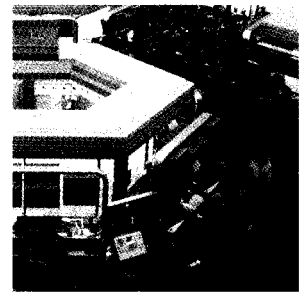


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# **Corporate Governance: A Framework for Implementation**

**Magdi R. Iskander  
Nadereh Chamlou**  
with a Foreword by Sir Adrian Cadbury



The World Bank Group

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# **Corporate Governance: A Framework for Implementation**

**Magdi R. Iskander  
Nadereh Chamlou**

**World Bank Group  
Washington, D.C.**

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## Foreword

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**I**t is a privilege to be asked to write a foreword to a report that deserves to be widely welcomed. With this report the World Bank Group has put corporate governance firmly onto the world stage. Earlier initiatives in this field have in the main been nationally inspired, although a degree of convergence of governance standards is already under way through the influence of the Organisation for Economic Co-operation and Development and international investors. This report is the outcome of a close working partnership between the public and private sectors. It builds on what has gone before but broadens its scope. For the first time we now have a framework that encompasses the widely differing regimes—political, economic, and social—within which corporations carry on their activities around the world.

The way corporations order their affairs, whatever their ownership structure, varies even within a single jurisdiction. Corporations, whether they be family firms, the dominant form of economic organization, or state enterprises, work within boundaries set by law, by regulations, by those who own and fund them, and by

the expectations of those they serve. The nature of these boundaries varies country by country and, crucially, changes through time. That is why, as the report makes clear, there can be no single, generally applicable corporate governance model. We can, however, all learn from each other, and the World Bank Group has set out the mechanism for just such an exchange of experience.

The report recognizes the complexity of the very concept of corporate governance and therefore focuses on the principles on which it is based. These principles—such as transparency, accountability, fairness, and responsibility—are universal in their application. The way they are put into practice has to be determined by those with responsibility for implementing them. What is needed is a combination of statutory regulation and self-regulation. The mix will vary around the world, but nowhere can statutory regulation alone promote effective governance. The stronger the partnership between the public and private sectors, the more soundly based will be their governance structures. Equally, as the report emphasizes, governance initiatives win

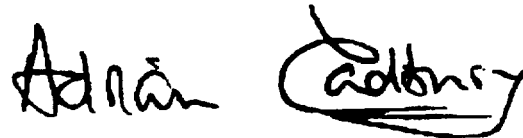
most support when driven from the bottom up rather than from the top down.

It could be argued that international investors and capital markets are bringing about a degree of convergence in governance practices worldwide. But the standards they are setting apply primarily to the corporations in which they invest or to which they lend. These standards set the target, but it is one that is out of reach for the majority of enterprises across the world today. In the past these standards might have spread by a gradual process of economic osmosis. However, the pace of change today is such that to leave the raising of governance standards to natural forces might put areas of the world where funds could be put to best use at a competitive disadvantage in attracting them. Adoption of the report's proposals offers enterprises everywhere the chance to gain their share of the potentially available funds for investment.

Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources.

The aim is to align as nearly as possible the interests of individuals, corporations, and society. The incentive to corporations and to those who own and manage them to adopt internationally accepted governance standards is that these standards will help them to achieve their corporate aims and to attract investment. The incentive for their adoption by states is that these standards will strengthen the economy and discourage fraud and mismanagement.

The foundation of any structure of corporate governance is disclosure. Openness is the basis of public confidence in the corporate system, and funds will flow to the centers of economic activity that inspire trust. This report points the way to the establishment of trust and the encouragement of enterprise. It marks an important milestone in the development of corporate governance, and I cannot commend it too highly.

The image shows two handwritten signatures in black ink. The signature on the left is 'Adrian' and the signature on the right is 'Cadbury'. Both are written in a cursive, flowing style.

Sir Adrian Cadbury  
September 1999





# Acknowledgments

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**T**his report was prepared under the direction of Magdi R. Iskander, Director of the Private Sector Development Department. The overview was written by Magdi Iskander and Nadereh Chamlou. The main report was written by Nadereh Chamlou with inputs from Malcolm Rowat and with the assistance of Uzma Ahmad and Z. Selin Hur. The annexes were prepared under the charge of Malcolm Rowat.

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The report was presented to and discussed by the Executive Board of the World Bank on September 13, 1999. The Board commended the report's attempt to cover a complex and evolving topic in a humble yet practical way and recommended that it be widely disseminated.





# Overview

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Corporate governance systems have evolved over centuries, often in response to corporate failures or systemic crises. The first well-documented failure of governance was the South Sea Bubble in the 1700s, which revolutionized business laws and practices in England. Similarly, much of the securities law in the United States was put in place following the stock market crash of 1929. There has been no shortage of other crises, such as the secondary banking crisis of the 1970s in the United Kingdom and the U.S. savings and loan debacle of the 1980s. In addition to crises the history of corporate governance has also been punctuated by a series of well-known company failures: the Maxwell Group raid on the pension fund of the Mirror Group of newspapers, the collapse of the Bank of Credit and Commerce International and Barings Bank. Each crisis or major corporate failure—often a result of incompetence, fraud, and abuse—was met by new elements of an improved system of corporate governance.

Through this process of continuous change, developed countries have established a complex mosaic of laws, regulations, institutions, and

implementation capacity in the government and the private sector. The objective is not to shackle corporations but rather to balance the spirit of enterprise with greater accountability. The systematic enforcement of laws and regulations has created a culture of compliance that has shaped business culture and the management ethos of firms, spurring them to improve as a means of attracting human and financial resources on the best possible terms. This continuous process of change and adaptation has accelerated with the increasing diversity and complexity of shareholders and stakeholders. Globalization, too, is forcing many companies to tap into international financial markets and to face greater competition. This has led to restructuring and a greater role for mergers and acquisitions and to expanded markets for corporate control.

The developing world has also faced its own corporate governance challenges. For instance, in Russia, a substantive share of the profits of an oil company was siphoned off by its controlling shareholder, leaving the company in debt to its creditors, employees, and the state. In the Czech

Republic, thousands of small shareholders lost their investments as “tunneling” schemes by insiders stripped privatized companies of their assets. The economic crises in East Asia and other regions have demonstrated how macro-economic difficulties can be exacerbated by a systemic failure of corporate governance stemming from weak legal and regulatory systems, inconsistent accounting and auditing standards, poor banking practices, thin and unregulated capital markets, ineffective oversight by corporate boards of directors, and little regard for the rights of minority shareholders. Unfortunately, the brunt of the impact has been shouldered by the poor, setting back social and economic gains by as much as a generation in some countries.

### **Why corporate governance matters—more than ever**

Increasingly for developing and transition economies, a healthy and competitive corporate sector is fundamental for sustained and shared growth—sustained in that it withstands economic shocks, shared in that it delivers benefits to all of society. Slow economic growth remains a major cause of poverty in many low-income countries, but the record also shows that a focus on growth alone is not enough. Poverty persists in part because the benefits of growth are distributed unevenly and because poor governance diminishes growth’s potential impact on poverty (World Bank 1999a). Countries are coming to realize that just as public governance (public administration, including service delivery, regulations, and tax administration) is important in the public sector, so corporate governance is important in the private sector. Moreover, public governance can have a major impact (positive or negative, depending on its quality and effectiveness) on private corporate behavior. Countries also realize that good governance of corporations is a source of competitive advantage and critical to economic and social progress. With globalization, firms must tap domestic and international capital markets in quantities

and ways that would have been inconceivable even a decade ago. Increasingly, individual investors, funds, banks, and other financial institutions base their decisions not only on a company’s outlook, but also on its reputation and its governance. It is this growing need to access financial resources, domestic and foreign and to harness the power of the private sector for economic and social progress that has brought corporate governance into prominence the world over.

Sound corporate governance is important not only to attract long-term patient foreign capital, but more especially to broaden and deepen local capital markets by attracting local investors—individual and institutional. Unlike international investors who can diversify their risk, domestic investors are often captive to the system and face greater risks, particularly in an environment that is opaque and does not protect the rights of minority shareholders. As a group, however, domestic investors frequently constitute a large potential pool of stable long-term resources critical to development. If local capital markets are to grow, corporate governance standards will need to improve to give investors the protection required to encourage them to provide capital.

Many developing and transition economies lack the supporting institutions and human resources so critical to sound corporate governance. The challenge for them is to adapt systems of corporate governance to their own corporate structures and implementation capacities, public and private, to create a culture of enforcement and compliance. They need to do so in a manner that is credible and well understood both internally and across borders—and they need to do it far more quickly than did developed countries before them. Because effective corporate governance can promote enterprise and ensure accountability, it is an essential foundation of the global financial architecture and central to the World Bank Group’s mission to fight poverty.

Corporate governance has only recently emerged as a discipline in its own right, although

the strands of political economy it embraces stretch back through centuries. The importance of the subject is widely recognized, but the terminology and analytical tools are still emerging. The burgeoning literature on corporate governance has largely neglected developing and transition economies. This report develops a framework for corporate governance reform based largely on the operational experience of the World Bank Group and practitioners in the field. This framework is used to identify the major elements and processes of reform required in emerging market economies and the contribution that the World Bank Group, together with its partners, can make to the objective of promoting enterprise and accountability.

### **Balancing divergent interests**

What makes corporate governance necessary? Put simply, the interests of those who have effective control over a firm can differ from the interests of those who supply the firm with external finance. The problem, commonly referred to as a principal-agent problem, grows out of the separation of ownership and control and of corporate outsiders and insiders. In the absence of the protections that good governance supplies, asymmetries of information and difficulties of monitoring mean that capital providers who lack control over the corporation will find it risky and costly to protect themselves from the opportunistic behavior of managers or controlling shareholders.

Without meaningful protection for external capital providers, those who control the corporation can use their position to misappropriate economic benefits, often at the expense of the long-term performance and value of the enterprise. Where poor corporate governance is the norm, the problem extends beyond underperformance in the corporate sector to greater vulnerability of the financial system, since it is difficult for local capital providers (banks and institutional investors) to avoid governance risks.

Lack of meaningful protection for capital providers makes it harder for firms to get financing on favorable terms.

Just what constitutes corporate governance is still a topic of debate. From a corporation's perspective, the emerging consensus is that corporate governance is about maximizing value subject to meeting the corporation's financial and other legal and contractual obligations. This inclusive definition stresses the need for boards of directors to balance the interests of shareholders with those of other stakeholders—employees, customers, suppliers, investors, communities—in order to achieve long-term sustained value for the corporation.

From a public policy perspective, corporate governance is about nurturing enterprises while ensuring accountability in the exercise of power and patronage by firms. The role of public policy is to provide firms with the incentives and discipline to minimize the divergence between private and social returns and to protect the interests of stakeholders.

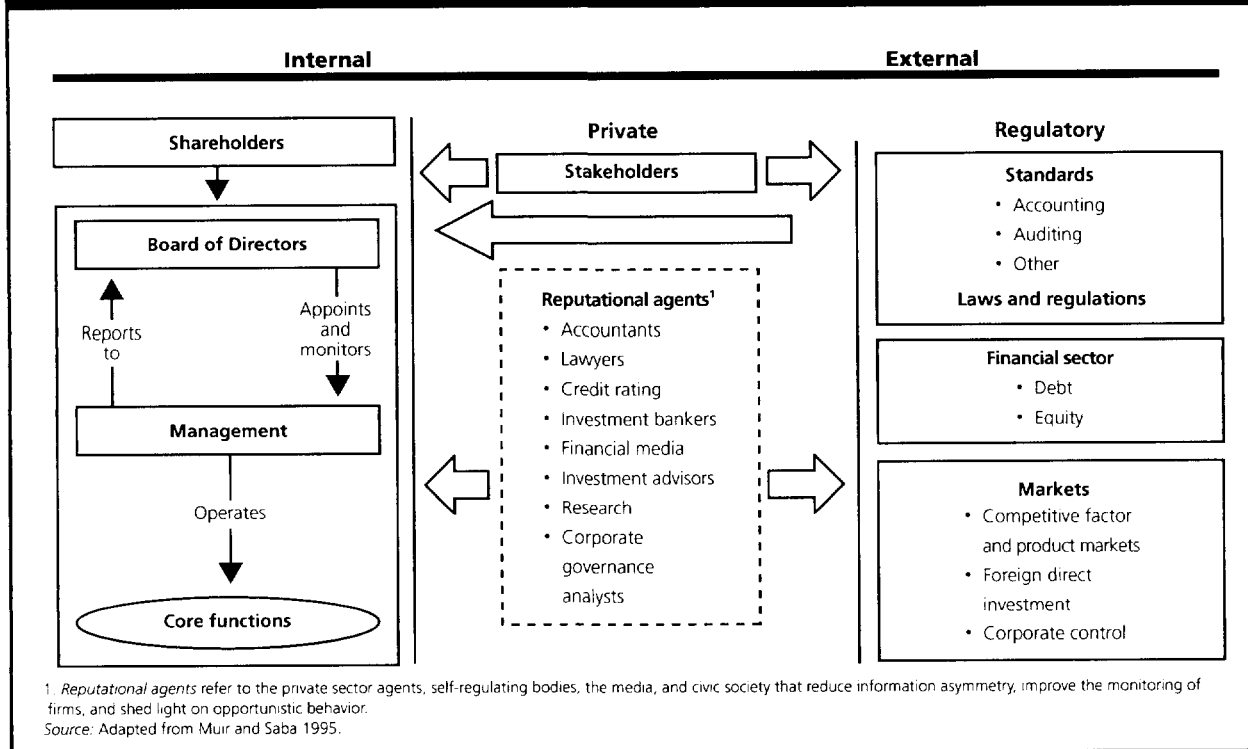
### **A corporate governance framework: the internal and external architecture**

These two definitions—from public and private perspectives—provide a framework for corporate governance (shown in figure 1) that reflects an interplay between internal incentives (which define the relationships among the key players in the corporation) and external forces (notably policy, legal, regulatory, and market) that together govern the behavior and performance of the firm.

#### ***The internal architecture defines the relationships among key players in the corporation***

In its narrowest sense, corporate governance can be viewed as a set of arrangements internal to the corporation that defines the relationships between managers and shareholders. The shareholders may be public or private, concentrated

**Figure 1 Modern corporations are disciplined by internal and external factors**



or dispersed. These arrangements may be embedded in company law, securities law, listing requirements, and the like or negotiated among the key players in governing documents of the corporation, such as the corporate charter, by-laws, and shareholder agreements.

At the center of this system is the board of directors. Its overriding responsibility is to ensure the long-term viability of the firm and to provide oversight of management. In many countries the board is responsible for approving the company's strategy and major decisions and for hiring, monitoring, and replacing the management. In some countries the board has fiduciary responsibility for ensuring compliance with laws and regulations, including accounting and financial reporting requirements. For a going concern the board is answerable to shareholders and in some systems to employees and creditors. Its task is to protect the interests of the company. When the company runs into financial difficulty, the duty of the

board shifts to the company's creditors; the primary duty of the director is to the company rather than to shareholders.

The governance problems that need to be addressed vary according to the ownership structure in the corporate sector. At one end of the spectrum is the publicly traded company with widely dispersed shareholdings. There, the challenge is for outside shareholders to control the performance of managers. Since managers dominate, the key governance mechanism is the rules for selecting directors, who need to have enough independence to ensure that they will properly monitor managers' performance. At the other end of the spectrum is the closely held company with a controlling shareholder and a minority of outside shareholders, where the manager acts at the dictate of the controlling shareholder. There, the primary governance issue is how outside shareholders can prevent the controlling shareholder from extracting excess benefits through

self-dealing or disregard the economic rights of minority shareholders. Common protections include limits on self-dealing by insiders, anti-dilution provisions, and appraisal or withdrawal rights for minority shareholders. Where a publicly traded corporation is dominated by a controlling shareholder, additional governance mechanisms may include voting rights, provision for outsider representation on the board, and takeover rules limiting the “control premium” that insiders can appropriate.

***External rules provide a level playing field and keep players in line***

These internal mechanisms for corporate governance are strengthened by external laws, rules, and institutions that provide a level, competitive playing field and discipline the behavior of insiders, whether managers or shareholders. In developed market economies these policies and institutions minimize the divergence between social and private returns and reduce costly agency problems, primarily through greater transparency, compliance mechanisms, and monitoring by regulatory and self-regulatory bodies. Notable among the institutions that discipline corporations are the legal framework for competition policy, the legal machinery for enforcing shareholders’ rights, systems for accounting and auditing, a well-regulated financial system, the bankruptcy system, and the market for corporate control.

**FIRMS ARE DISCIPLINED BY CONTESTIBLE MARKETS**

. . . The broader business environment creates compelling incentives for insiders to enhance the value of the enterprise. Competition and trade policies that ensure contestible markets reduce rent-seeking behavior. Together with policies that encourage foreign direct investment, competitive markets force insiders to improve corporate performance or risk bankruptcy or takeover. The discipline from competition is likely to be felt earlier and more sharply if there is an effective market for corporate control.

Underperforming enterprises become targets for acquisition by firms or investors who believe that they can create more value by running the enterprise themselves. Insiders have a powerful motive to improve the company’s performance in order to retain control. A control market may also redress some of the imbalance of power between insiders and outsiders. If the market is orderly and transparent, a contest for control often produces greater economic benefits for outside investors and creditors (at least in the short run) than if insiders had continued to operate an underperforming enterprise without challenge.

**. . . A WELL REGULATED BANKING SYSTEM THAT OPERATES AT ARM’S LENGTH FROM THE CORPORATE SECTOR . . .**

Competition for credit can produce better insider behavior as banks demand greater and more accurate information and better compliance with contracts. This ability to discipline insider behavior is greatly restricted, however, if the business environment has few creditor protections, weak contract enforcement, or unworkable bankruptcy laws. If the banking system and corporate sector are closely interlinked, corporate insiders may fail to share value with their creditors (and governments). If corporate insiders are, in addition, insiders of the banks, they may appropriate bank resources for their own purposes. It has become increasingly clear in recent years that for corporate governance to be effective, the banking system (both banks and their regulators) also needs good governance. This is especially important in many developing countries where banks provide most of corporate financing. It means that an effective governance system must include consideration of the role and responsibility of all capital providers.

**. . . AND TRANSPARENT, EFFICIENT, AND LIQUID EQUITY AND BOND MARKETS.** Efficient securities markets send price signals rapidly, rewarding or penalizing insiders through changes in the value of their interests in the company or in the com-

pany's access to capital. The system of rewards and penalties is severely diluted, however, if markets are not transparent, investments are costly to exit, or, in the case of institutional investors, if the investors themselves are poorly governed.

**FIRMS' PERFORMANCE IS MONITORED AND SPURRED BY REPUTATIONAL AGENTS AND ACTIVIST SHAREHOLDERS.**

Developed markets increasingly feature a dense network of reputational agents who significantly reduce monitoring costs.<sup>1</sup> They include accounting and auditing professionals, lawyers, investment bankers and analysts, credit rating agencies, consumer activists, environmentalists, and media. Keeping an eye on corporate performance and insider behavior, these reputational agents can exert pressure on companies to disclose relevant information, improve human capital, recognize the interests of outsiders, and otherwise behave as good corporate citizens. Some can also put pressure on government through their influence over public opinion.

Investors and activist shareholders have also championed governance reforms. Particularly in the United States but increasingly in other developed market economies, they have worked actively to ensure that managers and boards act in the interest of shareholders. Although these active institutional investors do not typically take a controlling ownership stake, their visibility and influence in capital markets give them a leverage that few corporations can afford to disregard. Venture capital firms too play a monitoring role in the governance of startup firms, particularly in knowledge-based industries. They have the expertise, resources, and responsibility to undertake intensive monitoring and overcome the information disadvantage that other investors may face.

***There is no single model of corporate governance . . .***

These internal and external features have come together in different ways to create a range of corporate governance systems that reflect specific

market structures, legal systems, traditions, regulations, and cultural and societal values. The systems may vary by country and sector and even for the same corporation over time. But they affect the agility, efficiency, and profitability of all corporations—private, publicly held, and state-owned. Among the most prominent systems of corporate governance in developed countries are the U.S. and U.K. models, which focus on dispersed controls, and the German and Japanese models, which reflect a more concentrated ownership structure. Recently, many countries and firms have updated their systems of corporate governance to reflect a broader and more inclusive concept of corporate responsibility that includes stakeholders, as reflected in the King Report for South Africa, the Commonwealth Association for Corporate Governance principles, and others.

***. . . but globalization is bringing harmonization***

Despite the diversity of corporate governance systems, the globalization of markets is producing a degree of convergence in actual operations and governance practices. Countries and firms compete on the price and quality of their goods and services (which has led to a convergence of cost structures and firm organization that in turn has spilled over into firm behavior and decisionmaking). They compete for financial resources in global capital markets. Increasingly, they also compete on their regimes for corporate governance. These global market pressures are providing the impetus for private corporations to harmonize corporate governance practices—to reduce risk to investors and hold down the cost of capital to corporations.

**UNIFORM STANDARDS ARE GAINING CURRENCY.** Similarly, governments, which retain priority in protecting savers, investors, suppliers, and the broader interests of the economy, are increasingly requiring that corporations operate in a fair, transparent, and accountable manner. Numerous public and private bodies have responded by



establishing standards and norms related to important aspects of corporate governance. Among them are the International Accounting Standards Committee, the Bank for International Settlements (BIS, for banking supervision and prudential regulation), the International Organization of Securities Commissions, the World Trade Organization, and the International Labour Organization.

**AND AGREEMENT ON BASIC PRINCIPLES FOR CORPORATE GOVERNANCE IS SPREADING.** Through a consultative process involving OECD members and observers, the private sector, international organizations, and a range of stakeholders, the OECD has distilled from diverse national practices a set of Principles of Corporate Governance. The principles deal mainly with internal mechanisms for directing the relationships of managers, directors, shareholders, and other stakeholders. They are also intended primarily for listed companies that function within an effective legal and regulatory environment with adequate competition.

The preamble to the principles states that they “are nonbinding and do not aim at detailed prescriptions for national legislation. They can be used by policy makers, as they examine and develop their legal and regulatory frameworks for corporate governance that reflect their own economic, social, legal and cultural circumstances and by market participants as they develop their own practices.”

The OECD recognizes these broad principles as a starting point for debate and consideration by governments seeking to raise standards of corporate governance. In brief, the principles cover:

- The rights of shareholders (and others) to receive relevant information about the company in a timely manner, to have the opportunity to participate in decisions concerning fundamental corporate changes, and to share in the profits of the corporation, among others. Markets for corporate control should

be efficient and transparent, and shareholders should consider the costs and benefits of exercising their voting rights.

- Equitable treatment of shareholders, especially minority and foreign shareholders, with full disclosure of material information and prohibition of abusive self-dealing and insider trading. All shareholders of the same class should be treated equally. Members of the board and managers should be required to disclose any material interests in transactions.
- Recognition of the role of stakeholders in corporate governance, as established by law. The corporate governance framework should encourage active cooperation between corporations and stakeholders in creating wealth, jobs, and financially sound enterprises.
- Timely and accurate disclosure and transparency on all matters material to company performance, ownership, and governance and relating to other issues such as employees and stakeholders. Financial information should be independently audited and prepared to high standards of quality.
- The responsibilities of the board for the strategic guidance of the company, the effective monitoring of management, and accountability to the company and shareholders.

***What it takes to succeed: a mix of regulatory and private voluntary actions***

The OECD principles draw on a report prepared by the Business Sector Advisory Group that emphasizes that good corporate governance can best be achieved through a combination of regulatory and voluntary private actions. On the regulatory side the report noted that government interventions on corporate governance are most effective when consistently and expeditiously enforced and when focused on ensuring fairness, transparency, accountability, and responsibility. It stresses that regulatory measures, though necessary, are not sufficient to raise standards. Indeed, the strengthening of corporate governance standards has been advanced by many corporate lead-

ers who recognize that prospering in the long term requires balancing business objectives with society's concerns.

These companies have gone far beyond the strictures of law by adopting voluntary measures that improve the quality of disclosure, ensure that directors discharge their fiduciary responsibilities, and increase the commitment of managers to running companies transparently to maximize value but with due regard for stakeholders' interests. The evidence increasingly suggests that such behavior enhances the reputation and value of companies. That recognition has spurred the voluntary adoption of good governance practices by firms that now find it necessary to abide by global rules set by global markets.

### **The challenge of corporate governance in emerging markets is daunting**

In advanced market economies the rich and complex governance system (of policy, laws, regulations, public institutions, self-regulated professional bodies, and managerial ethos) has evolved over centuries. In emerging markets, however, many elements of this mosaic are absent or countries are ill-equipped to address the corporate governance challenges they face. These challenges are all the more daunting because of the complexity of the ownership structure in the corporate sector, interlocking relationships between government and the financial sector, weak legal and judicial systems, absent or underdeveloped institutions, and scarce human resource capabilities.

#### ***The range of corporate structures makes the problems more complex***

Ownership patterns across developed, developing, and transition economies are extremely varied. Among successful developed economies, both dispersed and concentrated shareholdings have provided an efficient base for growth and capital accumulation as long as there has been a well functioning legal and regulatory framework,

active oversight by reputational agents, and adequate institutional and professional infrastructure.

The environment is different in many emerging market economies. The widely held publicly traded firms that constitute a significant part of the corporate sector in many developed countries are rare in emerging market economies. A more common pattern is dominance by public sector companies or closely held family-owned and -managed conglomerates with complex shareholdings. This concentrated pattern of ownership allows insiders to have tight control of the firm, but it also opens up opportunities for expropriation of outside shareholders and other providers of capital.

Transition economies face a different problem. Much of their corporate sector consists of "instant corporations" created through mass privatization programs implemented without the legal and institutional structures necessary to operate in a competitive market economy. With diffuse ownership, this has sometimes allowed insiders to strip assets and leave little value for minority shareholders. In both systems there is a need to build institutions and professional capacity.

These corporate structures complicate the problems associated with asymmetries of information, imperfect monitoring, and opportunistic behavior and make corporate governance reform more complex.

#### ***Less competitive markets and weaker institutions make the solutions more difficult***

In emerging market economies the business environment lacks many of the elements needed for a competitive market and a culture of enforcement and compliance. Inadequate competition policies entrench large dominant firms, prevent new entry, and discourage entrepreneurship. Change in corporate control is often subject to ambiguous laws with uncertain implementation, giving management considerable latitude to delay or derail any takeover attempt.

There are significant differences in legal and regulatory systems and traditions across devel-

oping and transition economies, but disclosure requirements and legal protections for shareholders are seldom up to international standards. Outdated contract and bankruptcy laws impede efficient operation and orderly exit, and judicial systems are poorly equipped to offer the speed and predictability required in today's global market. Even where legal and regulatory frameworks have been updated, enforcement remains uneven and sometimes selective, reflecting a critical shortage of skills and sometimes a misuse of official power.

Often the state has a heavy presence in both the real and financial sectors. It directs credit to privileged firms on subsidized terms through a poorly regulated banking system that conducts little credit analysis and seldom monitors or disciplines large borrowers effectively. In many countries private conglomerates are formed around banks, which then dominate both real and financial sectors. These alliances, and the absence of arm's length transactions within them, have led to excessive concentration of ownership, overreliance on debt financing, high leveraging, and in many cases investments in marginal or speculative projects.

These practices have also undermined the development of securities markets. Typically, trading volumes and liquidity are low, and securities markets are dominated by a few large firms. There are almost no long-term debt instruments. Institutional investors are few and not yet strong enough to insist on fairness, efficiency, and transparency. Their investments in emerging markets generally represent only a small part of a diversified portfolio, and because of opaque rules even the bigger institutional investors generally lack the confidence or incentives to assert their influence as shareholders. They often vote with their feet instead of voting their proxies, contributing to the volatility in global capital flows that has hurt many developing and transition economies. These conditions have also impeded the development of local pension and mutual funds. This environment offers little incentive

for sound corporate governance in either the real or the financial sector.

***Some countries have made major strides by focusing on the "basics" . . .***

Though reform is difficult, many countries have taken some of the necessary steps and a few have taken most of them, improving their institutions and human resources. Those that have stayed the course have seen impressive gains in corporate governance and economic performance. But even in this group, reform has been a long, uneven, and sometimes fragile process of successes and reversals. And some important institutions are just beginning to emerge, such as reputational agents and active shareholders.

Reforms have proved most effective when they have focused on fundamentals and have combined a complementary mixture of laws consistently enforced and incentives for firms to take voluntary actions. They have emphasized a comprehensive strengthening of external sources of discipline and internal incentives to improve corporate governance, especially by making corporate boards more effective and competent to exercise their duties of oversight and control over management. They have typically involved these elements:

- Establishing competitive markets by removing barriers to entry, enacting competition laws, establishing fair trade priorities, and removing restrictions on foreign direct investments, particularly in low-income transition economies, where foreign investors can take on the role of strategic investors.
- Requiring transparency, notably through the timely disclosure of material information about the financial and nonfinancial operations of the corporation.
- Enforcing financial discipline by severing the links between government, banks, and corporations; restricting directed and connected lending; restructuring banks and allowing private ownership of banks by reputable local and foreign strategic partners

(to bring much-needed financial, managerial, and technical capabilities to restructure the corporate sector); strengthening prudential regulation and supervision; and improving enforcement of contracts to suppliers and creditors. These measures should lead to less reliance on banking systems for corporate financing and provide greater incentives for raising capital on equity and corporate debt markets.

- Fostering growth of well-regulated and liquid securities markets by developing the infrastructure required for efficient capital markets, protecting minority shareholders, allowing open-ended mutual funds, enlarging the volume of equity through privatizations of state enterprises in financial and real sectors (particularly infrastructure firms), reforming the social security system, and allowing private firms to manage properly regulated pension funds.
- Updating and strengthening the legal, judicial, and tax systems to ensure clarity and effective enforcement.
- Building capacity by upgrading capabilities and preparing the next generation of professionals (accountants, regulators, bankers, company directors).

On the internal side, the focus of the reform is to make corporate boards more effective and competent to exercise their duties of oversight and control over management.

For these measures to work effectively, countries need to develop the necessary institutions and build human capacity. This takes years. While institutional and capacity building are essential tasks, countries no longer have the luxury of waiting until these measures come to fruition. In the short term countries have “borrowed” or drawn on the discipline imposed by global markets, such as global investors, regulations, and reputational agents.

Many countries have allowed privatized infrastructure firms (often accounting for 50–75 percent of market capitalization) to issue American

Depository Receipts and Global Depository Receipts or to list on large foreign stock exchanges, where financial disclosure requirements are generally higher than on local exchanges. This has raised the capacity of firms in an important segment of the local market to meet higher disclosure and reporting standards. Although some corporations still offer lower standards of reporting to domestic investors, they are gradually raising the benchmark for locally listed companies. Listing on external exchanges has also subjected firms to the scrutiny of foreign institutional investors, investment banks, credit rating agencies, and other reputational agents that follow the performance of listed firms. Drawing on foreign sources of discipline may initially provoke local resistance, but it can help the economy integrate with world markets, prepare firms for global competition, and serve the interests of both domestic and foreign investors. These benefits can more than compensate for any short-term loss of liquidity in local markets.

***... but they face resistance from powerful interest groups***

Reform of corporate governance systems is politically difficult. Vested interests within firms generally oppose greater transparency and disclosure of both financial and nonfinancial information, arguing that the requirements are costly to comply with and put them at a disadvantage relative to local or foreign competitors. These immediate drawbacks, they claim, outweigh the potential longer-term benefits of higher share values and lower financing costs that can come with greater transparency. Worried about diluting their privileged position in the company’s decisionmaking, insiders often oppose such substantive corporate governance requirements as one-share one-vote, cumulative voting, public tender offers, and independent directors. Giving greater power to minority shareholders is often opposed on the grounds that it could lead to foreign control of local firms, ignoring the benefits that could bring. Large firms tend to have con-

siderable political influence and access to the public media, opening the door for bribery and corruption. In developing countries and transition economies regulators or supervisors rarely have the political, human, and financial resources to prevail against the determined opposition of these vested interests.

Tough disclosure requirements and substantive changes in corporate governance are sometimes also opposed by members of exchanges (brokers, dealers, banks), who fear a loss of revenue if the measures discourage firms from listing. The threatened loss of privileged access to information can also provoke resistance to reform, particularly in smaller economies where ownership and control of industrial companies may overlap.

With such opposition, it is not surprising that corporate governance reforms (in developed countries as well as developing and transition economies) have often been driven by major economic crises or serious corporate failure. The recent financial crisis in East Asia prompted countries to take major steps to strengthen governance—closing insolvent banks, strengthening prudential regulation, opening the banking sector to foreign investors, revamping bankruptcy and takeover rules, tightening listing rules, requiring companies to appoint external directors, introducing international accounting and auditing standards, requiring conglomerates to prepare consolidated accounts, and enacting fair trade laws.

***The solution: ownership with due diligence***

The challenge for developing countries is to take the next steps toward sound corporate governance before another crisis erupts. The important initial steps already taken will not become fully effective until the supporting institutions and implementation capacity evolve and adjust to new monitoring and regulatory needs. The culture of state intervention and policy influence by large conglomerates will have to adapt to a global environment that puts a large premium on a culture of compliance and enforcement.

Effecting this change of culture will require a combination of regulatory reform and voluntary private action in a sustained process of consensus and capacity building involving all the players. Each country will have to find its own formula by assessing its strengths and weaknesses, setting priorities and sequencing reforms, creating strong institutions, and developing the necessary human capital. The winning formula has to be adapted to the corporate structure and to the implementation capacity in the private and public sectors. It has to provide both the incentives and the discipline for the private sector to adopt and consistently practice sound principles of corporate governance. It also needs to encourage a broadening and deepening of local ownership that will enable firms to compete more effectively in world markets—often by adhering to best practices and rules set by global markets.

For countries where companies obtain financing mainly through the banking system, reforms center on restructuring and privatizing banks and strengthening prudential and regulatory systems. For countries with a large number of listed companies, the most effective tools have been tightening listing requirements, improving protection of minority shareholders, attracting reputational agents, and encouraging companies with large financing requirements to list overseas. In all countries these steps have to be complemented by measures that minimize rent seeking, promote transparency and disclosure, and strengthen the enforcement capacity of the legal system. Given the limited institutional and human resources base, these policy and regulatory changes have to minimize the role of government in the day-to-day operation of business and focus on a core agenda of reducing economic regulation, strengthening prudential rules, and enforcing them consistently and relentlessly.

Corporate governance is not merely about enacting legislation. It is also about establishing a climate of trust and confidence through oversight. Ethical business behavior and fairness can-

not simply be legislated into being. Strengthening corporate governance is fundamentally a political process in which the government and the private sector have to join hands. There will never be sustained and meaningful public sector reform of governance laws and regulations until the private sector understands that support of reform creates a level playing field, which is in its own best interest. And ultimately, for governance to be fully implemented, the private sector needs to build on the base of law and regulation with voluntary actions of its own.

### **World Bank Group strategy for helping countries develop and implement a comprehensive reform program**

The World Bank Group has long been active in supporting client countries in undertaking difficult structural changes requiring reforms of legal and regulatory structures, the financial sector, and enterprises, including privatization of state-owned enterprises. These programs have addressed many issues central to corporate governance: creating competitive markets, establishing regulatory and supervisory capability in banking and capital markets, introducing greater transparency, adopting international accounting and auditing standards, and strengthening the competence and independence of boards of directors. Because a scarcity of qualified professionals often poses the most daunting challenge to effective reform, the Bank has also financed technical assistance operations in support of institutional development and capacity building in many areas affecting corporate governance, including auditing and accounting standards, legal and judicial systems, financial sectors, and capital markets.

The International Finance Corporation too has promoted better corporate governance by requiring that the firms in which it invests practice sound corporate governance and by insisting on proper internal controls and reporting. It has been instrumental in developing equity and cor-

porate bond markets, including listing and securities regulations. It has provided hands-on technical assistance to transition economies to establish sound systems of corporate governance. Similarly, the Multilateral Investment Guarantee Agency has ensured that its guarantee operations have a high standard of corporate governance.

### ***Marshalling support for corporate governance reform***

The Bank Group is scaling up its work on structural reform in developing countries, and corporate governance is a key element in that agenda. The Bank Group's and others' objective is to work with partners (multilateral agencies, international organizations, the private sector) to broaden the debate on corporate governance beyond OECD countries to developing and transition economies. While the Bank Group will respond to the growing needs of client countries to adapt international best practices to their own circumstances and to implement legal and regulatory reforms, it will not be in the business of setting standards or creating codes. Rather, it intends to marshal support nationally, regionally, and globally for countries' own initiatives. This work will be supported by a more concerted emphasis on governance by the Bank Group in its ongoing policy, lending, technical assistance, and private sector activities.

At the national level the Bank and its partners have supported a series of country self-assessments that identify strengths and weaknesses in corporate governance and help countries establish priorities. Complementing these assessments are investor surveys that identify market perceptions about the same issues. Together, the two assessments paint a clearer picture of corporate governance practices in individual countries, identify priority areas and pressure points, and set the stage for a comprehensive reform agenda. The twin objectives are to strengthen regulatory reform and enforcement while fostering private voluntary actions. This is consistent with the approach of the Bank's Comprehensive Development Framework,

which emphasizes good corporate governance as a key factor in development effectiveness. The Comprehensive Development Framework further stresses the importance of the private sector, both local and foreign, as a major player in the development process. It calls for a participatory process that involves all the major stakeholders in the design and implementation of a comprehensive reform strategy.

At the regional level the Bank has cosponsored with other multinational agencies (particularly, OECD, Asia Pacific Economic Cooperation, Asian Development Bank, European Bank for Reconstruction and Development) and other organizations active in this area a series of roundtables for government officials, legislators, regulators, local and foreign firms, investors, and rating agencies to help craft a consensus for reform.

On the global level the Bank Group has worked closely with the OECD to broaden the dialogue on corporate governance beyond OECD countries. The OECD Principles of Corporate Governance would be a starting point—but not a reference point. The Bank Group has also worked closely with the BIS on banking systems, with the International Organization of Securities Commissions on harmonizing listing requirements, and with the International Accounting Standards Committee and the International Forum for Accounting Development on transparency issues. It has supported the World Trade Organization and the International Labour Organization on competition policy and labor issues. In the private sector it has engaged the major accounting and auditing firms to ensure that their affiliates, which carry their name and reputation, adhere to the same international standards and guidelines.

#### ***Catalyzing reform through the Global Corporate Governance Forum***

A good part of the knowledge and expertise needed to support corporate governance and related reforms already exists in the public and private sectors. A wide range of organizations has

begun focusing on corporate governance. Although many of these efforts are still small and dispersed, together they account for substantial and diversified international reform efforts. If the corporate governance agenda is to be scaled up properly, a major effort is needed to distill this expertise and marshal it in a coordinated and timely way to support countries' efforts on both regulatory and voluntary fronts.

In a major step in this direction, the World Bank Group and the OECD signed a Memorandum of Understanding (see appendix 3.3) on June 21, 1999, to sponsor the Global Corporate Governance Forum. The forum will bring together other multilateral development banks, bilateral and international organizations, the IMF, the Commonwealth, Asia Pacific Economic Cooperation, International Accounting Standards Committee, International Organization of Securities Commissions, and the private sector. It will provide a rapid-response mechanism for coordinating and channeling practical technical assistance to specific constituents, on a national, regional, and global basis, to help design and implement reforms. Above all the forum will mobilize local and international public and private sector expertise and resources to and advance corporate governance on a fast track, emphasizing dialogue and consensus building.

The forum will build on what has already been achieved to help countries develop their own programs and institutions. To this end, the forum's activities will include:

- Broadening the dialogue to include perspectives from developing and transition economies.
- Supporting countries in carrying out self-assessments and investor surveys on the status and practice of corporate governance.
- Building consensus for policy, regulatory, and institutional reforms at global, regional, and local levels.
- Framing corporate governance strategies to take full advantage of the potential for private sector involvement.

- Developing the capacity of governments to design and implement reforms and the capacity of self-regulatory bodies to develop and execute their own regulations.
- Strengthening reputational agents.
- Sharing knowledge and best practices.
- Developing human capacity and building institutions to sustain and expand corporate governance practices.
- Addressing corporate governance issues that go beyond a specific country.

In implementing this ambitious agenda, the forum will be advised and supported by a high-level Private Sector Advisory Group. Leaders and captains of industry with established track records in corporate governance will lend their names and reputations to efforts to bring key stakeholders to the table to build a coalition for reform. The forum will also provide a channel for extensive consultation with important stakeholders (labor, organizations active in corporate governance, environmental agencies, NGOs, and others) and build on efforts already begun through roundtables and consultative groups.

