflict of interest regarding the remuneration consultant, containing the nature of the conflict and how the conflict is being addressed<sup>137</sup>

### 3.6.2 Compensation Discussion and Analysis (CD&A)

The US SEC requires listed companies to provide shareholders or investors with a Compensation Discussion and Analysis (CD&A) which contains the necessary material for understanding the listed company's compensation policy and decisions regarding the named executive officers (NEO): the CEO, the Chief Financial Officer (CFO) and the three most highly remunerated executives other than the CEO and CFO.<sup>138</sup>

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*“(A) If such compensation consultant was engaged by the compensation committee to provide advice or recommendations on the amount or form of executive and director compensation and the compensation consultant or its affiliates also provided additional services to the registrant or its affiliates in an amount in excess of \$120,000 during the registrant's last completed fiscal year, then disclose the aggregate fees for determining or recommending the amount or form of executive and director compensation and the aggregate fees for such additional services. Disclose whether the decision to engage the compensation consultant or its affiliates for these other services was made, or recommended, by management, and whether the compensation committee or the board approved such other services of the compensation consultant or its affiliates.*

*(B) If the compensation committee has not engaged a compensation consultant, but management has engaged a compensation consultant to provide advice or recommendations on the amount or form of executive and director compensation and such compensation consultant or its affiliates has provided additional services to the registrant in an amount in excess of \$120,000 during the registrant's last completed fiscal year, then disclose the aggregate fees for determining or recommending the amount or form of executive and director compensation and the aggregate fees for any additional services provided by the compensation consultant or its affiliates”.*

136 The Exchange Act, Section 10(c)(2)

137 The Securities and Exchange Commission's rules §229.407 (e)(3)(iv)

138 “Named executive officer” refers to the executive officers of a listed company as defined by Item 402(a)(3) of Regulation S-K that:

*“(i) All individuals serving as the registrant's principal executive officer or acting in a similar capacity during the last completed fiscal year (PEO), regardless of compensation level;*

According to § 229.402 (b) of US SEC Rules, CD&A shall discuss the grounds behind the compensation policy earned by the NEO including:

- (1) The elements of compensation
- (2) The objectives of the compensation programme
- (3) The method of compensation determination
- (4) The consideration of the most recent shareholder non-binding vote on executive compensation required by Section 14A of the Exchange Act.

CD&A reflects not only the visible roles of a remuneration committee, which is the responsibility of management, but also the recognition of the outcome of the ‘say on pay’ shareholder vote. As the SEC imposes the shareholder approval of the executive remuneration,<sup>139</sup> the company shall report the information, including how the company has considered the results of the most recent shareholder advisory vote required and how that consideration has affected the decision. In addition, listed companies need to show the relationship between the actual payment of executive remuneration and the financial performance of the company.<sup>140</sup> Pursuant to the requirements of the remuneration discussion and analysis, this disclosure covers the remuneration programme, its policies and decisions, and the important factors used for analysis.<sup>141</sup>

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*(ii) All individuals serving as the registrant's principal financial officer or acting in a similar capacity during the last completed fiscal year (PFO), regardless of compensation level;*

*(iii) The registrant's three most highly compensated executive officers other than the PEO and PFO who were serving as executive officers at the end of the last completed fiscal year; and*

*(iv) Up to two additional individuals for whom disclosure would have been provided pursuant to paragraph (a)(3)(iii) of this Item but for the fact that the individual was not serving as an executive officer of the registrant at the end of the last completed fiscal year.”*

139 The Exchange Act, Section 14A

140 *Id.* Section 14

141 The Securities and Exchange Commission's rules §229.402 (b)

### 3.6.3 Remuneration committee report

As the remuneration committee has an obligation to discuss, analyse and conclude all material with respect to the NEO compensation policy, the committee have to include a Remuneration Committee Report in its annual report on Form 10-K, and each member must sign the report in order to state whether they have approved the CD&A or not, and attest that the committee has discharged that obligation.<sup>142</sup> The provision of the Remuneration Report is to ensure the accountability of the CD&A and encourage the committee to review it carefully.<sup>143</sup>

### 3.6.4 Executive compensation table and additional annual disclosure regarding NEO compensation

The following tabular form of disclosure is required by the US SEC Rules §229.402 (c) to state the amounts of both cash and non-cash remuneration of the NEO separately, including some narrative description<sup>144</sup> and footnotes describing the quantitative information:

Table 3.1: The example of summary compensation table

| Name of the principal position | Year | Salary (\$) | Bonus (\$) | Stock awards (\$) | Option awards (\$) | Non-equity incentive plan remuneration (\$) | Change in pension value and non-qualified deferred remuneration earnings (\$) | All other remuneration (\$) | Total (\$) |
|--------------------------------|------|-------------|------------|-------------------|--------------------|---|---|-----------------------------|------------|
| 1                              |      |             |            |                   |                    |   |   |                             |            |
| 2                              |      |             |            |                   |                    |   |   |                             |            |

Source: The Exchange Act, Section 402(c)

<sup>142</sup> *Id.* §229.407 (e)(5)

<sup>143</sup> Skadden et al., *Supra Note* 103

<sup>144</sup> The Securities and Exchange Commission's rules §229.402 (e)

The table discloses the category of all compensation received by the NEO related to the preceding fiscal year, such as salary, bonus, equity awards, and change in pension value. Beside the noted Summary Compensation Table, the US Rule requires additional tables with information regarding:

- (1) Grants of plan-based award table<sup>145</sup>
- (2) Outstanding equity awards at fiscal year-end table<sup>146</sup>
- (3) Option exercises and stock vested table<sup>147</sup>
- (4) Pension benefits<sup>148</sup>
- (5) Non-qualified defined contribution and other non-qualified deferred remuneration plan<sup>149</sup>
- (6) Potential payments upon termination<sup>150</sup>
- (7) Golden purchase<sup>151</sup>

### **3.6.5 Director Compensation Table**

The US SEC Rule Item 402 (k) requires listed companies to disclose the information for the preceding fiscal year, together with a narrative description of the remuneration programmes including the name of each director, the amount of fee paid in cash, and other non-monetary remuneration separately, as shown below. The disclosure is not supplemented with the additional compensation tabular disclosure provided for NEOs.

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145 *Id.* §229.402 (d)

146 *Id.* §229.402 (f)

147 *Id.* §229.402 (g)

148 *Id.* §229.402 (h)

149 *Id.* §229.402 (i)

150 *Id.* §229.402 (j)

151 *Id.* §229.402 (t)

Table 3.2: The example of director remuneration table

| Name | Fees earned or paid in cash | Stock awards | Option award | Non-equity incentive plan remuneration | Change in pension value and non-qualified deferred remuneration earnings | All other remuneration | Total |
|------|-----------------------------|--------------|--------------|--|--|------------------------|-------|
| A    |                             |              |              |  |  |                        |       |
| B    |                             |              |              |  |  |                        |       |

Source: the Exchange Act, Section 402(k)

### 3.6.6 Pay ratio disclosure

The company shall disclose the comparison of the chief executive officer's compensation and the median compensation of other employees, including full-time, part-time, temporary and seasonal workers. The following amounts of remuneration shall be provided:

1. The median of the annual total remuneration of all employees excluding the chief executive officer
2. The annual total remuneration of the chief executive officer
3. The ratio of these amounts.

