

A nighttime photograph of a cityscape. A large bridge with lights spans across the water. In the background, a tall, modern building with a distinctive top is illuminated. The lights from the bridge and buildings reflect on the calm water surface.

Corporate governance at FSSA Investment Managers

July 2024

In FSSA's assessment of companies, we value the governance most highly; thus, the first step in our investment process is a thorough due diligence on the quality of the management team. We begin by building an understanding of how management have behaved in the past, looking far into a company's history and its key turning points to glean insights about the organisational culture.

We also seek a track record of sensible capital allocation – we are wary of acquisition-driven growth and teams that don't treat capital with respect. This exercise is inherently backward-looking, but our experience has taught us that leopards rarely change their spots. Investing, however, is necessarily forward-looking and therefore we carefully consider signs that might suggest a change in behaviour in the future.

Alignment of interest is another critical point. We pay close attention to the corporate structure, differential voting classes of shares and whether the incentive program encourages long-term behaviour. The board of directors acts to provide the proper checks and balances on executive behaviour; thus, we assess the quality and independence of directors by researching their reputations, other boards they may sit on, industry knowledge and whether they add much-needed diversity.

Once we have a reasonable sense of what management do, we want to reconcile it with what they say. We believe there is only so much one can learn from reading past annual reports and news articles. Meeting management teams regularly is a core part of our process, as we build our understanding and appreciation of a company's investment potential.

In this regard, we prefer to conduct in-person meetings, where possible, at the company's premises to pick up clues about the culture. We have found that by discussing long-term issues such as strategy, capital allocation, succession, professionalisation, board quality and environmental/social impact, their replies often provide the best insights into the direction of travel.



Case study: **Sharing constructive feedback to encourage reform**

Kasikornbank, formerly Thai Farmers Bank, is one of the largest private banks in Thailand. Founded in 1945 and listed in 1976, it is closely associated with the Lamsam family, in particular Banthoon Lamsam, who was the bank's CEO from 2002 until he became chairman in 2013 up to his retirement in 2020. The FSSA team has a 20-year history of meeting the bank's management team and were shareholders for a significant portion of this time.

Kasikornbank, like most of the Thai banking system, was significantly affected by the Asian Financial Crisis during the late '90s. Banthoon, who had been Kasikornbank's president since 1992, steered the bank out of the crisis with the support of investors who helped recapitalise it (including FSSA). After taking over the CEO position in 2002 he continued the reform process, resulting in strong performance over the subsequent 15-year period. From 2002 to 2017, the bank's book value per share grew at 16% CAGR. Average return on equity during this period was around 18% due to prudent asset quality management and cost controls. Valuations accorded to the bank rerated, further boosting shareholder returns to an impressive 20% CAGR in USD terms over this 15-year period.¹

There are repeated references to ESG in its filings, and the bank has been publishing a sustainability report since 2012. From its FY2022 sustainability report we note that it scores well on gender diversity, with 62% of women in leadership positions, including both the chairperson and the CEO as well as eight of the board's 18 directors.

There are clear climate targets and disclosures too – with net-zero targets for Scope 1 and 2 carbon emissions by 2030, and Scope 3 by 2050.² To that end, the bank has stopped financing new coal projects and expects to exit existing coal projects by 2030. In many aspects, the bank was well ahead of disclosure requirements set by Thai Stock Exchange (SET) years later.

However, after 2017 things started to go wrong for Kasikornbank. This coincided with central bank initiatives which disrupted the Thai banking system (for example, the launch of a payment interchange system, PromptPay, made bank transfers almost free) and a poor macroeconomic environment which led to rising levels of non-performing loans. As a result, we sold our shareholding in the bank.

In 2020 the Covid-19 pandemic resulted in further problems for the bank and asset quality deteriorated. Meanwhile, the senior management of the bank was reshuffled, with Banthoon retiring from the chairmanship and a new CEO, Kattiya Indaravijaya, taking over in the same year.

When we met the management in early 2023 valuations had de-rated significantly, to as low as 0.6x price-to-book. We believed the risk-reward looked attractive and re-initiated a small position, with the intention to engage with the management about our concerns. Our prior experiences with the bank suggested that the management might listen to constructive feedback from long-term minded shareholders.

1 From 31 December 2002 to 31 December 2017. Financial metrics are from Bloomberg and Factset.

2 Scope 1 emissions are greenhouse gas (GHG) emissions caused directly by a company in the normal operations of its business. Scope 2 emissions are indirect GHG emissions created through a company's use and purchase of energy, while Scope 3 emissions are indirect GHG emissions throughout a company's value chain – from suppliers to end users. For more information on GHG emissions categories, please click [here](#).

In August 2023 we wrote a detailed letter to the management with the following points:

- **Focus on asset quality:** We suggested that the culture surrounding asset quality decisions needed to change from the top, with an emphasis on tightening underwriting even if that meant lower growth in the near term.
- **Simplification of KPIs and structures:** The bank had 18 members on its board; and senior leaders were evaluated on more than 15 KPIs. In our opinion, the bank's focus would improve by simplifying and rationalising such matters.
- **Capital allocation:** With a low dividend payout ratio of around 27%, the bank lagged regional peers (typically in the 50–80% range). Further, we pointed out that the current valuation made a share buyback an especially good use of the bank's excess capital.
- **Employee stock ownership plans (ESOPs):** We pointed out that providing stock options to senior leadership might lead to more owner-like behaviours, much like the Lamsam family in the early years.
- **Better disclosures:** Whilst we remain impressed with most aspects of Kasikornbank's reporting on ESG matters, we pointed out that there were some shortcomings on financial disclosures, particularly in the Life Insurance business, where the return ratios had dipped significantly without explanation.

We received an encouraging response to our letter and the CEO requested a call with us. During that meeting, we offered an introduction to the senior leadership of one of our portfolio companies which had witnessed a remarkable cultural transformation over the past five years. We recognise that cultural changes will take time to show up in financial statements, but we are optimistic that Kasikornbank is on the road to reform. We remain patient shareholders and will continue to monitor its progress in the coming years.

Find out more about FSSA's approach to ESG integration by downloading [FSSA's ESG report](#).



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