Time is short. Crises highlight challenges and offer opportunities for governments and the private sector to change behavior and the rules of the game. But while reforms are most often initiated in the wake of crisis, they should not be viewed in the context of a short-term anticrisis package. Change will take a concerted effort in building consensus and sharing experience, expertise, and resources among all players. Above all, the private sector must see that implementing reform is in its own best interest. Likewise, reform of the public sector is central to an effective partnership. Because reforms are likely to yield results only over the medium to long run, sustainability and comprehensiveness in design and staying power during implementation are critical.

#### **Note**

1. *Reputational agents* refers to the private sector agents, self-regulating bodies, the media, investment and corporate governance analysts, and civic society groups that reduce information asymmetry, improve the monitoring of firms, and shed light on opportunistic behavior. Their actions influence both companies and governments.



# A Framework for Better Corporate Governance

**W**hat makes corporate governance increasingly important in today's global market is the demand from growing businesses for external domestic and international capital in quantities and ways that would have been inconceivable just a decade ago. Not too long ago, public sector and multilateral sources provided a good part of this financing. Increasingly, the private sector is providing investment resources (table A1.1).<sup>1</sup> But the bulk of international flows is short term—causing great volatility—and goes to only a limited number of emerging and transition economies. Obviously, the list has to be broadened. More and more, good corporate governance is becoming a crucial factor in attracting long-term “patient” capital rather than short-term speculative capital.

This rise in demand for and supply of private capital is broadening and deepening the markets for corporate finance and corporate control and is providing investors with a widening array of choices. Providers of corporate finance—whether individuals, banks, institutional investors, or other financial institutions—

require assurances that their investments will generate reasonable returns and be protected. Increasingly, they base their investment decisions not just on a company's outlook, but also on its reputation and governance.<sup>2</sup>

While the recent economic and financial crises in East Asia and elsewhere had a multitude of underlying causes, weak corporate governance has consistently been seen as a major contributor that needs to be addressed to revive investor confidence and decrease the impact and likelihood of future shocks. Good corporate governance is not only about its increasing importance to international investors but also about its protection of domestic investors. Unlike international investors, who have sophisticated instruments to diversify their overall portfolio risk, domestic investors are often captive to local markets and risk losing their life's savings when transparency is lacking and governance systems are defective. In an environment that does not protect minority shareholders' rights, these investors cannot risk investing in corporations directly, thus limiting their ability and potential to participate in or contribute to their economy's

development. As a group, however, they represent a large pool of stable, long-term resources critical to the development process. But only with effective corporate governance and protection for providers of finance can companies tap domestic resources for their investments and provide a safer environment to attract international investors as well.

This chapter develops a framework for implementing corporate governance reform. Chapter 2 expands on this framework to discuss specific corporate governance challenges in emerging markets. And chapter 3 proposes an agenda for action by the World Bank Group and its partners.

### **Analytical tools for examining corporate governance**

The concept of corporate governance, though as old as the concept of the corporation, has evolved considerably over time. It has different meanings to different people and in different contexts.<sup>3</sup> The definition used in this report starts with the notion that corporate governance is about ensuring that the business is run well and that investors receive a fair return. It is about giving overall direction to management and ensuring accountability to shareholders, other external providers of funds, and stakeholders. Corporate governance should not be confused with management, which is concerned with the day-to-day running of business (production, procurement, marketing, finance, personnel).

In a proprietary firm the owner-manager's efforts are directed at maximizing the firm's value because this maximizes the owner-manager's income as well. This relationship becomes complicated when corporations are owned by multiple shareholders (principals) but run by managers (agents). The need for corporate governance arises from the potential divergence of interests between those who have control over a firm and those who provide its external financing. This divergence can be described as a principal-agent problem (commonly known as agency

costs<sup>4</sup>). It is a function of the separation of ownership and control or, more broadly, of the distinction between corporate insiders (management or controlling shareholder) and outsiders.<sup>5</sup> Without governance protections, capital providers (owners, creditors, or taxpayers) who lack control over the corporation will find it risky and costly to protect themselves from opportunistic behavior by managers or controlling shareholders.

In a broader sense the need for corporate governance arises when public and private returns diverge. Unless meaningful protections are in place for external capital providers, those who control the corporation can use their position to misappropriate economic benefits, often at the expense of the long-term performance and value of the enterprise. Where poor corporate governance is the norm, the repercussions extend beyond underperformance in a single corporation to include the corporate sector and they extend to greater vulnerability in the financial system, since it is hard for local capital providers (banks and institutional investors) to assess risks adequately. Lack of meaningful protection for capital providers is likely to reduce the availability of finance on favorable terms and affect the overall efficiency of the economy.

Thus this report's definition of corporate governance incorporates the combination of laws, regulations, procedures, voluntary practices, and implicit rules that enable the corporation to attract financial and human capital, perform efficiently, and maximize long-term value for shareholders while respecting the interests of stakeholders and society (box 1.1).<sup>6</sup>

### **Evolution of corporate governance: from crisis response to international cooperation and convergence**

Corporate history is replete with cases of managerial opportunism: patronage, insider trading, extravagant rewards, unwarranted movements of funds from one company to another, and investments in projects well beyond the bounds of

### Box 1.1. Corporate governance from a private and public policy perspective

From a corporation's perspective, the emerging consensus is that corporate governance is about maximizing value in the long run *subject* to meeting financial and other legal and contractual obligations. This broader and more inclusive definition stresses that achieving long-term sustained value to shareholders requires balancing the interests of shareholders and financiers with those of other stakeholders—employees, customers, suppliers, investors, and communities.

From a public policy perspective, corporate governance is about nurturing enterprises while ensuring accountability in the exercise of power and patronage by firms. The central role of public policy is to provide the firm with the incentives and discipline to minimize the divergence between private and social returns and to protect the interests of stakeholders.

prudence. Another form of abuse involves managers so deeply entrenched that they cannot be removed even when they are no longer competent.<sup>7</sup> Still other abuses are committed by controlling shareholders at the expense of minority shareholders. Normally, all these transgressions are kept within reasonable bounds. But when bad management is combined with weak banks, underregulated capital markets, and poorly enforced laws for external discipline, the results can be disastrous: firms, stock markets, banking systems, and even economies can implode. Such crises or other visible failures have been the motive for much of the reform effort in corporate governance (box 1.2).

#### **Corporate governance responses to national crises**

One of the earliest governance crises was the bursting of the “South Sea Bubble” of 1720–21, which dramatically changed business habits and

### Box 1.2 Agency chains

In earlier stages of development, economies had much shorter agency chains. The shorter the agency chain, the easier it is to resolve a corporate governance problem. A modern market economy is based on highly developed agency relationships. In the more stable and developed market economies, long multistage chains of agency relationships have developed (workers are agents for managers who are agents for shareholders such as mutual funds that may provide pension funds to workers).

One of the most important ways real economies diverge from textbook models is in the problems of *asymmetric information*, *imperfect monitoring*, and *opportunistic behavior*. Accordingly, some of the most important economic institutions arise to alleviate agency problems. Among them are the legal machinery to enforce shareholder rights, liquid stock markets and open-end investment funds (so investors can “vote with their feet”), the legal framework for competition policy, the monitoring system of accounting and auditing, and the ethos of managerial professionalism. These agency institutions need to grow incrementally over decades—market economies created overnight may collapse in dysfunction.

*Source:* Stiglitz 1999.

regulations in Britain.<sup>8</sup> Britain rapidly enacted corporate statutes to protect the public from such abuses as the bubble scandal. The main elements are still with us: shareholders' rights to information and the ability to appoint and remove directors and auditors. Similarly, the U.S. stock market crash of 1929 prompted the development of the main body of securities law and regulation, starting with the Securities Act of 1933. Throughout, regulators were awakened from complacency by full-blown crises and evolutions in the market. They responded by filling

the gaps in regulation that had opened the way to a flood of regulatory abuse.

New concerns about corporate governance were provoked by the secondary banking crisis in the United Kingdom in the 1970s and the U.S. savings and loan crisis in the 1980s. Commercial banks were well supervised, but in a new era of deregulation the thrift industry was not. Many savings and loans took excessive risks and became insolvent. The official response was a raft of regulations and a new office to supervise thrift institutions. A decade later the abuses of the Bank of Credit and Commerce International in the United Kingdom highlighted the problems of cross-border operations and evasion of banking regulations. It spurred efforts for international prudential regulation and supervision of cross-border operations.

Most of these responses tackled specific regulatory gaps. In the late 1980s financial scandals leading to the collapse of several prominent companies came to light in the United Kingdom. This time there was a strong private response alongside the public regulatory response. The corporate sector responded to the loss of confidence in financial reporting by setting up the Cadbury Committee in 1990 to develop a code of best practice. But even as the committee sat, the chairman of the Maxwell Group raided the pension fund of the Mirror Group of newspapers to support other business ventures—all unopposed by directors of the firm. This highlighted the importance of governance in financial institutions, ultimately resulting in the 1995 Pensions Act. Soon other committees convened on a range of corporate governance topics, culminating in the adoption of a combined code by the London Stock Exchange in 1998. The government also initiated a major review of company law. The United Kingdom now has a broad mix of laws, regulations, and best-practice codes that provides an innovative and flexible environment for improving standards of corporate governance.

In the United States the response to governance failure was similar. The most recent round of reforms began as a result of takeovers and constituency statutes enacted under state law. In the late 1980s and early 1990s, as major performance problems became evident in many of the largest corporations, reform began to focus more on the quality of corporate boards and their independence. An active group of institutional investors began to emerge and grow. Since then, institutional investors (mostly pension funds) have stepped up their vigilance in exercising their fiduciary duties under the Employee Retirement Investment Securities Act (ERISA) of 1974.

With globalization, corporate governance issues in one country increasingly contributed to debate in others—countries have learned from each others' best and worst practices. Soon, shareholder activists around the world were tackling corporate ethics with vigor. They formed the Council of Institutional Investors to develop strategies for dealing with executive abuses on takeover provisions and pay. The council became a driving force in the recent evolution of corporate governance. Institutional investors such as pension funds and mutual funds have been active as significant minority shareholders in ensuring that managers and boards act in the interests of shareholders and stakeholders. Private investors, trade unions, and church groups have also been active in strengthening corporate governance. Together, they have made protecting shareholder rights, particularly the equitable treatment of minority shareholders, a central principle of corporate governance. In developing countries the issues were also taken up in a variety of ways, from the King Report in South Africa to the Confederation of Indian Industries Code.

#### ***International efforts among developed and developing countries***

As these changes were taking place in individual countries, a parallel movement was occurring internationally. To lay the foundation for the first set of international corporate governance stan-

dards to be discussed and adopted by member countries, the Organisation for Economic Cooperation and Development (OECD) formed the Business Sector Advisory Group in 1996 and a task force to distill a set of core principles of good corporate governance. The advisory group's report (OECD 1998) emphasized that good corporate governance can best be achieved through a combination of *regulatory and voluntary private actions*.

On the regulatory side, it noted that government interventions are most effective when consistently and expeditiously enforced. They should focus on:<sup>9</sup>

- *Fairness*: protecting shareholder rights and ensuring the enforceability of contracts with resource providers.
- *Transparency*: requiring timely disclosure of adequate information on corporate financial performance.
- *Accountability*: clarifying governance roles and responsibilities and supporting voluntary efforts to ensure the alignment of managerial and shareholder interests, as monitored by a board of directors—or in certain nations, a board of auditors—with some independent members.
- *Responsibility*: ensuring corporate compliance with the other laws and regulations that reflect society's values, including a broad sensitivity to the objectives of the society in which corporations operate.

The report also stressed that regulations, however well enforced, are not enough to promote best practices. Equally important are the *voluntary actions* of firms in setting up codes of conduct and the influence of an array of “reputational” agents that can pressure firms to comply with good governance practices.

While the corporate governance debate was evolving in developed countries, it was also generating interest in some developing countries. Representatives at the 1998 Commonwealth Heads of Governance Meeting in Ottawa launched an initiative making governance reform a priority in developing countries. A

new body, the Commonwealth Association for Corporate Governance, was formed to raise standards through institution building and capacity development. The crises in East Asia and elsewhere pushed corporate governance to the top of the reform agenda. Unlike earlier crises, East Asia's was not a crisis of fiscal profligacy or balance of payments. It was in large part a crisis of poorly governed firms making bad investments that ultimately threatened the stability of the entire global financial system. The response this time cannot be merely to fill regulatory gaps. The response has to be across the board, systematic, and over a much shorter period of time. Globalization, increased need for capital, and heightened volatility of markets will not allow corporate governance stragglers to survive for long.

### **A framework for corporate governance**

There are many perspectives on corporate governance—its purpose, its definition, and how to bring it about. As an organizing framework, corporate governance can be viewed as the dynamic interplay of internal and external incentives that affect the performance of all corporations, whether private, publicly traded, or state-owned (see figure 1 in the overview). The internal incentives are the organizational arrangements within a corporation that allow owners to direct managers to pursue goals the owners set. The external incentives are the regulatory structures, voluntary standards, and competitive market forces that, while not under the direct control of owners, exert discipline on the performance of owners and managers from the outside. The interplay of internal and external incentives for corporate governance varies from country to country, from sector to sector in the same country, and for the same corporation over time. But corporate governance ultimately affects the performance of all corporations, whether private, publicly held, or state-owned—determining their agility, their efficiency, and their profitability.

### **Internal mechanisms for good governance**

A well governed corporation needs to balance the roles of three groups of players: shareholders (and employees, if they have a governance role), boards of directors, and managers, while meeting all of its financial commitments and other obligations to a broad array of stakeholders.

*Shareholders* provide (risk) capital in return for the opportunity to benefit from profits and increases in corporate value. Shareholders may have a range of rights and powers under law and regulation that can include the right to elect and remove directors and auditors and to appoint and approve or disapprove fundamental changes, such as mergers or changes in capital structure. The shareholders' interest is generally in maximizing the value of the firm's equity and distributions relative to risk over time. Mechanisms for registering and transferring shares in a corporation protect shareholders' (especially minority shareholders') rights, including their rights to buy, own, sell, and transfer stocks—to vote with their feet, should management or corporate performance decline.

The *board of directors* represents the interests of shareholders and may have obligations to other stakeholders under various statutory and voluntary provisions. An independent board of directors, the core internal governance mechanism, is the bridge between management and owners, other stakeholders, and the outside world. The board needs to be independent, particularly of management, and its members should be well-versed in the firm's line of business or in general business areas such as business law, accounting, marketing, finance, or production. The board should also be of reasonable size, and the terms of its directors should be fixed (box 1.3). Making the board more effective is at the center of the corporate governance debate.

In some countries, such as Germany and the Netherlands, the board may include representatives of shareholders, creditors, and employees. In many countries directors have a fiduciary relationship to the company that includes duties

### **Box 1.3. Best practices and key responsibilities for boards of directors**

Board best practices generally recommend that:

- Board size should reflect the complexity of the corporation and the need for effective decision making; 15 members is the upper limit for board effectiveness in most cases.
- Boards should include a significant proportion of independent directors who are likely to make objective judgments because they have no close ties with management.
- Boards should meet often enough—at least once a quarter—to do their job effectively.
- Agenda and briefing materials should be sent to board members early enough before meetings to give members time to prepare.
- Board meetings should be used for discussion, not lengthy management presentations.
- There should be some limitations on services (term limits, limits on other comments) to help ensure fresh viewpoints and active participation.

Key responsibilities:

- Appointing, monitoring, and replacing senior management when necessary.
- Monitoring relationships with shareholders and society.
- Ensuring compliance with laws and regulations and monitoring the integrity of accounting and financial reporting.
- Approving the company's business plans and other major decisions. Generally, the board also oversees strategic planning (including acquisitions and mergers), dividend policy, and remuneration of senior executives. It may set up separate audit, remuneration, and succession committees to provide specialized technical advice.

For more details, see annexes 3 and 4a.

of loyalty and care that require that directors avoid self-interest in their decisions and act diligently and on a fully informed basis.

*Managers* report to the board and are responsible for day-to-day operations and for implementing strategy. Their business objectives include financial issues and such nonfinancial issues as environmental protection and employee training. Where the interest of managers, shareholders, or the public diverge, a governance problems arise.

*Stakeholders*—including workers, banks, creditors, suppliers, customers, and communities—also influence corporations. Stakeholders' interests are reflected in a rich variety of formal and informal provisions such as creditors' rights and insolvency laws, labor policies, consumer rights legislation, and environmental regulations.

Based on the tenets of fairness, transparency, accountability, and responsibility, the OECD ad hoc task force of the Business Sector Advisory Group has identified five basic Principles of Corporate Governance.<sup>9</sup> These have also been distilled by many industrial countries in their regulations or voluntary codes of best practice on internal corporate governance:

- *Protection of shareholder rights* to share in company profits, receive information about the company, and influence the firm through shareholder meetings and voting.
- *Equitable treatment of shareholders*, especially minority and foreign shareholders, with full disclosure of material information and prohibition of abusive self-dealing and insider trading.
- *Protection of stakeholder rights* as spelled out in contracts and in labor and insolvency laws, in a framework that allows stakeholder participation in performance-enhancing mechanisms, gives stakeholders access to relevant company information, and allows effective redress for violations of stakeholder rights.
- *Timely and accurate disclosure and transparency* on all matters material to company performance, as essential to market-based monitoring of companies, and shareholders' ability to exercise voting rights, with account-

ing according to quality standards of disclosure and audit, and with objective auditing by independent assessors.

- *Diligent exercise of the board of directors' responsibilities* to guide corporate strategy, to manage the firms' executive functions (such as compensation, business plans, and executive employment), to monitor managerial performance and achieve an adequate return for investors, to implement systems for complying with applicable laws (tax, labor, competition, environment), to prevent conflicts of interest and to balance competing demands on the company, and with some independence from managers to consider the interests of all stakeholders in the company, treat them fairly, and give them access to information.

#### **Corporate governance models in developed countries**

There is no one-size-fits-all blueprint for corporate governance. Several models of corporate governance have evolved that highlight the relative weight given to shareholder value or protection of stakeholder rights (see annex 4b). Most notable are the U.S., U.K., German, and Japanese systems (table 1.1 and annex 2).

*The U.S. and U.K. models* are often described as based on “outside” control and widespread ownership. Shareholder rights are relatively secure, and shareholders increasingly include institutional investors such as pension funds. There is one board per company, and directors are often drawn from outside of corporate management. Banks play no direct role on boards but are influential in their role as creditors. In the United States and the United Kingdom, the board members' legal duties to the company are delineated by law.

*The German model* relies on a two-tier board of directors, one executive and one supervisory, which includes representatives from labor. This is an “insider” model in which shareholders, banks, and representatives from labor appoint those who will monitor management.

**Table 1.1. Some differences in corporate governance structures in the United States, United Kingdom, Germany, and Japan**

	<i>United States</i>	<i>United Kingdom</i>	<i>Germany</i>	<i>Japan</i>
Board of directors	One board per company	One board per company	Two-tier (supervisory and executive) with labor represented in the supervisory tier	One board per company
Separation of debt and equity	Strictly separated by law and practice	No legal separation, but much in practice	Not separated by law; combined debt-equity positions exist	Separated by law; in fact, considerable interlinked debt-equity positions

Source: Prowse 1998a.

*The Japanese model* of one board per company also emphasizes insiders. The board normally includes representatives of management. Such insiders as suppliers, customers, and the “main” banks exert informal influence through extensive cross-holdings.

Despite their differences these models operate in the same basic external environment—that of a well regulated system—and all have common internal elements. Globalization has made it especially important to harmonize the main aspects of corporate governance to reduce the risks and transaction costs in international capital markets. Thus, while there may be many models and no fixed blueprint, there are commonly agreed elements of a framework for corporate governance.

**External discipline for good corporate governance**

Internal mechanisms of corporate governance work to check and balance the power of managers, shareholders, directors, and stakeholders. But while internal incentives are necessary for efficiency, they are not sufficient for good governance. In addition to these internal factors, corporations in market economies are also disciplined externally.

**THE DISCIPLINE OF A WELL FUNCTIONING REGULATORY SYSTEM.** Formal legal and regulatory obligations

are part of the external incentive structure designed to ensure that competing companies abide by common standards of fairness, transparency, accountability, and responsibility to protect shareholders, consumers, workers, the environment, and even competitors from abusive practices. A good legal and regulatory framework efficiently addresses the entry, operations, and exit of firms. Other external elements are developed by national and international bodies on best practices (quality of disclosure, accounting and auditing standards, labor rules, environmental standards, industrial product standards, listing requirements) and other areas of practices that are qualitative and evolutionary. Attempts to incorporate them in law can lead to overregulation and can curb entrepreneurial spirit. In many countries with extensive laws and regulations, corporate governance is still poor. In countries that have a good record of corporate governance, companies have gone far beyond the strictures of law.

**THE DISCIPLINE OF COMPETITIVE FINANCIAL MARKETS.**

Both equity and debt markets impose substantial discipline on management. Equity markets continuously monitor and place an objective value on corporations and, by extension, on their management. The day-to-day performance of a company’s shares on a stock exchange is a transparent reminder to managers and owners of the com-



pany's perceived viability and value. This assessment permits shareholders to assess management performance and gives managers an incentive to minimize the costs of equity, since failure to do so will make them vulnerable to takeover. An active market for corporate control, fluctuations in stock prices, and the influence of shareholders keep managers focused on efficiency and commercial success.

But share prices can be an effective measure of performance only if equity markets are deep and well regulated to ensure fairness, efficiency, liquidity, and transparency (Mobius 1999). In many countries (including some advanced economies) equity markets are still relatively thin or underregulated. Small trade movements in the market can create significant fluctuations in share prices. To access external funding and provide a more stable, objective measure of performance, many leading companies list on external exchanges (through American Depository Receipts or ADRs and Global Depository Receipts or GDRs), which provides certain benefits (box 1.4), even though this may affect the liquidity of their shares.

Debt markets impose additional and often more stringent and direct discipline through threats of bankruptcy or an end to a poorly performing firm's access to capital. Transparent and properly regulated markets for debt finance prod corporations to employ debt profitably by servicing it or by covering creditor losses if the debt cannot be repaid. To raise debt capital, management must often agree with creditors on a plan (usually in a loan contract) that requires maintaining certain debt-equity ratios and cash flow levels, so creditors exert discipline on corporations akin to that imposed by shareholders. If the state protects a corporation from that discipline (for example, by guaranteeing its debts), it introduces a moral hazard and a strong disincentive for management to be efficient and maximize value. The same disincentive applies to conglomerates that cross-guarantee each other's operations or those of subsidiaries. Such guarantees—as well as lax pru-

#### **Box 1.4. Cross-border securities listings**

Cross-border securities listings—American Depository Receipts (ADR) and Global Depository Receipts (GDR)—often introduce greater transparency in a given company. ADR growth has been substantial in recent years with 1,415 companies offering securities in 1998 compared with 836 in 1990, a growing number of these from developing countries (Bank of New York; see [www.bankofny.com](http://www.bankofny.com)). With about \$3 trillion of the \$14 trillion of U.S. market capitalization accounted for by nonAmerican shares, this portion is larger than the total capitalization of any other national stock market.

Foreign issuers whose securities are traded on international exchanges are usually required to meet higher accounting and reporting standards than are imposed in their domestic market. Even when securities of an emerging market issuer trade only among international institutional investors (as in the U.S. 144A market), such investors can be expected to insist on higher standards. The expectation is that foreign companies taking advantage of the ADR market will raise disclosure standards in their own countries through a “demonstration effect” for other domestic companies and by ensuring that their own domestic shareholders have access to the same quantity and quality of information as foreign investors purchasing ADR. However, exchanges such as the New York Stock Exchange do not generally require foreign issuers to meet the same substantive corporate governance requirements (independent directors, for example) that are imposed on domestic issuers.

dential regulations for disciplining banks—can mean serious financial difficulties for the state.

Instruments such as ADRs and GDRs, sovereign and corporate credit ratings, and accounting rules, as well as the emergence of new

financial intermediaries and players, have radically altered the corporate finance landscape, at least for larger enterprises. These enterprises, along with their governments, are increasingly conscious of the need to meet certain disclosure and reporting conditions if they are to tap into the large pool of global financial resources.<sup>10</sup>

**THE DISCIPLINE OF OTHER COMPETITIVE MARKETS.** A competitive product market forces management to adopt the most efficient methods of production since competitive markets expose inefficient firms. Increasingly, firms must compete on price and quality with products and services produced internationally. A de facto convergence of cost structures and firm organization, often down to the factory floor, spills over to firm behavior, decisionmaking, performance, and the need for up-to-date information and better governance. Effective competition promotes accountability and transparency and minimizes corruption, lobbying, and rent seeking, which have been among corporate governance weaknesses in developing countries. Competition and trade policies ensure contestible markets that reduce rent-seeking behavior. Together, these factors force insiders to improve the performance of the enterprise or ultimately to go out of business.

Competition in the *market for management and skilled workers* has also intensified, particularly in knowledge-based activities. Companies must offer opportunities and incentives to attract high quality staff. A convergence of education curricula means that business schools increasingly turn out graduates with similar skills, outlook, and sensitivity to corporate governance issues. Most developing countries now have a small but steadily growing pool of bankers, economists, businesspeople, and other professionals who have received world class training. All these factors contribute to an emerging and common set of business values, behavior, and practices and to greater demand and understanding of the need for information and transparency. Well governed

corporations often have an edge in attracting and compensating good managers and highly skilled workers. Infosys in India shows why (box 1.5).

Competition for *corporate control (takeovers)*—by providing incentives for efficiently managing corporations and by providing a market mechanism for replacing underperforming management—can also discipline managers to maximize shareholder value. Managers who fail to do so may risk takeover when outside investors perceive that the company's assets could produce higher earnings. Competition for corporate control creates the possibility of acquiring shares at a discount, replacing managers with more efficient ones, and taking other steps to maximize value. In the United States this process is often characterized as "hostile takeover." In Europe and East Asia the failure of management to keep up share value has resulted in a growing market for corporate control engineered among friendly players (Muir and Saba 1995). However, the high transaction costs and mixed evidence on net results have raised new interest in many countries in using shareholder pressure on boards as a more cost-effective solution to improving performance.

**THE DISCIPLINE OF REPUTATIONAL AGENTS.** Finally, an important element of the external incentives structure is the broad array of professional watchdogs, often referred to as reputational agents, who report to the investment community and keep a close eye on corporate performance (Black 1999).<sup>11</sup> These reputational agents—lawyers, investment bankers, investment analysts, credit rating agencies, consumer activists, environmentalists, and accounting and auditing professionals—exert enormous pressure on companies to disclose accurate information to the market, to improve human capital, and to align the interests of managers, shareholders, and other stakeholders. Their approval of a company implies to the investing public that they have carried out due diligence and that the company is in compliance with regulations and standards of behavior—and boosts its reputation.

### Box 1.5. Incentives to attract talent

Infosys Technologies Limited is a publicly held company based in India that provides information technology consulting and software services to Fortune 1000 companies and employs more than 3,000 people worldwide. Infosys has based its growth on several key principles of corporate governance: best practices, financial markets, and human capital. Its core value: *“To achieve our objectives in an environment of fairness, honesty, transparency, and courtesy towards our customers, employees, vendors, and society at large.”*

All Infosys activities are continually benchmarked with global best practices. The firm’s quality control and project management have helped it achieve total quality management accreditation. Feedback from process audits enable the reengineering of internal processes when required. International accounting practices are also followed. Infosys publishes all financial reports according to both U.S. and Indian Generally Accepted Accounting Practices. Best practices at Infosys are captured through a knowledge man-

agement systems that makes experience gained from various client assignments freely available in an intranet repository.

The first Indian-registered direct listing on a U.S. market, Infosys began trading on Nasdaq in March 1999. Infosys viewed the listing as a way to achieve a more liquid currency (through stock options) for attracting the best employees and future acquisitions. It anticipates that its presence on Nasdaq will give potential customers greater comfort and confidence in the company.

Infosys views its employees as its key resource. With “wealth creation for employees” as one of its stated objectives, Infosys provides innovative compensation and benefit packages. Infosys pioneered the concept of the employee stock ownership plan in India. Infosys also offers such benefits as training, asset acquisition, loans, housing, and personal assistance services. This combination of stock options and benefits allows Infosys to attract top talent to contribute to its growth.

*Source: Financial Times.*

### Box 1.6. Activist investors at work—the story of CalPERS

With 1,050,000 members and beneficiaries, over 1,500 equity securities, and assets worth \$126 billion, the California Public Employees Retirement System is one of the largest public pension funds in the United States, and a leader in shareholder activism. Each year its corporate governance program identifies 10 companies as the worst long-term performing companies in the system’s domestic equity portfolio, with governance weaknesses such as lack of independent directors. A series of studies con-

ducted in 1995–98 by Wiltshire Associates examined the performance of 62 such companies targeted by the pension fund over a five-year period. Results indicate that although the stock prices of these companies trailed the Standard & Poor’s 500 Index by 85 percent in the five years before the pension fund intervened, the same stocks outperformed the index by 54 percent the following five years, adding about \$150 million annually in additional returns to the fund.

*Source: [www.calpers.ca.gov](http://www.calpers.ca.gov).*

Many of these agents, such as accountants and auditors, belong to self-regulated professional associations. Operating independently of firms, the associations promote accountability and transparency in corporate activities, contributing to a culture of self-enforcement in following rules and adopting good business practices (box 1.6). A variety of other stakeholders, such as environmentalists and labor, human rights, and consumer activists, have also begun to push corporations to consider the wider interests of customers, suppliers, and the community.

## Conclusion

*Corporate governance is primarily a matter of oversight and accountability. It becomes important when a firm (private, public, or state-owned) accesses external debt or equity funds. The empirical evidence of a link between governance and performance may still be mixed (undoubtedly due to the difficulty in distinguishing the effects of governance from other influences on firm performance), but the connection makes considerable intuitive sense.*<sup>12</sup>

Corporations, as creatures of law, exist because societies recognize that incorporation is an efficient form of organization that benefits society as well as firms. Thus the importance of good corporate governance goes beyond the interests of

shareholders of individual companies. Corporate governance is essential for the efficient mobilization and allocation of capital and the efficient monitoring of corporate assets. How a corporation is governed affects the efficiency with which a firm employs assets, its ability to attract lower cost capital, its effectiveness in meeting society's expectations, and its overall performance.

For these reasons effective corporate governance should improve corporate economic and social performance. Weak corporate governance can severely curtail an economy's prospects and growth. To tolerate a poor system of governance is to impose on a company or a country an unnecessary competitive handicap.

## Appendix 1.1 Foreign direct investment

Foreign direct investment has stayed fairly constant since the crisis in East Asia and elsewhere, while portfolio flows and bank lending have dropped precipitously. High transaction costs discourage activist shareholders from monitoring corporate governance. Passivity among investors might also reflect a lack of confidence that they can influence corporations when rules and regulations about shareholder participation are opaque.

However, some foreign and domestic institutional investors are beginning to become more

**Table A1.1. Net private capital flows to emerging markets by region and financing type**  
(billions of US dollars)

	1994	1995	1996	1997	1998 (preliminary)
All emerging markets	153.2	192.1	213.5	147.3	62.4
Asia	67.9	95.8	102.8	4.8	-59.1
Five crisis-affected Asian countries	34.6	63.1	64.9	-18.2	-42.6
Western Hemisphere	46.9	38.1	81.8	88.5	68.7
Middle East	17.7	4.8	-3.2	6.9	22.4
Africa	4.5	5.5	6.1	14.1	9.4
Europe	16.1	47.9	26.0	32.9	20.9
Direct investment	83.2	98.0	119.4	144.8	135.5
Portfolio investment	107.3	41.7	81.4	67.8	36.3
Bank loans and other	-37.4	52.4	12.7	-65.3	-109.4

Source: IMF World Economic Outlook database.

**Table A1.2. U.S. ownership of international equities, 1995–97**  
(billions of US dollars)

<i>Region</i>	<i>December 1995</i>	<i>December 1996</i>	<i>March 1997</i>	<i>June 1997</i>	<i>September 1997</i>	<i>December 1997</i>
Asia-Pacific	78.4	84.2	98.1	97.1	86.4	86.8
Latin America	23.3	31.8	39.4	45.6	43.3	45.4
Europe	181.1	274.8	296.7	322.5	359	376.6
Canada	40.7	51.7	50.5	55.7	57.7	56
Other	14.1	21.9	23.3	27.8	30.2	30
<i>Total</i>	<i>337.6</i>	<i>464.4</i>	<i>508.0</i>	<i>548.7</i>	<i>576.4</i>	<i>594.8</i>

active in the equity markets of developing countries (table A1.2). For example, U.S. ownership of Latin American equities has more than doubled over the past two years, while ownership has stayed relatively constant in the Asia Pacific region despite the crisis.

## Notes

1. Private flows rose from US\$61 billion in 1990 to US\$299 billion in 1997; over the same period official flows declined from US\$63 billion to US\$39 billion (World Bank 1999b).

2. A Russell Reynolds Associates (1999) survey pointed out that good corporate governance practices are becoming a key way for companies to distinguish themselves when they are trying to attract capital. It's analogous to the steps some companies have taken to bring their accounting standards in line with Western methods.

3. Adam Smith (1776) is probably the first to discuss the issues of corporate governance.

4. In Anglo-American countries and some continental European countries, managers can have few or no shareholdings; in other OECD countries, Latin America, and most parts of Asia, management often holds controlling (but not majority) shares. In both cases, there is a significant gap between share ownership and managerial control. It is this gap that creates the agency problem.

5. Berle and Means (1932) documented the problem of widely held corporations, with ownership dispersed among small shareholders but with control concentrated in the hands of managers. "For at least two generations, this book fixed the image of the modern corporation as one run by professional managers unaccountable to shareholders. The book stimulated an enormous 'managerialist' literature

on the objectives of such managers." La Porta, Lopez-de-Silanes, and Shleifer 1998, page 2. Another classic exposition of modern corporate agency costs is Jensen and Meckling 1976. Managerial misuse of free cash flows diminishing corporate value in the US is discussed in Jensen 1986.

6. Ira M. Millstein, World Economic Forum, Davos, Switzerland (February 2, 1998). The term "corporate governance" can broadly encompass all of the corporation's relationships: relationships among capital, product, service, and human resource providers, customers, and even society at large. It can encompass all the laws designed to hold the corporation accountable to shareholders and the public, as well as the kings of the market for corporate control. It can refer to audit practices and accounting principles, and it can refer to shareholder activism. Even more narrowly, the term can be used to describe just the role and practices of the board of directors. The common denominator for all these definitions is this: Corporate governance concerns the relationships between a corporation's managers and shareholders, based on the foundation that the board of directors is the shareholders' agent to ensure that the corporation is managed in the shareholders' best interests. The paradigm is simple: managers accountable to boards, and boards accountable to shareholders.

7. Managers entrenching themselves and resisting being replaced is analyzed by Sheifer and Vishny (1989) and by Jensen and Ruback (1983).

8. Between 1720 and 1844, joint stock companies were permitted in the United Kingdom only by Act of Parliament or by charter. In 1720, investors purchased shares in the South Sea Company at inflated prices and were bankrupted when the market collapsed. That created a distaste for the company form of business, which was thought to be inherently unsound. The failure of the South Sea Compa-

ny, which had undertaken to take over the national debt, caused far more than a financial crisis. The frenzy of speculation that was unleashed and the eventual crash affected every segment of society (Maltby and Wilkinson 1997).

9. The OECD principles are the first multilateral set of principles. This is what distinguishes them from other more focused efforts. In addition to the Commonwealth codes, other efforts include the July 1999 Statement on Global Corporate Governance by the International Corporate Governance Network (ICGN) which was adopted explicitly as an investor's interpretation of the OECD principles. The ICGN represents institutional investors from around the world who account for some US\$6 trillion in assets. This Statement includes a 10-point "working kit" of corporate governance criteria.

10. The ADR and GDR requirement on governance guidelines are still lagging behind requirements of leading exchanges, such as NYSE. In fact, many companies in devel-

oped markets that want to circumvent these governance conditions opt to raise capital through ADRs rather than floating shares on the regular exchange.

11. On the pervasive role of reputational intermediaries in securities markets, see Gilson and Kraakman 1984.

12. See Millstein and MacAvoy 1998 for a review of studies both showing and refuting a connection between corporate governance and economic performance. Millstein and MacAvoy conclude that the observation and reasonable assumption that governance matters to performance is supported by data analysis from 1991-95 showing that U.S. corporations with active and independent boards of directors generated higher economic profit (operating earnings in excess of the costs of capital) than did corporations without such boards. Johnson and others (1999) show that, in the context of the East Asia financial crisis, measures of corporate governance explain the extent of stock market decline better than standard macroeconomic measures.

# Priorities for Reforming Systems of Corporate Governance

In industrial economies, where equity markets are an important source of capital, the debate over corporate governance focuses on the practices of widely held, publicly traded companies: the liability of boards, proxy voting by mail and electronic mail, and takeover mechanisms and defenses, among others. These can be viewed as second or third generation governance issues. In developing and transition economies the debate has to begin at a more fundamental level and go beyond publicly traded companies, which account for but a small portion of the corporate sector. Corporate governance in emerging markets has to consider closely held and family-controlled firms as well as conglomerates with concentrated ownership structures. It has to cover state-owned enterprises, recently privatized enterprises, foreign direct investment, and the “instant corporations” that emerged from mass privatizations in transition economies. So for developing and transition economies the debate has to include not only the banking sector but also governance issues for a far broader spectrum of firms and models.

*Corporate governance reform must be linked to the type of access that corporations expect to have to exter-*

*nal financing: debt, equity, or public funds.* In addition to these common aspects, each country has a unique set of social, economic, regulatory, institutional, and cultural characteristics that has affected its institutional infrastructure and human capacity, shaping unique corporate typologies and systems of political economy. In sequencing and prioritizing corporate governance reforms, each country requires a tailor-made solution that takes these characteristics into account.

This chapter builds on the framework of chapter 1 to highlight the range of challenges developing countries face in formulating a comprehensive reform agenda that incorporates both internal incentives and external discipline. (See annex 1 for details on regional initiatives and progress.)

### **Ownership structures shape internal corporate governance**

The ownership structure in the corporate sector and its financing sources have a defining impact on the design of corporate governance systems.

In the United States and the United Kingdom, for instance, corporate ownership habits have significantly shaped the “outsider” orientation of their corporate governance systems, while in Germany and Japan extensive bank ownership of corporations, rather than broad-based public ownership, has resulted in entirely different corporate governance models.

**Corporate sector characteristics span a wide spectrum**

The typology of corporate structure in developing and transition economies tends to fall along a spectrum from little or no public share ownership at one end to widely dispersed ownership (following mass privatizations) at the other (table 2.1). At the end where public share ownership is scarce, the corporate sector is dominated by state enterprises and large privately held or closely held conglomerates owned by a few families (box 2.1). Ownership by outsiders is either negligible or based on direct investment in the corporation. Equity markets are thin and play

only a token role in the financial system. In this setting there is a risk that insiders may run the business with little regard for minority shareholders. At the other end of the spectrum are countries with dispersed shareholdings. Large segments of the population hold shares, mostly employees of the former enterprises. Since these countries lack appropriate institutions and protection of shareholder rights, here too, shareholders have no way of exerting pressure on insiders, mostly managers, who frequently have stripped companies of their assets.

Between the extremes are economies in which large numbers of state-owned enterprises have been privatized, ownership in the corporate sector is being diversified among individual and institutional investors, and corporations are beginning to view equity markets as a way of raising external capital. In many countries there is also a burgeoning group of small and medium-scale corporations whose financing lifeline is through the banking sector and whose performance affects the health of the economy at

**Table 2.1 Governance under different corporate structures**

<i>Types of business entity</i>	<i>Ownership, control, and management</i>	<i>Governance benefits</i>	<i>Governance challenges</i>
State-owned enterprises	The state, as owner, provides capital and determines who manages the business and with what objectives.	Assets and revenues are controlled by management, which is appointed and controlled by the state. The state can use the corporation to pursue both social and economic objectives.	Fair treatment of stakeholders. Holding management accountable for achieving state-determined objectives as efficiently as possible. Investment is limited by public revenues and opportunities for corruption.
State enterprises in transition	The state shifts its ownership stake to investors and employees. Control of operations can shift to professional management. The board of directors can provide management oversight on behalf of the owners. Because there are minority shareholders, the board’s role as fiduciary agent and monitor gains importance.	There is a greater potential for more efficient operations because of increased profit incentives. Ownership interests are transferable, improving access to private capital. Government raises revenue by selling partial ownership stakes.	Fair treatment of stakeholders. Holding management accountable to providers of equity capital (state and other shareholders) for achieving objectives. Protecting minority owners from abuse by majority. (Note that new investors may not be positioned to provide active oversight.)