The ratio not only makes the information clearer, but also informs shareholders of the reasonableness of executive payment versus that of the average worker.

### 3.6.7 Risk and board-based compensation programme

As remuneration programmes for employment mainly cause risks and unfavourable effects on the company,<sup>152</sup> US SEC item §229.402 (s) requires further disclosure regarding the company's remuneration programme, risk management and risk-taking incentive discussion. The disclosure of relationships between the

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<sup>152</sup> Deunden Nikomborirak and Somkiat Tangkitvanich. *Corporate governance in Asia: a comparative perspective* conference held 3-5 March 1999

compensation practices and risk management certifies that the company oversees and reviews the risks associated with its executive and employee compensation programmes at least once a year.

### **3.7 Remuneration committee's duties and liabilities**

#### **3.7.1 Business judgement rule**

Directors conduct the business of the company so that their organization will run for the benefit of the shareholders. Most directors, including members of a remuneration committee, are required to exercise their power on the case-law derived doctrine of the so-called business judgement rule. The rule was declared by the Delaware Supreme Court to assume that 'in making a business decision, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interest of the company.'<sup>153</sup>

A director's business decision is presumed to be made in good faith and with due care, unless a third person is able to prove that the director has not met the duty of care or loyalty.<sup>154</sup> The business judgement rule is subject to a counterpart of fundamental fiduciary duties named the duty of loyalty and the duty of care.<sup>155</sup>

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153 *Smith v. Van Gorkom*, 488 A.2d 858, 872 (Del. 1985)

154 *See, e.g., Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984).

155 *See, e.g., Campbell v. Potash Corp. of Saskatchewan, Inc.*, 238 F.3d 792, 800 (6th Cir. 2001)

### 1. Duty of care

A director has an obligation to perform, on an informed basis, monitoring and management with the care of a person in a like position under similar circumstances<sup>156</sup> concerning the relevant materials and appropriate consideration.<sup>157</sup> The Delaware Supreme Court, however, rejected the reasonable person standard and extended a director's performance protection to all director actions not constituting gross negligence.<sup>158</sup> Thus, a director who has risen to the level of gross negligence in making a decision shall be proved as breaching the duty of care.

In order to make a determination related to remuneration matters without a claim of breach of duty of loyalty, a remuneration committee should:

- (1) Become familiar with all material information
- (2) Involve independent expert suggestions, such as from a compensation consultant
- (3) Actively participate in discussions and ask questions of all stakeholders including external experts
- (4) Understand and weigh alternative courses of conduct
- (5) Take appropriate time to make an informed decision.

### 2. Duty of loyalty:

Directors are required to act in good faith for the best interest of the company and all stakeholders, which is subsumed as the duty of loyalty. The duty definition was provided by the Delaware Supreme Court as:

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156 Jonathan, M. Hoff et al. **Public companies**. (1998)

157 *See e.g.*, Smith v. Van Gorkom, 488 A.2d 858, 874 (Del. 1985)

158 Jonathan, M. Hoff et al. *Supra Note* 156.



Corporation officers and directors are not permitted to use their position of trust and confidence to further their private interests. While technically not trustees, they stand in a fiduciary relation to the corporation and its stakeholders... The rule that requires an undivided and unselfish loyalty to the corporation demands that there shall be no conflict between duty and self-interest.<sup>159</sup>

Both executive and director compensation concern the duty of loyalty, since their compensation is fixed by the board's authority in some states.<sup>160</sup> When the directors have to approve their own compensation, a breach of the duty may occur. As a result, those directors are required by the court to prove that such a transaction was fair to the company.<sup>161</sup> The court, in addition, allows the directors to prove whether they are able to recover for their service or not by demonstrating:

- (1) The directors worked with the understanding that they would be compensated
- (2) The directors do not provide excessive remuneration to unreasonably enrich themselves
- (3) The company benefited from their work and would not be unjustly enriched if the directors were not compensated<sup>162</sup>

The court decision in the Disney case depicted the scope of duty of loyalty as negligence; that is, a failure to perform a duty of care, and stated that it should not cause the failed action in good faith. The court also ruled that an 'intentional dereliction of duty, a conscious disregard for one's responsibilities' shall be used as a measure for determining that a director has acted in good faith or not. In contrast, a director fails to act in good faith when the director:

- (1) intentionally acts with a purpose other than that of advancing the best interests of the company
- (2) acts with intent to violate applicable positive law or

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159 Guth v. Loft, Inc., 5 A2d 503 (Del. 1939)

160 See, e.g., Delaware: 8 Del. Code Ann §141(h) states that

*"Unless otherwise restricted by the certificate of incorporation or bylaws, the board of directors shall have the authority to fix the compensation of directors."*

161 See Delaware: Telxon Corp. V. Meyerson. 802 A.2d 257. 226 (Del. 2002).

162 Technicorp International II. Inc. V. Johnston. C.A. No. 5084. 1997 Del. Ch. LEXIS 126. at 45-46 (Del. Ch. Aug. 22. 1997)



(3) intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties<sup>163</sup>

### 3.7.2 Liabilities

1. The ‘relevant factors’ of a remuneration committee members’ adoption with reference to Section 10(C)(a)(1), are that listed companies must comply with the relevant factors used to determine the independence of the committee members, otherwise they shall be prohibited.<sup>164</sup>

2. In the implementation of the clawback requirement by virtue of Section 10D(a) of the Exchange Act, the national securities exchanges including NYSE and NASDAQ are required to prohibit the listed companies who do not comply with the clawback requirement.

3. If the filing of the remuneration disclosure statements required by law, such as Form K-08, were false or misleading, any person who made or caused to be made the said statement shall be liable for damages caused by such reliance.<sup>165</sup> However, this false or misleading statement must be only material statements which are described by the court as:

to prove whether statement is material, it is not necessary for an investor to show that the information would have caused the investor to show the information would have caused the investor to change his/her vote. It is sufficient for the investor to show only that the information would have been viewed by the reasonable investor as having significantly altered the total mix of information available about the matter.<sup>166</sup>

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163 See e.g. In re The Walt Disney Co. Derivative Litigation, 825 A 2d 275 (Del. Ch. 2003)

164 The Exchange Act Section 10(C)(a)(1) states that

*“The Commission shall, by rule, direct the national securities exchanges and national securities associations to prohibit the listing of any equity security of an issuer, ..., that does not comply with the requirements of this subsection.”*

165 *Id.* Section 18(a)

166 See e.g. TSC Indus. Inc. V. Northwat Inc., 426 U.S. 438, 449(1975)

## CHAPTER 4

### THAI LAWS IN RELEVANCE TO REMUNERATION COMMITTEES

Most Thai listed companies' ownership structure is different from other developed countries including the US. While Thai firms are owned by the same family or a group of families,<sup>167</sup> the US firms' shares are diffusely held by different parties as mentioned in Chapter 3. The consideration of the family-run business is important since this ownership concentration is assumed to influence the weak corporate governance practice of Thai listed companies causing the economic crisis in 1997.<sup>168</sup> Over 15 years, therefore, the Securities and Exchange Commission established by the government, in collaboration with the Stock Exchange of Thailand, and the Thai Institute of Directors have developed corporate governance principles to provide a benchmarking tool that helps listed companies achieve world-class governance levels.

