Corporate governance failures in developed countries, and their impact on not only the shareholders but also other stakeholders have attracted widespread attention. Employees, banks, consumers, governments, regulatory agencies, and multilateral organizations are all paying increasing attention to the accountability mechanisms that are in place for the private sector.

The state of corporate governance can have an important impact on the availability and cost of capital for firms and financial stability, a critical ingredient to sustainable development.

Corporate governance constitutes a set of relationships among a company's management, its board, its shareholders, and other stakeholders. Those relationships define, among other things, the property rights of shareholders, the mechanisms of exercising and protecting those rights, and the path of ensuring a fair return.

Corporate governance also sets the structure through which a firm sets its objectives, as well as determining the means of attaining those objectives and monitoring performance. Good corporate governance provides proper incentives for the board and management to pursue objectives that are in the interests of the company and its shareholders.

Rationale for Good Corporate Governance?

A good corporate governance regime is central to the efficient use of capital. First, it promotes market confidence; helps to attract additional long-term capital, both domestic and foreign; and fosters market discipline through appropriate disclosure and transparency. Second, good corporate governance helps to ensure that corporations take into account the interests of a wide range of constituencies, particularly when the board recognizes that corporate social responsibility can mutually benefit the company and its operating environment. Those actions, in turn, help to ensure that corporations operate for the benefit of society as a whole, and induce stable business development and growth, lower risk, and sustainability.

The experiences of economic transition and all too frequent financial crises in developing and emerging market economies have confirmed that a weak institutional framework
for corporate governance is incompatible with sustainable financial markets and private sector development. As a result, good governance structures are valued increasingly highly by investors, particularly those seeking to diversify their portfolios to include stakes in developing countries. They also mitigate the risks posed by weak institutions. Furthermore it is expected that poor corporate governance is going to become critical foreign policy issue as cross-border investors and the importance of securing their rights gain more importance.

OECD Principles of Corporate Governance

In response to a call by its council, the OECD issued the OECD Principles of Corporate Governance in 1999 after extensive consultations. These were later revised in 2004 following a comprehensive survey of corporate governance practices in and outside the OECD area. Since their launch, the principles have formed the basis for corporate governance initiatives in both OECD and non-OECD countries alike. They represent the minimum standard that countries with different traditions have agreed on, being applicable to countries with a civil and common-law tradition without being unduly prescriptive. The principles have been devised with four fundamental concepts in mind: responsibility, accountability, fairness, and transparency, and enabling diversity of rules and regulations. They outline the following: (a) the basis for an effective corporate governance framework, (b) the rights of shareholders, (c) equitable treatment of shareholders, (d) the role of stakeholders in corporate governance, (e) disclosure and transparency, and (f) the responsibilities of the board.

The 2004 revisions covered four main areas: (a) a new set of principles on the development of regulatory framework to underpin corporate governance mechanisms for implementation and enforcements; (b) additional principles to strengthen the exercise of informed ownership by shareholders that call on institutional investors to disclose their corporate governance policies and to strengthen the rights of shareholders when choosing Board members; (c) strengthened principles to reinforce Board oversight and enhance Board members' independent judgment; and (d) new and strengthened principles to contain conflicts of interest through enhanced disclosure and transparency.

Note: Information in this box is based on the OECD Principles of Corporate Governance, 2004.
disclosure and transparency (for example, on related party transactions), thus making auditors more accountable to shareholders and promoting auditors' independence.3

Most recently, in April 2005, the OECD adopted new guidelines on corporate governance of state-owned enterprises which provide suggestions on finding a balance between the state's responsibility for actively exercising its ownership functions while at the same time refraining from imposing undue political interference in the management of the company. The guidelines are also designed to foster a level playing field in markets where private sector companies can compete with state-owned enterprises. Furthermore, experience demonstrates that good corporate governance benefits SOEs in the same way it does private companies. Moreover, as in the case of private companies which may aspire to go public, SOEs which may be under consideration for privatization can gain significant value by early adoption of a good corporate governance regime.4

The OECD principles have been endorsed by the Bank and the Fund executive boards, and they form the basis of the corporate governance component of the World Bank–IMF Reports on the Observance of Standards and Codes (ROSCs).