**Table 2.1 Governance under different corporate structures (continued)**

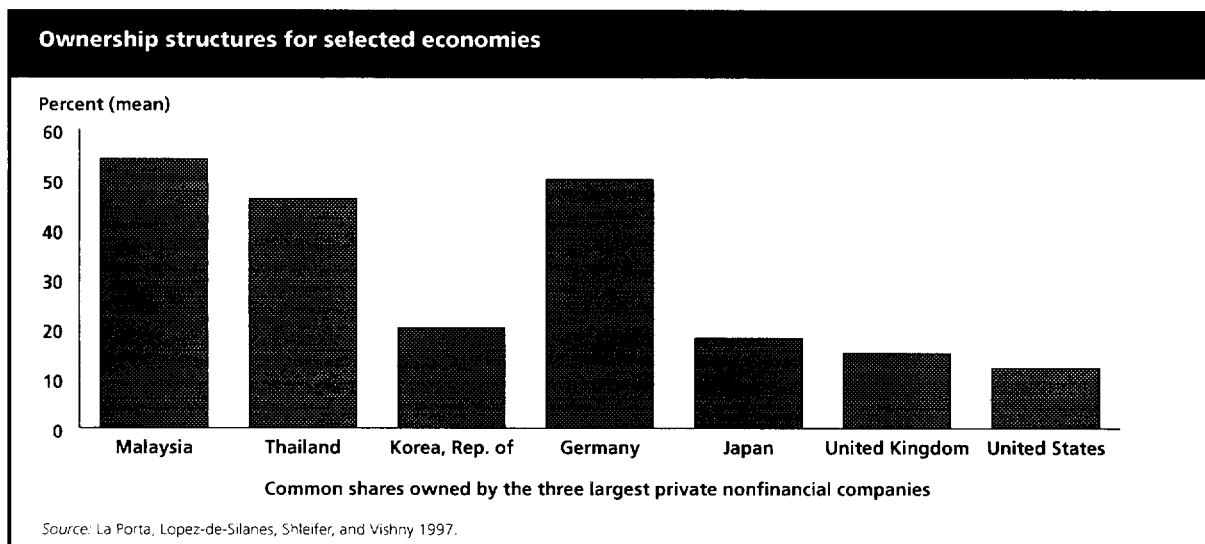
<i>Types of business entity</i>	<i>Ownership, control, and management</i>	<i>Governance benefits</i>	<i>Governance challenges</i>
Wholly owned private businesses	The providers of ownership capital directly control and manage the enterprise.	Owners control the business directly. Management and ownership control are not separate, so there is no principal-agent problem.	Fair treatment of stakeholders, including, among others, employees and creditors (such as banks). Limits to raising capital.
Closely held (private) corporations	The providers of ownership capital control the enterprise either directly or through a board of directors that they control. They may be involved in managing the business themselves or may rely on professional managers.	Aside from their investment, providers of ownership capital are not subject to the claims of corporate creditors and generally are protected from liability arising from corporate actions (limited liability). Unlike partnerships and sole proprietorships, the corporation continues to exist despite the withdrawal of, or transfer of shares by, officers, directors, shareholders, or employees (continuity of existence).	Fair treatment of stakeholders. Holding management accountable to providers of equity capital for achieving objectives. Protecting minority owners from abuse by majority.
Nascent public stock corporations	Those who provided ownership capital to the privately held entity may now hold controlling interests in a firm that has just “gone public.” Some of those early providers of capital may control seats on the board or serve as members of management. Transparency, shareholder rights, and accountability gain importance.	There is limited liability, continuity of existence, and free transferability of ownership interests. There is also increased access to capital: ownership interests can change hands, frequently in highly liquid markets, without affecting corporate control and management.	Fair treatment of stakeholders. Holding management accountable to shareholders. Protecting minority shareholders from abuse by majority.
Mature public stock corporations	The diffuse, dispersed providers of capital delegate control over the enterprise to a board of directors and the board hires, compensates, and replaces professional managers who run the business.	There is limited liability, continuity of existence, free transferability of shares and increased access to capital.	Fair treatment of stakeholders. Holding management accountable to shareholders. (The more ownership is dispersed, the greater the opportunity for management to dominate the board, and thereby entrench itself.)

*Note:* This is an expanded version of a table in OECD 1998 (p. 38).

### Box 2.1 Diversified conglomerates—closely held

At first blush, ownership concentration in the Republic of Korea appears not to be too far out of line with patterns in Japan, the United States, and the United Kingdom (see figure). But as in other East Asian countries, that assessment does not take into account shareholder affiliation and cross-holdings between firms—and so almost certainly underestimates true concentration. In Korea, families that run *chaebols* own less than 50 percent of related companies, but they have almost total control over combined business groups. Interlocking ownership allows them to control related companies with little equity of their own, with each member company holding shares in every other member company.

The biggest nonfinancial corporations in East Asia are the diversified conglomerates—closely held and controlled and managed by a family. One of the distinguishing features of this organizational firm (contrasted with corporations in developed countries) is the nature of large shareholders. In Germany and Japan big shareholders are banks and nonfinancial corporations, not individuals or families. And while large shareholders in Germany and Japan are often criticized for being too weak in protecting their own interests, large family shareholders in East Asia are, no doubt, highly motivated to maximize the returns on their family holdings, even at the expense of outside investors.



### Ownership of Korean business groups by insiders (percentage of common shares held)

	<i>Business group</i>	<i>Founder relatives</i>	<i>Member companies</i>	<i>Total</i>
Hyundai	3.7	12.1	44.6	60.4
Samsung	1.5	1.3	46.3	49.3
LG	0.1	5.6	33.0	39.7
Daewoo	3.9	2.8	34.6	41.4
Sunkyong	10.9	6.5	33.5	51.2
Ssangyong	2.9	1.3	28.9	33.1
Hanjin	7.5	12.6	18.2	40.3
Kian	17.1	0.4	4.2	21.9

Source: Koeh, Hak, and Kuh 1996.

large. Indeed, in some countries, particularly in Sub-Saharan Africa, the private sector is dominated by microenterprises and small enterprises that often have to avail themselves of informal sources of financing. These countries need better corporate governance to realize gains from privatizing assets, to foster confidence among the investing public, and to improve the efficiency of equity and debt markets in allocating resources to the most viable projects and corporations.

The two extremes (shallow public ownership and broad-based ownership following mass privatization) often face similar governance problems of inadequate protection of minority shareholders and legal systems that cannot enforce minority shareholders' rights. Across the spectrum of ownership structures, common weaknesses are lack of transparency, poor internal controls, and processes that significantly impede the mobilization and allocation of capital and the monitoring of resources, all of which affect corporate agility and the sustainability of growth.<sup>1</sup>

**OWNERSHIP CONCENTRATION IN PUBLICLY TRADED COMPANIES.** The widely held ownership pattern common in publicly traded companies in the United States and the United Kingdom is the exception to patterns found in much of the rest of the world.<sup>2</sup> A typical pattern in developing countries includes concentration of ownership in the hands of a few controlling shareholders and cross-ownership structures. These systems need effective mechanisms to protect minority shareholders against the risk of expropriation by management and controlling shareholders.

Concentration of ownership is not inherently undesirable. In fact, in the traditional view of corporate governance, agency costs are much lower when management owns a substantial proportion of shares. Some analysts also argue that concentrated ownership may reduce transaction costs and improve firm performance in settings where property rights are not well protected (Claessens and others 1998b). Corporate governance problems arise when ownership con-

centration is accompanied by weak protection of *minority* shareholders' rights and when controlling shareholders can manipulate the firm's assets for their own benefit.

*Cross-shareholding* patterns within conglomerates represent another common corporate structure in many emerging market economies. This structure can undermine protections for minority shareholders because affiliated firms hold large blocks of equity in each others' companies. This ownership pattern reduces opportunities for competition and takeover in the market for corporate control. It also creates a special set of corporate governance abuses, as firms provide loans and contracts to related companies on a noncompetitive basis, and profits from a successful firm can be diverted to support a faltering affiliate. Governance problems stem mainly from the fact that such corporate structures impede transparency and the ability of investors and creditors to assess risk in good times and bad. In East Asia the governance system of groups was designed to confuse outsiders and maximize the control of insiders. But it ultimately confused even insiders and greatly limited their ability to act swiftly and appropriately when the financial crisis struck (see box 2.1).

**CLOSELY HELD FAMILY-CONTROLLED COMPANIES.** Some of the largest industrial concerns in developing countries are owned by families or a small coterie of large shareholders acting in concert. The owners rarely sell their stakes because they are interested in the long-term development of the company or are unwilling to dilute their control. If they sell, they do so mostly to other large shareholders or strategic investors because the stock markets in most countries trade only in small volumes. Controlling parties often consider even the most basic information on the condition and prospects of the enterprise to be proprietary and seldom meet the transparency and financial disclosure requirements of public companies. Company insiders are often accustomed to using corporate assets for personal benefit.

Here again, closely held family-controlled companies are not bad in themselves since the main shareholders have a vested interest in paying close attention to the health of the business. This kind of ownership structure may be well suited to developing countries, where external monitoring is weak. In fact, there is little point worrying about governance mechanisms if there are no outside shareholders. Closely held companies may suffer from poor decisionmaking, but that is not necessarily a result of corporate governance shortcomings.

But while agency costs may not be a problem, society still has an interest in the governance of these enterprises and the efficient use of their assets. When they fail, society ultimately bears a social cost (through loss of employment) or a reputational cost. Society can also bear a direct cost if the firms obtained financing through the banking system. Given the lack of transparency and disclosure, these firms often obtain financing based on close relationships with bank management. There are many examples of easy access to bank loans leading to overinvestment in non-productive assets that do not meet benchmark rates of return. This can be avoided by reducing controlling ownership of banks by commercial entities and by restricting bank lending to related parties. Improved banking supervision and strict adherence to prudential regulation will force banks to lend on the basis of credit analysis and exposure limits rather than relationships. This would make it harder for closely held and family-owned firms to expand through bank debt financing alone and will drive closely held companies to equity or corporate debt markets, where standards of disclosure and transparency are higher (box 2.2).

In general, underdeveloped legal systems are severe impediments to the development of checks and balances that protects minority shareholders and stakeholders. They also fail to minimize the divergence between public and private returns. In such environments, ownership is likely to remain highly concentrated.

### **Box 2.2 Global integration improved corporate governance in Mexico**

Most listed industrial and financial firms in Mexico are controlled by families or small groups acting in concert. Some firms have part of their equity in limited or nonvoting shares.

Neither the Securities Markets Law nor the rules of the Mexican Stock Exchange imposed any special corporate governance requirements on listed companies. But due to the integration of Mexican securities market with the much larger markets of North America (particularly the United States), Mexican issuers in the international markets are improving accounting and disclosure standards to comply with U.S. securities law requirements.

This prompted the National Banking and Securities Commission of Mexico to prepare, in collaboration with a private sector-led committee, a voluntary corporate governance practices code in June 1999. The code will require that each issuer describe in its disclosure document the degree to which its practices conform to those recommended in the code. The code also addresses the functions and composition of the boards of directors and the personal liability of directors for failure to comply with disclosure rules.

Traditionally, the debate on corporate governance has centered on private companies. *Yet corporate governance is important for state enterprises as well.* State enterprises (ministerial entities, agencies authorized through legislation, and incorporated public entities with the legal status of a company) account for the largest number of firms and the greatest share of value of the corporate sector in many developing countries.<sup>3</sup> State enterprises can suffer from governance problems arising from conflicting mandates that put equal weight on social goals and commercial ones. Therefore, they may not be driven by profit incentives and market discipline. And in many

countries, state enterprises are run by managers appointed for political reasons rather than competence or merit—often in exchange for favors to the government officials charged with overseeing the enterprise.

Most state enterprises are also sheltered from the discipline of debt markets. When the financial sector is controlled by the government, state enterprises often receive preferential treatment on loans, with little regard for rates of return or prudential regulation. Directed lending, often at subsidized rates, distorts the efficiency of government as well as that of private sector nonfinancial enterprises. The losses of state enterprises are estimated at 8–12 percent of GDP, far exceeding expenditures on health, education, and social safety nets.<sup>4</sup> Improving these enterprises will enable the government to focus on social programs.

In particular, the generally poor performance of public enterprises has brought into sharp focus the economic and social costs of their inadequate governance. Governments have responded to this challenge in several different ways. Some are privatizing or corporatizing state enterprises and exposing them to competitive forces. State enterprises in telecommunications, manufacturing, and utilities have been privatized, often through strategic sales to foreign investors. Where privatization is not an immediate solution, because of market timing or the size of the public sector relative to the economy, governments are also realizing that the governance of public enterprises is a critical component of public sector governance and performance.

The governance issues in state-owned enterprises are more complex because of the lack of clarity about who the owner is, who is able to exercise the rights of the owner, and who is accountable. Most often the ownership function is not clearly vested in an identifiable source, and there are likely to be ambiguous objectives and weak monitoring of management performance. Where the ownership interest of the state has been “clarified” (by designating a state agency to man-

age the ownership interest or by vesting the state ownership interest in an individual minister), there is reasonable chance that the “owner,” alone or through a professional board of directors, will be able to set strategic objectives and monitor management.

Many developed and developing countries are formulating governance models for state-owned corporations and clarifying many of these issues. In many cases these countries are restructuring and “corporatizing” state enterprises as an interim measure, replacing civil servants with professional managers, establishing clear performance criteria, distancing the state enterprises from political influence, and strengthening their boards. South Africa, for example, has begun the debate, and Canada and New Zealand have addressed such governance issues through guidelines for state enterprises (box 2.3).

**PRIVATIZING ENTERPRISES IN EMERGING AND TRANSITION ECONOMIES.** When the state sells an enterprise, it ceases to control and oversee the enterprise’s management. In institutionally weak economies the lack of transparency and legal protection for minority shareholders also reduces the likelihood that the new owners will be able to make management accountable or contest management decisions. In fact, without proper internal and external discipline, privatization alone can reduce economic welfare by transforming a poorly functioning public monopoly into an opportunistic private one. In many instances, privatization gives insiders a greater opportunity to take advantage of the firm and its social assets for their own benefit at the expense of owners or society at large—this has been one of the strongest arguments used by opponents of privatization. Often, privatization (the transfer of ownership) is considered a first-generation task and governance a second. But as Bolivia shows, success is more likely when privatization and governance issues are tackled together (box 2.4).

Problems in Russia clearly highlight how privatization without due attention to corporate

### Box 2.3 Principles of effective governance in Canada's crown corporations

The guidelines from Canada's "Crown Corporations and Other Public Enterprises" recognize that effective governance is vital to achieving public policy objectives and corporate commercial goals. The report's 10 recommendations cover three main areas: stewardship, working with management, and functions of the board.

1. *Board responsibilities.* The board should explicitly assume responsibility for the stewardship of the corporation.
2. *Public policy objectives.* The board should examine its public policy objectives and legislated mandate periodically to ensure their continuing relevance.
3. *Communications.* The board should ensure that the corporation communicates effectively with the Crown, other stakeholders, and the public.
4. *Board and management relations.* The board and management should develop an effective working relationship.
5. *Board independence.* The board must be able to function independently.
6. *The position of the chief executive officer (CEO).* The board should periodically assess the CEO's position and evaluate the CEO's performance.
7. *Renewal of the board.* The board should assess its effectiveness and initiate its renewal.
8. *Education of directors.* Directors should receive orientation and education appropriate to their needs.
9. *Compensation.* The board should review compensation for directors.
10. *Responsibility for corporate governance.* The board should assume responsibility for developing the Crown corporation's approach to governance issues.

Source: Canada 1996.

governance is socially harmful and economically unsustainable. The transition economies have very different histories and institutions, but they share the twin legacies of state ownership of enterprises and legal systems that do not work. Mass privatization under voucher schemes or the "loans for shares" schemes in Russia after 1995 resulted in new enterprises with no governance, allowing insiders to take complete control. The government has not used the corporate charter to protect minority shareholders or require transparency in the firms it privatizes. Unconstrained by legal enforcement, managers of recently privatized firms have been able to divert enterprise resources for personal gain at the expense of shareholders, stripping firms of assets and leaving a corporate shell burdened with liabilities.

With weak judicial enforcement capacity (particularly in Russia) and cumbersome privatization procedures, it is not surprising that investors (particularly minority investors) receive

little protection. Weak protection of investors undermines markets for equity and for corporate control, making initial ownership and control structures unworkable (box 2.5). Moreover, weak banking sectors and poor financial discipline within formerly state-owned enterprises have forced governments to refinance loss-making entities. In many privatizations managers gained almost complete control. Unconstrained by proper incentives and rules, they let firm performance deteriorate. The few effective privatizations involved outside shareholders with enough power to control or replace management, thus improving incentives for efficiency.

#### ***The importance of good internal corporate processes—voluntary private actions***

In each of these cases, regardless of the state of development of the institutions of external discipline (discussed below), corporations can ensure good governance by creating rigorous

## Box 2.4 Privatizing and corporate governance

### A good case

Bolivia's capitalization program was conceived in the early 1990s and successfully implemented within three years (1994–97). All but one of the capitalized companies have proven profitable.

As with privatization, the capitalization program transferred administrative control of the state-owned companies to the private sector. But proceeds from the private investors' acquisition of 50 percent of the shares remained within the capitalized company, rather than being transferred to the state. The other 50 percent of shares went to the adult population, making each adult a shareholder of the company. This unusual model had two advantages: it ensured social and community participation, and the expanded shareholder base reduced the likelihood of nationalization.

The interests of the Bolivian population are represented by three directors on the board appointed by pension fund administrators. Although strategic investors control management of the privatized companies, corporate decisions on critical issues require the input of the pension fund representatives.

A good working relationship among the main stakeholders—the state, the strategic investor, and the consumer—is ensured by a strong regulatory framework. New laws safeguard the rights and obligations of each participant, and new autonomous agencies regulate the privatized industries, particularly those that could be natural or quasi monopolies. Over time, Bolivia will develop adequate capacity to realize the full potential of this arrangement.

### A bad case

In Russia the establishment of holding companies that bought into enterprises facilitated the theft of assets. For example, an oil holding company took over two Russian production companies and forced them to sell its oil at below market prices. The holding company captured the profits for the benefit of corporate insiders, while the production companies were left to deal with the costs. As a result, the two production facilities are on the brink of bankruptcy, with huge tax liabilities and unpaid workers and suppliers. Foreign investors in the subsidiaries also lost.

internal controls and oversight. One important requirement is disclosure of timely, accurate, material financial and nonfinancial information on corporate performance (annex 5a). Whatever the ownership structure, firms can provide information that is critical for lenders and shareholders to assess the firm's real risk exposure. In more mature markets active shareholders have pressured management to improve disclosure, demanding greater transparency and often replacing boards and management (sometimes through legal action) that fail to do so. Investor action groups are still rare in developing countries. It is clear, however, that fostering activism among investors (whether creditors or owners) and stakeholders will improve corporate gover-

nance, particularly in environments with weak government enforcement capacity (box 2.6).

But disclosure alone is not sufficient. Shareholders, through boards, must be able to exercise independent oversight of management, creating a system of checks and balances against abuses of insider power. Bad corporate governance does not arise solely from bad intentions or a desire to disadvantage outsiders. It can also be a by-product of lack of competence and training or uncertainty about roles and responsibilities. Ensuring independent oversight (including risk management) is a vital aspect of internal control. But making corporate boards more independent and knowledgeable is a daunting challenge in many emerging and tran-

### Box 2.5 Time to rethink privatization in transition economies

The Czech Republic was an innovator in mass privatization, using vouchers issued to the general public and exchangeable for shares. More than 1,800 companies were formed, and 40 percent of their shares are held either directly by individuals or by investment funds and other intermediaries. While the shares are publicly tradable, there is an active market only in a handful of companies, and supervision by regulatory authorities has been minimal (an independent Securities and Exchange Commission was established in early 1998).

The designers of the privatization program recognized the principal-agent problems inherent in this design but hoped that investment funds would fill the gap and become active monitors. Most of the large funds were owned by the major domestic bank—in which the Czech state retained a controlling stake. The result?

- Investment funds did not deal aggressively with poor performance in firms, since pulling the plug would force the fund's bank owners to write down the resources lent to these firms.
- The state-influenced, weakly managed banks tended to extend credit to high-risk, low-potential privatized firms.
- A weak bankruptcy framework diminished discipline of the financial market.
- Lack of prudential regulation and enforcement mechanisms in capital markets allowed fund managers to enrich themselves at the expense of minority shareholders.
- Corporate governance in the closed-end funds has been weak, with effective disenfranchisement of minority investors and few controls on expropriation by insiders. Funds have followed short-term value-maximization strategies by building up strategic stakes in large companies and selling control blocks at premium prices. Often though, control blocks have been used to extract benefits from the company with little regard for the interests of minority investors.

*Source:* Nellis 1999.

Weak laws and regulatory systems have allowed some of the largest funds to convert themselves into unregulated holding companies. Large numbers of minority investors have been locked in with reduced rights and little chance of exit. The structure of these funds is limited to at most a 20 percent stake in a portfolio company, and the funds are controlled by fund management companies receiving 2 percent of the asset value under management. This structure failed to align the interests of the fund managers with those of the owners. A result of the small fee was that fund managers found other channels to extract or "tunnel" value out of the portfolio companies.

With the country's possible accession to the European Union, the government has become more active in closing off the loopholes in the corporate governance system in order to meet EU standards. In particular, closed-end funds that are trading at a discount to net asset values are required to allow investors to redeem for cash, resulting in increased performance pressure. However, minority shareholder rights are still weak, and the fiduciary duties of directors and insiders still unclear.

The Czech experience demonstrates the importance of careful design of corporate governance systems and the creation of effective and complementary regulatory capacity. The resistance of corporate insiders to demands for accountability has been compounded by the inability or unwillingness of investment funds to use their voting power in the long-term interests of public investors. The government did not recognize early enough the need to actively monitor and regulate capital markets in order to protect minority investors and to allow open-end funds that would enable shareholders to "vote with their feet." The result has been disillusionment on the part of the general public with the credibility of the privatization program and with the capital markets, while foreign investors have suffered heavy losses on their early portfolio investments and show little inclination to return.



### Box 2.6 Shareholder activism in the Republic of Korea: a tale of two companies

#### One company responds

A Korean mobile phone operator with shares traded on the New York Stock Exchange as American Depository Receipts was accused by the Korean Fair Trade Commission of diverting profits by paying inflated nonmarket prices to affiliates for equipment and services. The company allegedly channeled funds from a profitable company to two other companies (the chairman of one is reported to hold 94.6 percent of the outstanding shares, the chairman's son and son-in-law are reported to hold 100 percent of the shares of the other).

International investors teamed with local Korean shareholders to assert their rights. After an organized proxy battle by minority shareholders, Company X took the unprecedented step of appointing three independent members to its board of directors and one independent auditor. In addition, the chairman agreed to return the disputed funds to shareholders—a significant victory for minority shareholder rights in Korea. (Note: since then, this company has lapsed somewhat in its internal procedures and in its treatment of its minority shareholders.)

#### Another doesn't

The flagship of one of the largest, most respected industrial groups (*chaebol*) in Korea and a blue chip on the Korean stock exchange has more than half its shares held by foreigners—either through depository receipts or shares purchased at a premium in the domestic market under the foreign shareholder quota.

Foreign institutional investors and local advocacy groups had been troubled for years by issues such as:

- Diversion of funds to support affiliates in unrelated businesses and to enrich the family of the major shareholder.
- A rubber stamp board of directors, with no representation of minority shareholders.
- Arbitrary dilutions of minority shareholders' equity holdings.

Emboldened by a new administration that wished to establish an arm's length relationship with business, local shareholder activists began to take on companies in shareholder meetings and bring law suits documenting management misdeeds. With the cooperation of foreign fund managers a shareholder rights advocacy group put forward an agenda for the annual general meeting of the blue-chip company. Proposals focusing on intercompany transactions, outside directors, and cumulative voting were in the spirit of new Korean legislation but were moderate by international standards. Initially reluctant, management soon began an unprecedented series of meetings with key foreign shareholders, eventually incorporating many of the proposed changes into its own proposal for the shareholders' meeting agenda.

Two days before the annual meeting, there appeared to be agreement on all issues but one, which was to be put to a vote at the meeting. Before the meeting, however, company management abruptly backed out of the negotiated agreement. At the meeting the company insisted on "package voting" rather than voting on individual resolutions despite written requests by foreign shareholders. The reform proposals were voted down. Despite the setback key issues once hidden from public scrutiny have now received shareholder and press attention and the company will be under pressure from both legislation and shareholders.

sition economies because of a shortage of skills and limited familiarity with board functions. In industrialized countries, failure to comply with minimum corporate governance practices

carries the threat of de-listing from the stock exchange.

Establishing appropriate internal processes is an effective way of creating positive and neg-

ative incentives that can spur voluntary compliance. In the absence of other mechanisms to encourage private companies to follow best practice codes, many countries are legislating mandatory model charters, requiring specific competencies for directors. Even training and certification can result in significant progress in improving corporate governance. Other requirements include the establishment of specific board committees, such as the audit, succession, and remuneration committees (annex 3).

Malaysia, for instance, requires newly listed companies to have nonexecutive directors and members of boards to receive director training. The Kyrgyz Republic requires that companies that wish to bid on government contracts first demonstrate their compliance with the model company charter. Thailand has reduced listing costs for companies that are in compliance with minimum governance standards.

### **Strengthening external incentives for good corporate governance**

The business environment can exert a strong influence on the governance of firms, chiefly by providing a framework of rules and market incentives. Countries with successful governance mechanisms have a number of common characteristics. At the most general level, they have well functioning competitive markets with enforceable rules for entry, operation, and exit of firms. They have generally well regulated and supervised financial systems. Above all, they have good legal protections for outside investors, whether creditors or shareholders. They also have some mechanism for bringing owners together to exert influence, either through takeovers or investor action groups.

### ***Strengthening standards and regulatory regimes***

**STRENGTHENING ACCOUNTING AND AUDITING STANDARDS.** To contribute to high standards of corporate governance, public governance must be

effective, transparent, and accountable—hence the serious concern with bribery and corruption. Attention to raising governance standards has highlighted the importance of transparency and proper accounting and reporting and with that the need to adopt the international accounting and auditing standards of the International Accounting Standards Commission and the International Federation of Accountants (annex 5b). Compliance with the standard on consolidation of accounts, for example, gives a much clearer picture of a corporation's financial state by shedding light on intragroup transactions, balances, investments, and unrealized profits. Group accounts are particularly important for conglomerates with substantial cross-shareholdings. Until most of the corporate sector has adopted such standards, even the best disclosure policies will be ineffective. Some companies are increasing transparency and reaping the gains of improved corporate governance (box 2.7).

Nonetheless, adopting standards is only one side of the equation. Rigorous implementation is the other. Thailand's corporate governance standards, accounting standards, and legal regime before the crisis were all reasonably sound. Similarly, Russia could be rated highly for procedural protection and company law (Prowse 1998a). But enforcement of these standards has obviously been much weaker.

**IMPROVING LEGAL AND REGULATORY FRAMEWORKS.** Many developing countries have made great progress in cutting subsidies, lowering trade barriers, creating well functioning market economies, and reducing economic regulations in the real and financial sectors. But the legal and institutional framework of a well designed competition policy for firm entry, operation (including conduct and structure), and exit remains weak. Legislative and administrative capacity is needed to deal with anticompetitive behavior (price fixing, bid rigging, customer and territory allocation) and to establish guidelines for mergers, asset sales, and privatizations that direct-

### **Box 2.7 Embracing good corporate governance**

A number of Asian companies have led the way in easing access to equity finance and increasing market value through greater transparency, more respect for shareholders, and better management oversight.

One such company is Hoya, a Japanese optical glass manufacturer, which outperformed broad indexes by a large margin, recording net profits for the past year of ¥17.8 billion (\$151million) on record sales of ¥201 billion. This followed the board's adoption of shareholder-friendly management practices that are innovative by Japanese standards. Hoya has increased transparency by providing quarterly (rather than yearly) reports, including information on sales and operating profits of individual divisions, and improving its information technology, enabling it to translate monthly management reports into quarterly budgeting and to allocate capital more efficiently. The company also focused on maximizing shareholders' return. This boosted investor confidence, and foreign investors now own 22 percent of the company.

Thailand's biggest manufacturing conglomerate and a leading blue-chip company, Siam Cement, is a model of transparency. Saddled with \$4.2 billion in unhedged foreign debt and facing a ferocious surge in global competition, it was forced to examine a sprawling empire of joint ventures, most with foreign partners. With advice from an international consulting firm, it decided to focus on its core businesses of paper, petrochemicals, and cement—everything else was put up for sale. Siam Cement has publicly revealed for the first time a rate-of-return target. This transparency has strengthened its share price and increased local interest in a recent 14 billion baht bond issue.

ly affect firm entry. Some countries have introduced a broad range of legal and regulatory reforms, including competition policy (Brazil,

Korea, and Mexico), commercial law (El Salvador, Hungary, and Poland), and environmental regulation (Chile).

Company and securities laws, including laws on the scope of fiduciary duties and general business legislation on creating, incorporating, and managing companies, are intended to restrain managerial opportunism and protect all participants in the corporation. If these laws are absent or deficient, as they are in many developing countries, enterprises will lack many of the incentives to prevent managers from deviating from commercial goals. Laws dealing with the competition for corporate control (takeovers) are also often absent, further reducing incentives for efficient management—although some countries (Chile for one) are initiating reforms in this area.

It is also important to improve creditors' rights through insolvency or takeover rules and proceedings and tender offer rules that provide for efficient reorganization, restructuring, or liquidation (exit). Without timely and transparent procedures, there is no balancing of the rights of creditors and debtors. There is little protection of collateral during bankruptcy proceedings or flexibility in reorganization proposals. And since there often is no recourse to courts (including bankruptcy courts) with qualified judges, there is no expedient basis for resolving competing claims and no mechanism for dealing with cross-border claims. During the 1990s many countries, including Argentina, Croatia, Hungary, Peru, Poland, and Russia, undertook significant reforms of their insolvency systems to provide a better framework for restructuring or liquidating companies.

#### **INCREASING JUDICIAL CAPACITY FOR ENFORCEMENT.**

Often compounding the weaknesses in the legal and regulatory environment is an ineffective judicial system. There are chronic delays because of archaic procedures, inadequate infrastructure, undertrained judges, and poor case flow management. There is no predictability in judicial outcomes because judges are often selected

for the wrong reasons, and poorly trained and paid. There is limited access to the system, particularly for the poor. And there is often no alternative system for dispute resolution. Beginning in Latin America in the early 1990s (Argentina, Bolivia, Uruguay, and Venezuela), and in other regions (Cameroon and Ghana) more recently, countries have made substantial progress in improving their court systems. Countries are also reforming their judiciaries, reducing judicial delays through procedural reform, and improving their judicial infrastructure through training and case flow management.

**STRENGTHENING ANTICORRUPTION STANDARDS.** Weak corporate governance often has its roots in the abuse of political power. Senior public officials may pursue personal gain by giving special privileges to companies run by their nominees or relatives. Such practices reduce the need to acquire operating efficiency. In some countries public officials are so extensively involved in business that it becomes rational for businesses to seek official connections as insurance against political risk. Investors may rely on political connections instead of good governance and competitiveness as a basis for investment decisions.

Corruption's corrosive influence on development has led to the adoption of codes that criminalize bribery of government officials by foreign parties, notably the OECD Convention on Combating Bribery of Foreign Public Officials in International Business (February 1999), ratified by 18 OECD members by mid-November 1999. But bribery by domestic firms is also a problem, as are the overall ethical standards of government officials. Transparency International's annual reports show that corruption is more extensive in developing countries than in OECD countries (though in the past year it has produced a separate "bribery index" that ranks foreign private bribery primarily from developed countries). Fraud, tax evasion, local bribery, insider dealing, false disclosure, and money laundering all tarnish a country's reputation and reduce

trust, resulting in misuse of resources and a higher cost of capital for corporations that need it. Preventing domestic violations of corporate ethics requires self-regulation and effective legal remedies, both weak in most developing countries. The World Bank is providing assistance to member governments implementing national programs to discourage corrupt practices. Its 1997 report, *Helping Countries Control Corruption*, includes guidelines for staff and a framework for addressing the causes of corruption, seen as a fundamental impediment to long-term economic growth and social development.<sup>5</sup>

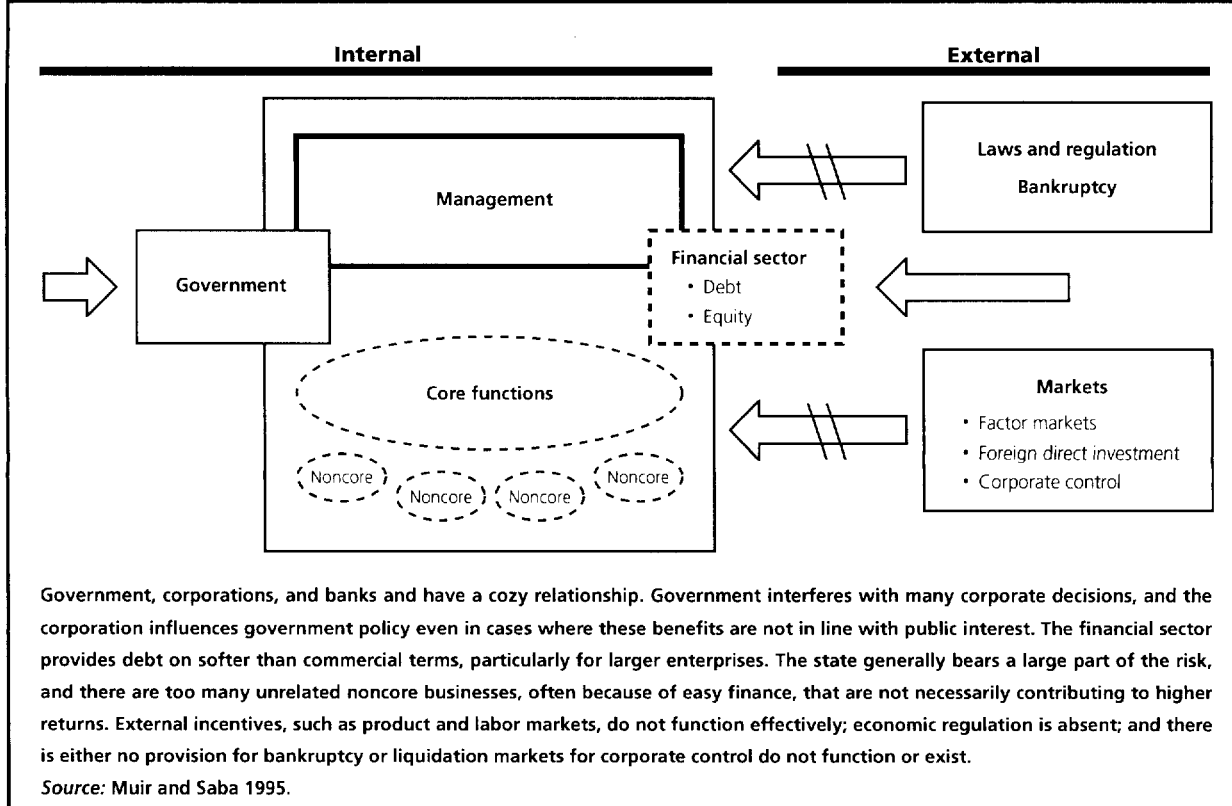
#### ***Developing and regulating financial markets***

Stronger corporate governance increases access to capital by making investments less risky and more attractive. This process helps to broaden and deepen financial markets. In turn, well developed financial markets strengthen market discipline for good corporate governance. The two processes are mutually reinforcing.

#### **PRIVATIZING AND CLEANING UP THE BANKING SYSTEM.**

Most developing countries have bank-dominated financial systems with close connections between government, corporations, and banks (figure 2.1). This has normally come at the expense of developing the financial sector as a whole, including the encouragement of domestic savings. Governments exert a strong influence on the corporate sector, often directing lending to favored industries and firms. Corporations, seeking credit or other privileges, often unduly influence government policy. And banks have interlocking ownership ties with corporations. Arm's length transactions are rare, and there are few incentives for proper banking supervision. Often, conglomerates are formed around banks, which then dominate the industrial sector and the financial sector. Corporations with easy access to debt are not exposed to the kind of market and regulatory discipline needed to ensure viable projects and good governance. The starting point for reform is thus to

**Figure 2.1 The interlinkages of government, corporations, and banks**



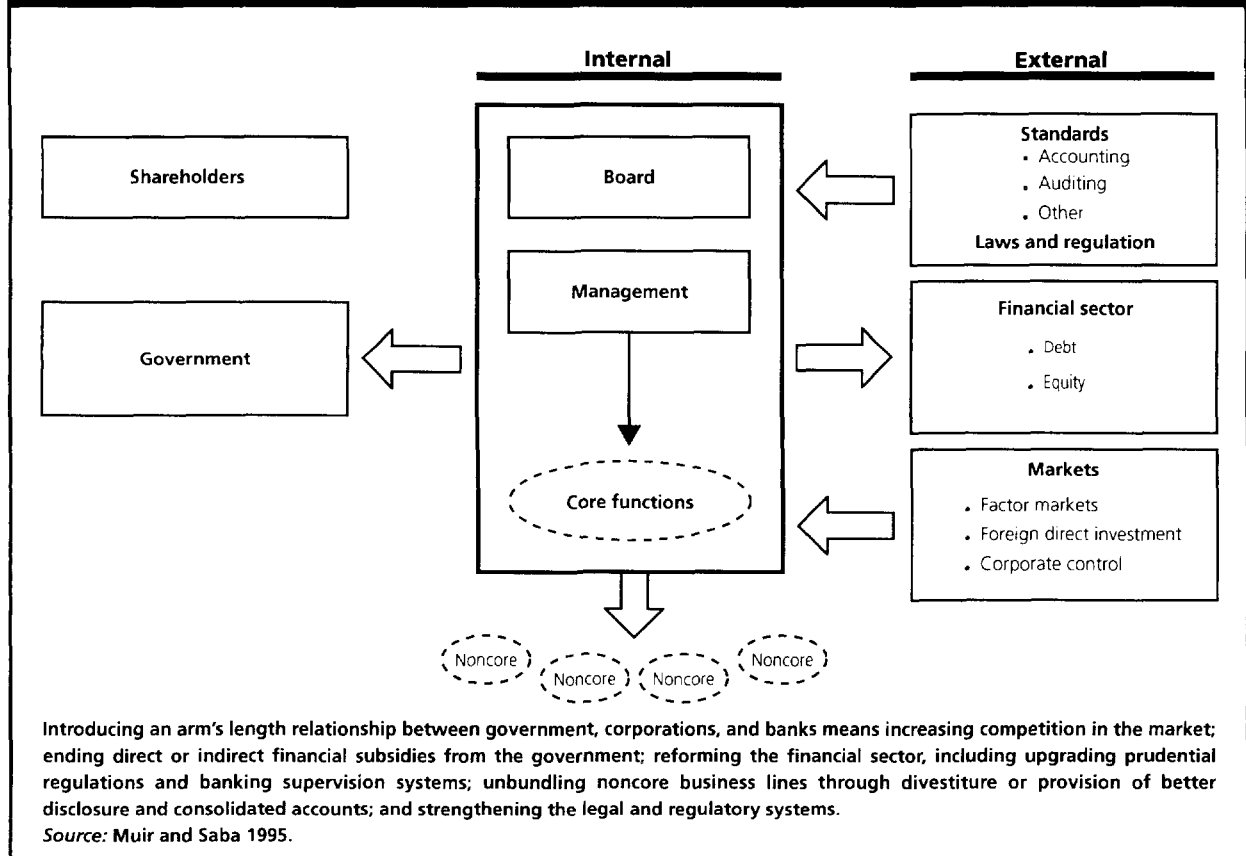
sever the unhealthy alliances between state, banks, and firms (figure 2.2).

In some countries, privatizing banks, especially through strategic sales to foreign banks, has dramatically improved the quality of the banking sector. Foreign partners have introduced state of the art management systems, better internal controls, diversified boards, and a culture of risk-based credit analysis. But privatization has not been sufficient to transform the financial system. Often, especially when banks are not allowed to operate a securities business directly, privatized banks own subsidiary nonbank financial institutions, such as broker-dealers. Parent banks are seldom interested in developing their debt securities business, since that could erode their lending business, so financial sectors continue to be bank-dominated. That builds up systemic risk in the economy, since companies lose their main source of finance if the banking sector collapses

(as in East Asia in 1997), and vice versa. Bank supervision also tends to be weak, so banks fail to fulfill their disciplinary function of exercising due diligence in allocating credit.

Improving governance (through better incentives, transparency, and accountability) and supervision of the banking sector would also improve corporate governance. It would put more immediate pressure on failing corporations to restructure their operations and finances. Banks would work to ensure that only high-quality corporate investments receive funding and that investments are properly monitored. Above all, this would induce fundamental cultural and institutional changes that are required to establish new corporate governance structures with transparent and arm's length relationships for governments, corporations, and banks. In countries dealing with crisis, the immediate task is to restructure the assets and liabilities of high-

**Figure 2.2 Establishing an arm's length relationship between government, corporations, and banks**



ly indebted firms and to reform the financial sector. The two go hand in hand because banks, to be profitable, need sound corporations to lend to (box 2.8).