Since the shareholding structure is concentrated in the family group, the controlling family members participate in the board<sup>169</sup> and hold executive director positions.<sup>170</sup> Thus, directors and executives can be compared to the representatives of the large shareholders. In this case, the conflict of interest between executives and shareholders is less because they have the motivation to improve the firm's performance and increase their private wealth<sup>171</sup> by preferring to receive dividend

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167 ยุทธ วรรณัฒรชาร. *ปัญหากรรมการอิสระ*. (Yuth Worachatharn. *The problems of independent directors*.) [http://www.set.or.th/sustainable\\_dev/th/cg/files/doc\\_seminar/2009/AW\\_CGCorner79\\_NOV.pdf](http://www.set.or.th/sustainable_dev/th/cg/files/doc_seminar/2009/AW_CGCorner79_NOV.pdf) (accessed March 15<sup>th</sup>, 2016)

168 Akira Suehio, *Family business gone wrong? Ownership patterns and corporate performance in Thailand* (2001). <http://www.adb.org/sites/default/files/publication/157194/adbi-rp19.pdf> (accessed March 15<sup>th</sup>, 2016)

169 Khanthavit, Polsiri and Wiwattanakantang *Did Families Lose or Gain Control after the East Asian Financial Crisis?* (2003) <http://ssrn.com/abstract=370120> (accessed March 15<sup>th</sup>, 2016)

170 Yupana, Wiwattanakantang. *Controlling shareholders and corporate value: evidences from Thailand*. **Pacific-Basin Finance Journal** 9. (2001): 323-362.

171 Jensen, Michael C. and Meckling, William H. *Supra Note 23*.

income rather than cash compensation.<sup>172</sup> However, these executives have controlling power to unreasonably benefit to themselves and to take advantage over outside investors or abuse small shareholders' rights, especially excess compensation. To summarize, there is a conflict of interest between the dominant shareholder and the minority shareholder. In the eyes of the minority shareholders, however, they do not actively participate at a shareholders' meeting to exercise their voting power in order to monitor the management and to protect their rights, because they cannot pool their forces to counterbalance the large shareholders. As a result, if there is any misconduct of the management, they usually choose to sell their shares to cut their losses rather initiating a lawsuit to seek redress.<sup>173</sup>

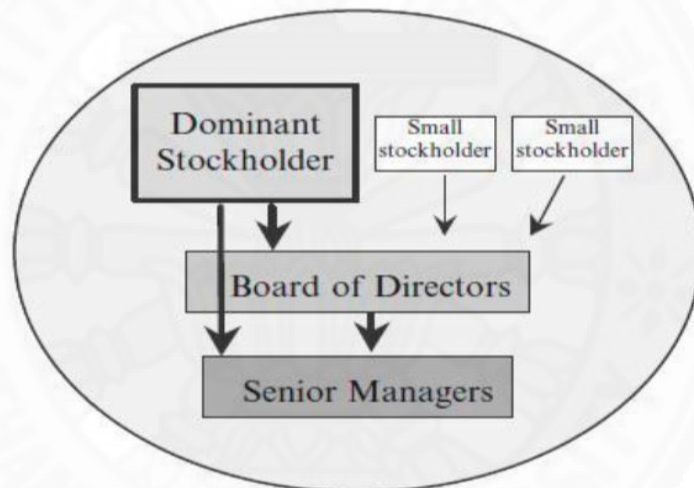


Figure 4.1: Horizontal governance: controlling dominant stockholder vs. small stockholder

Source: Roe, M.J., (2008), 7

172 Cheung, Y., Stouraitis, A., Wong, A.W.S., *Ownership concentration and executive compensation in closely held firms: evidence from Hong Kong*. **Journal of Empirical Finance** 12, (2005): 511–532.

173 The Securities and Exchange Commission. *Supra Note 57*.

Corporate governance is expected to promote the effective check and balance mechanism of a board of directors' functions, as well as to protect minority shareholders through shareholders meetings and disclosure. At present, the existing laws do not mention a remuneration committee directly, but there are some rules relating to the remuneration process and disclosure. In addition, the legal measures according to directors' duties and liabilities are considered, since a remuneration committee is a group of directors appointed and delegated power to review remuneration matters by the board of directors. These laws and regulations are as follows:<sup>174</sup>

1. The Public Company Act BE 2535 specifies the remuneration of directors and general duties and liabilities of directors.
2. The Securities and Exchange Act BE 2535 added the directors' duties and liabilities which do not appear in the Public Company Act.
3. The Securities and Exchange Commission announcements mention the disclosure of information related to the numbers of directors and executives including their remuneration.
4. The Stock Exchange of Thailand regulations, named the Principles of Good Corporate Governance of Listed Companies 2012 and the Remuneration Committee guidelines, provide for the report of good governances related to the remuneration committee and remuneration process.

In this chapter, an overview of Thai legal frameworks regarding remuneration committees is described and analysed by the consideration of the context of Thai listed companies.

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174 The Securities and Exchange Commission. **Directors' handbook Vol.2: Practice guideline for directors**, (2007) 18.

#### 4.1 Remuneration committee's responsibilities

According to the general principle of corporate governance, which states that, 'The person deciding remuneration should not be the same person as the one being evaluated, or be answerable to that person',<sup>175</sup> a remuneration committee is recommended by the SET to play a key role in considering the fair criterion, the forms, and the levels of director and executive compensation.<sup>176</sup> Before proposing the appropriate remuneration package to the board of directors, the committee should go through the following steps:<sup>177</sup>

- (1) Review current criteria (if any)
- (2) Compare the remuneration packages with other companies in the same industry
- (3) Establish reasonable criterion which will create the expected results and reward those directors and executives who contribute to the company's success
- (4) Review the amount and proportion of all forms of remuneration including retainer fees, attendance fees, and incentive payments
- (5) Consider whether the form of remuneration is in accordance with regulations and related recommendations

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175 The Securities and Exchange commission. **Directors' handbook Vol.1: Roles, duties and responsibilities of directors and board of directors.** (2007), 19.

176 The Stock Exchange of Thailand. *Supra Note* 46 at 94.

177 *Id.* at 150.

#### 4.1.1 Director remuneration

The provisions relating to the payment of directors is regulated under The Public Company Act as follows:

The company shall not pay money or give any property to a director, unless it is a payment of remuneration under the articles of association of the company.

In the case where the articles of association of the company is not stipulated, the payment of remuneration under paragraph one shall be in accordance with the resolution of the meeting of shareholders based on a vote of not less than two-thirds of the total number of votes of the shareholders attending the meeting.<sup>178</sup>

With regard to Section 90, directors shall be strictly compensated under the articles of association stipulated by the company. The rules set out in the article should be clear enough so that the board of directors does not determine its own remuneration, such as the exact amount of director fee or a gratuity for directors as a percentage of net profit.<sup>179</sup> The said rules, at the same time, should be flexible to be in line with the board's performance and should be periodically reviewed.

If there are no such articles, however, the remuneration of directors shall be approved by the annual shareholders meeting, considering that it should be competitive to the industry level in which the company operates, and reflect the experience, obligations, scope of work, accountability and responsibilities of each director.<sup>180</sup>

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178 The Public Company Act Section. 90

179 The Securities and Exchange Commission, *Supra Note 175*, at 89.

180 The Stock Exchange of Thailand. *Supra Note 46* at 107.

Listed companies may delegate to a remuneration committee to consider the remuneration of directors and the subcommittee by taking into account various factors and to present a report to the board before being approved by a shareholders' meeting.<sup>181</sup> The resolutions determining the directors' remuneration is a mechanism not only to encourage shareholders' participation in the remuneration setting, but also to develop accountability of directors.