World Bank ROSC Corporate Governance Assessments
As part of the ROSC initiative, the World Bank has established a program to assist its member countries in strengthening their corporate governance frameworks. The objectives of this program are to accomplish the following:5

• Benchmark the country's corporate governance framework and company practices against the OECD Principles for Corporate Governance.
• Assist the country in developing and implementing a country action plan for improving institutional capacity with a view to strengthening the country's corporate governance framework.
• Raise awareness of good corporate governance practices among the country's public and private sector stakeholders.

Participation in corporate governance ROSC assessment is voluntary and is conducted at the invitation of country authorities. Although the assessments are relevant to all countries, they are particularly pertinent in middle-income countries seeking to build strong capital markets. They are a useful instrument for transitional economies, where mass privatization has created a large pool of listed companies with thousands of shareholders, and for low-income countries seeking to attract international portfolio investors. The assessments also serve as a tool for communication between policy makers and domestic and international investors to reach a common understanding in an environment where countries are grappling with the establishment of new capital markets and are competing to attract capital investments.

The assessments are complementary to private sector rating activities in this field. The World Bank assessments focus on country analysis, whereas some rating agencies have started to focus on corporate governance of companies.

Key Findings from Country Assessments
The work of Fremont and Capaul (2002)6 reviews the lessons of corporate governance assessments and its findings are discussed in this section. In most countries surveyed, there is a growing interest toward improving corporate governance practices. A large number of countries, including Brazil, Croatia, the Philippines, and Romania have developed their own corporate governance codes of best practice. Some of the key policy issues that have arisen in corporate governance assessments can be accessed at http://www.worldbank.org/wbi/businessanddevelopment/.

Studies have demonstrated that, at the firm level, (1) investors will pay a higher premium for good corporate governance, (2) good corporate governance reduces the cost of debt, and (3) good corporate governance improves the stability, op
Equally important, poor governance contributes to the development of inefficient and unproductive companies, which can derive from better corporate governance.9 Longitudinal studies from Credit Lyonnais Securities Asia (CLSA) 8 in 2001 showed that emerging market companies by Credit Lyonnais governance practices. A study of the 100 largest companies with the best corporate governance were 76% higher than those with below-average governance requirements. Longitudinal studies from similarly highlight benefits that firms in their country average. There are many other measures of economic value added than firms with smaller local businesses to help them gain access to markets, financing opportunities, technological efficiencies and sustainability of business operations, whether large or small companies. Whether investors everywhere worry about expropriation, the importance of corporate governance differs across countries. Whether investors everywhere worry about expropriation, the importance of corporate governance differs across countries. Whether investors everywhere worry about expropriation, the importance of corporate governance differs across countries. Whether investors everywhere worry about expropriation, the importance of corporate governance differs across countries. Whether investors everywhere worry about expropriation, the importance of corporate governance differs across countries. Whether investors everywhere worry about expropriation, the importance of corporate governance differs across countries. Whether investors everywhere worry about expropriation, the importance of corporate governance differs across countries. Whether investors everywhere worry about expropriation, the importance of corporate governance differs across countries. Whether investors everywhere worry about expropriation, the importance of corporate governance differs across countries. Whether investors everywhere worry about expropriation, the importance of corporate governance differs across countries. Whether investors everywhere worry about expropriation, the importance of corporate governance differs across countries. Whether investors everywhere worry about expropriation, the importance of corporate governance differs across countries. Whether investors everywhere worry about expropriation, the importance of corporate governance differs across countries. Whether investors everywhere worry about expropriation, the importance of corporate governance differs across countries. Whether investors everywhere worry about expropriation, the importance of corporate governance differs across countries. Whether investors everywhere worry about expropriation, the importance of corporate governance differs across countries. Whether investors everywhere worry about expropriation, the importance of corporate governance differs across countries. Whether investors everywhere worry about expropriation, the importance of corporate governance differs across countries. Whether investors everywhere worry about expropriation, the importance of corporate governance differs across countries. Whether investors everywhere worry about expropriation, the importance of corporate governance differs across countries. Whether investors everywhere worry about expropriation, the importance of corporate governance differs across countries. Whether investors everywhere worry about expropriation, the importance of corporate governance differs across countries.