**FOSTERING THE EXPANSION OF DEBT MARKETS.** Companies in developing countries rely predominantly on debt financing, which generally means bank borrowing. Many banks are part of huge conglomerates that often automatically roll over short-term credit for group firms.<sup>6</sup> The result is that bank credit lines are also used to finance long-term investment. The corporate bond market is a difficult segment of domestic capital markets to develop because it competes directly with bank lending. In industrial economies, many companies have access to both domestic and international debt securities markets, making it possible for firms to diversify their financing sources.

**REGULATING SECURITIES MARKETS.** Securities exchanges and other self-regulating organizations also play only a limited role in developing countries. Securities exchanges rarely impose tougher disclosure or corporate governance requirements than national law and regulation require, and their monitoring and enforcement capacity are often weak. Tough requirements might discourage firms from listing, a direct hit on revenues for the securities exchange. Tougher reporting requirements might also be resisted by members of the exchange (broker-dealers and banks) whose privileged information on issuers would be diluted by fuller disclosure. Overlapping ownership and control of industrial companies and securities intermediaries, especially in smaller economies, is another constraint on effective securities regulation. Insider trading and self-dealing, which undermine the integrity of many

**Box 2.8 Promoting corporate restructuring and improving corporate governance by cutting the links between the *chaebols* and financial institutions**

The Republic of Korea has taken steps to curb the use of financial institutions controlled by the country's top five conglomerates—*chaebols*—to support their parent groups. The *chaebols* have used their 39 financial institutions, including asset management funds and insurance companies, to reduce the groups' debt-equity ratios to the government-set target of 200 percent at the end of 1999 by having the financial institutions buy equity issued by sister subsidiaries.

The buying spree of *chaebols'* financial units helped raise share prices in 1999. Limits on *chaebol* financial investments would force the conglomerates to begin selling businesses instead of using equity issues to lower debt levels. The *chaebols* have recently launched new asset management funds and attracted retail investors by promising healthy returns. The government lowered the limit on equity investments in sister companies of *chaebol*-owned asset management funds or investment trust companies to 7 percent of their trust assets from the current limit of 10 percent. *Chaebol* insurance companies are required to reduce their equity investments in affiliates and to cut loans given to related companies to 1–2 percent of total assets from the current limit of 3 percent.

Minority shareholders' rights would be strengthened and the number of outsider directors immediately increased to a fourth of the board and then to more than half. The plan is considered a preliminary step toward restricting *chaebol* ownership of nonbanking financial institutions. The *chaebols* are already limited to a 4 percent stake in banks.

Source: Financial Times, August 9, 1999.

emerging markets, are a particularly urgent problem. Given the seriousness of these problems and the need for markets to be fair and liquid, regulation against insider trading is a high priority for public policy. An area to be addressed quickly is developing better capacity in the security exchanges to monitor trades and the behavior of corporate insiders (box 2.9).

**TAKING A FUNCTIONAL APPROACH TO IMPROVE CORPORATE GOVERNANCE.** A sound market infrastructure requires mature investors and institutional shareholders. In developed economies institutional investors have used their ownership concentration as a powerful agent of change in corporate governance. Pension funds have been especially instrumental in raising standards of corporate governance in the United States and the United Kingdom. But in developing countries independently managed pension funds, mutual funds, investment advisors, and other domestic institutional investors that can create pressures for management accountability are still rare. Where they do exist they have largely avoided local equity markets, in which they lack confidence. This promotes a vicious circle in which local capital providers withhold investment in firms, which in turn are deprived of equity and of pressures for improved performance. Globalization of financial and other markets and general improvements in the quality and supply of external financing will put pressure on many corporations to improve their governance to attract financing (box 2.10). This channel for improving corporate governance has been significant for many emerging markets—many are now listing on the New York Stock Exchange through ADRs. Global markets are likely to see functional convergence before de jure convergence, at least for larger firms.

***Fostering competitive markets for products, labor, and corporate control***

Competitive markets ensure that the goals of firms and the welfare of consumers do not con-

### **Box 2.9 Transparency and disclosure strengthen investor confidence**

The Warsaw Stock Exchange made its debut in 1991 with stringent requirements for listed companies. Initially, only five companies met them. Listed issuers on the competing Prague Stock Exchange increased more rapidly, but the listings have dropped more than 25 percent in the past three years. By contrast, the Warsaw Stock Exchange steadily increased the number of listed companies, to 53 by 1995 and then to 107 by 1998.

Initially, the Prague Stock Exchange expanded much faster because of its flexibility in regulation and oversight. It immediately listed hundreds of companies throughout Eastern Europe and was the region's largest exchange, with over 1,700 listed companies in 1995. Less than 100 of these were actively traded, however. To rationalize its markets, the Prague Exchange delisted roughly 1,300 companies that were no longer deemed investment-worthy. Exchange chairman Tomas Jezek, who led efforts to clean up the market, stated: "the failure to regulate means lost credibility on both sides. Investors are afraid to lose money so they don't invest, and issuers are afraid of takeovers, so they don't list."

flict. They also align the goals of firms, shareholders, and society as a whole to increase overall economic welfare. When competition is fettered, prices may be distorted, leading to inefficient output and investment decisions. Firms may pursue objectives that harm society. Examples include government-sponsored production monopolies that use up more domestic resources than would be necessary with free trade. And firms sheltered from competition can become complacent, incur needless expenses, and ignore cost saving possibilities. Such firms are in no position to operate efficiently in a climate of increasing global competition. But

### **Box 2.10 Standard & Poor's ratings**

Standard & Poor's cites corporate governance practices as a key variable in its credit ratings for both corporate and sovereign debt. According to Standard & Poor's president and chief ratings officer, the globalization of capital flows will push governments to make structural changes in disclosure and regulatory practices that will aid the assessment of credit quality. Access to private capital in an increasingly competitive global economy requires changes: "regulation of financial institutions will be more stringent and a true credit culture embodying objective analysis will replace lax lending standards of the recent past." Standard & Poor's specifically cited corporate governance as a critical factor in Thailand's economic recovery program: "Regardless of the speed of a potential recovery, long-term growth prospects hinge on improving corporate and financial sector governance and reducing moral hazard."

many countries still have far to go in liberalizing product and factor markets.

### ***Promoting the emergence of reputational agents***

Self-regulating organizations are beginning to emerge in some developing countries. So are information providers—the information media, wire services, securities analysts, and credit rating agencies—that can monitor firms and securities markets. But the small number of issuers and the limited access to information restrict the potential for profitable information service providers. Their absence limits the effectiveness of strengthening standards for accounting and disclosure, for instance, countries are dealing with this shortage by training directors, promoting self-regulating bodies, and raising awareness of the need for better corporate governance. In many countries NGOs have stepped in as watchdogs representing stakeholders. Advance technology



has also drastically reduced the time and resources needed to print and distribute information, cutting the cost of transparency and disclosure. Information service providers such as rating agencies and wire services now help disseminate corporate information widely. And as advanced information technologies have become more available and affordable on the Internet, many developing countries have also been improving the efficiency of their capital market infrastructure, such as trading, clearing, and settlement systems.

### **Consensus building and country circumstances**

Developing countries need corporate governance models that allow their domestic capital markets to grow. The challenge for all countries is to act now rather than to wait until the next crisis forces them to act. By starting now, countries can put in place a sustainable system of corporate governance that takes into account their own corporate and market structures and implementation capacity. To foster a culture of enforcement and compliance, the public and the private sectors and other stakeholders need to join together in designing and implementing a reform agenda that reflects the specific needs of the country. Important in all these efforts is to set in motion a process that engages the players locally and internationally in a sustained effort to continue to improve the system for corporate governance. To be sustainable, reforms will need full ownership by all parties who will be affected by them or involved in implementing them.

**SOME UNIVERSAL MEASURES.** The debate over which reforms work and which do not continues. Many reforms go beyond the realm of pure corporate governance, such as creating a better business environment or better judicial or tax systems. Similarly, it is difficult to prescribe a sequence for reform that passes the test of universality. Nonetheless, countries that have successfully designed and implemented reforms have tackled the following areas in a systematic and time-

ly manner, while adjusting the reform to their own circumstances:

- *Establishing competitive markets* by removing barriers to entry, enacting competition law, establishing fair trade priorities to promote efficient operations, and removing impediments to exit of firms.
- *Improving disclosure of financial and nonfinancial operations* through greater access to accurate, timely financial and material non-financial reports, compiled using international standards of auditing and accounting. Many countries have already adopted international accounting and auditing standards; others are starting to. There is no shortage of good standards, but practice still falls short mostly because of a dearth of well-trained accountants.
- *Privatizing banks, particularly through sales to strategic investors of high reputation, and promoting competition in a well regulated and supervised banking system.* The banking sector still plays a significant role in mobilizing and allocating financial resources. Many developing and transition economies offer few financial instruments for the investing public outside of the banking system. Improving the soundness of the banking system through early prudential regulation, rigorous supervision, and sound credit analysis is one of the first building blocks to be considered in a reform agenda. Better governance in the banking sector is an important step toward better governance in the corporate sector.
- *Increasing the effectiveness of securities regulation* by enabling the fair transfer of ownership, barring insider trading, and preventing expropriation of capital by management. Also important is developing the hardware and software of the system. This could include developing share registrars, clearing systems, and custodians; instituting rules against insider trading and self-dealing; protecting minority shareholder rights; allowing open-ended mutual funds; increasing the depth of the market by

- facilitating privatization of state enterprises; and fostering local institutional investors (such as private pension and mutual funds).
- *Updating and strengthening the legal, judicial, and tax systems, to ensure clarity and effective enforcement by reducing incentives and opportunities for evasion.*
- *Building the capacity of institutions and people.* Achieving better governance will require stronger institutions and large pools of skilled people to implement the new standards—from directors and corporate secretaries to shareholder activists, accountants, auditors, financial advisors, and media reporters and analysts.

### Box 2.11 East Asian reforms

As with other development strategies, there is no one-size-fits-all blueprint for corporate governance. Each system must reflect the rich composite of social, cultural, and historical influences. But globalization and interdependence are pushing for a consensus about the direction and goals of reform. The challenge for each country—and each firm—is to design its own path. Many countries have revamped their company, insolvency, and capital markets laws. Others have established codes of corporate governance (annex 4c). And some have taken drastic steps toward fundamental reform.

Corporate governance reform in the Republic of Korea is being tackled through better legal and regulatory support, financial and capital market regulation, improved competition policy, and corporate restructuring. Starting this year, accounting information will comply with international accounting standards, and the largest conglomerates will issue consolidated financial statements accounting for all their subsidiaries. To improve management accountability, the government has lowered the minimum equity-holding required to file a shareholder resolution, inspect the company's books, and initiate legal action against a director. The Korean Stock Exchange now requires all publicly traded companies to have at least one nonexecutive member on the board of directors, a requirement that rises to 25 percent of board seats in 1999. Over 600 outside directors have already been named to serve on boards of publicly traded companies in Korea.

Thailand's corporate restructuring program includes reforms in the tax, legal, and regulatory

environment to encourage restructuring, more credible court-supervised insolvency procedures, improvements in capital market institutions, and better corporate disclosure. Starting in 1999, the financial statements of banks, public companies, and financial institutions with assets in excess of 1 billion baht must be prepared in accord with international best practices. The Stock Exchange of Thailand now requires listed companies to form board audit committees to review internal and external financial reporting and independent auditing. It has also identified corporate governance as a central part of its "Vision 2003" strategy. It has barred a dozen former executives from serving as chief executive officers or directors of a publicly traded company based on past negligence.

Malaysia is introducing structural reforms, including policies to enhance transparency and disclosure and to improve competitiveness by strengthening corporate governance. It also plans to strengthen the financial sector by consolidating finance companies and recapitalizing viable banks. Malaysia has been asked by finance ministers of Asian-Pacific Economic Cooperation members to draw up a code of corporate governance practices as a benchmark for other member countries. In addition, Malaysia has created a High-Level Finance Committee on Corporate Governance to promote best practices, spell out the role of independent directors, and increase transparency and disclosure. Training and education programs for management and directors will be a requirement for listing.

- *Strengthening the oversight of management* by establishing corporate boards of directors that are competent and independent and that can ensure that the interests of shareholders and stakeholders are taken into account.

**AREAS FOR FURTHER WORK.** Aside from these universal measures, many other second-generation issues remain—appropriate levels of corporate executive compensation, treatment of off-shore financial safe havens—to be examined once the fundamental issues have been addressed.

**DEALING WITH RESISTANCE TO REFORM.** Resistance to changing the status quo should be expected. In corporate governance, as in other areas of reform, a strategy for dealing with the political economy of reform (who benefits, who loses) is an essential diagnostic tool and pre-requisite for reform. While the state may find it easier to dictate top-down reforms during periods of crisis (box 2.11), these reforms may slip when the crisis ends. Such reforms may seem to establish a foothold, may even change business practices and corporate governance over the long run, but as the urgency ebbs, many players will chafe against the restrictions of measures they did not initiate and may not be fully committed to.

When the reform process is not rooted in significant consensus building in the public and private sectors, its results are fragile. Reforms initiated and led by the private sector have proven far more sustainable. Compliance has been quicker, and enforcement by the government more effective. It is critical, therefore, to engage all players at an early stage, particularly those in the private sector. Morocco (box 2.12) demonstrates a case in which well-intentioned and well-designed reforms were rejected by the corporate sector because it was not sufficiently involved in the reform process.

#### **Box 2.12 The need for private sector involvement in Morocco's reform process**

Considerable improvements have taken place in the corporate governance of Moroccan companies over the last few years. Starting in 1993, the accounting and auditing professions were reorganized. Within a year, new accounting standards were released, modeled on recent directives from the European Union. These standards substantially increased the degree and level of disclosure in Moroccan companies. A Securities Exchange Commission was created in January 1994, under the authority of the finance ministry. Later that year new disclosure requirements and rules and regulations governing mutual funds came into effect.

On October 17, 1997, a new law governing limited companies replaced the antiquated law passed in the 19th century. The law differentiates between the functions of the board of directors, management, and auditors. The board sets the company's strategy, management executes it, and the auditors monitor what is at stake. For example, if the company cannot pay its creditors, management is legally bound to file for bankruptcy. Two forms of corporate governance are available: a board of directors elected by the shareholders at the annual general meeting or a "Conseil de Surveillance," which decides on company strategy and elects a *directoire* to execute its decision.

But the complexity of the new law has been criticized by the corporate sector, which feels that it was not adequately consulted about the law. A number of amendments to simplify the legislation are now being considered.

## Appendix 2.1 Selected comparative data

**Table A2.1 Market capitalization in selected countries, 1997**

<i>Country</i>	<i>Market capitalization (millions of dollars)</i>	<i>Number of listed domestic companies in 1996</i>	<i>Market capitalization as a share of industry and service GDP (percent)</i>
Argentina	59,252	147	20.6
Australia	311,988	1,135	85.5
Brazil	255,478	551	37.1
Canada	486,268	1,265	86.7
Chile	72,046	291	106.8
China	206,366	540	24.4
France	591,123	686	39.5
Germany	670,997	681	29.2
India	128,446	8,800	47.1
Indonesia	29,105	253	15.6
Italy	258,160	244	23.0
Japan	3,088,850	2334	66.0
Malaysia	93,608	621	109.6
Mexico	156,595	193	42.9
Netherlands	378,721	217	97.0
Philippines	31,361	216	43.9
Singapore	150,215	223	147.6
Spain	242,779	357	43.9
Sweden	247,217	229	108.7
Switzerland	402,104	213	128.3
Thailand	23,538	454	15.6
United Kingdom	1,740,246	2,433	144.1
United States	8,484,433	8,479	111.4

*Note:* Publicly traded corporations in developing economies are few, but their market capitalization accounts for a substantial share of the industrial and service sector GDP. Even in countries with relatively thin and less developed capital markets, listed companies may be limited in number but not in influence.

*Source:* World Bank 1999c, table 16.

**Table A2.2 Control of publicly traded firms around the world, 1996**  
(percent)

<i>Economy</i>	<i>Widely held</i>	<i>Family owned</i>	<i>State owned</i>	<i>Widely held financial</i>	<i>Widely held corporation</i>	<i>Other</i>
<i>OECD countries (non-Bank borrower)</i>						
Australia	65	5	5		25	
Austria	5	15	70			10
Belgium	5	50	5	30		10
Canada	60	25			15	
Denmark	40	35	15			10
Finland	35	10	35	5	5	10
France	60	20	15	5		
Germany	50	10	25	15		
Greece	10	50	30	10		
Ireland	65	10			10	15
Italy	20	15	40	5	10	10
Japan	90	5	5			
Netherlands	30	20	5		10	35
New Zealand	30	25	25		20	
Norway	25	25	35	5		10
Portugal	10	45	25	15	0	5
Spain	35	15	30	10	10	
Sweden	25	45	10	15		5
Switzerland	60	3		5		5
United Kingdom	100					
United States	80	20				
<i>Bank borrowers and others</i>						
Argentina		65	15	5	15	
Hong Kong	10	70	5	5		10
Israel	5	50	40		5	
Mexico		100				
Singapore	15	30	45	5	5	
Korea, Rep. of	55	20	15		5	5

*Note:* The data are based on cross-sectional analysis of the ownership structure of the 20 largest firms by capitalization in 27 countries using a 20 percent threshold for control. The limited sample size gives disproportionate influence to large firms. The proportion of family shareholdings of corporations was considerably larger in developing countries than in developed countries. Of firms included in the sample, families controlled 100 percent in Mexico and 65 percent in Argentina, but 20 percent in the United States and 5 percent in Japan.

*Source:* Claessens and others 1998b.

**Table A2.3 Control of publicly traded companies in East Asia, by size, 1996**  
(unweighted)

<i>Economy</i>	<i>Category</i>	<i>Widely held</i>	<i>Family owned</i>	<i>State owned</i>	<i>Widely held financial</i>	<i>Widely held corporation</i>
Hong Kong	All firms	7.0	66.7	1.4	5.2	19.8
	Largest 20	5.0	72.5	7.5	10.0	5.0
	Middle 50	6.0	66.0	2.0	4.0	22.0
	Smallest 50	14.0	57.0	3.0	1.0	25.0
Indonesia	All firms	5.1	71.5	8.2	2.0	13.2
	Largest 20	15.0	60.0	20.0		5.0
	Middle 50	6.0	62.7	3.3	3.0	25.0
	Smallest 50		93.0	0.0	1.0	6.0
Japan	All firms	79.8	9.7	0.8	6.5	3.2
	Largest 20	90.0	5.0	5.0		
	Middle 50	96.0	2.0			2.0
	Smallest 50		57.0		30.0	13.0
Korea, Rep. of	All firms	43.2	48.4	1.6	0.7	6.1
	Largest 20	65.0	20.0	10.0		5.0
	Middle 50	66.0	11.0	5.0		18.0
	Smallest 50		97.0		1.0	2.0
Malaysia	All firms	10.3	67.2	13.4	2.3	6.7
	Largest 20	30.0	35.0	30.0		5.0
	Middle 50	12.0	69.0	10.0	4.0	5.0
	Smallest 50		84.0	5.0	2.0	9.0
Philippines	All firms	19.2	44.6	2.1	7.5	26.7
	Largest 20	40.0	40.0	7.5	7.5	5.0
	Middle 50	16.0	42.0		9.0	33.0
	Smallest 50	16.0	45.0	2.0	6.0	31.0
Singapore	All firms	5.4	55.4	23.5	4.1	11.5
	Largest 20	20.0	32.5	42.5		5.0
	Middle 50	10.0	46.0	35.0	4.0	5.0
	Smallest 50	2.0	67.0	4.0	5.0	22.0
Taiwan, China	All firms	26.2	48.2	2.8	5.3	17.4
	Largest 20	45.0	15.0	15.0	5.0	20.0
	Middle 50	36.0	38.0		6.0	20.0
	Smallest 50	6.0	80.0		4.0	10.0
Thailand	All firms	6.6	61.6	8.0	8.6	15.3
	Largest 20	10.0	57.5	20.0	7.5	5.0
	Middle 50	6.0	47.0	10.0	15.7	21.3
	Smallest 50		76.7	2.7	5.0	15.7

*Note:* Data are from surveys of 2,980 publicly traded corporations (including financial and nonfinancial institutions).  
*Source:* Claessens and others 1998b.

**Table A2.4 Means of enhancing control in East Asian corporations**  
(full samples, percentage of total)

<i>Economy</i>	<i>Average share of value of common equity to control 20 percent of vote</i>	<i>Pyramids with ultimate owners<sup>a</sup></i>	<i>Cross holdings<sup>b</sup></i>	<i>Controlling owner alone<sup>c</sup></i>	<i>Management<sup>d</sup></i>
Hong Kong	18.84	25.1	9.3	68.1	53.4
Indonesia	19.17	66.9	1.3	50.9	84.6
Japan	19.89	36.4	11.6	87.2	37.2
Korea, Rep. of	19.64	42.6	9.4	76.7	80.7
Malaysia	18.11	39.3	14.9	37.4	85.0
Philippines	18.71	40.2	7.1	35.1	42.3
Singapore	19.91	55.0	15.7	37.0	69.9
Taiwan, China	19.61	49.0	8.6	43.3	79.8
Thailand	19.22	12.7	0.8	18.9	67.5
East Asia Nine	19.23	40.8	8.7	50.6	66.8

*Note:* Data are from surveys of 2,980 publicly traded corporations (including financial and nonfinancial institutions).

a. Equals 1 if the controlling owner exercises control through at least one publicly traded company, 0 otherwise.

b. Equals 1 if the company has a controlling shareholder and owns any amount of shares in its controlling shareholder or in another company in its chain of control, 0 otherwise.

c. Equals 1 if there is no second owner holding at least 10 percent of the stock, 0 otherwise.

d. Equals 1 if the CEO, board chair, or vice-chair come from the controlling family, 0 otherwise.

*Source:* Claessens, Djankov, Fan, and Lang 1998b.

## Notes

1. The report does not advocate one form of ownership structure over another and certainly not the Anglo-US models. These markets have developed over time in response to investor needs, institutional capacity and the investing preferences of the population. They cannot be easily copied in other environments.

2. While publicly traded corporations in developing economies are few in number, their market capitalization accounts for a substantial part of the industrial and service sectors as a share of GDP in many countries, even those with relatively thin and less developed capital markets (see table A.1).

3. Accountability is even more complicated in numerous instances when a state owned enterprise is owned by a

number of other state enterprises, such as pension funds, insurance companies, and banks. These types of structures involve agency theory as much as conventional joint stock companies.

4. Most state owned enterprises are audited by their own governmental audit bureaus rather than independent auditors.

5. Transparency International has now embraced corporate governance as an important tool in fighting corruption.

6. An additional impediment is the lack of government bond market to provide the foundation for a broader, more effective debt market, but this remains an illusive goal in most emerging market economies. The lack of a liquid market for benchmark instruments also hampers the development of institutional investors.

## Chapter 3

# The Role of the Bank and Its Partners

The East Asia crisis and problems in Russia increased the urgency in dealing with corporate governance and its effects on global financial markets. As discussed in the first two chapters, much of the debate in industrial economies focuses on enhancing shareholder value and strengthening internal corporate governance, including disclosure, transparency, composition and duties of directors, and treatment of shareholders (particularly minority ones). These are equally important for emerging markets, but the reform agenda also has to tackle the external environment for corporate governance. Many governments have already begun identifying key players, finding advocates, formulating guidelines and codes, addressing legal and market issues, and building institutional capacity. A great deal of activity is also taking place internationally and between countries.

### Challenges to overcome

There are many challenges to good corporate governance: each country should design its own reform agenda (assessing strengths and weak-

nesses), set priorities and sequence reforms, create strong institutions, develop human capital, and above all, ensure that regulatory reforms and policymaking spur private voluntary measures to create a culture of enforcement and compliance. Many countries have initiated reforms in response to crises or corporate failures. But countries need good corporate governance (both the internal and external framework) *before* a crisis hits. And countries that have already initiated reforms, either voluntary or in response to a crisis, need to maintain the momentum and prevent backsliding.

Still another challenge is to use scarce resources efficiently. Countries are spending large amounts of public and private human and financial resources on fragmented, overlapping, and reactive interventions with insufficient linkages and coordination. This lack of coherence has resulted in limited sharing of experience among practitioners in developed countries, international organizations, self-regulatory bodies, and the public and private sectors. Because the magnitude of the problems exceeds the supply of resources, countries need to exploit economies of



scope through better coordination and synergy between players globally and nationally.

### **Formulating reform agendas**

As described in chapter 2, for countries with a large private sector and many listed companies, the most effective tools have been tightening listing requirements, improving protection of minority shareholders, attracting reputational agents, and encouraging companies with large financing requirements to list overseas. For countries where firms obtain financing mainly through the banking system, reforms must also focus on improving governance in the banking sector by restructuring and privatizing banks and strengthening prudential and regulatory systems. Furthermore, developing mechanisms that include evaluation of a borrower's corporate governance practice as part of the lending process is an effective way of hard wiring corporate governance across the economy. For countries where the state sector still accounts for a large share of the industrial and service sectors, focusing on private companies alone will be insufficient. In these countries, the reform agenda must also address governance of state-owned enterprises. And regardless of the structure of the corporate sector, any reform measures have to be complemented by policies that minimize rent seeking, promote transparency and disclosure, and strengthen the enforcement capacity of the legal system (box 3.1).

For implementation, consultation and consensus building among major stakeholders is as important as the reform itself. Only with support from both public and private sectors can governance reforms be meaningful and durable. Many sound pieces of legislation have never seen the light of day because they were not developed through consensus building among stakeholders. Sustainable reforms have been achieved when the private sector led the reform process; failure and evasion have been common when the private sector was not involved from the start. Intense competition in global markets has convinced the private sector

#### **Box 3.1 Reforms with major impact**

In the end, developing countries need to structure their corporate governance models so that *domestic* capital markets can grow. In most countries, a handful of reforms have had the most sustained impact:

- Establishing competitive markets
- Adhering to better disclosure requirements and to international accounting and auditing standards
- Privatizing banks and promoting competition in a well regulated and supervised financial system
- Implementing effective securities regulation
- Instituting regulatory, tax, and judicial reforms, including protecting minority shareholders' rights
- Developing institutions and building human capital.
- Strengthening the role and function of boards and "internal" governance.

of the need to harmonize domestic and global rules—the basis for good corporate governance.

#### ***National action to identify priorities and devise plans***

The country remains the focal point of reform. To help countries establish priorities, the Bank and its partners have supported a series of country self-assessments that identify strengths and weaknesses in corporate governance. (These include: China, the Philippines, Malaysia, Indonesia, Thailand, Korea, Mexico, and Chile. Another seven assessments are scheduled for fiscal 2000.) To complement these assessments, the Bank is also supporting investor surveys that gauge how involved market players perceive the same issues. Together, the two assessments will produce a clearer picture of corporate governance in individual countries. This will help identify priorities and pressure points, and set the

stage for developing a comprehensive reform agenda and evaluating its implementation (appendix 3.1). The twin objectives are to strengthen regulatory reform and enforcement while fostering private voluntary actions and compliance.

**Global action to build consensus and marshal support**

Implementing strong corporate governance systems is not only technical, it is above all political. The World Bank and the OECD have agreed to establish a Global Corporate Governance Forum to broaden the dialogue and respond to individual countries seeking to strengthen corporate governance. The forum has an ambitious agenda (box 3.2). Completing it will require building on the strength of the Bank Group and its partners (appendix 2). The forum will help build coalitions for consensus

by bringing together players and institutions active in corporate governance and mobilizing local and international public and private sector support to scale up and move forward on reform. It will serve as a hub for exchanging information and experience, for leveraging the actions of various players, and for marshaling expertise to support countries' efforts on both regulatory and voluntary fronts.

The forum will tap into the expertise and resources of the larger corporate governance community—ranging from individual companies, corporate associations, institutional investors, and investor action and research groups to self-regulated professional and listing bodies.

For these activities to begin, credible champions are needed in the public and private sectors at the country and global levels. An important component of the forum is the high-level Private Sector Advisory Group, composed

**Box 3.2 The Global Corporate Governance Forum**

**The Forum's agenda**

- Raising awareness, building consensus, and supporting local initiatives.
- Channeling technical assistance to help governments and the private sector carry out self-assessments and investor surveys, design reform agendas, and implement them.
- Designing and implementing pioneering projects in such areas as research on corporate governance and distance learning on corporate governance issues (such as director training).
- Supporting institution strengthening and human resource development locally, regionally, and globally to sustain reforms.
- Identifying, disseminating, and promoting local, regional, and global best practices, such as toolkits, networks linking corporate governance practitioners, and Web sites.
- Addressing corporate governance issues that may go beyond a specific country and affect a wider range of clients.

**The Forum's structure**

The forum's main sponsors, the World Bank and the Organisation for Economic Co-operation and Development (OECD), will be joined by bilateral donors, multilateral development banks, other international organizations (such as the International Monetary Fund), the International Accounting Standards Committee, the International Organization of Securities Commissions, the International Organization of Supreme Audit Institutions, representatives of developing country groups such as the Commonwealth Association, Asia Pacific Economic Cooperation, and a number of private sector participants.

The forum will meet once a year to determine the annual work program and financial plan.

The Secretariat of the Forum will be housed in the World Bank, with one member stationed at the OECD. It will be responsible for the day-to-day delivery of the work program and for administering the budget.

of key private sector figures from developed and developing countries. They have agreed to put their reputation and influence to work—championing reform, developing a network of corporations with good practices, and initiating programs that encourage voluntary private action. The advisory group will focus on providing global technical assistance and identifying, disseminating, and promoting best practices on matters related to corporate governance reform.

Corporate governance is about more than codes and rules. It is about building trust and confidence through information and expertise. The forum will support a series of roundtables in key countries to bring public and private players together to create awareness, present different viewpoints, and help bring about a consensus for reform. The roundtables will enable learning from others by exchanging experiences on best and worst practices. Roundtables have already taken place successfully in the Republic of Korea and Russia. Others are planned for Russia, and for Latin America, Africa, and East Asia. The Secretariat for these roundtables will be at the OECD.

The forum will also organize a yearly consultative process to exchange views to enrich the agenda and share experiences. In addition, ad hoc task forces will be convened to bring together public, private, and other stakeholders from developed and emerging markets to work on specific issues of cross-country and cross-disciplinary importance.

### **The World Bank Group's involvement**

The Bank has long helped countries through difficult structural reforms that require legal and regulatory change, enterprise restructuring, and privatization of state-owned enterprises. The reform programs have addressed many issues now considered under the corporate governance umbrella: creating competitive markets, supervising banks, introducing greater transparency and compliance with international accounting standards, improving internal controls, sup-

porting judicial reform and anticorruption measures, requiring competent boards of directors.

The World Bank Group has also been active in developing the soft and hard infrastructure of capital markets. Its private sector arm, the International Finance Corporation (IFC), has lent to and invested in private entities worldwide and acted as a corporate governance agent in countries that do not have well developed systems (box 3.3). Its representatives have served on company boards. The IFC has been instrumental in developing equity and corporate bond markets, helping to set rules and improve corporate governance. It has also promoted reputational agents, such as credit agencies, in several client countries.

### **Global Corporate Governance Forum**

The Global Corporate Governance Forum will complement, not substitute for, regular Bank instruments. It will provide a rapid-response mechanism for channeling small amounts of technical assistance to specific constituents or entities that would not otherwise receive Bank

#### **Box 3.3 Capital market development and the International Finance Corporation**

IFC's advisory work in domestic capital markets helps:

- Governments put in place the basic legal framework for securities markets
- Securities regulators and stock exchanges develop financial, accounting, and disclosure standards for issuers, intermediaries, and other market actors
- Private sectors organize the basic institutional infrastructure of securities markets, including registrars, depositories and clearing and settlement systems.

IFC's Emerging Markets Data Base complements these efforts by providing critical and timely information and performance benchmarks on emerging markets to foreign portfolio investors.

funds. It will also support strategic regional and global activities not easily covered by individual country assistance programs. The in-country and global experience of the forum will naturally contribute to the formulation of the Bank's country assistance strategies, completing the loop of policy and transaction. Approval of country-specific assignments by the forum will require confirmation by the Secretariat that the activity could not be more practically funded from another source (including Bank lending) and consultation with relevant country directors on the activity's fit with the overall country strategy.

### ***Policy formulation***

The Bank's new development tool, the Comprehensive Development Framework, takes a holistic view of development, linking performance across key sectors to a common set of indicators. Prominent concerns are governance, judicial reform, and private and financial sector development. Corporate governance is an important building block for all. It is also a critical part of the design of a new international financial architecture. The Comprehensive Development Framework suggests that the World Bank Group address development issues systematically in its country dialogue and strategy formulation, that the Bank use the Comprehensive Development Framework to prepare the groundwork for lending and technical assistance, and that it monitor progress.

Corporate governance reforms, though commonly initiated in the wake of a crisis or failure, should not be viewed as a short-term anticrisis package, because these reforms are likely to succeed only in the medium to long run. That makes the sustainability and comprehensiveness of the design and the staying power during implementation critical. Many countries are establishing corporate governance codes and benchmarks, revising listing requirements for new companies, or developing rules for their domestic institutional investors (annex 4b).

### ***World Bank Group lending and advisory operations***

On the lending side the Bank Group will continue to support structural reforms that address corporate restructuring, privatization or commercialization of state enterprises, banking sector reform, capital market development, and legal and regulatory reform. These activities will be complemented by investment operations that reinforce the requirement that recipients of Bank funds meet the same rigorous disclosure standards as companies that want to raise public money in capital markets (annex 6).

When the Bank lends to state-owned enterprises it insists on internal controls—modern accounting systems, financial covenants, external audits by independent auditors, and performance and compliance audits—that go beyond financial statements to capture critical aspects of an entity's operations and governance. These requirements have often exceeded the financial and nonfinancial disclosure practices of enterprises not receiving Bank loans. The Bank will now go even further and require that state enterprises adopt good corporate governance practices. This requirement would improve governance in a significant part of the corporate sector, strengthen the banking system, and pave the way for eventual corporatization and privatization of state enterprises.

The International Finance Corporation and the Multilateral Investment Guarantee Agency will continue to implement corporate governance best practices at the company level through equity investments and advisory, guarantee, and lending operations. The IFC will also continue to provide technical assistance to help governments establish capital markets and implement capital market reforms. Corporate governance and financial markets development are interdependent and mutually reinforcing.

### ***Institutional capacity and human development***

A lack of qualified professionals is often the most daunting challenge to effective reform. Effective governance is not just a set of rules on paper: it

must be driven by the responsible behavior of individuals in their direct actions and their relations with each other. Introducing international accounting and auditing standards will not automatically increase transparency. The standards have to be consistently applied by a strong cadre of well-trained accountants and auditors.

The Bank has done much to support training for regulators (through the International Forum for Utility Regulators, for example), bank supervisors, judges, and accountants and has developed academic and professional programs for establishing such disciplines and professions. This work needs to be scaled up to support training programs in all disciplines relating to corporate governance. For example, judicial system reform is often stalled by a lack of trained legal

professionals. And through projects for higher education the Bank can improve the quality and curriculum of university and professional programs affecting corporate governance issues.

#### ***Supporting standards and best practices at the global level***

The World Bank Group has a range of instruments for addressing public policy issues and private sector actions over the short and long runs and a rich background of cross-country experience. And it has the convening power to draw together the many organizations and players that must cooperate to make changes at the country or international level.

The Bank supports public and self-regulatory organizations that establish international stan-

#### **Box 3.4 The Bank helps harmonize and develop international accounting and auditing standards**

International standards and benchmarks of best practice play an important role in developing the institutional framework necessary for a strong international financial system. Auditing and accounting standards have proven particularly important in reducing the structural sources of vulnerability in the new international financial environment. The Bank, as an important opinion maker and indirect user of the work of international accounting firms and organizations, takes a keen interest in developments in this field.

The Bank has supported the International Accounting Standards Committee and the International Federation of Accountants in harmonizing standards internationally. Because the Bank is concerned with auditing quality and wants its borrower accountability policies to be well understood, it has met with the leading audit firms on two occasions—in Washington in March 1996 and in Paris in October 1997. The Paris meeting coincided with World Bank President James Wolfensohn's keynote address to 4,000 leaders in the accounting profession. President Wolfensohn reiterated the

need for global accounting and auditing principles and standards in the fight against corruption and as a vehicle for transparency. He asserted that good governance is the lifeblood of progress.

The Bank and the International Federation of Accountants have also met on several occasions (together with other multilateral agencies) to discuss a more concerted and coordinated effort to improve financial accountability frameworks through donor support. The International Forum for Accounting Development has held four exploratory meetings and will move forward on the agenda for a two-year trial.

The Bank has also supported the United Nations Conference on Trade and Development in further research and guidance on environmental financial accounting and the International Organization of Supreme Audit Institutions for auditor-general staff training. The Bank will continue to encourage the harmonization and development of the international financial architecture and greater transparency through rigorous compliance with sound standards.

dards. The Bank's role is not in standard setting, but in global implementation of these standards. In addition to the OECD, World Trade Organization, International Labour Organization, and other international agencies, the Bank has strongly supported the work of the International Accounting Standards Committee and International Forum for Accounting Development. The Bank has met with the big five auditing firms to discuss ways to bring auditing standards up to international best practices (box 3.4). The Bank is also working with the International Organization of Securities Commissions to harmonize listing requirements. In the private sector it recognizes the significance of the most important players in corporate governance reforms, the institutional investors and rating agencies that are key to monitoring standards and building confidence in markets.

## Conclusion

Corporate governance deals with enterprise, power, and patronage. In places where a culture of corporate governance is new, enterprise needs to be nurtured and trained. But the real challenge is to develop a workable system of accountability for the power and patronage that entrepreneurs need to exercise. This is no easy matter in practice, because the spirit that drives entrepreneurs forward is irked by the constraints that accountability imposes. This means that progress will depend on harnessing all available forces—from the international community and indigenous organizations alike—to create a climate of opinion, legal and economic structure, and process that together will help produce the desired result.

### Appendix 3.1 Developing a clear picture for investors

#### **Corporate governance assessments**

The World Bank Group and the Asian Development Bank are assessing corporate governance norms and practices in developing

economies. Reports will review the legal and regulatory basis for corporate governance, characterize current practices, and recommend reforms to strengthen the framework for effective governance. Now being implemented in 8 of 15 countries, the project:

- Provides a methodology for assessing national corporate governance practices.
- Develops input for corporate governance reforms.
- Promotes productive interaction on corporate governance systems and practices by investors, regulators, and public decisionmakers.
- Strengthens the rationale for reform by highlighting emerging international practices.
- Provides benchmark indices for self-evaluation in corporate governance reforms.
- Enables domestic and international investors to better evaluate and compare systems.

Although each country has unique concerns, traditions, and institutions, several common issues are emerging from the first set of assessments:

- *Lack of effective oversight by boards of directors.* Controlling shareholders, whose duties to the company and other stakeholders are frequently not clear or enforceable, have the sole right to appoint and remove directors. Too often boards have not been able to exercise proper oversight of management, leading to failures of internal control, poor business judgment, and misallocation of resources. Indonesia and the Republic of Korea have responded by including in their commercial codes a fiduciary duty to the corporation for directors. Malaysia and Korea require a minimum number of independent directors, Malaysia is introducing a requirement that directors of listed companies be accredited, and Thailand requires audit committees.
- *Poor disclosure.* Lack of transparency has contributed widely to governance failures. International accounting and audit standards for reporting are often not followed, so markets are unable to price risk or enable informed decisions. Disclosure on related-party transactions,

foreign currency exposure, corporate structures, and relationships within and between companies is poor. A notable exception is Chile, whose Stock Corporations Law has strict disclosure requirements. A number of countries are now revising their reporting requirements in line with international standards.

- *Weak compliance with statutory and regulatory requirements.* While the assessments have highlighted the areas of law and regulation requiring amendment, in many cases appropriate rules exist but enforcement and compliance are weak. Lack of confidence in the judicial process, high costs of litigation, and weak regulatory powers mean that rules are sometimes ignored. Mexico's National Banking and Securities Commission has considered promoting voluntary improvements in corporate governance through a Practices Code with provisions for the board of directors, minority shareholders' rights, and disclosure requirements. In 1998 the Czech Republic augmented the Securities Commission's substantive enforcement powers and drew high-level professionals by raising salaries above public sector wages.
- *Tight insider control.* The assessments highlight the concentration of ownership in many markets—concentration that gives insiders extensive powers that are neither subject to checks and balances nor balanced by duties to minority investors or other stakeholders. Networks of corporate cross-holdings, state-controlled shareholdings, or dominant family stakes in companies allow corporate assets to be deployed for the benefit of the controllers, while minority interests are unprotected. The situation is exacerbated when enterprises are in a dominant market position that allows inefficiency to go unchecked by competition. Across these markets, though, foreign and private minority investment is growing as companies seek public listings. To expand the capital pool for these economies, it is vital to restore investor confidence. Malaysia is planning to exclude controlling shareholders from

voting on matters in which they have an interest and is introducing cumulative voting to allow minority investors to appoint directors to the board. Korea is establishing auditor selection committees at the top 30 *chaebol* comprising outside directors and large and noncontrolling shareholders.