#### 4.1.2 Executive remuneration

Unlike director remuneration, the existing law does not exactly regulate the executive remuneration approval. According to the Corporate Governance Principles, it is suggested that the executive remuneration package is considered by a remuneration committee in compliance with the company's regulations and related recommendations before presenting to a board of directors. For the best interests of the company, the SET additionally recommends that the level and composition of remuneration, including salaries, bonuses, and other long-term compensation, not only corresponds to the performance of each executive, but is also comparable to remuneration packages of other companies in the same industry. Moreover, a remuneration package should be related to shareholders' benefit and the sustainability of the company.<sup>182</sup>

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181 For example in the annual report 2015 of Total Access Communication Public Company Limited (DTAC) disclosed that *"In determining the remuneration of the Board of Directors of the Company and the subcommittees... The Remuneration Committee will consider the remuneration of directors and propose to the Board of Directors' and shareholders' meetings for consideration and approval on an annual basis."* Similarly, annual report 2014 of True Corporation Public Company Limited (TRUE) stated that *"the Compensation and Nominating Committee reviewed the appropriateness of the remunerations of directors, taking into consideration the performance standards of the same industry, as well as the experience, duties and responsibilities of directors, and recommended to the Board of Directors meeting.....should be presented to the 2014 AGM for approval."*

182 The Stock Exchange of Thailand, *Supra Note 46*.



It is undeniable that a remuneration committee's operation may involve executives by being brought into the pay-setting process by negotiating with those executives to find an acceptable compensation package. The package determined through the negotiation does not cause manager-shareholder conflict because the executives and the owners are the same person<sup>183</sup> and they generally manage the business for the long-term interest of the company, which benefits all shareholders at the same time. However, the conflict will shift to the executives-minority shareholders<sup>184</sup> since they may use their power to obtain unreasonable overpayments for themselves.<sup>185</sup>

In summary, a remuneration committee's responsibilities for remuneration determination should be left for each company to decide. The appraisal of remuneration determination, including executive performance, financial performance, long-term strategic performance, and a career development plan<sup>186</sup> should be retained as a guideline. According to the executive remuneration which is approved by the board, the arm's length contract is unavoidably made by the committee or the board, and the executive is likely to be suitable in the Thai firms' context as the executives are highly concentrated and own most of the shares of the company.<sup>187</sup> However, legal limitations concerning good corporate governance practice should promote equity and transparency by promoting the independence of the remuneration committee to effectively monitor executive behaviour and to determine their remuneration without any incentives. In addition, the disclosure requirements, including the remuneration scheme, whether fixed or variable according to the performance of the company, should be promoted so that the minority shareholders can make appropriate investigations.

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183 Wiwattanakantang, Y. *The equity ownership structure of Thai firms*. (2000). [www.ssrn.com/abstract=271358](http://www.ssrn.com/abstract=271358) (accessed June 2<sup>nd</sup>, 2016)

184 *Id.*

185 Jakkravudhi Chobpichien. *CEO Controlling Ownership, Board of Directors' Quality, and Level Of Voluntary Disclosure in Thailand*, **Hatyai Journal** 12,1 (2014): 11-31

186 The Stock Exchange of Thailand, *Supra Note* 46.

187 *Id.*



#### 4.2 The existence of a remuneration committee

Unlike an audit committee, a listed company is not required either by the PCA or by the SEA to establish a remuneration committee. It is, however, suggested that a committee be set up<sup>188</sup> as an additional board committee, which could be helpful in developing accountability.<sup>189</sup> With reference to the survey of 100 SET listed companies in 2014, almost all of the companies contained either a remuneration committee or a combination with a nomination committee as shown in Figure 4.2. Moreover, the number of listed companies establishing a remuneration committee has been increased since the existence of the committee is considered to be a good governance practice cited in the ASEAN Corporate Governance Scorecard.

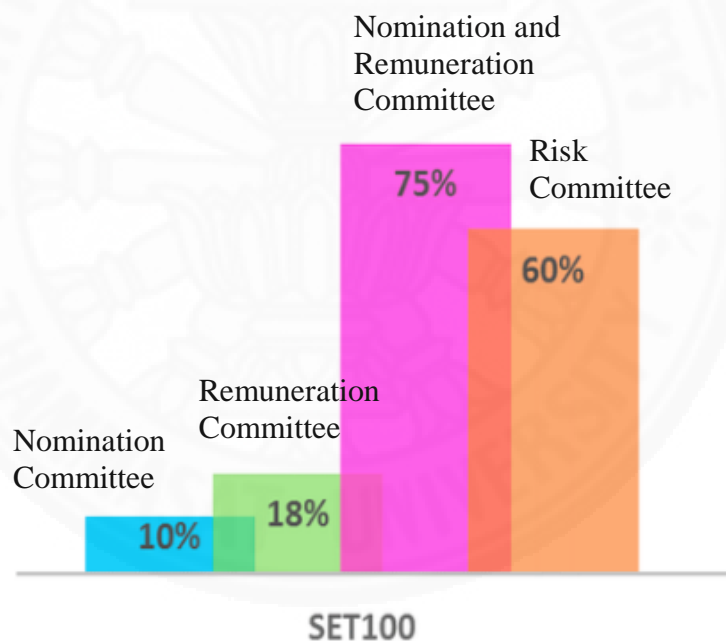


Figure 4.2: The percentage of the sub-committee of 100 Thai listed companies in 2014, “Thai Directorship 2014,” [http://www.set.or.th/sustainable\\_dev/th/cg/files/2015/Infographic.pdf](http://www.set.or.th/sustainable_dev/th/cg/files/2015/Infographic.pdf) (accessed November 23, 3015).

188 The Stock Exchange of Thailand, *Supra Note 46*, at 94.

189 Report on the observance of standards and codes: *Corporate governance country assessment Thailand* <http://www.sec.or.th/TH/Documents/CGROSC.pdf> (accessed March 5<sup>th</sup>, 2016)

As a result, SET should provide the regulation requiring the establishment of a remuneration committee as an effective corporate governance mechanism which will minimize agency problems by monitoring managers to perform in the best interests of the firm.<sup>190</sup>

### 4.3 Remuneration committee's composition

#### 4.3.1 Remuneration committee members

There are no regulations for remuneration committee membership and composition, however, the SET suggests that the committee should consist of at least three members.<sup>191</sup> Its majority members should be either independent directors or non-executive directors including its chairman.<sup>192</sup> At the same time, the chairman of the board of directors should not be the chairman of the remuneration committee or a member.

The rule made by the Thai SEC regarding the qualifications of independent directors who are recommended to be remuneration committee members requires that a director:

- (1) Must not hold more than 1 percent of the shares in the company or its associated companies, including persons who are connected to independent directors<sup>193</sup>
- (2) Must not have current benefits or a financial or managerial interest in the company or its associated companies, or have had such during the past two years<sup>194</sup>

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190 Jensen, Michael C. and Meckling, William H. *Supra Note 23*.

191 The Stock Exchange of Thailand, "Remuneration committee guidelines 2008" [http://www.set.or.th/sustainable\\_dev/en/cg/files/2008/RCinEngPublishing.pdf](http://www.set.or.th/sustainable_dev/en/cg/files/2008/RCinEngPublishing.pdf) (accessed June 28<sup>th</sup>, 2015)

192 The Stock Exchange of Thailand, *Supra Note 46*, at 95.

193 The Securities and Exchange Commission Notification No. TorJor 4/2552

194 *Id.*

(3) Must not have close family ties with other directors, executives, major shareholders, or any person who is to be nominated as a director or executive<sup>195</sup>

(4) Shall not have financial and managerial prohibited relationships, including executive director, employee, worker, adviser who receives a regular salary or controlling person<sup>196</sup>

(5) Must never have been in a competing company or have held in excess of 1 percent of the shares in a competing company<sup>197</sup>

In the family-owned context, the management is not able to be separated from the controlling shareholders. The concept of independence of directors has a very strong prospect of increasing good corporate governance<sup>198</sup> since it is desirable to check and balance the managerial power and to protect minority shareholders. Hence, a remuneration committee consisting of a large number of independent directors ensures that it can perform a remuneration arrangement with transparency, honesty and trustworthiness.<sup>199</sup>

However, the composition of the committee is just a voluntary guideline. A scholar additionally argues that in an environment where families still control the majority of a listed company's shares, the composition of a majority of independent directors is not expected by the controlling shareholders.<sup>200</sup> In contrast, a remuneration committee purely consisting of independent directors may not have the sufficient information necessary to oversee and consider the remuneration of directors and executives. As a result, the need for non-executive directors in the remuneration

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195 *Id.*

196 *Id.*

197 *Id.*

198 Fernández-Rodríguez, Gómez- Ansón and Cuervo-García. *The stock market reaction to the introduction of best practices codes by Spanish firms*, **Corporate Governance: An International Review**, 12(1), (2004): 29–45.

199 The Stock Exchange of Thailand, *Supra Note 46*.

200 Akira Suehiro and Natenapha Wailerdsak. *Family Business in Thailand Its Management, Governance, and Future Challenges*, **ASEAN Economic Bulletin** 21,1 (2004): 81-93.

committee should be considered, because they may provide useful information relating to the management for remuneration determination.

In conclusion, the SET should set compulsory provision that a remuneration committee must consist of a majority of independent directors.

#### 4.3.2 Remuneration committee's consultants

In order to support a remuneration committee's work, remuneration consultants may be additionally retained by the committee or by the board of directors. Unlike the US, there are no rules or recommendations of the SET providing requirements to consider the selection of these consultants.

With regard to the presence of remuneration consultants, their qualifications and employment have major impacts on executive remuneration<sup>201</sup> including:

(1) With the reference to the Conference Board's suggestion, the independence of remuneration consultants is emphasized, 'when the compensation committee uses information and services from outside consultants, it must ensure that consultants are independent of management and provide objective, neutral advice to the committee'.<sup>202</sup>

(2) As Warren Buffet commented, remuneration consultants 'had no trouble perceiving who buttered their bread'.<sup>203</sup> In order to reduce remuneration consultants' incentives to favour executives and pay more attention to the objectives

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201 United States House of representatives committee in oversight and government reform. *Executive pay: conflicts of interest among compensation consultants* (2007). <http://www.eri.com/PDF/Executive-Consultant-Conflicts.pdf> (accessed June 2<sup>nd</sup>, 2016)

202 The Conference Board. *The Evolving Relationship Between Compensation Committees and Consultants* (2006). <http://www.adb.org/sites/default/files/publication/157194/adbi-rp19.pdf> (accessed June 2<sup>nd</sup>, 2016)

203 Bebchuk, Lucian A. and Fried, Jesse. *Supra Note 67*, at 224.

of the remuneration committee and not to those executives,<sup>204</sup> the committee may be required to have sole authority to hire these consultants.<sup>205</sup>

As a result, the existence of remuneration consultants should be voluntary with recommendation that their retention should be on the remuneration committee's authority. However, there should be the requirement that the basic factors for assessing the consultants' independence are similar to the independent director's qualifications.

#### **4.4 Remuneration committee's duties**

There are no regulations providing specific enforcement to the remuneration committee. However, since the members of the committee are a group of directors who perform the duty in lieu of the board of directors, they still have legal duties to prescribe how each individual director should perform his/her duties. In this study, the directors' duties related to remuneration committee are emphasized.

##### **4.4.1 General duties**

###### **4.4.1.1 Public Company Act**

Section 85 states that:

[I]n conducting the business of the company, the directors shall comply with all laws, the objects and the articles of association of the company, and the resolutions of the meeting of shareholders in good faith and with care to preserve the interests of the company

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204 *Id.*

205 NYSE Listed Company Manual Section 303A.05(c)(i)

The fundamental duty of the directors is to conduct the business in accordance with:

1. The law
2. The company's objectives
3. The company's articles of association
4. The resolutions of the meeting of shareholders

In all cases, they must perform their duties in good faith and with care.

#### **4.4.1.2 Securities and Exchange Act**

Section 89/7 specifies that:

[I]n conducting the business of the company, a director and an executive shall perform his duty with responsibility, due care and loyalty, and shall comply with all laws, the objectives, the articles of association of the company, the resolutions of the board of directors and the resolutions of the shareholders' meeting

This provision conforms to the general duty stated in Section 85 of the Public Company Act; however, the vague interpretation of what constitute the care and honesty duties is more obviously stated in the Securities and Exchange Act.

##### 1. Duty of care

The legal measure determining whether a director has performed his/her duties with the care required by law is that a director shall act in a similar manner to an ordinary person undertaking the same business under similar circumstances.<sup>206</sup> They shall not only act as a reasonable director would act, but must also act on an informed basis without reasonable doubt regarding the reliability of the information on which the decision is based.<sup>207</sup>

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<sup>206</sup> The Securities and Exchange Act, Section 89/8.

<sup>207</sup> The Stock Exchange of Thailand, *Supra Note 46*, at 8.

A remuneration committee's performance is considered to be a business decision because it performs to the advantage of the company. Under the business judgment rule provided in Section 89/8 paragraph 2 of the Securities and Exchange Act, the committee shall prove that its duties were performed responsibly and with due care. The committee shall make the decision with an honest belief and on reasonable grounds for the best interests of the company. Moreover, it has to decide with neither direct nor indirect interest in reliance on information honestly believed to be sufficient.

Furthermore, the considerations of whether a remuneration committee performs its duties with care or not are:

1. The positions that directors hold in the company
2. The scope of responsibility in the position
3. The knowledge, capability, and experience of the directors including the purposes of appointments

The remuneration committee is entrusted by the board to have power on remuneration approval. Since it has specific responsibilities prescribed by the board, it must ensure that its functions are undertaken more carefully than other directors.