- *Shareholder and creditor passivity.* When disclosure is poor, controlling groups are not required to protect minority interests. When enforcement is poor, neither shareholders nor creditors have much incentive to protect their own interests. Instead, credit dries up and investors leave, voting with their feet. Measures to help investors and creditors protect their position rather than exit include Malaysia's plan to help shareholders form an activist body through a new corporate governance institute. Korea will introduce a provision to allow shareholders to pursue class actions. In Thailand shareholders owning 20 percent of the capital can apply to the Ministry of Commerce for an inspector to investigate a company's affairs. The Czech Republic's voucher privatization has created an interesting challenge for shareholder rights. Reforms have strengthened protection for direct minority shareholders in joint stock companies, but not the rights of shareholders in the major holding companies (formerly investment funds) that control about 25 percent of these companies' total equity on behalf of Czech citizens.

#### **Value of investor surveys**

The World Bank Group is working with the private sector on a survey of local and foreign investors in emerging markets to measure how corporate governance affects investment decisions. The survey will examine a cross-section of the corporate sector: domestic and international investors and providers and recipients of foreign direct investment, including large multinationals and small enterprises. The survey will also gauge the private sector's response to the progress on reform—and its credibility. The survey will build

on a recent survey of U.S. companies conducted by McKinsey & Company, which showed that investors are willing to pay a 16 percent premium for good board governance (Felton, Hudnut, and Van Heeckeren 1996), and a recent survey by Russell Reynolds Associates (1999), which found that fund managers in Japan and Germany increasingly look at a company's governance profile in their investment decisions. Together with the corporate governance assessments, the survey will enable the World Bank Group to identify points for action.

### Appendix 3.2 The Bank's main partners

One organization alone cannot meet the challenges of corporate governance reform. The World Bank is proud to be partners with many international organizations, multilateral lenders, local stock exchanges, business groups, professional groups, trade associations, and civil society organizations in each of the Bank's member countries. The Bank's chief *multilateral partners* are:

- *Organization for Economic Co-operation and Development (OECD)*. OECD has been an indispensable partner. In its report on corporate governance, OECD's Business Sector Advisory Group (1998) proposed nonbinding international principles of good corporate governance. The Bank can complement this work by improving access to capital markets and by helping to translate OECD principles into country-specific practices suitable for developing countries.
  - *Commonwealth Association for Corporate Governance (CACG)*. Formed in 1998, CAGC has launched several projects to stimulate debate on corporate governance through its seminar and outreach program. It helps organize workshops and provide training on best practices in corporate governance in Africa and elsewhere.
  - *International Accounting Standards Committee (IASC)*. The Bank has supported IASC and related organizations in developing inter-
- national accounting standards for agriculture, the public sector, and the environment and helped them develop and provide training programs for auditing and accounting. The Bank is working closely with countries to adapt international accounting standards to local conditions. It has also convened the leading international accounting firms and urged them to strengthen the auditing practices of their local partners in accordance with international standards.
  - *International Organization of Securities Commissions (IOSCO)*. IOSCO issued a statement of objectives and principles of securities to help its members assess and improve policies, regulatory frameworks, and practices for securities exchanges. The Bank will collaborate with IOSCO in developing assessment methodologies, improving securities market regulations and supervision, and providing interpretive guidance for adoption of IOSCO principles. The Bank will also provide support for IOSCO's summer training program.
  - *United States Agency for International Development (USAID)*. USAID has a long history of involvement in corporate governance activities, many of them in cooperation with the Bank Group through donor committees. USAID programs increasingly focus on the rule of law, transparency, and civic participation in areas of economic policy reform. In response to Asia's financial crisis, USAID developed programs to promote transparency in the financial sector.  
Among *regional organizations*, the Bank's chief partners include:
    - *Asian Development Bank (ADB)*. ADB has cooperated with the Bank in reviewing corporate governance practices in common member countries (including corporate governance in loan conditions for structural adjustment lending after Asia's financial crisis, for example) and is providing technical assistance loans to improve corporate governance in state enterprises, including a project in Indonesia.



- *Asia-Pacific Economic Cooperation (APEC)*. APEC has commenced research and analysis on improving corporate governance. Both ADB and APEC have partnered with the World Bank to assess corporate governance needs in their regions.
  - *European Bank for Reconstruction and Development (EBRD)*. In its role as lender to governments and investor in private corporations, EBRD drafted guidelines on corporate governance standards. Firms in transition economies may not all be able to achieve those standards immediately, but those seeking EBRD funding will use the guidelines to revamp their governance processes.
  - *Inter-American Development Bank (IDB)*. The IDB has been addressing external constraints on the corporate sector, including legal and institutional reform in capital markets (especially securities regulation) and banking, as well as improvements in accounting and auditing standards.
  - *African Development Bank (AfDB)*. The AfDB has been developing transparent institutional arrangements for privatization and divestiture; conducting legal reform, including the preparation of texts on corporate rights and bankruptcy; developing legislation for financial and securities markets and trading activities; and improving accounting, auditing, management, and information technology.
- In the *private sector*, the Bank Group will continue working with institutional investors, credit rating agencies, stock exchanges, trade associations, organizations of institutional investors, investment analysts, research institutes, consulting firms, and nongovernmental organizations active in the field. These partnerships—formal and informal—will involve joint participation in research, conferences, communications, and training. There are many players in the private sector whose cooperation is essential for translating principles, legal standards, and government regulations into the practice of good corporate governance:
- As providers of capital, *institutional investors* have been a driving force behind corporate governance reform around the world. Using their proxy voting power, they have demanded greater accountability from the managers of firms in their portfolios. Since the financial crisis in emerging markets they have assigned even greater weight to corporate governance and disclosure in their investment decisionmaking. The California Public Employees Retirement System, one of the most vocal and effective U.S. advocates of corporate governance reform (see box 1.6), has proposed Global Principles of Corporate Governance—minimum standards for promoting transparency, accountability, and equity in governance and management in all markets. Mutual funds, too, are paying increased attention to board structure and the rights of minority shareholders.
  - *Credit rating agencies* bring greater transparency wherever they work. In issuing ratings, these firms have increasingly highlighted qualitative factors, such as corporate governance practices, as well as quantitative measures of financial performance. They have always addressed issues of disclosure in their ratings process and are now paying greater attention to board structure and minority shareholder rights in ratings for both countries and firms. Standard & Poor's, for example, increasingly takes into account corporate governance practices in its sovereign and corporate debt ratings.
  - *Stock exchanges* help improve corporate governance through their listing requirements, which call for improved disclosure, external auditing and an internal audit committee, and an independent board of directors. Exchanges have also taken a leading role in crafting national codes of best practice for corporate governance. Such codes have been issued or are being drafted by the exchanges in Amsterdam, Hong Kong, Johannesburg, London, Singapore,

Bangkok, and Toronto. The Korean and Jakarta stock exchanges have also recently taken steps to develop codes of corporate governance.

The International Federation of Stock Exchanges represents 51 stock exchanges—more than 97 percent of the world's stock market capitalization. The federation plays an important part in promoting improved corporate governance by advising exchanges on listing requirements relevant to corporate governance and disclosure. It supports emerging market stock exchanges work on establishing member standards. And it seeks to develop healthy securities markets by building prosperous exchanges that can self-regulate.

- *Trade associations* in the private sector are working with the World Bank Group to develop workshops on corporate governance to increase awareness and institutional capacity. Workshops for managers and board members in Indonesia took place in 1999 with the Jakarta Stock Exchange, the Capital Markets Society of Indonesia, the Transparency Society, and the Association of Listed Companies. Several trade associations also have initiatives to promote corporate governance. The Federation of Thai Industries has approved a code of business ethics that tries to set a new standard for good governance among Thai corporations. The Malaysian Institute of Corporate Governance promotes awareness of corporate governance and self-regulation among Malaysian firms. The International Bar Association provides international guidance on competition, bankruptcy, and company law.
- *Institutional investors* have also contributed to the Bank's strategy on corporate governance reform. Several organizations representing institutional investors have shared information, including the Conference Board's Global Corporate Governance Research Center, the Council of Institutional Investors, Institutional Shareholder

Services, the Investment Company Institute, the Investor Responsibility Research Center, and the U.K.'s Pensions Investment Research Consultants. These groups have also provided feedback on the Bank's methodology and on the findings of its assessment reports on corporate governance in member countries.

- *Investment analysts and research and consulting firms* provide research and recommendations for their clients on both sovereign and firm issues and facilitate international proxy voting by summarizing issues and regulations and recommending voting strategies. Since the East Asian crisis, research analysts have increased their coverage of corporate governance reforms in their investment recommendations. Goldman Sachs's Asia Strategy Team now cites corporate governance practices as a major consideration in its investment recommendations at both the national and the firm level. Flemings has issued a set of corporate governance ratings for emerging markets based on their framework for disclosure, shareholder rights, and the role of the board of directors.
- *Nongovernmental organizations (NGOs)* are also playing a significant part in promoting improved corporate governance. Active at the grassroots level, they can mobilize the opinions of company stakeholders, including customers, suppliers, workers, and society. They are developing standards of corporate governance that can be adopted by corporations and other capital market institutions. They also disseminate amendments to laws and regulations through seminars and publications. The Bank Group works with NGOs in both developing and developed economies. It is giving financial support to the Center for Economic Development for a corporate governance conference in Sofia, Bulgaria, and also has close links with the European Corporate Governance Network.

## Appendix 3.3 Memorandum of Understanding

### On the Establishment of the Global Corporate Governance Forum

#### *The World Bank and The Organisation for Economic Co-operation and Development*

##### 1.0 OVERVIEW: A FRAMEWORK FOR CO-OPERATION

1.1 The improvement of corporate governance practices is widely seen as one important element in strengthening the foundation for individual countries' long-term economic performance and in contributing to a strengthened international financial system. Therefore, corporate governance has emerged as an important focus of efforts by multilateral organisations to assist countries in improving financial architecture. Efforts in the area of corporate governance could benefit greatly from closer and more structured co-operation. The International Bank for Reconstruction and Development ("the World Bank") and the OECD have agreed to broaden the global policy dialogue and co-operation on corporate governance reform and to respond to the need of individual countries to improve corporate governance.

1.2 Implementing strong corporate governance is fundamentally a process, in which the government and the private sector join hands. The central concept in this broad international co-operation is the promotion of dialogue and exchange of experience between the main public and private players on a global scale. Ultimately, change in corporate governance practices must be implemented at a local, country level. The establishment of a platform for international dialogue, structured around an agenda with broad public and private sector support and expertise, will lend important support to regional and country efforts to effect such change. This is because:

- 1.3 • It raises awareness of the need to build consensus for the support of local, regional and global initiatives, in order to bring about a coalition for reform.
- 1.4 • It is an efficient way to marshal international expertise in a concerted, co-ordinated and timely way and to identify, disseminate, discuss and promote global and regional best practices, building on international experience.
- 1.5 • It can be an effective tool for the identification of country and regional technical assistance needs.

1.6 The OECD Principles of Corporate Governance provide an important starting point. As it is stated in their Preamble:

*The Principles are non-binding and do not aim at detailed prescriptions for national legislation. Their purpose is to serve as a reference point. They can be used by policy makers, as they examine and develop*

*their legal and regulatory frameworks for corporate governance that reflect their own economic, social, legal and cultural circumstances, and by market participants as they develop their own practices.*

1.7 However, the dialogue process should move beyond basic common principles of governance to help countries identify specific issues and problems and develop their own programmes and institutions to strengthen corporate governance. Regional and national codes of best practice have been developed over the last few years while important changes will continue to take place in this field. These will provide important input for discussion and dialogue that will contribute to the future reassessment of the OECD Principles.

1.8 The co-operative effort between the World Bank and the OECD will draw upon the respective complementary strengths and membership of the two organisations. It is also essential to build on the work of various international organisations in the effort to promote better corporate governance.

## **2.0 STRUCTURE**

The proposed co-operation will be structured along two major initiatives: (a) the Global Corporate Governance Forum, and (b) World Bank/OECD policy dialogue and development.

### *(a) Global Corporate Governance Forum*

2.1 The Global Corporate Governance Forum will be set up to provide a framework for international cooperation and create synergies for the design and implementation of joint or individual projects by participating countries and institutions.

2.2 The Global Corporate Governance Forum will:

- build a consensus in favor of appropriate policy, regulatory and institutional reforms
- coordinate and disseminate corporate governance activities
- provide support for regulatory and private voluntary action
- promote institutional development and human capacity building in the associated fields of corporate governance
- train the various professions and the other agents who are essential to bring about a culture of compliance.

2.3 The World Bank and the OECD will sponsor the Global Corporate Governance Forum, which will consist of regional development banks and other international organisations and groupings such as APEC, IASC, IOSCO, IMF, Commonwealth Association, private sector participants and institutions as well as donor and developing/transition countries. The Global Corporate Governance Forum will ordinarily meet once a year. It will approve the objectives, policies, and monitoring of the Forum's Secretariat. It will also review the annual work programme and the financial plan, as proposed by the Secretariat, with the support of the Private Sector Advisory Group.

2.4 The Global Corporate Governance Forum will consult with representatives of nongovernmental organisations and stakeholder groups with a specific interest in corporate governance.

2.5 A senior *Private Sector Advisory Group (PSAG)* will be established. The improvement of corporate governance practices within countries will require partnership between public and private sectors. The PSAG will engage the private sector in playing a major role in the improvement of corporate governance practices within countries. Effective, continuing and easily accessible private sector support and input are essential elements in the process of policy dialogue and country-specific implementation envisaged by the two organisations.

2.6 The PSAG will consist of a small, flexible, representative group of private sector international leaders. The very senior level of the PSAG membership will enable the group to mobilise support among private sector players world-wide and carry weight with senior officials from the government/regulatory side. The group will be representative, drawing on individuals from different regions of the world and on all types of private sector players, from the corporate, institutional, individual investor and self-regulating bodies. It will be well integrated into the Global Corporate Governance Forum. It will report and advise the Global Corporate Governance Forum on the programme.

2.7 The mandate of the PSAG will be to:

- work with the Secretariat (see below) to promote good corporate governance in accordance with approved work program of the Global Corporate Governance Forum (as per paragraph 1.6 and 1.7).
- 2.8 • advise on and assist in the development of regional and country-specific corporate governance programmes and of the activities of the Policy Dialogue and Development Round Tables (see below), by providing senior private sector participation and input.
- 2.9 • advise on, and participate in country-specific technical assistance and educational efforts to improve corporate governance practices in the private sector, in close co-operation with members of the Global Corporate Governance Forum and its member organisations and institutions.

2.10 The World Bank Private Sector Development Department will house the *Secretariat for the Corporate Governance Forum*. The Secretariat will be responsible for managing the programme and will be accountable to the Global Corporate Governance Forum. It will present to the Forum for its approval the annual work programme to be prepared in consultation with PSAG and other interested parties. The Work programme will consist of country-specific regional and international initiatives. A member of the Secretariat will be located at the OECD. Continuing close contact will be maintained between the responsible staffs of the two organisations.

*(b) Policy Dialogue and Development Round Tables*

2.11 Policy Dialogue and Development Round Tables will be set up by the World Bank and the OECD on a regional (and, where appropriate, country specific) basis. The round tables will provide the framework for continuing policy dialogue and a multilateral process of exchange of experience. This process will bring together OECD member country experts and national decision-makers from the private sector and governments in different regions (or countries) of the world. The World Bank/OECD Seoul meeting and the recently established Corporate Governance Round Table for

Russia are examples of such activities. The OECD will house the Secretariat for the Round Tables, with a permanent contact point at the World Bank.

2.12 A series of *joint activities for the research and dissemination of corporate governance information*, including publications, will be undertaken.

### 3.0 PROCEDURE

3.1 Following agreement on the Memorandum of Understanding, a programme of co-operation for the next three years will be drafted, resources identified and tasks assigned to the World Bank and the OECD.

3.2 The World Bank and the OECD will agree on the initial composition of the Global Corporate Governance Forum and the Private Sector Advisory Group by August 1999.

3.3 The Global Corporate Governance Forum and the PSAG will be launched at a high level meeting in the context of the World Bank's Annual Meetings in late September 1999.

3.4 The implementation of the proposed co-operation is subject to the internal procedures of the World Bank and the OECD.

3.5 Both parties will use their best efforts to secure adequate funding for the implementation of the co-operation program.

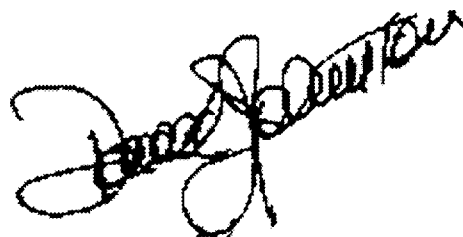
Paris, 21 June 1999

For the World Bank



James D. Wolfensohn  
President

For the OECD



Donald L. Johnston  
Secretary-General

## Appendix 3.4 News release

FOR IMMEDIATE RELEASE

The World Bank



News Release No. 99/2217/S

*Contact: Nadereh Chamlou (202) 458-0473*  
[Nchamlou@worldbank.org](mailto:Nchamlou@worldbank.org)

### WORLD BANK, OECD ANNOUNCE GLOBAL FORUM ON CORPORATE GOVERNANCE

**WASHINGTON, May 27, 1999**—The World Bank and the Organisation for Economic Co-operation and Development (OECD) have agreed to sponsor a **Global Forum on Corporate Governance** to broaden the dialogue on this topic and to respond to the growing need of individual countries that want to strengthen corporate governance. This coincides with the finalization of OECD's Principles of Corporate Governance.

There is widespread recognition that sound corporate governance is an essential foundation for a well-functioning market economy and hence for long term development. It is also critical in strengthening the international financial system.

The Forum is intended to provide the basis for a global dialogue on corporate governance reform and assist individual countries in developing their own programs for improved corporate governance. The Forum will bring together relevant international institutions, developing and developed countries, as well as private sector participants and other stakeholders. The Forum will help interested countries make self-assessments of their corporate governance systems and conduct investor surveys to identify the priorities of the reform agenda that reflect the countries' own economic, social, legal, market structures, and cultural circumstances. It will further support these efforts by marshalling public and private expertise.

The success of the corporate governance reform process will ultimately depend on the active participation, and in some cases leadership, of the private sector and the support of stakeholders. For this purpose, the Global Corporate Governance Forum will establish a high-level **Private Sector Advisory Group** consisting of distinguished corporate and institutional leaders from developed and developing countries that have championed and pioneered best practices in this area. The Forum will also consult periodically with NGOs and other stakeholder groups with a specific interest in corporate governance.

The World Bank has had a long experience working with developing countries to develop effective corporate governance systems and helping create the necessary infrastructure to support

them. The OECD, meanwhile, has developed a set of Corporate Governance Principles that were finalized and adopted by its member country ministers following a broad consultative process among the public and private sectors of its member and nonmember economies. These will serve as a starting point for the debate.

The Global Forum on Corporate Governance will be launched during the World Bank's Annual Meetings in late September of 1999. In parallel, a Policy Dialogue and Development Forum will be set up by the World Bank and the OECD to help continue the exchange of views and experiences that will bring together experts and decision makers from the private sector and governments in different regions.



## NEWS RELEASE

Paris, 27 May 1999

### **World Bank and OECD step up co-operation to promote improved corporate governance**

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**MEMBER  
COUNTRIES**  
Australia  
Austria  
Belgium  
Canada  
Czech Republic  
Denmark  
Finland  
France  
Germany  
Greece  
Hungary  
Iceland  
Ireland  
Italy  
Japan  
Korea, Rep. of  
Luxembourg  
Mexico  
Netherlands  
New Zealand  
Norway  
Poland  
Portugal  
Spain  
Sweden  
Switzerland  
Turkey  
United Kingdom  
United States

The OECD and the World Bank have agreed to co-operate in the promotion of improved corporate governance on a world wide basis. This co-operation responds to mandates from finance ministers and central bank governors of the Group of Seven major industrial countries, from representatives of the Group of 22 countries and from ministers of the 29 OECD member countries. Its purpose is to broaden policy dialogue and co-operation on corporate governance reform and to respond to the need of individual countries to improve corporate governance.

Good corporate governance is important for enhancing individual countries' long-term economic performance and strengthening the international financial system. This is one of the basic lessons that the world has learned from the recent crisis in emerging markets. Moreover, implementing strong corporate governance is fundamentally a political process, in which the government and the private sector have to join hands. Effective, continuing and easily accessible private sector support and input are hence essential elements in the process of corporate governance reform efforts.

The proposed co-operation between the World Bank and the OECD in this context will be structured along two major initiatives: a newly created Global Corporate Governance Forum, and enhanced structures for policy dialogue and development in regions and individual countries.

The Global Corporate Governance Forum will be set up by the World Bank and the OECD provide a framework for international co-operation and create synergies for the design and implementation of joint or individual projects by participating countries and institutions. The Global Forum will bring together regional development banks and international organisations, along with private sector participants and institutions as well as donor and developing/transition countries.

The Global Forum will include a senior Private Sector Advisory Group bringing together international leaders from the private sector from different regions of the world. The Global Forum will also consult with representatives of nongovernmental organisations and stakeholder groups with a specific interest in corporate governance.

In parallel, Policy Dialogue and Development Fora will be set up by the OECD and the World Bank on a regional (and, where appropriate, country specific) basis. These will help to develop a continuing policy dialogue and multilateral exchange of experience on corporate governance. The Fora will bring together country experts and decision-makers from the private sector and governments in different regions of the world.

The World Bank has had a long experience of working with developing and transition economies to develop effective corporate governance systems and helping create the necessary infrastructure to support them. The OECD, meanwhile, has developed a set of Corporate Governance Principles that were finalised and adopted by its member country ministers following a broad consultative process amongst the public and private sectors in its member and nonmember economies.

The Global Corporate Governance Forum will be launched in the context of the World Bank's Annual Meetings in late September 1999.

## Regional Diversity in Corporate Governance Reform in Developing Countries

Just as developed countries have experienced widely different evolutions of their corporate governance framework due to differences in history, private sector corporate roles and ownership structures, role of the financial sector, institutional capacity, and the legal system, to name just a few, so too developing countries offer a rich array of diversity in corporate governance practices that are evolving in ways that were inconceivable a decade ago. This annex provides a summary of the corporate governance context, practice, and prospect of the regions of the developing world including one detailed country example of each. This should lay the groundwork for a Bank Group implementation strategy for corporate governance reform.

### Corporate Governance in the Europe and Central Asia Region

In eastern and central Europe and Central Asia (the ECA countries), weaknesses in corporate governance predated the current crisis in East Asia. Several factors specific to the ECA countries

have increased the difficulties in improving corporate governance.

- In order to rapidly transform the centrally planned economies into market-based systems, the ECA countries relied heavily on the use of vouchers through “mass privatization” programs, where workers and managers alike were given vouchers to buy their own company or invest in another enterprise. Vouchers were used as the primary method of privatization in 11 of the 26 ECA countries and as the secondary method in another 8 countries. The extent of employee and management ownership was in some countries very high. In Russia, for example, by the end of the privatization program, over half the shares of privatized companies were held by the employees for those enterprises. However, companies owned by employees and management have few institutional incentives to encourage restructuring of the former state enterprises—and little ability to access new capital or expanded markets.
- Even in the most market-orientated of the ECA countries and where other methods,

such as trade sales were used, privatization was conducted in the absence of fully effective laws and regulations on shareholder rights. Such weaknesses in the legal environment limited the ability of outside shareholders, particularly investors with minority ownership positions, to oversee their investments.

- Moving to a market economy also required reform of the commercial banking sector to transform the banks from a mechanism for distribution of funds for the state (or for the leading political party) to a set of institutions focused on profitability and adequacy of capital reserves. Until the banking system has been reformed, the commercial banks have little economic incentive to try to restructure their loan portfolios—or enforce their creditor rights.
- With newly created domestic stock exchanges and weak regulatory agencies, the domestic capital markets have little ability to improve corporate governance even among the handful of companies listed on the stock exchanges. However, by 1999 the ECA countries were also enjoying a number of specific advantages:
- Inflows of foreign direct investment (FDI) is needed as an important source of financing of balance of payments deficits. Foreign investors will continue to press for improvements in corporate governance in order to protect the quality of their investments.
- For the ECA countries with agreements to join the European Union, improvement in corporate governance is an important issue in the discussions for accession. Weaknesses in corporate governance were noted, for example, in the European Commission's (1997) report for future membership of the Czech Republic. In the EU-accession countries, FDI is likely to continue to increase since such investments provide access to a large market of some 310 million people.
- For the other ECA countries, joining the other international organizations such as

the World Trade Organization (WTO) and the Organisation for Economic Co-operation and Development (OECD) is a priority. Both require improvements in corporate governance of the applicant countries.

Nevertheless, to address these weaknesses the ECA region plans to identify countries for Bank Group assistance in improving governance in the private sector. In its *1998 Transition Report*, the European Bank for Reconstruction and Development (EBRD) rated countries on several private sector development issues, including corporate governance and enterprise restructuring. The EBRD characterized 17 of its 26 client countries as suffering from soft budget constraints (tax credit and subsidy policies weakening financial discipline at the enterprise level) or moderately tight credit and subsidy policy but weak enforcement of bankruptcy legislation. Four countries were described as particularly weak—Belarus, Bosnia and Herzegovina, Tajikistan, and Turkmenistan.

Following a review of the countries with weak corporate governance based on corporate governance assessments, the ECA region would identify countries to receive assistance based on the commitment of their government administrations to: increase foreign direct investment and require that insolvent enterprises release unused productive assets for sale to the marketplace. Decisions by international investors on long-term equity investments as foreign direct investments is made based on a number of factors, notably the size of the market to which they would have access. However, failure to establish minimum legal rights for equity shareholders, particularly minority shareholders, can diminish the ability to make profitable investment. This has been clearly seen, for example, in the Czech Republic. Similarly, government commitment to a strong bankruptcy code, especially enforcement of the bankruptcy and liquidation procedures, is necessary to encourage international investors to invest in loss-making activities.

Where the government commitment to improving corporate governance is strong, the Bank Group can assist by highlighting corporate governance issues in economic and sector work, such as country economic memoranda and other economic papers. This has been done, for example, in Lithuania and in the Russian Federation. The economic papers play an important role in improving corporate governance. The papers are made available to the public, notably

the domestic and the international business community. In this way, the policy notes become part of the ongoing dialogue in the country on measures necessary to encourage the growth of the private sector.

In addition, the papers help establish part of the basis or structural adjustment programs. Since the beginning of transition in late 1989, structural adjustment loans have included provisions to strengthen commercial laws, account-

### **Box 1 The Czech Republic—a two-tier governance problem**

The Czech Republic was an innovator in mass privatization, using vouchers issued to the general public and exchangeable for shares. Over 1,600 companies were formed and 40% of their shares are held either directly by individuals or by investment funds and other intermediaries. While the shares are publicly tradable, there is an active market only in a handful of companies and supervision by regulatory authorities has been minimal (an independent SEC was established in early 1998).

The designers of the privatization program recognized the principal-agent problems inherent in this design but hoped that investment funds would fill the gap and become active monitors. The results have been disappointing for several reasons: most importantly, corporate governance in the funds themselves has been weak with effective disenfranchisement of minority investors and few controls on expropriation by insiders. Funds have followed short-term value maximization strategies through building up strategic stakes in large companies and selling control blocks at premium prices. Often though, control blocks have been used to extract benefits from the company with little regard for the interest of minority investors.

Weak laws and regulatory systems allowed some of the largest funds to convert themselves into unregulated holding companies. Large numbers of minority investors have been locked in with little chance of exit and with reduced rights. Corporate

governance in these funds has been neutralized and insider transactions are rife. With the country's possible accession to the European Union, the government has become more active in closing off the loopholes in the corporate governance system in order to meet EU standards. In particular, funds that are trading at a discount to net asset values are required to allow investors to redeem for cash, resulting in increased performance pressure. However, the government has so far failed to move aggressively on strengthening minority shareholder rights and clarifying the fiduciary duties of directors and insiders.

The Czech experience demonstrates the importance of careful design of corporate governance systems and the creation of effective and complementary regulatory capacity. The resistance of corporate insiders to demands for accountability has been compounded by the inability or unwillingness of investment funds to use their voting power in the long-term interests of public investors. A laissez-faire government did not recognize early enough the need to actively monitor and regulate capital markets in order to protect minority investors. The result has been disillusionment on the part of the general public with the credibility of the privatization program and with the capital markets, while foreign investors have suffered heavy losses on their early portfolio investments and show little inclination to return.

ing regulations, bankruptcy laws and institutions, and capital market development. Technical assistance loans—tied to the structural adjustment programs—or self-standing facilities have helped to provide the foreign consulting assistance necessary to implement the structural programs.

To a degree not seen in other Bank Group-supported programs, improvements in corporate governance require commitment by both the government and the private sector. In preparing a program supporting corporate governance, the domestic and international private sectors are key partners in identifying the key issues and working out solutions to address the issues. The challenge in the transition countries is to encourage the domestic private sector to participate in an active way, particularly where in the past the private sector found itself in the unrestricted underground economy. However, long-term growth and access to liquid capital markets require better organization of the domestic private sector in order that their voices be heard.

Similarly, in implementation of a corporate governance program, the private sector is needed. This may take the form of business advisory groups to the government or to the local stock exchanges—or the World Bank. Development of domestic corporate governance policies and practices requires review of international practices and adaptation to the domestic economy. This can only be done by the private sector, although they may be assisted by international organizations such as the World Bank.

The work of the World Bank in encouraging improved corporate governance is seen in the nature of a number of projects approved for countries in the ECA region, generally as part of financial and enterprise sector projects or structural adjustment projects. In addition, the International Finance Corporation (IFC) has embarked on three targeted corporate governance projects—in Russia, Ukraine and, most recently, Armenia. For the three countries, the focus has been on developing corporate gover-

nance manuals for enterprise managers and directors and providing training in applying corporate governance standards. Over time, additional reforms may be needed, for example, to require that all publicly listed companies have independent directors on their Boards of directors or to establish liability to auditing companies for the audits they prepare. However, training and education remain an important first step in the ECA countries. And the work done by the IFC will provide a valuable contribution to future programs and investments—supported by the Bank Group as well as other public and private sector international organizations.

### **Corporate Governance in the Middle East and North Africa Region**

It is difficult to draw any conclusions on corporate governance for a region as heterogeneous as the Middle East and North Africa (MENA). In many countries, the private sector is characterized by the dominance of family ownership coupled with a close relationship to banks and government; insufficient transparency of capital markets due to a lack of full acceptance of international standards of accounting, financial reporting, auditing, and disclosure; and the persistence of a strong state-owned sector.

Many large private companies throughout the region are exclusively or predominantly family-owned. The willingness to sell shares to the public or even to a strategic investor is usually low. Access to bank credit is preferred and in many cases easy, given the predominant close relationship between the management of large companies and the management of banks. If minority shareholders exist, their rights to access to information or to participate in decisionmaking are often severely curtailed. Large companies also usually maintain good relations with the government and are thus protected from the kind of arbitrary administrative harassment to which many small and medium enterprises are often subjected, such as unpredictable and rigid tax audits.

Financial reports are sometimes not disclosed, and if they are, it is not always clear whether the underlying accounting principles

conform to international practice. The situation has considerably improved recently in some countries, especially concerning companies list-

### **Box 2 Morocco updates its commercial code and corporate governance**

Considerable improvements have taken place in the corporate governance of Moroccan companies over the last years. Starting in 1993 the professions of accountants and auditors were reorganized; within the following twelve months, new accounting standards (*plan comptable*) were released modeled on recent directives from the European Union. These standards increased substantially the degree of transparency and the level of disclosure of Moroccan companies. The Conseil Deontologique des Valeurs Mobilières (the CDVM), the Moroccan Securities and Exchange Commission, was created in January 1994 under the authority of the finance ministry who appointed its chairman. Later that year, new disclosure requirements and rules and regulations governing mutual funds came into effect.

On October 17, 1997, a new law governing limited companies was published in the Bulletin Officiel of the Kingdom of Morocco (*Loi N°17-95, Relative aux sociétés anonymes*). The new law came to replace an antiquated text drafted in the 19th century. The law on limited companies distinguishes the functions of the board of directors, management, and auditors. The board of directors sets the company's strategy, management executes it, and the auditors are at stake. For example, if the company cannot pay its creditors, management is legally bound to file for bankruptcy. Corporate governance can take two alternative forms: either a straight board of directors elected by the shareholders at the annual general meeting, or a Conseil de Surveillance that elects a Directoire. In this case, the Conseil de Surveillance decides on the company's strategy and the Directoire executes the decision. However, the new law, which was due to take effect in 1999, has not been well

received by the corporate sector due to its complexity and the fact that they were not adequately consulted prior to its passage. A number of amendments are now under consideration to simplify the legislation.

Starting in 1998 six pilot commercial tribunals and three courts of appeal have been created and their magistrates have received special training in commercial law. The Government's long-term objective is to cover the entire country with the curriculum of the commercial tribunals. The Government has also started an in-depth reform of Institut Nationale de Etudes Judiciaires, the Moroccan law School for judges, so that its magistrates become well versed in domestic and international corporate law issues and are capable of resolving disagreements between corporations in a fair and efficient manner.

Chapter 5 of the Commercial Code deals with bankruptcy procedures. Companies that default vis a vis their creditors but which remain viable going concerns can be restructured and taken out of bankruptcy. Those no longer viable as going concerns are liquidated through the office of an Administrateur Judiciaire nominated by the president of the Commercial tribunal where the company filed for bankruptcy.

Filing requirements for listed companies have improved steadily since 1993 when the first prospectus was filed with the CDVM, the securities market Watch Dog institution. In addition, the protection of minority shareholders of listed companies improved markedly after the CDVM introduced the requirement for investors to make a public announcement when their shareholding in a listed company reaches five percent, or multiple thereof. Investors must not only inform the public of their shareholding but must also declare their intentions.

ed on the stock exchange. Accounting standards in the more advanced countries are now very close to international standards, although in no country are they yet in full conformity. A strong driving force to improve accounting standards was the creation and rapid development of stock markets. Although the capitalization of some stock markets relative to the size of the economies is now similar to Europe, a large share of the trade in the existing markets is in bonds, and the number of companies listed and traded remains low. Some countries still have no stock market at all. The regulation of financial markets is still patchy because these commissions lack autonomy.

Although some countries have embarked on ambitious privatization programs, a large share of the economy remains dominated by state-owned enterprises. These state enterprises often lack financial independence and managerial autonomy. In many cases, the institutional and legal environment of state enterprises remains unclear, thus slowing down the privatization efforts. In most countries, there is no private participation in infrastructure, although a few countries have embarked on the corporatization of utilities with the ultimate objective to privatize them.

The World Bank Group has promoted efforts to strengthen corporate governance in almost every client country in the region. In several countries, the Bank Group supports reforms of the judicial system to strengthen the enforceability of contracts and to speed up proceedings. The IFC is very active in promoting the regulation and the transparency of capital markets, among others through its support for the Inter-Arab rating Agency and of a capital markets regulatory agency in the West Bank and Gaza. The latter has a broader mandate and a higher degree of autonomy than its counterparts in the region and its own funding sources. The Bank Group also support improved banking regulation as well as wider and more comprehensive adoption of internationally accepted standards of accounting and auditing. Finally, the Bank

Group's support was instrumental in reforming company laws in Morocco and Tunisia. These laws have strengthened the autonomy of public companies and clarified the roles of supervisory boards, boards of directors and auditors.

### **Corporate Governance in the South Asia Region**

Corporate governance reform in South Asia focuses on supplies of finance to corporations, both from equity investors (owners and shareholders) and lenders (banks, bondholders, and creditors). The World Bank is assisting the countries in South Asia to implement the following reforms in corporate governance, discussed in order of priority.

The first and most important reform is to privatize the state-owned banks and to better regulate all banks. In the past, banks have lent on noncommercial terms for various reasons (lack of skills, political interference, fraud, and corruption) creating a large stock of loans that the borrowers cannot or will not repay. As a result, inefficient and loss making firms continue to operate while potentially profitable firms are denied financing to modernize and expand. This reform will result in a hard budget constraint that will improve the efficient operation of enterprises perhaps more than any other reform.

The second reform is to privatize state-owned enterprises in addition to the banks. Compared to private owners, governments have proven that they are poor owners mixing commercial, social, and political objectives and incapable of monitoring and controlling the managers of enterprises. The methods of privatization should be those that attract the most qualified and capable private owners whether domestic or foreign. These enterprises include those in energy and infrastructure in addition to manufacturing and services. To maximize efficiency gains, the private firms should be subject to competition from both domestic and imported suppliers and to predictable, transparent regulation where necessary.



### Box 3 India and the use of a voluntary code to improve corporate governance

Like many common law countries, India has a Compliance Act that offers an adequate corpus of law to protect the interests of shareholders. In fact, the financial and nonfinancial disclosures mandated by law, including disclosures about directors and their interest, go far beyond those that are practiced in most parts of continental Europe and East Asia. Corporate laws require mandatory disclosure of non-financial information and connected interests; shareholder approval, often at the 75 percent level, is needed for major or interested transaction; shareholders enjoy preemptive rights on new stock issues and proxy votes and can call emergency meetings as well as make proposals in annual shareholder meetings. Companies have to follow the principle of one share—one vote, there is a fairly transparent market for corporate control, and minority shareholder rights are protected.

The problem with corporate governance in India is relatively poor enforcement of the law. In most cases, the penalties are trivial, and when they are not, infringements generally do not get penalized quickly enough.

It was in recognition of lax corporate government enforcement that the Confederation of Indian Industry (CII), India's largest industry association, drafted a code of best practices for listed Indian companies ["Desirable Corporate Governance: A Code," in April 1998]. The initiative flowed from public concerns regarding protection of investor interest, especially the small investor; the promotion of transparency within business and industry; the need to move toward international standards in disclosure of corporate information; and through all this, increase the level of public confidence in business and industry. The code consisted of 17 best practice recommendations, some of which need stating.

Independent nonexecutive directors should constitute no less than 30 percent of the board of large listed companies and preferably be in the majority. Companies must provide boards with much more relevant information and the code suggests a list of such information. Listed companies above a certain size must have Audit Committees consisting of at least three nonexecutive directors. The quality of disclosure accompanying domestic public issues should be no different to those for GDR and ADR issues. Stock exchanges should mandate for a corporate governance compliance certificate. One remarkable feature of the CII code was that it was prepared by proactive and progressive elements of the industry and not by irate shareholders.

Although it is too early to say whether this voluntary code will have a bite, the data of better performing listed companies suggest that many have accepted the code in its letter and spirit. Moreover, at least two dozen well managed companies, who account for roughly 20 percent of the market capital are voluntarily disclosing information that go far beyond what was suggested by the code.

There are still many lacunae—one of which is that Indian companies are not legally required to present consolidated financial statements of the corporate group. Nevertheless, there is a realization that good governance creates shareholder confidence and generates long term value. This is borne out by a recent, yet unpublished CII study. Over the last four years, 35 large Indian listed companies earned both positive economic value added (return on capital less cost of capital) as well as return on net worth in excess of 20 percent per year. All of them were rewarded by the market. And 30 of them are recognized for good corporate governance.

The third reform is to improve the laws and institutions such as the courts and regulatory bodies that allow suppliers of finance (both equi-

ty and debt) to monitor and control the managers of enterprises. In the case of debt, this includes the laws and institutions dealing with collateral,

debt collection, bankruptcy, and credit ratings. In the case of equity, this includes financial disclosure, minority shareholder protection, rules on takeovers, and company law dealing with the relationship between shareholders, board of directors, and managers.

The fourth reform is to encourage the development of private financial institutions in addition to banks that can provide financing for enterprises and assist in corporate governance. These include leasing companies, mutual funds, pension funds, and insurance companies. These institutions as well as banks should be allowed to provide both equity and debt financing. As providers of equity, they should have the same rights as any other shareholders. Such large institutions can play a central role in corporate governance if the other equity is widely dispersed among many small shareholders.

South Asia lags behind some other regions in the first two reforms (bank and enterprise privatization) and these are the region's first priority. A number of projects are underway to implement the third reform (improving the legal and institutional framework). The fourth reform (development of other financial institutions) has just begun. Other international development institutions also provide assistance for these reforms, and we have developed a joint strategy with them in most cases. One example is the assistance provided by the Asian Development Bank for capital market reforms.

### **Corporate Governance in the Africa Region**

Recognizing the pivotal role that an efficient corporate sector plays in economic development, the Africa Region is assisting member countries in their efforts to put in place an external incentive framework and internal checks and balances conducive to good corporate governance. The corporate sectors of most African countries have been, and to a lesser degree still are, dominated by large state owned enterprises, many of which were beneficiaries of IDA assis-

tance. The private sector on the other hand continues to consist primarily of unincorporated micro, small-and medium-scale enterprises, the majority of which do not benefit directly from Bank projects. In most countries in Sub-Saharan Africa, the formal modern private sector is small, representing less than 10 percent of aggregate output. Early initiatives by the region to improve corporate governance therefore focused on putting in place the requisite external incentive framework, particularly by addressing weak legal, regulatory and financial systems. In addition, public enterprise projects and public sector management projects had components for the disclosure of relevant financial and operational information and the strengthening of management systems and accountability. Increasingly from the mid-1980s, technical assistance and training projects focussed on improving accounting, auditing and financial reporting capacity at the national level.

By the early 1990s many countries in Sub-Saharan Africa recognized the need to role back over-extended state sectors and to foster private sector investment, both domestic and foreign, to achieve the higher rates of growth necessary to lift Africa's people out of poverty. Bank (and donor) assistance is being provided through a variety of projects for corporatization and privatization of state owned enterprises and to promote dynamic private sector development. Such projects address internal corporate governance issues, including Board and management arrangements, financial reporting and auditing, disclosure requirements, shareholder rights and other factors which enhance the ability of investors, financial institutions and other stakeholders to assess corporate performance. Typically, they also seek to strengthen further the external incentive framework. Ongoing projects of this type include for example: putting in place transparent institutional arrangements for privatization and divestiture, reorganizing loan recovery agencies, and supporting judicial reform (Cameroon and Ghana); building capacity for

managing privatization, developing legislation for financial and securities markets and trading activities (Gabon, Tanzania, and Ghana); enhancing public enterprise autonomy and accountability and strengthening accounting and management systems (Gambia and Niger); modernizing legislation on corporate rights and bankruptcy; improving national accounting and auditing standards (Mali, Mauritania, Tanzania, and Zambia); and restructuring and capacity building to enhance corporate autonomy and management accountability in the main power utility and to facilitate private participation in the sector (Zambia). In addition to the Africa Region's efforts, the IFC, through its investments and representation on the Boards of Directors, assists individual private sector companies in improving and maintaining acceptable standards of corporate governance.

Notwithstanding these efforts, serious issues remain and need to be addressed to improve corporate governance in most African countries. A number of countries, for example, do not have laws on bankruptcy and liquidation, and where such laws do exist, they are ineffective and the enforcement process is cumbersome and lengthy. Where legislation for the incorporation and management of companies ("Companies Acts") exists, it is frequently outdated, and adherence not enforced, or enforced arbitrarily because of weak enforcement agencies. The independence of judicial systems is impaired in many countries and their capacity to enforce contract law seriously inadequate. Weak accounting and internal control systems and inadequate auditing standards continue to be widespread issues. Minority shareholder rights are sometimes denied when the Government is the majority shareholder. Privatization is often externally imposed and not internalized, making implementation difficult and resulting in outcomes that lack transparency, particularly when those responsible for managing privatization programs (often line ministry staff) lack the business expertise to manage them effectively. While stock

exchanges have been established in several countries to facilitate privatization, markets tend to be shallow and illiquid, and the institutional frameworks under which the stock exchanges operate are weak and do not adequately protect the rights of small investors.

The region will continue to address such corporate governance issues in the implementation of ongoing projects and in its future lending and ESW program. The most important vehicles for this purpose in the fiscal 1999–2001 lending program will be projects dealing with privatization and private sector development (Lesotho, Malawi, Uganda, Kenya, Côte d'Ivoire, Togo, Niger, Benin, and Senegal). Projects dealing with private participation in infrastructure in power, telecommunications, and transport utilities and regulatory reform will also be important vehicles in several countries, including Malawi, Uganda, Côte d'Ivoire, Benin, Tanzania, Zimbabwe, and Lesotho. Projects focussing on judicial reform will be supported in Guinea and Sierra Leone building on private sector assessments being carried out under the economic and sector work program. A subregional program to harmonize commercial and corporate laws and accounting standards among 16 countries of West and Central Africa is being supported by the Bank, as is a related program to establish common regulations and standards to facilitate operation of the newly created regional stock exchange for the West African Monetary Union countries.

### **Corporate Governance Issues in the Latin America and the Caribbean Region**

Although problems of corporate accountability are not new, the issue of corporate governance has been ignited in the region by the Mexican, Asian, Russian and Brazilian crises. Beginning in the early 1990s, Latin American countries have taken measures to improve corporate governance as a response to their liberalization and privatization efforts. Countries in the region have taken the

additional steps of improving capital markets, judicial systems, and oversight and management of public enterprises.

Some components of these initiatives include:

- Reforming the banking sector and introducing modern supervision and regulation (Argentina, Mexico, Peru, Bolivia ).
- Strengthening securities law and increasing the supply of securities.
- Judicial reform (Argentina, Guatemala, Peru, Venezuela) Mexico reformed judicial administration (Consejo Nacional de la Juridicatura) beginning in late 1994.
- Improving the efficiency, accountability, and transparency of the financial management of the public sector through implementation of accounting and auditing standards in public enterprises.

These measures have helped to improve the external incentive framework. However, changes in the corporate governance environment , recent events in the Asian crises and in Chilean securities market will prompt LAC countries to update their regime of corporate governance.

There are three main entry points to better corporate governance in Latin America.

#### ***Better information, transparency, and disclosure***

- In terms of reporting financial and accounting information, Latin American countries are generally *tax-driven*. Corporations prepare their financial statements in accordance with accounting principals generally accepted in each country in order to comply with the letter of tax law. Current reporting practices (for example, annual reports and financial statements) do not include additional information such as operations or investment in related parties that would allow shareholders to understand better the firm's activities. Some countries require that information for exchange traded (or listed) companies. Furthermore, nonregistered companies exclusively distribute the infor-

mation to a select group of managers and bank creditors.

- The Bank has made strong efforts to improve accounting and reporting standards of their clients through project compliance with OPM 1002 in line with the international accounting and auditing standards.
- There is evidence that banking supervision has not prevented bank failures, and because of moral hazard, governments (ultimately taxpayers) in the region have met some or all of the costs of these failures. The initial response to banking crises is to seek more regulation and more supervision. This situation creates additional moral hazard and more financial risks. For example, especially in periods of crisis, firms make up their balance sheets and financial statements when they report them to banks. Likewise, banks try to avoid monitoring of their bad loan portfolios by the Superintendency of Banks. Particularly in periods of crisis, firms need to improve the quality of financial reporting. Similarly, domestic banks should improve their monitoring efforts of corporate governance and request externally audited reports.
- Latin American firms will face increasing pressure from better informed stakeholders. These will insist on adequate and timely disclosure of information on corporate activities which is lacking in the region. Colombia is the only country where firms that are not registered in the stock market report financial performance data to a specialized institution. Countries in the region should stress the importance of collecting corporate data regularly and should institutionalize it.
- Under tight credit for emerging markets, Latin American countries will have to compete to attract more foreign direct investment. One way to differentiate themselves could be to provide a greater transparency of financial information and greater accountability of management for prospective investors.

### **Bankruptcy laws**

- In Latin America, bankruptcy laws need to be reformed (Rowat and Astigarraga 1999). The majority of the countries have laws that have not been adapted to the new conditions. In addition, there is a culture of not filing for bankruptcy in the region. Four explanations are provided for this situation. First, many business owners perceive filing for bankruptcy as a sign of failure. In fact, a stigma is attached to the businessman who files for bankruptcy. Second, because of previous government interventions, many businesses have relied on the government to bail out failing industries rather than fostering a “rescue culture” that encourages reorganizations/work-outs through the cooperation of debtors and creditors (and government subsidies to both). Third, creditor rights are weak in the region, so creditors will not choose to incur in legal costs to force a firm to file for bankruptcy, particularly when priority rules discriminate against secured creditors and almost always against foreign creditors. As an example, in the past twenty years no major corporation has been forced into bankruptcy and liquidation by its creditors in Mexico (Heather 1998). A similar situation exists in all the other countries in the region. Fourth, the judicial system suffers from a lack of technical and processing capacity in this area in addition to corruption. Special training programs beyond traditional skill enhancement that are focused on bankruptcy law would be necessary for judges and in some cases, more specialized bankruptcy courts could be useful.
- Some countries have implemented changes in their bankruptcy laws and procedures (Argentina, Colombia, Chile, Costa Rica and Peru). In some cases, the reform shifted the bankruptcy procedures from the traditional judicial system to a credible administrative agency (Superintendence of Companies and Indecopi). Although the reforms are relatively new, results indicate that bankruptcy

cases are being resolved more quickly. These experiences could demonstrate to other countries some useful lessons in dealing with distressed companies.

### **Shareholders rights**

- Being a shareholder of a Latin American corporation does not automatically provide a voice in the way the firm is governed. In Latin America corporations, majority shareholders exercise total control. In contrast to the United States, in Latin America majority shareholders normally do not owe a fiduciary duty to minority shareholders. This is aggravated by the fact that many minority shareholders are not cognizant of their rights such as election of directors and increases in the number of shares the corporation issues. This situation has improved due to privatization schemes that issued shares for the public and employees (Peru, Brazil, Chile, Bolivia, Argentina). As a result, some shareholders have become aware of their rights and are demanding dividend payments from the newly privatized companies.
- Directors and managers in the corporate sector in Latin America sometimes face perverse incentives. They know that judicial systems would not enforce or protect the rights of minority shareholders. There has been very few experiences in which shareholders have attempted to hold directors or managers liable. It is usually the government which initiates criminal actions when fraud has occurred. Countries in the region should consider to introduce regulations relating to board practices and director responsibility.
- Ownership of the corporate sector is highly concentrated by a small number of economic groups, for example, families and banks. For that reason, the rights of minorities are limited. Brazil and Mexico are the only countries that have made proposals on a Code of Best practices for private compa-

#### **Box 4 Mexico integrates its securities market with other North American markets**

Since the late 1980s the Mexican securities market has evidenced a greater and greater degree of integration into the much larger market of its North American trading partners (United States and Canada). Privatizations of major industries, particularly of the banking sector, were followed by public and institutional offering of equity securities in U.S. and global markets. Today, the bulk of the market capitalization of the Mexican Stock Exchange (Bolsa Mexicana de Valores—BMV) trades (through American Depository Receipts) on the principal U.S. stock exchanges. Indeed, one of the most active shares on the New York Stock Exchange is the Mexican telephone company, Telmex.

In order to comply with U.S. securities law requirements and market expectations, Mexican issuers in the international markets had to improve substantially their accounting and disclosure standards. The greater disclosure typically provided to foreign investors in English-language offering documents and periodic reports sparked demands for more detailed disclosure to be provided to domestic investors. It also contributed to more rapid convergence of U.S. and Mexican accounting standards.

However, there has been much slower convergence with respect to corporate governance practices. Most listed Mexican industrial and financial

firms remain effectively controlled by families or small groups acting in concert. Some very important firms have a large portion or a minority of their equity in the form of limited or nonvoting shares. Neither the Securities Markets Law nor the rules of the BMV impose special corporate governance requirements on listed companies. However, in response to recent domestic and international debate over corporate governance in Mexico (particularly after the banking debacle of 1994/5), the private sector Business Coordinating Council, in collaboration with the National Banking and Securities Commission (Comisión Nacional Bancaria y de Valores—CNBV) has issued a voluntary corporate governance practices code. Although compliance with the Code will be strictly at the discretion of issuers, each issuer will be required under CNBV regulations to describe in its disclosure documents the degree to which its practices conform to those recommended in the Code. The Code addresses the functioning and composition of the Board of directors, including recommendations respecting finance, audit and compensation committees. Other specific provisions are expected to cover: limiting the number of directors to less than 15, cumulative voting, independent directors, and personal liability of directors for corporate disclosures.

nies (see annex 4b). The next challenge is how to enhance the influence of different stakeholders (creditors, suppliers, employees, and customers).

#### **Current work**

The recent widespread financial crises, low commodity prices, macroeconomic imbalances, and credit rationing in the region have induced countries to request funding from the Bank to meet current account deficits and public sector imbalances. The Colombian government requested a US\$500 million Financial Sector Adjust-

ment, which would put in place a comprehensive structural and institutional reform measures, including improved deposit insurance and bank failure resolution mechanisms, and reform and privatization of state-owned banks and cooperatives. Ecuador has also requested a US\$150 million for a Financial Sector Adjustment Loan, to address current inadequacies in the process of resolution of problem banks and associated institution building needs. Argentina received a special package (SSAL) approved in November 1998. The funds from the SSAL were to be used by the government to meet its financial com-

mitments from end-1998 to about mid-1999, while protecting and improving its social programs, strengthening the financial sector and capital markets and increasing regulation. Some issues to be covered include the reform of the legal and supervisory framework for insurance, coordination of regulatory agencies in the financial sector and access to credit for small enterprises. World Bank and IFC are assisting OECD, and the Brazilian CVM, Banespa, and IBGD to organize a regional roundtable on corporate governance for policy makers in the major Latin American markets. COSRA, the Western hemisphere association of securities regulators, has also put corporate governance initiatives on the top of its agenda for 2000.

### **Corporate Governance in the East Asian and Pacific Region**

A host of factors have been cited as causes of the East Asian financial crisis, but none as consistently as the prevalence of poor external and internal corporate governance practices. These included a weak legal and regulatory environment that exercised insufficient control over corporations in product, labor, and financial markets; insufficient disclosure and transparency; inadequate accounting and auditing standards and inconsistent practices; concentrated ownership and minimal protection of minority shareholder rights; lack of oversight of management; and limited role of supervision of the financial sector. These practices contributed to overinvestment in nonproductive resources and overcapacity, untenable financial leverage, overexposure to foreign short term borrowings, and so on. The crisis has underscored the need to improve corporate governance as a fundamental part of the structural reforms necessary to rebuild confidence and competitiveness in these countries' corporate sector and as the backbone of the new financial architecture.

With some degrees of difference, by and large, the East Asian economies share the following characteristics:

- High concentration of ownership and control by families or corporations that led to governance structures enabling the dominant shareholder to make key decisions without consideration of minority shareholder rights. Generally, the appointment of directors was entirely in the hands of the main shareholders, with a high degree of conflict of interest of the dominant shareholder/manager and often at the expense of the minority shareholder. Remedies for violation of shareholder rights were not sufficient and well enforced.
- Existence of cross guarantees and linkages between corporations which resulted in huge conglomerates with interlocking ownership. Added to this problem was the lack of consolidated accounting which made it nearly impossible for outsiders as well as insiders to assess the extent and structure of the corporation's risk exposure.
- Cozy relationship between the government, the corporate sector and the banks which encouraged subsidized borrowing. This strategy appeared to be a successful strategy for a long period of time and allowed these corporations to grow and expand markets by having preferential access to credit. Ultimately, it resulted in the perception of implicit guarantees, moral hazard, and over leveraging of the corporate sector. It further stifled the development of the equity markets, as debt financing was considerably cheaper.
- Weak supervision of the financial system and neglect in exercising corporate governance within financial institutions. Since scrutiny from equity markets is generally more rigorous, the lax standards of the banking sector further pushed the corporations to rely on debt financing instead of accessing equity markets. Increasingly, funds available through the banking sector were of short term nature, which exposed the corporations to external and cyclical shocks and increased systemic risk in a globalized financial market.

- Inadequacy of laws and regulations governing the entry, operations and exit of corporations, such as bankruptcy, reorganization, or take-over laws. Even in cases where laws existed on the books, the inadequacy of the institutional infrastructure, such as availability of experienced judges and other professionals, impeded enforcement and made these laws practically meaningless. Also contributing were weak accounting and auditing standards, practices, and professions that reduced the transparency and reliability of financial reporting.
- Inadequate competition and relative closeness of the economies to foreign investors. This reduced further the disciplining potential of the market and the role that foreign investments could play as governance agents.

Given the long track record of the Asian economic miracle, these inherent systemic weaknesses were largely neglected. However, since the crisis, the governments across the regions have become more aware of such underlying weaknesses and have introduced a number of fundamental reforms to address the issues raised above (box 5).

#### ***The Role of the World Bank***

The crisis has given the Bank and the countries most affected by the crisis a renewed opportunity to tackle some of the tough structural issues in the financial and corporate sector. The Bank has focused on two broad activities with the objective of addressing systemic problems, minimizing the cost to the taxpayer and reducing the chances of recurrence. First, the need to address wide-spread and large scale corporate insolvencies which have had serious social costs in order to enable viable companies to resume operations and nonviable ones to an orderly exit. In the aftermath, Bank assistance in these countries is likely to change the structural make-up of the corporate sector and break-up of conglomerates through reduction of cross holdings and cross-guarantees, liberalizing the economy

through improved competition laws, greater transparency, developing accounting and auditing standards, and supporting legal and regulatory reforms. These impact mostly what is called “external” corporate governance. Second, Bank activities focused on strengthening the “internal” corporate governance measures, such as specific provisions to improve corporate governance such as strengthening the role of the Board of Directors, strengthening minority shareholder rights, audit committees, and so on.

#### **REPUBLIC OF KOREA**

- Establishment of a framework for corporate debt workouts led by creditor banks under guidelines established by the FSC and aligned to financial sector restructuring. The work-out process is supported by policies to limit “emergency” loans; reduce cross-guarantees; facilitate debt-equity swaps, asset sales, and mergers and acquisitions; remove tax disincentives; and improve the legal and regulatory enabling environment.
- Strengthening of the responsibilities, independence, and accountability of corporate boards, and enhancing the rights of minority shareholders and institutional investors.
- Enhancement of creditors’ rights through improvements in insolvency laws focusing on expedited procedures (including prepackaged work-outs) and in laws on secured lending.
- Adoption by financial institutions and corporations of accounting, auditing, and reporting standards consistent with international best practices, introduction of audit committees of boards of directors, and enhancement of the role of independent professional bodies in standard setting and regulation in accounting and auditing.
- Enhancement of competition through strengthening the Fair Trade Act and its enforcement; ensuring a competitive framework for *chaebol* restructuring; further liberalizing foreign investment; simplifying



### Box 5 Corporate Governance Reforms in East Asia

The crisis in East Asia has highlighted the importance of corporate governance in fostering sound economic development. Policymakers responded by proposing a number of reforms to strengthen the framework for good governance.

*Republic of Korea.* Corporate governance reform in Korea is being tackled through better legal and regulatory support, financial and capital markets regulation, improved competition policy and corporate restructuring: starting this year, Korean accounting standards will be adjusted to comply with International Accounting Standards and the largest conglomerates will issue consolidated financial statements accounting for all their subsidiaries; in order to improve management accountability, the government has lowered the minimum equity-holding required to file a shareholder resolution, inspect the company's books and initiate legal action against a director; the Korean Stock Exchange now requires that all publicly traded companies have at least one nonexecutive board director, a requirement which will increase to 25% of board seats in 1999 (over 600 outside directors have already been named to serve on Boards of publicly traded companies in Korea).

*Thailand.* Thailand has taken a number of steps to improve corporate governance practices as part of a corporate restructuring program, including reforms in the tax, legal and regulatory environment to encourage restructuring, more credible court-supervised insolvency procedures, improvements in capital market institutions and better corporate disclosure. The government has announced that, starting in 1999, the financial statements of public companies, banks and financial institutions with assets in excess of 1 billion baht must be prepared in accordance with international best practices. The Stock Exchange of Thailand now requires listed companies to form an audit committee on the Board to review internal and external financial reporting and independent auditing. The Stock Exchange of Thailand also has identified corporate governance as a central part of its future strategy, Vision 2003.

The Exchange barred over a dozen former executives from ever serving as chief executive officers or directors of a publicly traded company based on their past negligence of governance responsibilities.

*Malaysia.* Structural reforms, including policies to improve competitiveness by strengthening corporate governance and enhance transparency and disclosure, have been announced by the Malaysian government. It also plans to strengthen the financial sector through consolidation of finance companies and recapitalization of viable banks. Malaysia has also been asked by the Asian-Pacific Economic Cooperation (APEC) finance ministers to draw up a code of corporate governance practices that could be used as a benchmark for other member countries. In addition, Malaysia has created a High-Level Finance Committee on Corporate Governance to establish best practices, the role of independent directors, increased transparency and disclosure, and better training and education programs for management and directors.

*Indonesia.* The government of Indonesia is continuing its work to develop strong capital markets and is pursuing a series of structural reforms to re-establish economic growth. In order to improve disclosure, the regulatory authority BAPEPAM mandated that every publicly traded company name a corporate secretary to ensure proper communications and disclosure to investor and the public. BAPEPAM is currently reviewing potential changes in securities regulation in Indonesia which may involve an expanded role for independent board members and external auditors. Discussions are also underway toward developing a code of best practice in corporate governance by a committee that includes leaders from the public and private sectors. Legal liabilities for board members were also strengthened to increase accountability and responsibility and the Jakarta Stock Exchange has announced its intention to hold a series of workshops on corporate governance for managers and board members of listed companies.

customs and certification procedures and removing restrictions on the establishment of holding companies.

- Improvement of the regulatory and institutional framework to support the Government's program of privatization and SOE reform, especially in the infrastructure sectors.

#### **THAILAND**

- Corporate sector restructuring, such as encouraging debt restructuring, debt-equity swaps, mergers and acquisitions, securitization of as a means of divestiture of problem assets.
- Reform of several key pieces of legislation governing such areas as insolvency and foreclosure, enterprise reorganization, improvement of enforcement of commercial contracts and legislation.
- Financial accountability by improving listing rules of companies on the Stock Exchange, such as requirements for an audit committee, independent directors on the board of directors, guidelines on the functions and responsibilities of listed company directors, strengthening of private professional bodies, such as the accountancy and auditing profession and adaptation of international accounting standards.
- Public enterprise reform and corporatization of several enterprises for eventual divestiture.
- Expeditious exit of nonviable firms and rehabilitation of insolvent but viable companies.

#### **MALAYSIA**

- Strengthening and enhancing the efficiency of the securities industry and protecting investors by promoting mergers and branching of existing industries in the industry. In addition, the Securities Commission has proposed requirements on risk based capital adequacy for brokers and asset managers that mirror very closely those of the European Union.
- Enhancing transparency by requiring a higher quality of disclosure and greater frequency

of reporting. The accuracy of financial data will be enhanced by requiring companies to comply mandatorily with the standards and guidelines established by the Malaysian Standards Board and the financial reporting foundations.

- Protecting minority shareholders.
- Facilitating market-based corporate restructuring.
- Competition policies.

#### **INDONESIA**

- Strengthening of corporate disclosure and governance mechanisms through new disclosure standards, particularly for firms undergoing reorganization.
- Modification and strengthening of bankruptcy laws to facilitate the reorganization, restructuring, or liquidation of companies.
- Establishment of special purpose institutions.
- Provision of special support for small debt holders.

#### ***Future Policy Direction***

Ultimately, the sustainability of these reforms will depend on the institutional infrastructure within these countries to enforce the rules on a consistent and fair basis, and a gradual but firm culture change. Several developments will help move in that direction.

First, the corporate governance infrastructure will have to be developed. This will include developing a strong cadre of directors, auditors, regulators, and other professionals who understand their role and exercise their responsibilities within the system. It will require significant investment in training and recruitment of competent and ethical individuals, as well as enforcement of the rules in a timely and fair manner.

Second, the increased vigilance on banking sector oversight will undoubtedly reduce the access of corporations to expand with debt financing only and push them into the equity markets. Given the initial thinness of equity markets in these countries, many corporations

will have to either open up to foreign investors or list on external stock exchanges. Both these forces will increase the need for greater transparency and adherence to international accounting/auditing standards and listing requirements. Just to mention one example, the adoption of the accounting practice for consolidation will have an immense impact on disclosure of cross holdings and size of conglomerates. Many of the East Asian countries have already or will adopt shortly the full extent of this requirement.

Last, the push toward greater corporate governance will be a demographic one. Falling birth rates and increasing life expectancies will heighten the pressure to develop retirement funding for the elderly without resorting to taxing the young. Increasingly, governments are considering developing defined contribution schemes that are controlled by individuals or private entities. In the

United States/United Kingdom, pension funds have become the key drivers for improved corporate governance, and shareholders representative groups have become vocal in the debate. By contrast, Japan and continental Europe, pension funds, which still run on defined benefit options, thus far have played a less influential role in corporate governance with management focusing on sales and assets. This rapid expansion in small-scale population will not only push for greater corporate governance but also for societal attitudes as the impact of good economic policies and globalization becomes increasingly obvious to a wider cross-section of the community. The development of long term contractual savings institutions is an important pressure point in ensuring long-term sustainability of corporate governance reform, development of equity and debt markets, and in the provision of long term “patient” financial resources.

# Corporate Governance in the United Kingdom, Germany, and Japan

### **Corporate governance in the United Kingdom**

Corporate governance in the United Kingdom is encouraged by a loose framework of law elaborated in the 19th century and by a wide range of detailed listing rules issued and updated regularly by the main stock exchange and supplemented by a number of “best practice” codes that have evolved since a committee chaired by Sir Adrian Cadbury met in 1991–92. The last of such codes was issued in a report from a group chaired by Sir Ronnie Hampel in 1998. Although this mix of laws, regulations, and best practice codes appears complicated, it has provided an innovative and flexible environment in which to improve standards of governance. The U.K. government is currently reviewing the framework as part of a comprehensive review of company law, which will result in new recommendations for the year 2003.

#### ***The legal framework***

U.K. law for governance is established mainly by the Companies Act which was first set out by

Parliament in the 1840s. Companies have a single board of directors elected by shareholders, who also appoint auditors every year. Shareholders have other important rights: to convene company meetings if they hold 10 percent of the votes and to put forward resolutions if they hold either 5 percent of the votes or 100 votes combined with a minimum holding of £10,000.

Shareholders also have the power to remove directors or field their own candidates. Normally, an ordinary resolution will do for both, and requires no qualifying holding. This framework governs all companies, from the smallest grocery store to the largest multinational that are listed on the stock market. Although the law is detailed in its provisions for shareholders, little is said about directors. The law simply requires that companies have a minimum of two directors. There is no formal distinction under the law between the duties of executive and nonexecutive directors.

#### ***The regulatory framework for governance***

The regulatory framework for corporate governance in the United Kingdom is mainly direct-

ed toward companies that have raised capital through a public listing. Listed companies dominate the U.K. economy, with investors ranging from 10 million private individuals (who collectively hold 20 percent of those shares) to major institutions that provide retirement, health, and housing for well over half of the population. The London Stock Exchange is authorized under the Financial Services Act 1998 as the Competent Authority to issue rules (set out in the Yellow Book) but is limited in its liability to either monitor or enforce those rules.

Stock exchange rules have strict provisions to ensure that controlling shareholders and directors cannot exploit their position of power to the detriment of the economy. The rules set out a definition of independent (executive and nonexecutive) directors: they must not be connected to controlling shareholders. Similarly, directors are required to follow detailed guidelines on disclosure and proper conduct in a “related party transaction” and are not allowed to trade shares for a limited period of time before announcements are made to the market (about either price-sensitive information or financial results).

### **Best practice codes**

The Cadbury Code’s aim was to identify best practice rather than try to invent it. The Cadbury committee also took evidence from a wide range of parties on its draft proposals and issued a code of best practice for companies, their auditors, and shareholders to consider. The Code focused particularly upon financial reporting and controls as required, but also addressed a number of issues becoming important in public debate, such as directors’ remuneration. The Code consolidated best practice as it had evolved at leading companies, investor groups, and advisory bodies, and significantly helped widen support for governance through smaller companies and across the listed market. Central to this support, as the committee recognized, was the stock exchange’s support for its advice through the list-

ing rule requiring that listed companies give shareholders the information they need to see how a company’s governance structure and practice is organized.

The formal successor body to the Cadbury committee, established in 1997 and chaired by Sir Ronnie Hampel, had a broader remit: to consider not just financial reporting and controls but other important issues, such as the role of shareholders and how much effective corporate governance could improve performance. The Hampel report, issued in 1998, effectively consolidated the Cadbury and Greenbury advice into a Combined Code, which also reflected two new interests: the role and responsibilities of institutional investors and directors’ responsibilities to stakeholders. U.K. companies are reporting under the Combined Code on Corporate Governance for the first time in 1999.

### **Corporate governance in Germany**

The German system of corporate governance has been more than a hundred years in the making and is still evolving. It reflects a different concept of the company’s role, as being both social and economic. The basic law speaks of the “public weal.” Historically banks are more important than the stock market as an external source of corporate finance in Germany. “Hausbanks” (the company’s lead bankers) often hold seats on the supervisory boards of their customers, reflecting the concept of Universalbanken, banks as providers of a wide range of services. Banks holding sizable stakes in many companies could appear to create conflicts of interest. Technically most shares are held in bearer form, meaning that shares have to be held by authorized depositories—generally banks, which are subject to the law and the expressed wishes of the shareholder. Since the early 19th century there has been a two-tiered approach to shareholder monitoring, involving a supervisory board (Aufsichtsrat) with 6 to

20 members, which can dismiss executive board members only with a two-thirds majority. The introduction of “co-determination” after 1945 gave employees representation on the supervisory board. The addition to the board representation for employees and unions—mandatory once the firm has more than 500 employees—employees have a voice through works councils, in which they have defined rights to information and consultation. Corporate management is entrusted to a group—the *Vorstand*—rather than to an individual (except in small companies) and members of the group have secure tenure. In practice, the group elects a leader—the *Sprecher*—who is first among equals. Some *Sprecher*s, by force of personality, become more dominant than others, but even so the “gap” between them and fellow members of the *Vorstand* is smaller than the gap between the board and a CEO or PDG in a comparable U.K., U.S., or French company. There tends to be a powerful, even dominant, shareholder. German culture is opposed to “hostile” takeovers, although there are plenty of “friendly” mergers. The voluntary takeover code published January 1, 1998, by the Commission of Experts on the Stock Exchange had a mixed reception. Accounting conventions are opaque by U.S. standards, and Germany’s typically cautious approach permits the building up of hidden reserves.

### **Practice**

Firms in Germany can take a variety of legal forms, but the most common are *GmbH*, or unlisted companies and *AG*, or listed companies. There are about 360,000 unlisted companies—often but not necessarily small. In 1993 there were only 478 listed companies in Germany’s large economy. Much of the country’s economic success had rested on unlisted medium-size enterprises—the so-called *mittelstand* companies. Recent years have brought significant changes because the postwar founders are reaching retirement age and they or their successors

are coming to the capital markets for all the usual reasons. By 1998 there were 650 listed companies in an active and vigorous small-company market. Another 150 are due for flotation this year.

German practice is to allocate the management function to a board (the *Vorstand*) or, in small companies, to a manager (the *Geschäftsführer*). Shareholders have two opportunities to protect themselves: through the *Aufsichtsrat* and through their power in the general meeting to change its membership. Management does not have to deal directly with shareholders but is appointed and can be dismissed by the supervisory board for cause. Many companies do not have “one share, one vote” but an arrangement designed to give the founding family special voting rights or to limit the rights of others. There is an annual general meeting for shareholders.

The supervisory board meets quarterly at most and has a limited but important range of authority. Formally, it selects the *Vorstand*, but in practice its composition is often influenced by the *Vorstand*. The strength of the system is the clarity of the division between enterprise and accountability; its weakness is that the supervisory board may know too little and act too late. In practice, the banker’s role is important. Because of the banks’ variety of interests and contacts, banks have considerable influence—which, however benign, has often attracted criticism.

### **Recent trends**

The German approach is to look to the law (not voluntary codes) to govern structure and process, notwithstanding the recently published DSW guidelines (1998). The recent law on control and transparency (the *KonTrag* law) is a case in point. It requires the *Vorstand* to install a control risk management system, for example, and to tell the supervisory board in detail about future policies and the planning schedule for personnel, production, investment, and finances. It also requires more information in the election material for members of the supervisory board

and changes some of the rules about auditors, to ensure their independence and sharpen their role (they will, for example, be obliged to examine the management's presentation of company risks).

There have been changes, too, in shareholders' voting rights. Over a five-year period "one share, one vote" will become the rule. Moreover, the rules governing the banks' rights and duties to vote the shares deposited with them have been tightened by the KonTrag law and the number of bank representatives on supervisory boards has been diminishing. The picture is one of increasing concern for shareholders' rights, greater shareholder activity and protection, and greater attention to international concerns, which is why companies will soon be free to use international accounting standards, such as GAAP or IAS. The tendency of German companies to have more plants overseas is gradually affecting the composition of the employees' component on the supervisory board. So is the impact of a growing number of foreign strategies and institutional investors in German companies. In many cases, minorities appear to be poorly protected.

### **The Japanese financial *Keiretsu*—good governance or double jeopardy?**

Most Japanese corporations are affiliated with a financial *keiretsu*. This arrangement is characterized by extensive intra-group trade; complex cross-holdings of equity and debt; a group's main bank having a strong role in corporate borrowing, managerial decisions, and choice of CEOs; and heavy financial leveraging. Some have argued that this interlocking of equity—which accounts for between 65 percent and 75 percent of voting stock—frees management from an overpreoccupation with the short-term bottom line, and allows it to focus on longer-term investment and growth. The fact that the main bank is the group company's largest creditor and a substantial equity holder has also been cited as the reason for the

apparently excellent monitoring of Japanese companies. The argument is that the close dance between debt and equity sharply reduces agency costs, raising corporate values in good times and mitigating costs in times of distress.<sup>1</sup>

The data to support the argument do not extend beyond the late 1980s and there is nothing to suggest that the conclusions are incorrect. But if close dancing between debt and equity was so good for Japanese governance until the late 1980s, how can one explain the spate of corporate bankruptcies and colossal banking failures in 1997–98? Were there other factors at play? Or did a rapidly appreciating yen expose the Achilles heel of close dancing?

Today, the balance of evidence suggests that the *keiretsu*—main bank system placed companies in double jeopardy. The main bank encouraged excessive leveraging and investments in highly risky areas, something that might not have happened if funds had been obtained from independent banks that followed prudential norms for arm's length lending. Moreover, although the complex system of cross holding equity prevented hostile takeovers, it also militated against a healthy market for corporate control. Cross-holdings also seem to have a realistic understanding of the return on net worth of each company.

These factors might have remained hidden from view if the yen had not appreciated the way it did between 1990 and mid-1995, hurting Japanese competitiveness, severely squeezing corporate cash flows, and increasingly exposing the downside of leverage-driven growth. Up to a point the financial *keiretsus* and main banks could deal with the problem in their usual way: support the company with managerial resources, reschedule debt, and pump in more debt loans, when needed. By 1997, the risk spilled over, leading to corporate bankruptcy and then large scale sickness in the financial sector. Today, there is an estimated \$700 billion in nonperforming assets on the books of Japan's main banks.

Is there a single prescription for the problems of corporate governance? The consensus is no. Solutions depend on a mix of several elements: ownership structures, the strength and enforceability of contracts, the competitive environment, the relative powers of shareholders and debtholders, the legal system, and relevant institutional capacity. As the report to the OECD observed, "Corporate governance practices vary and will continue to vary across nations and cultures. . . [These] will also vary as a function of ownership structures, business circumstances, competitive conditions, corporate life cycle and numerous other factors."<sup>2</sup>

## Notes

1. See Hoshi, Kashyap, and Scharfstein (1990a and 1990b), Lichtenberg and Pushner (1994), Prowse (1990, 1992, and 1996), and Roe (1990 and 1993).

2. The Report of the Committee on the Financial Aspects of Corporate Governance (or the Cadbury Committee Report 1992) was in response to the BCCI and Maxwell scandal. The recent report to the OECD (1998, p. 13), *Corporate Governance: Improving Competitiveness and Access to Capital in Global Markets* explicitly recognizes the episodic nature of corporate governance codes: "Corporate governance tends to gain public attention when performance problems are apparent, both at national and company levels." For a complete listing of Corporate conduct codes, see annex 4b.



# Improving Management Oversight by the Board of Directors

## The role of boards of directors

A universally accepted principle of corporate governance is that a board has a fiduciary role. Equally, directors must control the efforts of the board with due enterprise and integrity. As elected representatives of the shareholders, the board is expected to use its integrity and capability to vet corporate strategies, policies, plans, and major decisions, and to oversee and monitor management in the interests of the shareholders and society. Therefore, the key to good governance of any modern corporation is an informed and well functioning board of directors.

However, there are far too many instances where corporate boards either have no professionally competent independent directors, or where executive directors form the overwhelming majority. The excuses are similar: either independent directors do not know the business, or there aren't enough people who fit the bill and have time to serve. Quite often, gray outsiders are appointed instead of truly independent directors.<sup>1</sup>

In practice, too many boards have been mere "ornaments on a corporate Christmas tree" as a

### Board best practice

It is the duty of the board to meet often enough to set the business strategy of the company. Best practice suggests that:

- The board should meet no less than four times in any given financial or calendar year, with at least one meeting per quarter.
- Board members should set their agenda well in advance so that they have time to be conversant with the issues by timely dissemination of meeting papers and reports.
- Well-performing boards tend to have specialized committees on detailed monitoring, advisory, and oversight tasks, such as financial audit; remuneration of executives and senior managers; environmental, health, and safety compliance; and executive search. These committees should confer greater quality on the stewardship and fiduciary responsibilities of the board.
- Ensure that not only the board, but the company and its employees operate ethically.

landmark study of boards by Harvard Business School Professor Myles Mace once put it—decorative and decorous baubles with no real purpose.... Somehow, directors forgot—if they ever knew—that they were in the board room to act on behalf of shareholders... Only when the directors were prodded by investors and activists, only after their companies and CEOs were publicly pilloried, were many finally goaded into action—what some call “governance by embarrassment” (*Business Week*, November 25, 1996, 82).

The last fifteen years, however, have seen changes for the better. More people understand that a board consisting wholly or largely of management cannot minimize agency problems. Companies in which shareholders (and sometimes secured and senior creditors) have exercised appropriate control over management have recognized that a board’s ability to successfully discharge its fiduciary obligations hinges upon having a core group of professionally acclaimed independent directors. For example, PRO NED (Promoting Nonexecutive Directors) was set up in the United Kingdom to persuade British companies to add enough able nonexecutive directors to their board to achieve a critical mass. Its rationale for independent nonexecutive directors is worth quoting.

The purpose of appointing nonexecutive directors is first to provide the board with knowledge, objectivity, judgment and balance which may not be available if the board consists only of full time executives; and secondly to ensure that the performance of the executive directors and the management of the company are up to the standard required. (PIRC, *Nonexecutive Directors in FTSE-350 Companies: Assessing Independence*, January 1998, 6)

Independent directors need to bring their special expertise and knowledge to bear on the strategy and enterprise of the company. They

### Independent directors

Minimum attributes of an independent director:

- Should not be a former executive and must not have a professional relationship with the company (for example, represent the company’s audit or law firm, or be one of the consultants).
- Should not be a significant customer or supplier.
- Should not be recommended or appointed on the basis of personal relationships.
- Should be selected by a formal board process.
- Should not be a close relative of any executive director.
- Should not hold a major share stake or represent any major shareholder.
- Should be an active participant on the board, not passive.

Professional capabilities of an independent director:

- Should know how to read financial statements and have some knowledge of various company laws, except for those who are invited to join the board as experts in other fields, such as science and technology, human resource development, the environment, or other areas germane to the company business.
- Should familiarize themselves with the operations of the company and the milieu in which it operates.

Nonexecutive directors should meet the above-mentioned criteria for independence and should ideally account for no less than a third of the board for a publicly listed company.

*Source:* Culled from the Cadbury Committee Report (1992), ICS “Role and Duties of Directors” (1991 and 1993), PRO NED “Recommended Practice on Nonexecutive Directors” (1993), and PIRC “Shareholder Voting Guidelines” 1996).

must bring an independent judgement or issues of conformance and performance. Independent directors must be of sufficient caliber that their views will carry significant weight on the board regardless of whether or not the Chairman is an elective or nominative director. Nonexecutive directors have to be independent enough not to avoid contentious issues, and professional enough to assess them properly.

It does not mean that companies with proficient independent directors with strong boardroom voices will immediately do brilliantly in the market—just as it is not the case that all companies with executive-stacked boards invariably sink. It is important to recognize that even the best performers risk stumbling some day if they lack strong and independent directors. And there is evidence of correlation between independent directors and higher corporate value. *Business Week* shows that the best boards tend to be dominated by independent directors and such companies also have higher than industry average annual returns. Millstein and MacAvoy (1998) use a sample of 154 large, publicly traded U.S. corporations and show that companies with active and independent boards have performed much better in the 1990s than those with passive, nonindependent boards.

In the United States and many parts of Western Europe, there is a growing trend toward independent directors. Until the mid-1980s, the boards of British companies were packed by friends and looked like closed-door clubs. Insti-

tutional investors have brought about a sea of change, as table A3.1 shows.