## 2. Duty of loyalty

The duty of loyalty of directors is required by both Section 90 of the Public Company Act and the Securities and Exchange Act. The said laws specify that the directors shall perform their fiduciary duty in good faith, which goes beyond simple honesty. The identification of the duty of loyalty in this context is specified in Section 89/10 of the Securities and Exchange Act as:

1. Act in good faith in the best interest of the company
2. Act with proper purposes
3. Make decisions without a conflict of interest

In this case, the Act also specifies an additional presumption of the significant conflict with the interest of the company.<sup>208</sup>

#### 4.4.2 Specific duties

##### 4.4.2.1 Public Company Act

As discussed in 4.1.1, the committee shall determine the remuneration strictly according to either the articles of association or the resolutions of the meeting of shareholders.<sup>209</sup>

In contrast, executive remuneration approval is not addressed by law. Thus, a remuneration committee which sets the executive remuneration package shall determine under the general principle of Section 85 of the Public Company Act. This is to act in good faith and with care, to maintain the interest of the company by following the company's articles of association or the resolutions of the meeting of shareholders based on each company's remuneration policy. If the committee fails to comply with these duties in its performance, it shall be responsible for any damages caused by its actions.<sup>210</sup>

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208 The Securities and Exchange Act, Section 89/11 states that

*“Any of the following acts which provides a director, an executive or a related person any financial benefits other than those that should be ordinarily obtained or causes damages to the company shall be presumed significant conflict with the interest of the company:*

*(1) entering into transaction between the company or the subsidiary and the director or related person which does not comply with Section 89/12 or Section 89/13;*

*(2) use of learned information other than that already disclosed to the public or;*

*(3) use of asset or business opportunity of the company in contravention of the rules or general practice as specified in the notification of the Capital Market Supervisory Board.”*

209 The Public Company Act Section. 90

210 *Id.* Section. 90



#### 4.4.2.2 Securities and Exchange Act

The Securities and Exchange Act requires listed companies to disclose information in their reports to promote transparency. The disclosures related to director and executive remuneration are discussed in Section 4.6.

In summary, the existent regulations requiring directors to perform their duties in good faith and with due diligence and care are sufficient to force a remuneration committee to perform in the best interests of the company and its shareholders. The level of these duties including the concept of trust and faith given detail by the Securities and Exchange Act also resemble those required in the US. Moreover, the disclosure duty is able to promote good corporate governance practice in the area of transparency. However, the need for development of disclosure is considered in the next section.

#### 4.5 Disclosure

Sufficient disclosure with accurate information in financial statements and reports presented to shareholders enables them to have enough information to monitor the company's performance. It also promotes the transparency of the company. The Public Company Act specifies that the board of directors shall deliver the annual report of the board to the shareholders.<sup>211</sup> In addition, relevant to remuneration committee disclosure, Section 56 of the Securities and Exchange Act regulates that the company shall prepare the disclosed report for additional information as specified in the notification of the Capital Market Supervisory Board<sup>212</sup> named the Annual information disclosure form (Form 56-1).

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211 The Public Company Act, Section.114(4)

212 Notification of Capital Market Supervisory Board TorChor. 44/2556 Rules, RE: Conditions and Procedures for Disclosure regarding Financial and Non-financial Information of Securities Issuers

#### 4.5.1 Information relating to the remuneration committee structure

##### 1. Members

The company is required to list the names of directors including the position held in the company.<sup>213</sup> The nomination of the remuneration committee and the process of election are also filed in the Form 56-1. In addition, the company shall file the number of meetings attended by each member.

Table 4.1: An example of the display of directors' names on Form 56-1

| Name of director | Position  | Directors' meeting |                      |
|------------------|---|--------------------|----------------------|
|                  |   | Number of meeting  | Number of attendance |
| Mr.....          | Independent director and director of remuneration committee | x                  | x                    |

Source: The Securities and Exchange commission, *Form 56-1 and Form 69-1*, Bangkok: Company development (2013): 36

##### 2. Conflict of interest

Section 89/14 of the Securities and Exchange Act states that:

A director and an executive shall file with the company a report on his interest or a related person's interest in relation to management of the company or the subsidiary in accordance with the rules, conditions and procedures specified in the notification of the Capital Market Supervisory Board.

As required by law, the members of a remuneration committee, especially independent directors, shall disclose their qualifications and any conflict of interest that they may have. Moreover, the executives tend not only to dominate the nomination process where the board of directors appoint the remuneration

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<sup>213</sup> The Public Company Act Section. 114(4)

committee's members, but also choose the members of their own preference.<sup>214</sup> Thus, the nomination of a remuneration committee can result in a conflict of interest.

In the case of remuneration consultants, the law does not require the company that retains these consultants to disclose their conflict of interest. It is just recommended by the Principles of Good Corporate Governances for Listed Companies 2012 that the said information should be reported.

#### **4.5.2 Information relating to financial statements and reports**

The Public Companies Act requires the board of directors to report the benefits which directors receive from the company, including remuneration, shares, and debentures, to the shareholders.<sup>215</sup> In addition, the Form 56-1 specified in the notification of the Capital Market Supervisory Board requires listed companies to disclose a financial statement. The conditions of Form 56-1 filing include the director and executive remuneration. The company shall explain the following issues:

##### **1. Financial remuneration**

1.1 The director's remuneration is disclosed as the type and the amount of remuneration paid to each director of the company. If any directors also received remuneration as an executive, such remuneration will be disclosed as management remuneration. In the case of independent directors who hold the same position in the company's subsidiaries, their remuneration paid by the company and its subsidiaries shall be disclosed.

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<sup>214</sup> *Id.*

<sup>215</sup> The Public Company Act, Section 114

1.2 The board shall also disclose the total remuneration paid to all executives including the number of executives and types of remuneration.<sup>216</sup> The policies require disclosure of the board's individual monetary remuneration and aggregate disclosure of executives. The specific remuneration amounts for individual executives shall be disclosed voluntarily.

## 2. Non-financial remuneration (if any)

The non-financial remuneration of directors and executive earnings from the company shall be reported and each type of remuneration described, such as the employee stock option plan and provident fund. The amount of non-financial remuneration shall be disclosed in the same way as financial remuneration.

According to the disclosure required of a board of directors by law and Form 56-1, disclosure of the policy of remuneration setting is not required, even if the Principles of Good Corporate Governance for Listed Companies provide disclosed information rather than the forms and the amounts of payment to each person. The further information disclosable is the remuneration policies for directors and executives that correspond to the contributions and responsibilities of each person. Moreover, the Principles suggest that if any director of the company is also a director of its subsidiaries, the amount paid by each subsidiary to each director should be disclosed as well. These additional disclosures are only recommended but not required by law, as a result, listed companies do not comply with the suggestions as expected.

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216 สำนักงานคณะกรรมการกำกับหลักทรัพย์และตลาดหลักทรัพย์, *แบบแสดงรายการข้อมูลแบบ 56-1 แบบ 69-1*, กรุงเทพฯ: ฝ่ายพัฒนาบริษัท (2556): 38. (The Securities and Exchange commission, *Form 56-1 c/d Form 69-1*, Bangkok: Company development (2013): 38)

The current disclosure requirements are consistent with the international standard in terms of substance and frequency.<sup>217</sup> In comparison with the US, however, the requirements are less developed. Consequently, the adoption of the US disclosure rules should be considered because these regulations with respect to transparency and disclosure of information are more restrictive and facilitate monitoring of the management.<sup>218</sup> To promote the transparency of Thai listed companies and to protect against the loss of minority shareholders' interest caused by overabundant executive power, there should be more regulatory disclosure requirements including:

1. Nomination of a remuneration committee's members and its consultants
2. Non-cash remuneration of executives
3. A discussion relating to the rationales of executive payment including the relationship between the firm's performance and the level of executive remuneration (resembling the US CD&A)<sup>219</sup>

In the case of the disclosure of each executive's remuneration, this information is very sensitive to the personnel management and confidential business information. Thus, this disclosure may not be suitable for compulsory disclosure, especially in highly competitive industries.