Despite this trend, many countries are not in a position to induct independent, professionally competent nonexecutive directors. For instance, Japan's corporate governance forum appreciates the need for such persons to enhance the effectiveness of boards, but admits that widespread cross-holding of shares has resulted in an insufficient supply of people with these attributes.<sup>2</sup>

In a world that is integrated by global capital flows, international institutional investors will increasingly call for more independent nonexecutive directors on corporate boards. To the extent that companies need to access global finance, they will have to acquiesce to this demand.

The need for independent nonexecutives is clear. What should be the desirable mix between executive and nonexecutive directors on a board? In the United States and in the United Kingdom, the consensus is that at least majority of the board should consist of nonexecutive directors, more so if the chairman is also the CEO or managing director.

### Limits on directorships

Getting the right type of director is one way of ensuring diligence. It has to be buttressed by the concept of limitation. People can't be expected to hold nonexecutive directorships in a plethora of companies and yet diligently discharge fiduci-

**Table A3.1. The increasing prominence of nonexecutive directors in the United Kingdom**  
(percent)

	1993	1996
Nonexecutive directors < one-third of the board	13.6	6.2
Nonexecutive directors < half of the board	34.0	26.0
Share of nonexecutive directors	50.2	53.9
Independent nonexecutive directors (as percent of total nonexecutive directors)	57.4	68.5
Independent nonexecutive directors (as percent of total directors)	28.8	36.9

Note: Sample size, FTSE-350.

Source: PIRC 1998.

ary obligations and duties. The view of 1,000 directors and chairmen of U.S. corporations was that directors should not serve on more than an average of 2 to 3 boards (*Business Week*, November 25, 1996, 104). In November 1996 a panel of 30 corporate governance experts co-opted by the U.S. National Association of Corporate Directors (NACD) issued two guidelines:

- Nonexecutive directors should budget at least four full 40-hour weeks of service for every board on which they serve.
- Senior executives should sit on no more than three boards, including their own. Retired executives and professional nonexecutive directors should serve on no more than six.

Unfortunately, such norms are not met in most countries. Multiple directorships prevail in Japan where large numbers of group companies interlock their shareholdings and board positions. In Germany, with its two-tier boards, the chair of a supervisory board—typically the chair of the company’s lead bank (*hausbank*)—often holds directorships in many companies.<sup>3</sup> Not surprisingly, very few codes of corporate governance stipulate such a number. Even so, active institutional investors have created an awareness that holding too many directorships is inimical to good governance. The California Public Employees’ Retirement System (CalPERS), one of the world’s largest pension funds, has been keeping a close watch on the independence of nonexecutive directors and the number of board positions that they hold—as has PIRC in the UK, which represents over £300 billion worth of British pension funds. Both recommend voting against the nomination of directors who hold too many board positions. If listed corporations wish to attract international funds, they should ensure that their directors do not hold more than five to six directorships. In many countries, this will be difficult to achieve in the short run, but it should be a medium-term objective in the interest of good governance.

## Essential information for the board

The effectiveness of nonexecutive directors depends on the quality of information available to the board. In many countries companies have considerable expertise at hiding key information from nonexecutive directors. Agenda papers are either very thin or strategically voluminous, often arriving just a day or two before the board meeting. To ensure that “independent oversight” has meaning, certain key information must be placed before the board and form part of the agenda papers.

### Information for the board

- Annual operating plans and budgets, together with updated long term plans.
- Quarterly results for the company as a whole as well as business segments.
- Tax audit and internal audit reports.
- Default in payment of interest or nonpayment to any class of creditor.
- Major capital expenditure proposed.
- Any issue that involves possible public or product liability claims of a substantial nature.
- Any deviation from the agreed policy or strategy.
- Environmental, health and safety issues of significance in terms of cost and regulations.
- Disclosure of share dealings by directors in the company’s shares.
- Disposal of investments that are of material nature.
- Details of joint venture agreements.
- Actual or potential labor and employee problems and their proposed solutions.
- Quarterly details of foreign exchange exposure, their tenure, the extent of exchange rate cover, and the steps taken to limit the risks of adverse exchange rate movement.
- Security analysts’ comparisons of the company and others in the same industry.

Most international codes of corporate governance insist that the information to be supplied to the board must be sent reasonably in advance to allow nonexecutive directors sufficient time to review the issues contained in the agenda papers and, if necessary, to make their own independent inquiries. Very few, however, specify what constitutes “minimum” information (see “Information for the board” box for a suggested list).

### Board-level committees

Today’s complex business corporations cannot be governed by only four or six general board meetings a year. Governance requires specialized skills that are best exercised through board level committees. In general, these are:

- *Executive Committee*, for day-to-day management supervision.
- *Audit committee*, supervises a company’s internal audit procedures and interacts with the external statutory auditor to ensure full financial compliance with the law and regulations governing accounting standards and financial reporting.
- *Executive remuneration committee*, decides the appropriate compensation package for the company’s executive directors and senior managers.
- *Nomination committee*, conducts a systematic search for appropriately qualified, independent nonexecutive directors.

Terms of reference for these committees must be clearly defined. These three committees are the minimum expected by institutional investors in large, publicly listed companies. Many corporations in the United States, United Kingdom, and elsewhere go beyond this list. Increasingly, large multilocation chemical, oil exploring, refining, and transporting companies and mining conglomerates also have Environmental Safeguard Committees. Others have committees that ensure compliance with corporate governance standards.

### Board-level committees

Listed companies should have at least three board-level committees: audit, remuneration, and nomination. Companies with potential environmental risks must also have an environmental compliance committee, consisting of only independent nonexecutive directors.

- The *audit committee* should consist of at least three members, the majority of whom must be independent, nonexecutive directors. It should provide effective supervision of the financial reporting process, and assist the board in fulfilling its functions related to corporate accounting and reporting, financial and accounting controls, and financial statements and proposals that accompany the public issue of any security. Members must be fully conversant with corporate finance, accounting procedures and those aspects of corporate law that are germane to preparing annual, half-year, and quarterly accounts. They must regularly interact with the company’s internal auditor or chief financial officer and be available to the statutory external auditors. They should have the professional ability to sign a compliance certificate which states that all proper financial, accounting and internal auditing procedures have been met by the company.
- The *remuneration committee* should also consist of at least three members, all of whom must be independent, nonexecutive directors. This committee should set compensation packages reflecting industry trends and the company’s own financial state.
- The *nomination committee* should consist of at least three members, of whom the majority should be independent nonexecutive directors.

Typically, neither the audit nor the remuneration committee should have as a member any executive director or at least should have a majority of nonexecutive directors. Nothing

suggests that only nonexecutive directors should man nomination committees. However, even here, the committee should have a majority of independent nonexecutive directors to ensure that gray outsiders do not slip in as independent directors.

### **Directorial and board performance**

The board of directors should periodically assess its performance as a collegial body as well as the performance of individual directors.<sup>4</sup> Second, a committee of the board consisting of independent, nonexecutive directors should evaluate the performance of the company's CEO, other executive directors, as well as the role of the CEO.

Evaluating directors is important to the long-term success of corporate governance but is bound to have considerable disfavor because there are no clear-cut objective criteria for conducting such a review. There is, however, a bare minimum benchmark for underperforming nonexecutive directors: attendance at board and committee meetings.

There is a more uniform consensus about the board formally evaluating the performance of the CEO, other executive directors, and the senior

### **Review of CEO and senior management**

Independent nonexecutive directors must review annually the performance of the company's CEO and senior management. Whether this review is conducted by independent directors or by outside professionals should be left to the company. However, the review has to be based on clearly defined objective criteria, whose norms the CEO and other executive directors should know well before the evaluation process starts. Moreover, there should be a clearly laid down procedure for communicating the board's review to the CEO and his team of executive directors. Managerial remuneration should be based on such reviews.

management team that is one rung below board level. The most comprehensive statement on this is found in the recommendations in the 1997 report of the U.S. Business Round Table: "The selection and evaluation of the chief executive officer and... the corporation's top management team is probably the most important function of the board ... The performance of the CEO should generally be reviewed at least annually, without the presence of the CEO or other inside directors" (Gregory and Forminard 1998, 66). The 1996 report of the National Association of Corporate Directors (United States), the Bosch Report (Australia), and the 1997 board guidelines of the General Motors Corporation also endorse similar views.

### **Remuneration of directors**

In most countries corporate law requires that the compensation of CEOs and other executive directors be recommended by the board and ratified by the shareholders at the company's general meeting. Similar procedures are often laid down for the compensation of nonexecutive directors. Often, these details have to be reported in the company's annual report. There is usually no well-

### **Attendance of directors**

- The attendance record of directors coming up for reappointment should be made available to all shareholders.
- Corporate boards should not recommend the reappointment of nonexecutive directors who have not had time to attend (with leave of absence or otherwise) even 50 percent of board meetings and/or committee meetings.
- The nomination committee should not recommend directors who have had poor attendance records in their capacity as board members of other companies.

### **Directors' pay package**

Compensation for executive directors should be determined by the board, preferably based on a recommendation from the remuneration committee. The details must be disclosed to shareholders in a general meeting, and in the annual report. To elicit better efforts from the board, companies should consider offering stock options and performance bonus based on financial results. An appropriate mix of the two gives a director the incentive to keep an eye on both short-term profits and longer-term shareholder value. A small percentage of total compensation to nonexecutive directors should be flat fees. Also, they should not be offered retirement benefits and large perquisites.

defined guideline on the size or composition of the compensation package, but one principle is becoming evident: Companies should be flexible in how they remunerate their board members, but the compensation should be in line with similar companies in the same industry and must be fully reported to the shareholders. The trend is for pay packages of both nonexecutive and executive directors to be restructured to relate rewards to corporate performance through bonuses, and stock options.<sup>5</sup> Institutional investors are also asking shareholders to veto compensation packages for nonexecutive directors that contain retirement benefits and certain other perquisites normally associated with full-time employees.

### **Term, reappointment, and retirement of directors**

In many countries, the term of a directorship, method of reappointment, and retirement age are laid down by corporate law. The appointment or reappointment of a director also has to be approved by shareholders. There is no legally stipulated retirement age. Usually, legal structures are fairly lax. Does good corporate

governance demand tighter norms? There is no consensus on the subject. Most international codes on corporate governance argue that, subject to corporate laws, the term of directors and their retirement age should be matters of discretion for a company's board and shareholders. On two issues, however, there is agreement.

### **Separation of chair and CEO**

This is a very contentious issue. Institutional shareholders have been insisting that the chair of the company cannot be its CEO because the CEO is the chief of management and the chair is the chief supervisor of the board, which includes the executive directors and CEO. To combine the two roles is to invite moral hazard. It is also argued that if the chair is the CEO, there can be a genuine conflict when the tie-breaking vote is cast.

There should be no hard and fast rule that the chair of a company cannot be its CEO, but when the same person holds both posts, it is absolutely essential that the majority of directors be independent, nonexecutive directors with sufficient caliber that their opinions carry significant weight on the board.

### **Disclosures about directors**

Directors represent shareholders, so transparent governance requires that the owners of the

#### **Appointment of directors**

- The reappointment of directors should not be automatic and must be subject to board and shareholder review.
- All directors should be appointed for a specific term.<sup>a</sup>

a. One exception is the Business Round Table Report (United States).

## Information disclosure about directors

### Disclosures about directors

- Full details about the remuneration of all directors should form part of the annual report of all listed companies. Salary or basic fees, retirement benefits if any, commissions and bonuses, quantity and value of stock options, and the value of all perquisites should be provided.
- A comprehensive report about the relatives of directors—people who are either employees or fellow board members—must be an integral part of the directors report that accompanies the annual report of all listed companies.
- The shareholding of all directors in the company—individually and as a whole—should form part of the directors report.
- Details of loans to directors should be fully disclosed in the directors report in addition to being part of the financial statements accompanying the audited accounts of a listed company. This is required in many countries, such as South Africa.
- Companies must send to their shareholders a document that discloses any interests a director may have in any contract or arrangement of the company. This should be done at least once a year, preferably before the annual general meeting of companies.

### Communication by directors

- Present a balanced and understandable assessment of company's position.
- In this window, when the society demands greater transparency, they should address not only financial values but values of significant importance to the company's offering, such as environmental, health and safety and employee issues.

### Definitions of Independence

*King Report (South Africa):* The Institute of Directors in Southern Africa, The King Report on Corporate Governance, 4.2.1-4.2.4 (Nov. 29, 1994).

[nonexecutive directors should be ]: [1] independent of management and ...not [receive] any benefits from the company other than their fee. This is not intended to exclude...nonexecutive director[s] who have a contractual nexus with the company for reward or to prevent a nonexecutive director from acquiring shares in the company by means independent from the company:

- Director and managers of the company's holding company, or major investor, who have no executive responsibilities in the company.
- Former executive directors who are no longer employed on a full-time basis by nevertheless are capable of giving valuable input to the board arising from their past experience.
- Senior executive director of major listed subsidiaries and associated of the holding company, who have no executive responsibilities in the holding company.

*Stock Exchange of Thailand: Set Notification Governing the Qualification of Independent Directors* (Oct. 29, 1993)

An independent director must meet all of the following requirements:

- Be independent from the major shareholders of the company or any shareholder in the group.
- Not be an employee, staff member or an adviser receiving a regular salary or other regular benefit from the company or any affiliated company, associated company or related company.
- Have no share in their own name, or in a related person's name, representing more than 0.5 percent of the respective paid-up capital of the company, an affiliated company, associated company or related company.
- Be able to protect the interests of all shareholders of the company equally.
- Be able to prevent conflicts of interest between the company and its management, major share-

*(continues on next page)*



holders, or other companies which have same management group or major shareholders as the company.

- Be able to attend board meetings to make decisions on significant company activities.

*Vienot Report (France):* Conseil National du Patronat Francais (CNPFF) & Association Francaise des Enter-

prises Privees, The Board of Directors of Listed Companies in France (Vienot Report), at 11 (July 10, 1995).

The notion of independent director is not only opposed to that of executive director, it is also opposed to that of any director with any sort of special interest in the company, whether as a shareholder, a supplier or a customer.

company be given all relevant information about corporate activity, remuneration, and business interests. Corporate laws in many countries specify minimal disclosure requirements. These vary considerably across nations, and often have no implementing or penalizing force. As with most changes in corporate governance, the movement toward greater disclosure about directors is being spearheaded by international institutional investors. Given the growing need for global capital, the next ten years are certain to see more disclosure than before and companies that want to tap international capital flows have to adopt best practices as soon as possible.

## Notes

1. "Gray outsiders" are family members of executive directors, attorneys who represent the company, investment or commercial bankers who have a close financial relationship with the company, long-term consultants, or directors who either personally or through their employers/companies have substantial business dealings with the company.

2. Currently an efficient supply of independent external directors does not exist in Japan. This limited market for independent directors and corporate auditors may be an Achilles heel. In the medium term, the uniquely Japanese system of cross-shareholding may begin to unravel, necessitating a system of governance more reliant on independent and external directors, in turn leading to a market for such individuals (Gregory and Forminard 1998).

3. Given that German supervisory boards usually have only four meetings per year, many high-profile executives hold several board memberships. The maximum number permitted by law is 10 supervisory board memberships—and this has been criticized as being too high (*International Financial Law Review*, special supplement, April 1998).

4. This is most succinctly stated by the Day Report of Canada: "Every Board of directors should implement a process ... for assessing the effectiveness of the board as a whole, the committees of the board, and the contribution of individual directors" (Guideline 5).

5. In many countries, however, stock options are not permitted by law. Until 1998 they were not legal in Germany and Finland and had to be circumvented by issuing bonds with a warrant attached to purchase shares. Countries such as Holland charge up-front penal tax rates on such options. Gradually, these laws are being amended.

# Overview of Corporate Governance Guidelines and Codes of Best Practice in Developing and Emerging Markets

When a firm's management is separate and distinct from the providers of the firm's capital, managers have a responsibility to use assets efficiently in pursuit of the firm's objective. Ensuring that they do so is important to a firm's successful economic performance as well as to its ability to attract long-term, stable, low-cost investment capital. This is true whether the firm is publicly traded, privately held, family-controlled or state-owned. (It is only when the managers of a firm themselves own the entire firm—and are committed to relying solely on their own capital—that managers generally are free to apply corporate assets (as their own private property) inefficiently or for nonproductive uses.) The fundamental concern of corporate governance is to ensure the means by which a firm's managers are held accountable to capital providers for the use of assets.

The responsibilities and functions of the corporate board in both developed and developing nations are receiving greater attention as a result of the increasing recognition that a firm's corporate governance affects both its economic performance and its ability to access patient,

low-cost capital. After all, the board of directors—or, in two-tier systems, the supervisory board—is the corporate organ designed to hold managers accountable to capital providers for the use of firm assets. The past five years has witnessed a proliferation of corporate governance guidelines and codes of “best practice” designed to improve the ability of corporate directors to hold managements accountable. This global movement to emphasize that boards have responsibilities separate and apart from management, and to describe the practices that best enable directors to carry out these responsibilities, is a manifestation of the importance now attributed to corporate governance generally and, more particularly, to the role of the board.

Corporate governance guidelines and codes of best practice arise in the context of, and are affected by, differing national frameworks of law, regulation and stock exchange listing rules, and differing societal values. Although boards of directors provide an important internal mechanism for holding management accountable, effective corporate governance is supported by and dependent on the market for corporate control,

securities regulation, company law, accounting and auditing standards, bankruptcy laws, and judicial enforcement. Therefore, to understand one nation's corporate governance practices in relation to another's, one must understand not only the "best practice" documents but also the underlying legal and enforcement framework.

Some governance codes are linked to listing or legally mandated disclosure requirements. Others are purely voluntary in nature, but may be designed to help forestall further government or listing body regulation. In the developing nations, governance codes are more likely to address basic principles of corporate governance that tend to be more established in developed countries through company law and securities regulation, such as the equitable treatment of shareholders, the need for reliable and timely disclosure of information concerning corporate performance and ownership, and the holding of annual general meetings of shareholders. However, in both developed and developing nations, codes focus on boards of directors and attempt to describe ways in which boards can be positioned to provide some form of guidance and oversight to management, and accountability to shareholders and society at large.

## Overview

The modern trend of developing corporate governance guidelines and codes of best practice began in the early 1990s in the United Kingdom, the United States and Canada in response to problems in the corporate performance of leading companies, the perceived lack of effective board oversight that contributed to those performance problems, and pressure for change from institutional investors. The Cadbury Report in the United Kingdom, the General Motors Board of Directors Guidelines in the United States, and the Dey Report in Canada have each proved influential sources for other guideline and code efforts (see annex 4b).

Over the past decade, governance guidelines and codes have issued from stock exchanges,

corporations, institutional investors, and associations of directors and corporate managers. Compliance with these governance recommendations is generally not mandated by law, although the codes linked to stock exchanges may have a coercive effect. For example, listed companies on the London and Toronto Stock Exchanges need not follow the recommendations of the Cadbury Report (as amended in the Combined Code) and the Dey Report, but they must disclose whether they follow the recommendations in those documents and must provide an explanation concerning divergent practices. Such disclosure requirements exert a significant pressure for compliance. In contrast, the guidelines issued by associations of directors, corporate managers and individual companies tend to be wholly voluntary. For example, the GM Board Guidelines simply reflect an individual board's efforts to improve its own governance capacity. Such guidelines can have wide influence, however. In the case of the GM Guidelines, institutional investors encouraged other companies to adopt similar guidelines.

In developing nations, both voluntary guidelines and more coercive codes of best practice have issued as well. For example, both the Code of Best Practices issued by the Brazilian Institute of Corporate Directors and the Code of Corporate Governance issued by the Corporate Governance Committee of the Mexican Business Coordinating Counsel are wholly aspirational and not linked to any listing requirements. Similarly, the Confederation of Indian Industry Code and the Stock Exchange of Thailand Code are designed to build awareness within the corporate sector of governance best practice, but are not, at this time, linked to stock exchange listing requirements. In contrast, Malaysia's Code on Corporate Governance, the Code of Best Practice issued by the Hong Kong Stock Exchange, and South Africa's King Committee Report on Corporate Governance, all contemplate mandatory disclosure concerning compliance with their recommendations.

Some of the key elements of governance guidelines and codes of best practice, particularly as issued in developing nations, are summarized below.

### The corporate objective

Variations in societal values lead different nations to view the corporate objective or “mission” distinctly. Expectations of how the corporation should prioritize the interests of shareholders and stakeholders such as employees, creditors and other constituents take two primary forms. In the Anglo-Saxon nations—Australia, Canada, the United Kingdom, and the United States—maximizing the value of the owners’ investment is considered the primary corporate objective. This objective is reflected in governance guidelines and codes that emphasize the duty of the board to represent shareholders’ interests and maximize shareholder value. Among developing nations, the Brazilian Institute of Corporate Governance Code, the Confederation of Indian Industry Code, the Kyrgyz Republic Charter of a Shareholding Society, the Malaysian Report on Corporate Governance, and the Korean Stock Exchange Code of Best Practice all expressly recognize that the board’s mission is to protect and enhance the shareholders’ investment in the corporation.

In other countries, more emphasis is placed on a broader range of stakeholders. However, this view is not strongly advocated in the governance guidelines and codes emanating from developing nations, although some documents recognize that stakeholder interests should be considered. (For example, the King Report from South Africa states: “Directors must act with enterprise and always strive to increase shareholders’ value while having regard for the interests of all stakeholders.” (ch. 5:27.7)) This may be due to a convergence in perceptions about the corporate objective. There is a growing recognition that shareholder expectations need to be met in order to attract patient, low-cost capital. Likewise,

#### Corporate objective

*The mission of the board of directors is to maximize shareholder value.* Brazilian Institute of Corporate Governance Code of Best Practice at 1.

*The Board of Directors represents the shareholders of the Society, and it has a duty to act in the interests of the shareholders.*

Charter of a Shareholding Society (Kyrgyz Republic) 17.1.

*The single overriding objective [of] all listed companies . . . is the preservation and enhancement over time of their shareholders’ investment.*

Report on Corporate Governance (Malaysia), Introduction § 1, 3.3.

there is growing sensitivity to the need to address stakeholder interests in order to maximize shareholder value over the long term. As the General Motors Board of Directors Mission Statement recognizes, “the board’s responsibilities to shareholders as well as customers, employees, suppliers and the communities in which the corporation operates are all founded upon the successful perpetuation of the business.” Simply put, shareholder and stakeholder interests in the success of the corporation are compatible in the long run.

#### Board responsibilities and job description

Most governance guidelines and codes of best practice assert that the board assumes responsibility for the stewardship of the corporation and emphasize that board responsibilities are distinct from management responsibilities. However, the guidelines and codes differ in the level of specificity with which they explain the board’s role. For example, Canada’s Dey Report, France’s Vienot Report, Malaysia’s Report on Corporate Governance, Mexico’s Code of Corporate Gov-

ernance, South Africa’s King Report, and the Korean Stock Exchange Code all specify board functions such as strategic planning; risk identification and management; selection, oversight and compensation of senior management; succession planning; communication with shareholders; integrity of financial controls; and general legal compliance, as distinct board functions. The Kyrgyz Republic Charter sets out a detailed list of matters requiring board approval. Other governance guidelines and codes of best practice are far less specific. For example, the Hong Kong Stock Exchange Code simply refers to directors’ obligations to ensure compliance

with listing rules as well as with the “declaration and undertaking” that directors are required to execute and lodge with the Exchange. The different approaches among codes on this point likely reflect variations in the degree to which company law or listing standards specify board responsibilities, rather than any significant substantive differences.

### **Board composition**

Most governance guidelines and codes of best practice address topics related to board composition including director qualifications and membership criteria, the director nomination process, and board independence and leadership.

#### **Board functions**

The main functions of a board are to . . . :

- Direct the company both as to strategy and structure.
- Establish from time to time a strategy for the company, including a determination of the businesses that the company should be in and those that it should not be in.
- Ensure that the executive management implements the company’s strategy as established from time to time.
- Ensure that the company has adequate systems of internal controls both operational and financial.
- Monitor the activities of the executive management.
- Select the chief executive, ensure succession and give guidance on the appointment of senior executives.
- Provide information on the activities of the company to those entitled to it.
- Ensure that the company operates ethically.
- Provide for succession of senior management.
- Address the adequacy of retirement and health care benefits and funding.

The King Report (South Africa), Ch. 4:1.

#### **Criteria**

The quality, experience, and independence of a board’s membership directly affect board performance. Board membership criteria are described by various guidelines and codes with different levels of specificity, but tend to highlight issues such as experience, personal characteristics (including independence), core competencies and availability.

#### **Director nomination**

The process by which directors are nominated has gained attention in many guidelines and codes, which tend to emphasize a formal and transparent process for appointing new directors. The use of nominating committees is favored in the United States and United Kingdom as a means of reducing the CEO’s influence in choosing the board that is charged with monitoring his or her performance. (See, in the United States, the Report of the National Association of Corporate Directors Commission on Director Professionalism (1996), and the General Motors Board of Directors Guidelines (1994); in the United Kingdom, the Hampel Committee Report (1998)). The Malaysian Corporate Governance Report expresses a similar view: “[T]he adoption of a formal procedure for appointments to the board, with a nomination

*Every nonexecutive director must ensure that he can give sufficient time and attention to the affairs of the issuer . . . and satisfy the Exchange that he has the character, integrity, experience and competency to serve as a director of a listed company.*

The Hong Kong Stock Exchange Code, Code of Best Practice 10 and Guideline A.5.

*The board should have a diversity of background, knowledge and experience.*

The Brazilian Institute of Corporate Governance Code of Best Practice at 3.

[nonexecutive directors should] *know how to read a balance sheet, profit and loss account, cash flow statements and financial ratios, and have some knowledge of various company laws.*

The Confederation of Indian Industry Code, Recommendation 4.

[A] *candidate should have integrity and independence of thought; the courage to express their independent thought; a grasp of the realities of business operations; an understanding of the changes taking place regionally, nationally and internationally; [and] an understanding of business and financial "language."*

The King Report (South Africa), Ch. 9:8.2.

committee making recommendations to the full board, should be recognized as good practice.” (Explanatory Note 4. See also Korean Stock Exchange Code of Best Practice II.3.) At the same time, however—and as advocated by the King Report (South Africa)—it is generally agreed that the board as a whole has the ultimate responsibility for nominating directors.

### **Mix of inside and outside or “independent” directors**

Most governance guidelines and codes of best practice agree that some degree of director independence—or the ability to exercise objective judgment of management’s performance—is

important to a board’s ability to exercise objective judgment concerning management performance. In the United States, the United Kingdom, Canada, and Australia, although not required by law or listing requirements, best practice recommendations generally agree that boards of publicly-traded corporations should include at least some independent directors. This viewpoint is the furthest developed in the United States and Canada, where best practice documents call for a “substantial” majority of the board to be comprised of independent directors. Elsewhere best practice recommendations are somewhat less stringent and seek to have a balance of executives and nonexecutives, with the nonexecutives including some truly independent directors. (Although “nonmanagement” or “nonexecutive” directors may be more likely to be objective than members of management, many code documents recognize that a nonmanagement director may still not be truly “independent” if he or she has significant financial or personal ties to management.)

*The board shall include outside directors capable of performing their duties independently from management, controlling shareholders and the corporation.*

Korean Stock Exchange Code of Best Practice at II.2.2.

*The majority of the board members should be independent.*

Brazilian Institute of Corporate Governance Code of Best Practice at 3.

*No board should have less than two nonexecutive directors of sufficient calibre that their views will carry significant weight in board decisions.*

The King Report (South Africa) 2.2.

*[I]t is recommended that Independent Directors represent at least 20% of the total number of Board members.*

Mexico Code of Corporate Governance, Principle at 6.

Nonetheless, a general consensus is developing throughout a number of countries that public company boards should include at least some nonexecutive members who lack significant family and business relationships with management.

Definitions of “independence” vary. For example, according to the Brazilian Institute of Corporate Governance, a director is independent if he or she: has no link to the company besides board membership and share ownership and receives no compensation from the company other than director remuneration or shareholder dividends; has never been an employee of the company (or of an affiliate or subsidiary); provides no services or products to the company (and is not employed by a firm providing major services or products); and is not a close relative of any officer, manager or controlling shareholder.

*Every listed company should have independent directors, i.e., directors that are not officers of the company; who are neither related to its officers nor represent concentrated or family holdings of its shares; who, in the view of the company’s board of directors, represent the interests of public shareholders, and are free of any relationship that would interfere with the exercise of independent judgment.”*

Malaysian Report on Corporate Governance, Explanatory Note 4.23.

*In February 1998, the Korean Stock Exchange adopted a listing requirement that will mandate that outside directors soon comprise at least a quarter of the board of every listed company. Included among the list of persons who do not qualify as “outside directors” are: controlling shareholders; a spouse or family member of a director who is not an outsider; current or recent officers and employees of the corporation, its affiliates, or of corporations that have “important business relations” with the corporation; and persons who serve as outside directors on three or more listed companies.*

Article 48-5 KSE Listing Regulation.

In comparison, the Cadbury Code simply refers to directors who—apart from their fees and shareholdings—are independent from management and free from any business or other relationship which could materially interfere with the exercise of independent judgment. And many of the best practice documents—such as the Cadbury Report and the National Association of Corporate Directors Report on Director Professionalism (U.S.)—view the ultimate determination of just what constitutes “independence” to be an issue for the board itself to determine.

### **Independent board leadership**

Independent board leadership is thought by some to encourage the nonexecutive directors’ ability to work together to provide true oversight of management. As explained by the U.S. National Association of Corporate Directors: “the purpose of creating [an independent] leader is not to add another layer of power but . . . to ensure organization of, and accountability for, the thoughtful execution of certain critical independent functions”—such as evaluating the CEO; chairing sessions of the nonexecutive directors; setting the board agenda; and leading the board in responding to crisis.

Many guidelines and codes seek to institute independent leadership by recommending a clear division of responsibilities between Chairman and CEO. In this way, while the CEO can have a significant presence on the board, the nonexecutive directors will also have a formal independent leader to look to for authority on the board. Documents that place less emphasis on the need for a majority of independent directors seem to place more emphasis on the need for separating the role of Chairman and CEO. For example, the Indian Confederation Report expressly relates the two concepts—recommending that if the Chairman and CEO (or managing director) are the same person, a greater percentage of nonexecutive directors is necessary (Recommendation 2). The Malaysian Report on Corporate Governance similarly emphasizes that

“[w]here the roles are combined there should be a strong independent element on the board.” (Best Practice AA.II) This is in accord with the Cadbury Report, which states that, where the Chairman is also the CEO “it is essential that there should be a strong and independent element on the board” (Section 1.2).

## Board committees

In developed nations it is fairly well accepted that many board functions are carried out by board committees. For example, a nominating committee, an audit committee and a remuneration committee are recommended in Australia, Belgium, France, Japan, the Netherlands, Sweden, United Kingdom and the United States. While composition of these committees varies, it is generally recognized that nonexecutive directors have a special role.

The functioning and composition of the audit committee receives significant attention in most guideline and code documents because of the key role it plays in protecting shareholder interests and promoting investor confidence.

*Special emphasis has been placed on the need for all listed company boards to establish audit committees to ensure the effective and efficient control and review of a company's administration, internal audit procedures, the preparation of financial statements and the general disclosure of material information to investors and shareholders.*

President's Message, Stock Exchange of Thailand Code and Guidelines, pp. iv-v.

*[There should be] a mechanism that lends support to the Board in verifying compliance of the audit function, assuring that internal and external audits are performed with the highest objectivity possible and that the financial information is useful, trustworthy and accurate.*

Mexico Code of Corporate Governance, Recommendation at 12-13.

Certain countries specifically recommend the size of an audit committee. In India, the minimum size recommended is three members, as it is in Malaysia and the United Kingdom. Also, South Africa and India both emphasize the extra time requirements demanded of audit committee members, and the importance of written terms of reference for this committee. Malaysia also refers to the need for written terms of reference for audit and other board committees.

## Disclosure issues

Disclosure is an issue that is highly regulated under securities laws of many nations. However, there is room for voluntary disclosure by companies beyond what is mandated by law. Most countries generally agree on the need for directors to disclose their own relevant interests and to disclose financial performance in an annual report to shareholders. Generally this is required by law, but some guidelines and best practice documents address it as well. Similarly, even though directors are usually subject to legal requirements concerning the accuracy of disclosed information, a number of codes from both developed and developing nations describe the board's responsibility to disclose accurate information about the financial performance of the company, as well as information about agenda items, prior to the annual general meeting of shareholders. Many codes also itemize the issues reserved for shareholder decision at the AGM. Generally, guidelines and codes of best practice place heavy emphasis on the financial reporting obligations of the board, as well as board oversight of the audit function. Again, this is because these are key to investor confidence and the integrity of markets. South Africa lays out the key points that the directors must comment on, whereas other countries do not go to this level of detail, but the distinction is not necessarily substantive since disclosure tends to be heavily regulated in many nations through securities laws.

\* \* \* \*



This brief review of the primary principles addressed by various guidelines and codes indicates that there is no single agreed upon system of “good” governance. Each country has its own corporate culture, national personality and priorities. Likewise, each company has its own history, culture, goals and business cycle maturity. All of these factors need to be taken into consideration in crafting the optimal governance structure and practices for any country or any company. However, the influence of international capital markets will likely lead to some convergence of governance practices.

This convergence is evident in the growing consensus in both developed and developing nations that board structure and practice is key to providing corporate accountability—of the management to the board and the board to the shareholders—in the governance paradigm.

*As regulatory barriers between national economies fall and global competition for capital increases, investment capital will follow the path to those corporations that have adopted efficient governance standards, which include acceptable accounting and disclosure standards, satisfactory investor protections and board practices designed to provide independent, accountable oversight of managers.*

Report to the OECD by the Business Sector Advisory Group on Corporate Governance (April 1998) (the Millstein Report).

#### **Note**

This review was written by Holly J. Gregory, a partner in the international law firm of Weil, Gotshal & Manges LLP. Referenced reports are listed in annex 4b.

**ANNEX 4B. INTERNATIONAL COMPARISON OF BOARD "BEST PRACTICES" IN DEVELOPING AND EMERGING MARKETS  
KEY ISSUES**

Holly J. Gregory<sup>1</sup>

November 1999

GM Board Guidelines <sup>2</sup>	CACG Guidelines (International) <sup>3</sup>	IBGC Code of Best Practice (Brazil) <sup>4</sup>	Hong Kong Stock Exchange Code / Guide (Hong Kong) <sup>5</sup>
<b>OVERVIEW</b>			
<p><i>The General Motors Board Guidelines were developed by the GM Board in 1994 (and have been regularly updated) and are widely viewed as a seminal expression of a board's voluntary efforts to improve its own governance. The GM Guidelines have been widely discussed and emulated, and their influence has extended well beyond the U.S.</i></p>	<p><i>The Commonwealth Association for Corporate Governance ("CACG"), established in April 1998 in response to the Edinburgh Declaration of the Commonwealth Heads of Government meeting in 1997, has promulgated Guidelines for both state-owned and private sector companies in Commonwealth countries. Although these Guidelines are not legally binding, they are intended to facilitate best business practice and behavior throughout the entire Commonwealth.</i></p> <p><i>Note that many member countries of the Commonwealth have already established their own corporate governance codes (for example, the United Kingdom, Australia, Canada, India, Malaysia, South Africa -- see both this COMPARISON and the INTERNATIONAL COMPARISON OF "BEST PRACTICES" IN DEVELOPED MARKETS). The CACG has now issued "CACG Guidelines: Principles for Corporate Governance in the Commonwealth" (November 1999), consisting essentially of 15 Principles and commentary upon them.</i></p>	<p><i>The Brazilian Institute of Corporate Governance (Instituto Brasileiro de Governança Corporativa "IBGC"), formerly known as the Brazilian Institute of Corporate Directors (Instituto Brasileiro de Conselheiros Administração - "IBCA"), issued its Code of Best Practice on May 6, 1999. The IBGC Code builds upon the Preliminary Proposal for a Brazilian Code developed by the Top Management Summit held at Itú, Brazil, in 1997, with further reference to the International Comparison of Board "Best Practices" prepared by the law firm of Weil, Gotshal &amp; Manges LLP (1999).</i></p> <p><i>The current version of the IBGC Code, like most others, is focused on the board of directors. However, the IBGC intends to expand the Code to deal with owners (many Brazilian corporations are controlled by family groups), board committees, the CEO, the independent auditors and the fiscal board.</i></p> <p><i>(Cf. letter from Bengt Hallqvist (IBGC) to Ira M. Millstein (WG&amp;M) dated May 8, 1999, and The Code, Introduction, p. 1.)</i></p>	<p><i>Prepared by the Stock Exchange of Hong Kong, The Code of Best Practice and The Guide for Directors of Listed Companies are intended to furnish a "brief and practical introduction" to directors of listed companies concerning their responsibilities under the Rules Governing the Listing of Securities (Listing Rules).</i></p> <p><i>While The Code and The Guide are not intended to amend or substitute for the Listing Rules, the Listing Rules require that all listed companies include a statement of compliance with the Code in their annual and interim reports.</i></p>

<sup>1</sup> Holly J. Gregory, a Partner in the law firm of Weil, Gotshal & Manges LLP, specializes in the Firm's corporate governance practice, which is led by Ira M. Millstein. Frederick W. Philippi, a senior paralegal, assisted in this comparative analysis. [See also INTERNATIONAL COMPARISON OF BOARD "BEST PRACTICES" IN DEVELOPED MARKETS (revised November 1999); INTERNATIONAL COMPARISON OF BOARD "BEST PRACTICES": INVESTOR VIEWPOINTS (revised November 1999); and COMPARISON OF BOARD GUIDELINES AND "BEST PRACTICES": UNITED STATES (revised November 1999).]

<sup>2</sup> General Motors Board of Directors, GM Board of Directors Corporate Governance Guidelines on Significant Corporate Governance Issues (January 1994; revised August 1995, June 1997 and March 1999). This COMPARISON OF BOARD GUIDELINES AND "BEST PRACTICES" IN DEVELOPING AND EMERGING MARKETS - KEY ISSUES uses the General Motors Board Guidelines as its "vertical axis" for organizational purposes.

<sup>3</sup> Commonwealth Association for Corporate Governance ("CACG"), CACG Guidelines: Principles for Corporate Governance in the Commonwealth (Final Version, November 1999).

<sup>4</sup> Instituto Brasileiro de Governança Corporativa ("IBGC"), Code of Best Practice of Corporate Governance (May 6, 1999).

<sup>5</sup> The Stock Exchange of Hong Kong Ltd., Code of Best Practice (adopted December 1989; revised June 1996); the Stock Exchange of Hong Kong Ltd., Guide for Directors of Listed Companies (July 1995).

Indian Confederation Code (India) <sup>6</sup>	Charter of a Shareholding Society (Kyrgyz Republic) <sup>7</sup>	Report on Corporate Governance (Malaysia) <sup>8</sup>	Reserved
<b>OVERVIEW</b>			
<p><i>The Indian Confederation Code consists of 17 Recommendations and commentary upon them. It is intended to build awareness within the corporate sector to implement board "best practices" in Indian business and industry.</i></p> <p><i>While compliance with The Code is voluntary, it urges major Indian stock exchanges to gradually implement a policy of insisting upon receipt of a compliance certificate from each listed company which will indicate the extent to which the company is implementing The Code.</i></p>	<p><i>A Model Charter of a Shareholding Society of Open Type was approved by a decree of the government of the Kyrgyz Republic in July 1997. It specifies the standards and procedures of corporate governance with which enterprises in the Kyrgyz Republic must comply. These standards were developed from international best practice but have been customized to the needs and conditions of the Kyrgyz Republic.</i></p> <p><i>The Model Charter provides for a two-tier board structure consisting of a Management Board and a Board of Directors.</i></p> <p><i>A Handbook accompanies the Model Charter. It provides the Charter's rationale, explaining, among other things, what corporate governance is, and why it is important.</i></p> <p><i>All texts cited below are from the Model Charter.</i></p>	<p><i>The Malaysian government established the High Level Finance Committee in March 1998 as a partnership effort between the government and the private sector with the mandate of establishing a framework for corporate governance and setting best practices. The Committee published its Report on Corporate Governance dated February 1999.</i></p> <p><i>The Report proposes that its Code on Corporate Governance (Ch. 5 of the Report) be backed by the listing rules of the Kuala Lumpur Stock Exchange ("KLSE"). Under the proposal, companies listed on the KLSE would be required to disclose the extent of their compliance with the best practices set out in The Code.</i></p> <p><i>The Code consists of Principles of Corporate Governance (Part 1), Best Practices in Corporate Governance (Part 2), Principles &amp; Best Practices for Other Corporate Participants (Part 3) and Explanatory Notes and certain other practices which are proposed merely for consideration (Part 4). (Cf. Foreword by Datuk Dr. Aris Othman, Secretary General of the Treasury and Chairman of the Committee, and Ch. 5, The Code on Corporate Governance § 1.)</i></p>	

<sup>6</sup> Confederation of Indian Industry, Desirable Corporate Governance -- A Code (April 1998).