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217 The Securities and Exchange Commission. *Supra Note 57*.

218 Niels Hermes and Annemarie Schulenburg, *Executive Compensation and Anglo-American Influence: European Evidence* (2008)

<http://dx.doi.org/10.2139/ssrn.1980353> (accessed June 2<sup>nd</sup>, 2016)

219 Discussion and Analysis (CD&A) is required by § 229.402 (b) of U.S. SEC Rules to contain necessary material for understanding of the listed companies compensation policy and decision regarding the named executive officer- the CEO, the Chief Financial Officer (CFO) and the three most highly remunerated executive other than the CEO and CFO.

## **4.6 Remuneration committee liabilities**

### **4.6.1 Public Company Act**

#### **1. Liability for director remuneration**

According to Section 91, if the payment of money or giving of other property to a director is not in accordance with either the articles of association of the company or the resolution of the meeting of shareholders, the director shall be jointly liable for any damage to the company.

#### **2. Liability for disclosure**

Section 207 of the Public Company Act states that if the information presented by the board of directors is incomplete or inaccurate as to truthfulness, the board shall be liable to a fine. Moreover, if the disclosure under the Securities and Exchange Act contains a false statement or conceals material facts which should have been stated in reports concerning the financial condition and causes any damage, the directors shall be jointly liable, unless the director can prove that, by his position, he could not have been aware of the truthfulness of the information or lack of information.<sup>220</sup>

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220 The Securities and Exchange Act, Section 89/20

## 4.6.2 Securities and Exchange Act

### 1. Liability for the failure of directors' duties

If a director acts in breach of the fiduciary duties and his performance causes loss or damage, he will be criminally liable.<sup>221</sup>

### 2. Liability for the conflict of interest disclosure

With reference to Section 281/3, a director shall be liable to a fine if he does not file a report with the company on his interest or a related person's interest in relation to management of the company or the subsidiary.<sup>222</sup>

In summary, the existing laws provide sufficient liabilities for directors and the members of a remuneration committee who fail to perform their acts to comply with fiduciary duties. Even though the law does not require a clawback provision,<sup>223</sup> unlike the US, the executive who intentionally carries out 'window dressing' shall be liable for the breach of duty of loyalty by virtue of Section 281/2 of the Securities and Exchange Act.

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221 The Securities and Exchange Act, Section. 281/2

*“Any director or executive of the company who fails to perform his duties with responsibility, due care and loyalty in accordance with section 89/7 which causes damage to a company or causes himself or another person to obtain any benefit from the contravention or failure to comply with such duties shall be liable to a fine not exceeding the damages or the benefit obtained but not less than five hundred thousand baht.*

*In cases where a person who commits an offense under the first paragraph with dishonest intent, he shall be liable to imprisonment for a term not exceeding five years and a fine not exceeding two times the damages incurred or the benefit obtained but not less than one million Baht, or both.”*

222 The Securities and Exchange Act, Section 281/3 states that

*“Any director or executive of the company who fails to comply with Section 89/14 shall be liable to a fine not exceeding five hundred thousand baht and a further fine not exceeding three thousand baht for every day during which the contravention continues.”*

223 Claw back is the obligation requiring the duty to exclusively recover incentive-based compensation back (including stock options) from current and former executives who are paid based on improper financial statements or a material non-compliance with any financial reporting requirement under the SEC Rules during the prior three years after the year in which the errors were made in the report.

## 4.7 The rights of shareholders

According to the agency theory perspective, shareholders are regarded as the owners of the company who appoint directors to act as their representatives<sup>224</sup> and to work for their interest.<sup>225</sup> The shareholders currently exercise their rights relating to the remuneration committee by participation and voting in shareholder meetings, as well as by obtaining relevant and adequate information on the company.

### 4.7.1 Shareholders obtaining relevant and adequate information on the company

Shareholders use the information disclosed to make investment decisions and to review the real value of the company under the present management.<sup>226</sup> Hence, if the disclosure required by law is sufficient the rights of the shareholders will be effectively protected. This relates to the disclosure issue mentioned in 4.5.

### 4.7.2 Shareholder participation in shareholders' meeting

Shareholders shall attend and vote at the meeting of shareholders called either by the board of directors<sup>227</sup> or by the request of shareholders.<sup>228</sup> While

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224 The Stock Exchange of Thailand, *Supra* Noted 46.

225 Livia Bonazzi and Sardar M.N.Slam, *Supra Note 5*.

226 The Securities and Exchange Commission *Supra Note 57*.

227 The Public Company Act authorizes the board of director to call an annual ordinary meeting shareholders and to call an extraordinary meeting of shareholders any time by the virtue of Section 98 and 99

228 The Public Company Act Section 100 states that

*“Shareholders holding shares amounting to not less than one-fifth of the total number of shares sold or shareholders amounting to not less than twenty-five persons holding shares amounting to not less than one-tenth of the total number of shares sold may, by subscribing their names, request the board of directors to call an extraordinary meeting at any time, but the reasons for calling such meeting shall be clearly stated in such request. In this regard, the board of directors shall proceed to call a meeting of shareholders to be held within one month as from the date the request is received from the shareholders.”*



the directors' compensation is a matter approved at the shareholders' meeting,<sup>229</sup> the law does not require executive remuneration to be approved by shareholders. In practice, the managerial remuneration presented by a remuneration committee is decided by the board. The SET suggests that the remuneration of both executives and directors should not only be in accordance with the board policy, but also be within the limit approved by shareholders.

In terms of executive remuneration, the shareholders' benefit is one of the evaluations of executives' performance, as well as the conflict of interest between those managers and the small shareholders that may arise. Therefore, the shareholders should be the ones who can recommend on executive remuneration matters. Although shareholders have the opportunity to approve all forms of executive remuneration it is not possible for those minority shareholders to obtain sufficient votes to affect the level of executive compensation. However, their resolution sends a signal to the board to carefully decide the remuneration matters in order to maximize all groups of shareholders.

Lastly, the adoption of the US provision concerning the 'say on pay vote'<sup>230</sup> should be considered. The law should specify that the shareholders have the right to exercise a non-binding vote on executive remuneration. The objective of this vote is to strengthen the remuneration committee and, in accordance with their fiduciary duty, the board should not to oversee the remuneration because this advisory vote does not immediately affect the board decision.

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229 The Public Company Act Section 90

230 Say on Pay Vote is the vote that the shareholders have a direct signal to approve any type of compensation of executives through advisory vote.

## CHAPTER 5

### CONCLUSIONS AND RECOMMENDATIONS

#### 5.1 Conclusions

Over the past 20 years, since 1997 when the economic crisis was partially attributed to poor governance, the Thai capital market has awakened to corporate governance principles improvement. The Thai Securities and Exchange Commission (Thai SEC) plays a significant role in continuing to strengthen the good governance practices of Thai listed companies. Furthermore, other professional associations, namely the Stock Exchange of Thailand (SET) and the Thai Institute of Directors (IOD) always collaborate with the Commission to survey and promote the good corporate governance guidelines. The evolution of the guidelines mentioned in Chapter 2 shows that this consideration has led Thai listed companies not only to be ready for the competition in ASEAN, but also to raise themselves to international standards of good governance.

While good corporate governance is realized to be the most appropriate mechanism which controls a corporation's management, in order to lessen the agency problem and maximize all stakeholders, a large amount of literature, especially in the US, has been concerned that the remuneration alignment affects executives' behaviour and shareholders' protection. In addition, the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act in the US, which created the provisions addressing executive compensation and corporate governance, has widely been well-received at an international level and is likely to be adopted.<sup>231</sup>

In Thailand, similar to other countries, the functions of the board of directors are expected 'to play an important role in corporate governance for the best interests of the company. The board is accountable to shareholders and independent of

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231 Pipop Udorn., *Supra Note 74*.

management'.<sup>232</sup> The establishment of a sub-committee is required by law<sup>233</sup> and recommended by the SET.<sup>234</sup> The Good Corporate Governance Principles 2012 suggest a remuneration committee be appointed by the board and be responsible for director and executive remuneration package determination before presentation to the board. With reference to the current regulations, there is only the provision under Section 90 of the Public Company Act BE 2535 stating that director remuneration determination shall be either specified by the articles of association of the company or approved by shareholders. In this case, the role of the remuneration committee should be monitored because its performance regarding other remuneration matters, such as executive remuneration determination and disclosure, are not enforced by law, but the committee is only encouraged to follow the SET guidelines.

As a result, the voluntary guidelines related to a remuneration committee's performance brings about the question as to whether or not current regulations concerning executive and director remuneration are sufficient to force the listed companies in the stock exchange to manage and operate in compliance with good corporate governance principles. In comparison with the US law, there are some distinctions of the regulations providing the requirements of the remuneration committee and its functions. The related regulations specified by the Thai SEC and the SET do not require:

1. The requirement for the existence of a remuneration committee and its membership
2. The independence qualifications of remuneration consultants
3. The principles regarding remuneration for executives, ie the shareholders' approval (say on pay vote), the presentation of the relationship between compensation and the company's performance (pay for performance) and the recovery of erroneously awarded remuneration policy (clawback)

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232 The Stock Exchange of Thailand, *Supra Note 46*.

233 e.g. Audit Committee

234 e.g. Nomination Committee and Remuneration Committee

#### 4. The thorough disclosure of director and executive remuneration packages and pay-setting process

Regarding a remuneration committee's duties and liabilities as stated in the Public Company Act BE 2535 and the Exchange Act BE 2535, its members' duties are governed, similar to the US regulations, under the concept of fiduciary duties. The members are required to perform in the best interest of the company and to act as an ordinary person undertaking the like business under similar circumstances. However, the jurisprudence of directors' fiduciary duties and the business judgement rule regarding a remuneration committee have never been identified by Thai courts because there are no related cases.

Before drawing a conclusion, one important thing that should be considered is that the ownership structure of most Thai listed companies is different from the US where shares are diffusely held by different parties.<sup>235</sup> The Thai firms are characterized as highly concentrated and the majority of shares are owned by the same family, so the executives and the owners are the same person. The executives, at the same time, are assumed to have a managerial power over the remuneration committee.

In this regard, Thailand does not need to adopt all US legal provisions to develop Thai listed companies' corporate governance, since some of them are not applicable in the Thai context. This includes the requirement for a remuneration committee exclusively consisting of independent directors and the disclosure of each executive's compensation. In addition, some corporate governance principles currently recommended by the SET should be retained because they conform to those stated in the US regulations and international standards; for example, the criteria of

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235 Nuntana Panyasrivanit. *Ownership Structure, Risk and Performance of Thai firms: Evidence from Stock Exchange of Thailand*  
[http://mif2.tbs.tu.ac.th/02/getFileDownload.php?path=file\\_doc/3320131119104726.pdf](http://mif2.tbs.tu.ac.th/02/getFileDownload.php?path=file_doc/3320131119104726.pdf) (accessed March 18<sup>th</sup>, 2016).

executive remuneration determination should be a flexible guideline as appropriate in each company.

Lastly, the assessment of Thai listed companies' corporate governance provided by the SET in collaboration with IOD reflects that Thailand is in a position where its governance practice is at an acceptable level and continually developing to meet the international standard. In the same way, the role of a remuneration committee is emphasized as a governance mechanism, maximizing shareholders' values by the issue of the Good Corporate Governance Principles and the Remuneration Committee guidelines. The above scenario illustrates that the rules and regulations concerning executive and director remuneration, especially the structure of the remuneration committee, the exercise of shareholders' rights and transparency, are not sufficient to force the companies listed in the stock exchange to manage and operate in compliance with good corporate governance principles. As a result, regulation must obviously be improved in order to demonstrate good governance in compliance with the international standard.

## **5.2 Recommendations**

These recommendations help listed companies to achieve better performance. In the writer's opinion, while the US principles regarding executive remuneration and disclosure were created by the Dodd-Frank Act to handle the excessive payment problem and to raise the transparency of the company, some of these provisions should be considered for adoption into Thai law in order to avoid an incident of 'locking the stable door after the horse has bolted'.

### **1. Remuneration committee**

The SET should provide compulsory regulation requiring the establishment of remuneration committees consisting of a majority of independent directors, as an effective corporate governance mechanism to minimize agency problems caused by unreasonable payment and to monitor executive performance. In addition, the existence of the remuneration committee should be voluntary, with a

recommendation that the retention of remuneration consultants should be the remuneration committee's authority. However, there should be the requirement of the basic factors for assessing these consultants' independence similar to the independent director's qualifications.

## **2. The increase of shareholders' rights**

Typically, the board of directors has an authority to approve the composition and level of executive remuneration after it is proposed by the remuneration committee. Since the size of a remuneration package earned by an executive in both cash and non-cash compensation affects the shareholders' interest, they should be able to participate in this process. The law should specify that the shareholders have the right to exercise a non-binding vote on executive remuneration. The objective of this vote is to strengthen the remuneration committee and the board, who must perform with fiduciary duty, and not oversee the remuneration, because this advisory vote does not immediately affect the board decision.

## **3. The increase of disclosure requirements**

This is the most important corporate governance mechanism because it not only raises the company's transparency and accountability, but also increases the outsider's confidence. The effective disclosure also indirectly protects minority shareholders who rarely play the role of monitoring executive behaviours. Hence, the listed companies should be required to disclose:

- 1) Nomination of the remuneration committee's members and its consultants
- 2) Non-cash remuneration of executives
- 3) The discussion relating to rationales of executive payment including the relationship between the firm's performance and the level of executive remuneration.

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|                        |  |
|------------------------|--|
| Name                   | Miss Ratchanikarn Suwadist   |
| Date of Birth          | July 20, 1989  |
| Educational Attainment | 2010: Bachelor of Laws, Thammasat University<br>2014 Master of education, Burapha University   |
| Work Position          | Teacher<br>Pichayasuksa School, Pakkred, Nonthaburi  |
| Publications           | Effect of project-based learning in a science integrated English class on primary student outcomes in the scientific method, scientific process skills and a science (The thesis of Master of Education, Burapha University, 2014. |
| Work Experiences       | Teacher:<br>Pichayasuksa School  |