<sup>7</sup> Prime Minister's Office of the Kyrgyz Republic, Department of Economic Sectors Development, Model Charter of a Shareholding Society of Open Type (July 1997).

<sup>8</sup> High Level Finance Committee on Corporate Governance (Malaysia), Report on Corporate Governance (March 9, 1999).

Code of Corporate Governance (Mexico) <sup>9</sup>	King Report (South Africa) <sup>10</sup>	Code of Best Practice (South Korea) <sup>11</sup>	The SET Code and Guidelines <sup>12</sup> (Thailand)
<b>OVERVIEW</b>			
<p><i>El Consejo Coordinador Empresarial ("CCE") and la Comisión Nacional Bancaria y de Valores ("CNBV") issued a Code of Corporate Governance, consisting of Principles and Recommendations, in 1999.</i></p> <p><i>The Code recognizes the unique needs and context of Mexican corporations, including their stockholder structures.</i></p> <p><i>The CNBV (Mexico's equivalent of the U.S.A.'s SEC) has announced that, commencing in 2001, all public companies will be required to disclose whether they are following these governance guidelines. Many companies are expected to begin voluntary compliance with the Code in 2000.</i></p> <p><i>(Cf. letter from Carlos Jimenez (ALFA) to Frederick S. Green, Esq. (WG&amp;M) dated July 2, 1999; memorandum from Mr. Green to Ira M. Millstein (WG&amp;M) dated October 25, 1999; and Introduction to the Code at 1-2.)</i></p>	<p><i>The King Commission was formed by the Institute of Directors in Southern Africa ("IOD"), and supported by the South African Chamber of Business ("SACOB") and the Johannesburg Stock Exchange ("JSE"), among other groups. The Commission's task was to draft corporate governance guidelines that would help South Africa reenter the international community, and address the emergence of previously disadvantaged communities into the business community. Chapter 20 of the Report contains The Code of Corporate Practices &amp; Conduct.</i></p> <p><i>The Report recommends that the JSE adopt a listing rule requiring companies to disclose in their annual financial statements the extent of their compliance with the Report's Code of Corporate Practices and Conduct. Some of the Report's recommendations include proposed changes to legislation such as the Companies Act, which, if enacted, will affect all corporate entities.</i></p> <p><i>A number of the recommendations in the King Report advocating changes to the Companies Act have in fact been processed by the legislature and are now law. (Cf. Letter from R.S. Wilkinson, Executive Director, Institute of Directors in South Africa dated April 8, 1999.)</i></p>	<p><i>The South Korean Committee on Corporate Governance, a non-governmental body convened in March 1999, issued its Code of Best Practice in September 1999. The Code is intended to serve as a model for Korean corporations to structure their own internal governance, and also as a standard for the review of Korean law to determine whether amendment is necessary.</i></p> <p><i>The Code is arranged as follows:</i></p> <ul style="list-style-type: none"> <li><i>Preamble</i></li> <li><i>I. Shareholders</i></li> <li><i>II. Board of Directors</i></li> <li><i>III. Audit Systems</i></li> <li><i>IV. Stakeholders</i></li> <li><i>V. Management Monitoring by the Market Recommendations.</i></li> </ul> <p><i>The Code is intended to apply to listed and other public companies, but non-public enterprises are urged to observe it as well, to the extent applicable.</i></p>	<p><i>The Stock Exchange of Thailand ("SET") has issued a manual titled The Roles, Duties and Responsibilities of the Directors of Listed Companies. Chapter 1 of this manual contains The SET Code of Best Practice, Chapters 2 through 9 provide additional guidelines.</i></p> <p><i>The Code and other guidelines in the manual are not intended to be legally binding. They are intended to provide a guiding standard for boards of companies listed on the SET and improve understanding of the functions of directors. (Cf. Message from the President of the SET dated December 22, 1997, which appears as preface to the manual, and The Code, 1.)</i></p>

<sup>9</sup> El Consejo Coordinador Empresarial ("CCE") y la Comisión Nacional Bancaria y de Valores ("CNBV"), Código de Mejores Prácticas (June 1999). English translation: CCE/CNVB, Code of Corporate Governance (July 1999), further revised by Weil, Gotshal & Manges LLP.

<sup>10</sup> The Institute of Directors in Southern Africa, The King Report on Corporate Governance ("King Report") (Nov. 29, 1994).

<sup>11</sup> Committee on Corporate Governance (sponsored by the Korea Stock Exchange, et al.), Code of Best Practice for Corporate Governance (September 1999).

<sup>12</sup> The Stock Exchange of Thailand ("SET"), The Roles, Duties and Responsibilities of the Directors of Listed Companies (first published December 1997; second publication October 1998).

GM Board Guidelines	CACG Guidelines (International)	IBGC Code of Best Practice (Brazil)	Hong Kong Stock Exchange Code / Guide (Hong Kong)
<b>1. The Mission of the Board of Directors</b>			
<p>The General Motors Board of Directors represents the owners' interest in perpetuating a successful business, including optimizing long-term financial returns. The Board is responsible for determining that the Corporation is managed in such a way to ensure this result. This is an active, not a passive, responsibility. The Board has the responsibility to ensure that in good times, as well as difficult ones, Management is capably executing its responsibilities. The Board's responsibility is to regularly monitor the effectiveness of Management policies and decisions including the execution of its strategies.</p> <p>In addition to fulfilling its obligations for increased stockholder value, the Board has responsibility to GM's customers, employees, suppliers and to the communities where it operates — all of whom are essential to a successful business. All of these responsibilities, however, are founded upon the successful perpetuation of the business. (Introduction)</p>	<p>The board should exercise leadership, enterprise, integrity and judgment in directing the corporation so as to achieve continuing prosperity and to act in the best interest of the business enterprise in a manner based on transparency, accountability and responsibility. (Principle 1)</p> <p>The board should determine the corporation's purpose and values, determine the strategy to achieve its purpose and to implement its values in order to ensure that it survives and thrives, and ensure that procedures and practices are in place that protect the corporation's assets and reputation. (Principle 3)</p> <p>The board should monitor and evaluate the implementation of strategies, policies, management performance criteria and business plans. (Principle 4)</p> <p>The board should ensure that the corporation complies with all relevant laws, regulations and codes of best business practice. (Principle 5)</p> <p>The board should ensure that the corporation communicates with shareholders and other stakeholders effectively. (Principle 6)</p> <p>The board should serve the legitimate interests of the shareholders of the corporation and account to them fully. (Principle 7)</p> <p>The board, under an effective Chairman, must be in a position to ensure a balance between enterprise and control in the direction it gives to the corporation.</p> <p>The fundamental responsibility of each board is to improve the economic and commercial prosperity of the corporation. (Commentary on Principle 1)</p>	<p>The mission of the board of directors is to maximize shareholder value. (p. 1)</p> <p>The board of directors should pursue the objectives, values and beliefs of the shareholders. (p. 1)</p> <p>It is the function of the board to evaluate officers and management. (p. 2)</p> <p>The board of directors supervises and controls the officers of the company. (p. 4)</p> <p>See p. 1 (The board of directors should stimulate the creation of a formal code of ethics for the company.)</p>	<p>A very basic responsibility of a listed company director is to become familiar with the Listing Rules, the terms of the Listing Agreement entered into between the company and the Exchange, and the Declaration and Undertaking with regard to Directors which every director must execute and lodge with the Exchange. (Guideline A.1)</p> <p><i>A Director should:</i></p> <ul style="list-style-type: none"> <li>▪ use his best endeavours to procure the company's compliance with the Listing Rules;</li> <li>▪ comply, and use his best endeavours to procure the company's compliance, with the Securities (Disclosure of interests) Ordinance, the Code on Takeovers and Mergers, the Code on Share Repurchases and all other relevant securities laws and regulations in Hong Kong; and</li> <li>▪ cooperate in any investigation conducted by the Listing Division and/or the Listing Committee.</li> </ul> <p>(Guideline B.1.1)</p>

Indian Confederation Code (India)	Charter of a Shareholding Society (Kyrgyz Republic)	Report on Corporate Governance (Malaysia)	Reserved
<b>1. The Mission of the Board of Directors</b>			
<p>[The board should] maximize long term shareholder value. (Recommendation 1)</p> <p>The key to good corporate governance is a well functioning, informed board of directors. The board should have a core group of excellent, professionally acclaimed non-executive directors who understand their dual role: of appreciating the issues put forward by management, and of honestly discharging their fiduciary responsibilities towards the company's shareholders as well as creditors. (p. 2)</p>	<p>The Board of Directors represents the shareholders of the Society, and it has the duty to act in the interests of the shareholders. (17.1)</p> <p>The Board of Directors has no right to act on behalf of the Society. The Board of Directors exercises control over the activity of management and implements other functions set out in this charter. (17.2; see 14.2)</p> <p>[T]he Board of Directors . . . give[s] its advice on all issues (including management) to the Management Board and the Audit Commission and to the General Meeting of Shareholders. (17.3)</p> <p><i>See 3.1 (The Society pursues profit as its main purpose.).</i></p> <p><i>See also 14.3 ([The Management Board] has all the decision-making rights in the Society other than those exclusively reserved for other governing bodies.).</i></p> <p><i>For a list of transactions exclusively within the jurisdiction of the Board of Directors, see 17.2.</i></p>	<p>Every listed company should be headed by an effective board which should lead and control the company. (Principle A.1)</p> <p>[Principle A.1] endorses the unitary board structure for Malaysian companies (Explanatory Note 4.1 on Principle A.1 at 75)</p> <p>The single overriding objective by all listed companies, whatever the size or type of business, is the preservation and enhancement over time of their shareholders' investment. All boards have this responsibility and their policies, structure, composition and governing processes should reflect this. (1.3.3)</p> <p>[T]he board's task is to approve appropriate policies and to approve the performance of management in implementing them. (1.3.4)</p> <p>While Directors as a board are responsible for relations with stakeholders, they are accountable to the shareholders. The policy considerations underlying such a definition of board responsibility are fundamental to capital formation and the financing of businesses. (1.3.5)</p> <p>[I]t is clear that the responsibility for good corporate governance rests primarily with the board of directors. . . . The recommendations in the Code reflect this balance. (1.3.8)</p> <p><i>See also Topic Heading 2, below.</i></p>	

Code of Corporate Governance (Mexico)	King Report (South Africa)	Code of Best Practice (South Korea)	The SFT Code and Guidelines (Thailand)
<b>1. The Mission of the Board of Directors</b>			
<p>It is recommended that . . . powers of the Board of Directors include:</p> <ol style="list-style-type: none"> <li>i. establishing the strategic vision of the corporation;</li> <li>ii. assuring that shareholders and the market have access to public information on the corporation;</li> <li>iii. establishing internal control mechanisms;</li> <li>iv. assuring that the corporation has the necessary mechanisms that allow for evidence that it complies with applicable law; and</li> <li>v. evaluating on a regular basis the performance of the <i>Director General</i> and the high-ranking officers of the corporation.</li> </ol> <p>(Principle at 3)</p> <p>It is suggested that the Board of Directors meet at least four times per year. It is recommended that one of these meetings be dedicated to the definition of the medium- and long-term strategy of the corporation. (Principle at 8)</p> <p>[T]he definition of the strategic vision of the company and the approval of its operations should be the responsibility of the Board of Directors. All members of the Board bear responsibility for such duties. (Recommendation at 2)</p> <p>See Recommendation at 2 ([T]o facilitate its duties, the Board should have the support of a medium layer - intermediate management bodies dedicated to evaluating and proposing actions in specific areas. . . . There should be an assurance that clear rules of operation and performance by the Board exist.)</p>	<p>The board must retain full and effective control over the company, monitor the executive management and ensure that the decision of material matters is in the hands of the board. (Ch. 20, The Code of Corporate Practices &amp; Conduct (hereinafter “The Code”), 2.3)</p> <p>The board must be in a position to lead, control and monitor the business of the company. The board has a collective responsibility to provide effective corporate governance. Shareholders should ensure that their boards are constituted in a manner that provides a balance between enterprise and control. (Ch. 4: 3)</p> <p>Directors must act with enterprise and always strive to increase shareholders’ value while having regard for the interests of all stakeholders. (Ch. 5: 2-7)</p> <p>Directors have to ensure that the business remains a going concern, <i>i.e.</i>, that it survives. They have to make the business thrive with enterprise and innovation. In short, directors’ duties in relation to their companies are to drive, strive, survive and thrive. (Ch. 5: 9)</p>	<p>The Board shall make the key management policy decisions in the best interests of the corporation and its shareholders, and shall perform effective supervision of the directors and management. (II.1)</p> <p>[I]t is highly advised that the Board concentrate on key management decision-making and mandate lesser or trivial matters to the respective director or management; or that the Board establish internal committees within itself to which a portion of the authority can be delegated. (Commentary on II.1.2)</p> <p>Directors shall perform their duties . . . in the best interests of the corporation and its shareholders. (II.7)</p>	<p><i>The board of directors should:</i></p> <p>Conduct their duties honestly, comply with all laws, the object[ive]s and the articles of association of the company, and the resolutions of any shareholder meetings in good faith, and with care to preserve the interests of the company. (Ch. 1, The SET Code of Best Practice (hereinafter “The Code”), 2.1)</p> <p>Implement and direct the company’s policies, as well as monitor and supervise its operations to maximize economic value and shareholders’ wealth. (The Code, 2.2)</p> <p>Ensure management’s accountability to shareholders: preserve their rights and interests, clearly and fully disclose information. (The Code, 2.3)</p> <p>Ensure that the company has management with the competency, knowledge and experience to run the business. (The Code, 3.2)</p> <p>Ensure the company is determined to carry on the business continuously. (The Code, 3.3)</p> <p>[Independent directors should d]emonstrate independent judgment to prevent any conflicts of interest. If they oppose any proposal they should state their reasons for disagreeing in the minutes of the board meeting. (The Code, 6.1)</p> <p>A board of directors holds the power to manage the business of a listed company. Shareholder approval is, however, required for certain crucial decisions. (Ch. 2: 2.1)</p> <p>See Topic Headings 2 and 16, <i>below</i>.</p>

GM Board Guidelines	CACG Guidelines (International)	IBGC Code of Best Practice (Brazil)	Hong Kong Stock Exchange Code / Guide (Hong Kong)
<b>2. Board Job Description</b>			
<p><i>Not covered directly, but see Topic Heading 1, above.</i></p>	<p>The board should appoint the chief executive officer and at least participate in the appointment of senior management. (Principle 12)</p> <p>The board should ensure that information technology and systems used in the corporation are adequate to properly run the business and for it to remain a meaningful competitor. (Principle 13)</p> <p>The board must identify key risk areas and key performance indicators of the business enterprise and monitor these factors. (Principle 14)</p> <p>The board must ensure annually that the corporation will continue as a going concern for its next fiscal year. (Principle 15)</p> <p>The concept of a unitary board . . . is the favoured board structure. . . .</p> <p>The board should strive to focus on “performance” in directing the commercial and economic fortunes of the corporation, and not only concentrate on issues of “conformance.” . . .</p> <p>Each director should be diligent in discharging his or her duties to the corporation, endeavour to regularly attend meetings and must acquire a broad knowledge of the business of the corporation so that they can provide meaningful direction to it. Equally, every director should be aware and conversant with the statutory and regulatory requirements affecting the direction of the corporation. (Commentary on Principle 1)</p> <p>The board should also monitor management and staff morale generally. (Commentary on Principle 12)</p>	<p>Article 142 of the Company Law determines the authority of the board of directors. Special emphasis should be given to strategy formulation, election and dismissal of officers, supervision and control of management, and selection and dismissal of independent auditors. (p. 1)</p> <p>The activities of the board of directors should be specified in writing, clarifying its authority and responsibilities, in order to avoid conflicts with the chief executive officer. (p. 1)</p> <p>The board of directors, having access to any company information, should avoid getting involved in the operating matters of the company. (p. 1)</p> <p>It is the function of the board to evaluate officers and management. (p. 2)</p> <p>The board of directors supervises and controls the officers of the company. It is a typical situation of conflict of interest if you supervise and control yourself. Consequently, one should avoid situations when the same person is both officer and board member. (p. 4)</p> <p>The board of directors should annually make a formal performance evaluation of the chief executive officer. (p. 6)</p> <p>The board of directors should always have an up-to-date succession plan for the chief executive officer. (p. 6)</p>	<p><i>See Topic Heading 1, above.</i></p>



Indian Confederation Code (India)	Charter of a Shareholding Society (Kyrgyz Republic)	Report on Corporate Governance (Malaysia)	Reserved
<b>2. Board Job Description</b>			
<p>For non-executive directors to play a material role in corporate decision-making and maximizing long-term shareholder value, they need to:</p> <ul style="list-style-type: none"> <li>▪ become active participants in boards, not passive advisors;</li> <li>▪ have clearly defined responsibilities within the board, such as the audit Committee; and</li> <li>▪ know how to read a balance sheet, profit and loss account, cash flow statements and financial ratios, and have some knowledge of various company laws. This, of course, excludes those who are invited to join boards as experts in other fields such as science and technology.</li> </ul> <p>(Recommendation 4)</p> <p>See Recommendation 1 (There is no need to adopt the German system of two-tier boards to ensure desirable corporate governance. A unitary board, if it performs well, can maximize long-term shareholder value just as well as a two- or multi-tiered board.)</p> <p>See also Topic Heading 1, above.</p>	<p>The Board of Directors is responsible for monitoring the employment policy of the Society and the internal control mechanisms established by the Management Board, in particular, the financial control mechanisms operated by the Management Board. (17.37)</p> <p>The Board of Directors may, through its Chairman, offer such advice as it thinks appropriate to the Management Board, and to the General Meeting of Shareholders and to the Audit Commission. (17.40)</p> <p><i>For a list of matters/situations requiring the approval of the Board of Directors, see 17.38.</i></p> <p><i>For a list of issues on which the Board of Directors must offer advice at a General Meeting of Shareholders, see 17.41.</i></p>	<p>The board should explicitly assume the following six specific responsibilities, which facilitate the discharge of the board's stewardship responsibilities:</p> <ul style="list-style-type: none"> <li>▪ Reviewing and adopting a strategic plan for the company;</li> <li>▪ Overseeing the conduct of the company's business to evaluate whether the business is being properly managed;</li> <li>▪ Identifying principal risks and ensuring the implementation of appropriate systems to manage these risks;</li> <li>▪ Succession planning, including appointing, training, fixing the compensation of and, where appropriate, replacing senior management;</li> <li>▪ Developing and implementing an investor relations programme or shareholder communications policy for the company; and</li> <li>▪ Reviewing the adequacy and the integrity of the company's internal control systems and management information systems, including systems for compliance with applicable laws, regulations, rules, directives and guidelines.</li> </ul> <p>(Best Practice AA.I)</p> <p>The board should meet regularly, with due notice of issues to be discussed, and should record its conclusions in discharging its duties and responsibilities. (Best Practice AA.XIV)</p> <p>The board, together with the Chief Executive Officer, should develop position descriptions for the board and for the Chief Executive Officer, involving definition of the limits to management's responsibilities. In addition, the board should approve, or develop with the Chief Executive Officer, the corporate objectives, which the Chief Executive Officer is responsible for meeting.</p> <p>(Best Practice AA.XVI)</p>	

Code of Corporate Governance (Mexico)	King Report (South Africa)	Code of Best Practice (South Korea)	The SET Code and Guidelines (Thailand)
<b>2. Board Job Description</b>			
<p>[I]t is considered important that the corporation have a general framework of rules governing board performance. It is recommended that Directors observe the following six Principles:</p> <ul style="list-style-type: none"> <li>▪ disclose to the Chairman and Secretary of the Board of Directors any situation that may result in a conflict of interest, and participate in any corresponding deliberations;</li> <li>▪ use the corporation's assets or services only in compliance with its corporate purpose, and clearly define policies that, by exception, allow use of such assets for personal matters;</li> <li>▪ devote the time and attention necessary for the performance of duties, attending at least 70% of Board meetings;</li> <li>▪ maintain absolute confidentiality with regard to all information which may affect the operations of the corporation, as well as with regard to any deliberations that take place in Board meetings;</li> <li>▪ keep his/her respective alternate Director informed of matters discussed in Board meetings, to the extent necessary; and</li> <li>▪ support the Board of Directors with opinions, recommendations and suggestions based on analysis of the operations of the corporation, so that any decisions adopted by the Board will be based on professional and qualified personnel with broad and independent views on the operations of the corporation.</li> </ul> <p>(Principles at 10-11)</p> <p>It is suggested that the accounting policies for the preparation of the financial information of the corporation be submitted for approval to the Board of Directors. (Principle at 16)</p>	<p><i>The main functions of a board are:</i></p> <ul style="list-style-type: none"> <li>▪ to direct the company both as to strategy and structure;</li> <li>▪ to establish from time to time a strategy for the company, including a determination of the businesses that the company should be in and those that it should not be in;</li> <li>▪ to ensure that the executive management implements the company's strategy as established from time to time;</li> <li>▪ to ensure that the company has adequate systems of internal controls both operational and financial;</li> <li>▪ to monitor the activities of the executive management;</li> <li>▪ to select the chief executive, ensure succession and give guidance on the appointment of senior executives;</li> <li>▪ to provide information on the activities of the company to those entitled to it;</li> <li>▪ to ensure that the company operates ethically;</li> <li>▪ to provide for succession of senior management; and</li> <li>▪ to address the adequacy of retirement and health care benefits and funding.</li> </ul> <p>(Ch. 4: 1)</p> <p>See The Code, 2.1 (The unitary board structure is appropriate in South Africa rather than a management and supervisory board structure. The unitary board structure provides greater interaction among all board members when dealing with matters such as strategy, planning, performance, resources, standards of conduct and communication with stakeholders.)</p> <p>See Topic Heading 1, above.</p>	<p>The Board, holding comprehensive power over corporate management, shall perform the following functions of decision-making and management supervision:</p> <ul style="list-style-type: none"> <li>▪ Setting business goals and strategies;</li> <li>▪ Approving business plans and budgets;</li> <li>▪ Supervising management and evaluating management performance;</li> <li>▪ Replacing the management and also reviewing the remuneration;</li> <li>▪ Monitoring major capital expenditures and corporate takeover;</li> <li>▪ Mediating the conflicting interests among directors, management and shareholders;</li> <li>▪ Ensuring integrity of the accounting and financial reporting systems;</li> <li>▪ Supervising risk management and financial control;</li> <li>▪ Supervising the compliance of statutes and ethics-related regulations;</li> <li>▪ Monitoring the effectiveness of governance practices; and</li> <li>▪ Overseeing the process of information disclosure.</li> </ul> <p>(II.1.1)</p> <p>The most important role of outside directors is to enable the Board to perform its management supervisory functions effectively. Such directors . . . mak[e] effective management supervision and objective management counseling possible. (Commentary on II.2.2)</p> <p>Directors . . . shall not divulge or use, for their own or third parties' benefit, any corporate secret obtained. (II.7.3)</p> <p>Outside directors have the same rights and responsibilities as standing directors. However, considering the limitations on the actual performance of duties due to time constraints and the limitations of acquiring information as a non-standing director, outside directors shall be given responsibilities proportionate to the range of operations they can realistically perform. (Recommendation 6)</p>	<p><i>Directors should:</i></p> <p>Conduct themselves honestly and with integrity. (The Code, 3.1)</p> <p>Clearly understand the mission, objectives, capability and efficiency of the listed company and be prepared to devote their time and re-sources to attending and performing their du-ties at every board meeting. (The Code, 4.1.4)</p> <p>Ensure the company secretary completes the minutes for each board of directors and shareholder meeting within the period specified in the relevant laws. Carefully review such minutes. (The Code, 4.1.6)</p> <p>Continuously follow and monitor the business performance and operations of the company . . . (The Code, 4.2.1)</p> <p>Appoint a company secretary to take care of all the directors' activities and to conduct the company's business in full compliance with all . . . laws and . . . regulations. (The Code, 4.2.2)</p> <p>In addition to the duty of care, and the duty of loyalty required from all directors (including independent directors), independent directors are expected to, in general, guard against any acts by the board of directors which may prejudice the interests of the company's minority shareholders. (Ch. 2: 10.1)</p> <p>[T]he board of directors may pay interim dividends to shareholders if it believes the company's profits justify such payment. (Ch. 3: 5.2)</p> <p>[D]irectors and executives of a listed company which is an acquirer should familiarize themselves with the SEC's Notification and the SET's Regulations Governing Takovers and be assured that the contemplated transaction is conducted in strict compliance therewith. (Ch. 7: 5.3)</p>

GM Board Guidelines	CACG Guidelines (International)	IBGC Code of Best Practice (Brazil)	Hong Kong Stock Exchange Code / Guide (Hong Kong)
<b>3. Board Membership Criteria</b>			
<p>The Committee on Director Affairs is responsible for reviewing with the Board, on an annual basis, the appropriate skills and characteristics required of Board members in the context of the current make-up of the Board. This assessment should include issues of judgment, diversity, age, skills such as understanding of manufacturing technologies, international background, etc. — all in the context of an assessment of the perceived needs of the Board at that point in time. (Guideline 1)</p>	<p>The board should ensure that through a managed and effective process board appointments are made that provide a mix of proficient directors, each of whom is able to add value and to bring independent judgment to bear on the decision-making process. (Principle 2)</p> <p>The board should be composed of people of integrity who can bring a blend of knowledge, skills, objectivity, experience and commitment to the board which should be led by a capable Chairman who brings out the best in each director. (Commentary on Principle 2)</p>	<p><b>Personal characteristics of the board member[s]</b></p> <p>Each board member should have:</p> <ul style="list-style-type: none"> <li>▪ personal integrity,</li> <li>▪ capacity to read and understand financial statements,</li> <li>▪ absence of conflicts of interest with the company,</li> <li>▪ time availability, and</li> <li>▪ motivation.</li> </ul> <p>(p. 2)</p> <p><b>Core competencies of the board of directors</b></p> <p>The following experiences and competencies should be available among the members of the board of directors:</p> <ul style="list-style-type: none"> <li>▪ experience from good boards,</li> <li>▪ experience as chief executive officer,</li> <li>▪ experience of crisis management,</li> <li>▪ knowledge of finance,</li> <li>▪ knowledge of accounting,</li> <li>▪ knowledge of the industry of the company,</li> <li>▪ knowledge of the international market,</li> <li>▪ strategic vision, and</li> <li>▪ contacts of value for the company.</li> </ul> <p>(pp. 2-3)</p> <p>The board should have a diversity of background, knowledge and experience. (p. 3)</p>	<p>Every non-executive director must ensure that he can give sufficient time and attention to the affairs of the issuer and should not accept the appointment if he cannot. (Code of Best Practice (hereinafter “The Code”), 10)</p> <p>Every director, in the performance of his duties as a director, must</p> <ul style="list-style-type: none"> <li>▪ act honestly and in good faith in the interests of the company as a whole</li> <li>▪ act for proper purpose</li> <li>▪ be answerable to the company for the application or misapplication of its assets</li> <li>▪ avoid actual and potential conflicts of interest and duty</li> <li>▪ disclose fully and fairly his interests in contracts with the company</li> <li>▪ apply such degree of skill, care and diligence as may reasonably be expected of a person of his knowledge and experience and holding his office within the company.</li> </ul> <p>(Guideline A.4)</p> <p>Every director of a company listed on the Exchange must satisfy the Exchange that he has the character, integrity, experience and competence to serve as a director of a listed company. The Exchange expects this requirement to be satisfied on a continuing basis. (Guideline A.5)</p>

Indian Confederation Code (India)	Charter of a Shareholding Society (Kyrgyz Republic)	Report on Corporate Governance (Malaysia)	Reserved
<b>3. Board Membership Criteria</b>			
<p>No single person should hold directorships in more than 10 listed companies. (Recommendation 3)</p> <p>For non-executive directors to play a material role in corporate decision-making and maximizing long-term shareholder value, they need to:</p> <ul style="list-style-type: none"> <li>▪ become active . . . ;</li> <li>▪ have clearly defined responsibilities . . . ; and</li> <li>▪ know how to read a balance sheet, profit and loss account, cash flow statements and financial ratios and have some knowledge of various company laws. This, of course, excludes those who are invited to join boards as experts in other fields such as science and technology.</li> </ul> <p>(Recommendation 4)</p> <p>[The Code recommends a] [r]eduction in the number of companies where there are nominee directors. It has been argued by [Financial Institutions] that there are too many companies where they are on the board, and too few competent officers to do the task properly. So, in the first instance, [Financial Institutions] should take a policy decision to withdraw from boards of companies where their individual shareholding is 5 percent or less, or [their] total holding is under 10 percent. (Recommendation 17)</p>	<p><i>Not covered directly, but see 17.5 (No member of the Management Board or the Independent Auditors may be a member of the Board of Directors.).</i></p>	<p>Non-executive directors should be persons of calibre, credibility and have the necessary skill and experience to bring an independent judgement to bear on the issues of strategy, performance and resources including key appointments and standards of conduct. (Best Practice AA.III)</p>	

Code of Corporate Governance (Mexico)	King Report (South Africa)	Code of Best Practice (South Korea)	The SET Code and Guidelines (Thailand)
<b>3. Board Membership Criteria</b>			
<p>Independent Directors are persons selected for their abilities, experience and professional recognition. (Principle at 4)</p> <p>[I]t is important to incorporate the concept of Patrimonial Director. The main characteristic of this member of the Board is that he/she has a significant holding of the capital stock of the corporation. The participation of the Patrimonial Director is appropriate in view of the fact that he/she will maintain permanent supervision of his/her investment, which will be for the benefit of the corporation. (Recommendation at 5)</p>	<p>Each board member must, of course, have absolute integrity. (The Code, 2)</p> <p>While it is preferable to balance the board, with an appropriate mix of skills and expertise among the non-executive directors, it must be accepted that it may not always be practical in South Africa because of the present skills shortage. (Ch. 4: 9)</p> <p>[A] candidate should have integrity and independence of thought; the courage to express their independent thought; a grasp of the realities of business operations; an understanding of the changes taking place regionally, nationally and internationally; an understanding of business and financial "language". (Ch. 9: 8.2)</p>	<p>The Board shall . . . appoint[ ] competent professional directors. (II.3.3)</p> <p>[D]irectors shall be competent and professional. Such directors . . . possess[ ] the following qualities: a vision for and a strategic perception of corporate management; a level-headed and sound managerial judgment; an ability for managing and supervising an organization; a knowledge of law and finance; and some experience suitable for the corporation concerned. (Commentary on II.3.3)</p> <p>See II.2 (The Board shall be composed so as to allow effective decision-making and supervision of management ).</p>	<p>[Board members must c]onduct themselves honestly and with integrity. (The Code, 3.1)</p> <p>[Potential directors should o]nly accept the position of director or non-executive director on the board of listed companies that he/she has the time to attend appropriately. (The Code, 4.3.1)</p> <p>All directors must be natural persons and:</p> <ul style="list-style-type: none"> <li>i. be <i>sui juris</i>, i.e., 20 years of age or older.</li> <li>ii. be solvent and not incompetent, or quasi-incompetent.</li> <li>iii. never been imprisoned based on a final judgement for a fraudulent offence related to property.</li> <li>iv. never been dismissed, or removed from government service, a government organization or agency due to dishonesty in the performance of their duties.</li> </ul> <p>Additionally, the director of a listed company involved in some businesses must have qualifications as prescribed by the laws governing such businesses, i.e., the director of a bank or financial institution. (Ch. 2: 2.3)</p> <p>All directors need not have domicile in Thailand. However, not less than half of them shall reside within Thailand. (Ch. 2: 2.5)</p> <p>There are no restrictions on shareholders becoming directors of a listed company. (Ch. 2: 2.6)</p> <p>See Message from the President of the SET, p. iii ([E]ach member of a board of directors must possess . . . a good education, a high standard of business knowledge and experience, and a company belief in ethical corporate behavior. A director must also perform their duties with care and loyalty and avoid any conflict of interest between the company and its management or the major shareholders.).</p>

GM Board Guidelines	CACG Guidelines (International)	IBGC Code of Best Practice (Brazil)	Hong Kong Stock Exchange Code / Guide (Hong Kong)
<b>4. Selecting, Inviting, and Orientating New Directors</b>			
<p>The Board itself should be responsible, in fact as well as procedure, for selecting its own members and in recommending them for election by the stockholders. The Board delegates the screening process involved to the Committee on Director Affairs with the direct input from the Chairman of the Board and the Chief Executive Officer. The Board and the Company have a complete orientation process for new Directors that includes background material, meetings with senior management and visits to Company facilities. (Guideline 2)</p> <p>The invitation to join the Board should be extended by the Board itself via the Chairman and Chief Executive Officer of the Company, together with the Chairman of the Committee on Director Affairs, or the Chairman of the Executive Committee. (Guideline 3)</p>	<p>The board should ensure that through a managed and effective process board appointments are made that provide a mix of proficient directors, each of whom is able to add value and to bring independent judgment to bear on the decision-making process. (Principle 2)</p> <p>The selection process must be managed by asking what skills are needed on the board to add value to the processes of the board in the context of the business of the corporation. Consequently, the composition of the board should be planned with strategic considerations and objectives of the corporation in mind.</p> <p>New directors should be familiarized with the corporation's operations and senior management, its business environment and be inducted in terms of their fiduciary duties and responsibilities as well as in respect of the board's expectations. If a new director has no board experience, they should receive training in this onerous responsibility which carries with it significant personal liabilities.</p> <p>The board, as a whole, should be involved in the selection of directors. (Commentary on Principle 2)</p> <p>To remain effective, the board should select, appoint, induct and develop or remove board members as necessary from time to time. Incompetent or unsuitable directors should be removed, taking relevant legal and other matters into consideration. In practice, the Chairman will usually play a lead part in such issues. (Commentary on Principle 9)</p> <p>Training opportunities for existing and potential directors should be identified and appropriate development undertaken. (Commentary on Principle 11)</p>	<p>Each new board member should be exposed to an introduction program including a board file with a job description for board members, the last annual reports, the minutes from ordinary and extraordinary general assemblies, the minutes from the board meetings, and other information about the company. The new board member should be introduced to his or her colleagues, to the officers and to key personnel. There should be visits to factories and other places of business. Depending on the type of company, additional training should be included. (p. 6)</p>	<p>Every listed company director is required to execute and deliver to the Exchange a Declaration and Undertaking with regard to Directors. (Guideline B.1)</p> <p>The Director's Declaration and Undertaking requests background information on the director or proposed director in order to assist the Exchange's assessment of the person's suitability to serve as a director of a listed company. (Guideline B.1.3)</p>

Indian Confederation Code (India)	Charter of a Shareholding Society (Kyrgyz Republic)	Report on Corporate Governance (Malaysia)	Reserved
<b>4. Selecting, Inviting, and Orienting New Directors</b>			
<p>It would be desirable for [Financial Institutions] as pure creditors to re-write their covenants to eliminate having nominee directors except:</p> <p>a) in the event of serious and systematic debt default; and</p> <p>b) in case of the debtor company not providing six-monthly or quarterly operational data to the concerned [Financial Institutions].</p> <p>(Recommendation 14)</p> <p>Securing the services of good, professionally competent, independent non-executive directors does not necessarily require the institutionalizing of nomination committees or search committees. (p. 2)</p> <p>[I]nsofar as creditors are not shareholders, and so long as their dues are being paid on time, they should desist from demanding a seat on the board of directors.</p> <p>This is an important point in the Indian context. Almost all term loans from [Financial Institutions currently] carry a covenant that [they] will be represented on the board of the debtor company via a nominee director. . . . It would be desirable for [them] to eliminate [this practice]. (p. 7)</p>	<p>Any two Minor shareholders may together nominate a candidate for election to the Board of Directors. (17.10)</p> <p>The AGM may elect one member of the Board of Directors from a list of one or more nominations provided by the employees of the Society. (17.11)</p> <p>The AGM may elect one member of the Board of Directors from a list of one or more nominations provided by the largest outstanding creditor of the Society. (17.12)</p> <p>The AGM may, where appropriate, elect one further member to the Board of Directors from nominations provided by other interested parties, <i>e.g.</i>, long-term suppliers or customers/ consumers, a second large creditor, <i>etc.</i> (17.13)</p>	<p>There should be a formal and transparent procedure for the appointment of new directors to the board. (Principle A.IV)</p> <p>As an integral element of the process of appointing new directors, each company should provide an orientation and education program for new recruits. (Best Practices AA.XIII)</p> <p>The board's process for assessing existing directors and identifying, recruiting, nominating, appointing and orienting new directors is central to enhanced governance. This function can be performed by the board as a whole. But we endorse the view that the adoption of a formal procedure for appointments to the board, with a nomination committee making recommendations to the full board, should be recognized as good practice. (Explanatory Note 4.4 on Principle A.IV at 76)</p> <p>We endorse the view that it is the board's responsibility to appoint new directors and the shareholders' responsibility to re-elect them. Re-election at regular intervals not only promotes effective boards but affords shareholders the opportunity to review the directors' performance in turn and where necessary to replace them. (Explanatory Note 4.5 on Principle A.V at 76)</p>	

Code of Corporate Governance (Mexico)	King Report (South Africa)	Code of Best Practice (South Korea)	The SET Code and Guidelines (Thailand)
<b>4. Selecting, Inviting, and Orientating New Directors</b>			
<p>It is suggested that, when Directors are appointed for the first time, adequate instruction on their new responsibilities be provided to them. At a minimum, the corporation shall provide information related to the corporation and business environment, as well as the obligations, responsibilities and duties implicit in the position of Director. (Principle at 9)</p> <p>[New Directors] should know, among other things, what position the corporation holds in its business sector, and who are its main competitors, clients and suppliers. (Recommendation at 9)</p> <p>Directors are legally responsible for the performance of their duties. Lack of knowledge of their obligations does not release Directors from their duties. It is therefore important that the legal scope and consequences of their duties, as well as the provisions applicable to the Board that are contained in the corporation's by-laws, be disclosed to new Directors. (Recommendation at 9)</p> <p>It is important that shareholders receive [prior to the annual meeting] all information in connection with the candidates for Directors of the corporation, specifically, brief résumés, in order to be able to evaluate their backgrounds and proceed with a more informed vote. (Recommendation at 21)</p> <p>See Recommendation at 3 (It is important to avoid indiscriminate substitutions of Directors by alternates when a Director cannot be present at a Board meeting . . . . [However,] it is considered acceptable for a Director to team up with a specific alternate, in order to foster more effective performance as a Director.)</p>	<p>The selection and appointment of directors should be matters for the board as a whole and as such nomination committees are not recommended. (The Code, 5.1)</p> <p>In the event of there being a nomination committee, the selection process should be tabled and agreed by the whole board and not delegated to the nomination committee which should only make recommendations. (Ch. 9: 5)</p> <p>A new director needs to visit the company's operations, meet senior executives and generally become familiar with the company. They should be told by the chair what is expected of them and there should be briefings on personal liability, dealing in the company's shares and their responsibilities on any committee on which the director may be required to serve. If they have no board experience they should receive training (Ch. 9: 8.4)</p> <p>Each newly appointed director should have proper internal training, <i>i.e.</i>, a proper process of induction into the company's affairs. If a new director has no prior board experience they should undergo some training before taking their seat on the board. (Ch. 10: 3)</p> <p>The training and development of directors is important for good governance and needs to be uppermost in the minds of boards in making new appointments. (Ch. 10: 5)</p>	<p>Directors shall be appointed through a transparent procedure that reflects broadly the diverse opinions of shareholders. (II.3)</p> <p>It is advised that a committee be established and managed for the fair nomination of directors. The committee shall be organized such that the fairness and independence of the nomination process are ensured. (II.3.1)</p> <p>At least half of the nomination committee members should be outside directors. (Commentary on II.3.1)</p> <p>The opinions of shareholders other than the controlling shareholder shall also be reflected when appointing directors. (II.3.2)</p> <p>The corporation shall, by disclosing the nominated directors prior to the general shareholder meeting, ensure that shareholders exercise their voting rights with information on the nominees. (II.3.4)</p> <p>When minority shareholders are looking to nominate directors, such intentions shall be announced at the time the general shareholder meeting is notified; then the nominees shall be recommended and disclosed before the general shareholder meeting. (Commentary on II.3.4)</p>	<p>The Act [<i>i.e.</i>, the Public Limited Companies Act of 1992] prescribes that directors shall be elected at a shareholders' meeting in accordance with the rules and procedures as prescribed in the Articles of Association. If the Articles of Association do not provide the rules and procedures for the appointment of directors, the Act states that cumulative voting should be applied. In the case of a vacancy on the board of directors for reasons other than the expiration of a director's term in office, the board of directors shall elect another person as a substitute director. The substitute director shall hold office only for the remaining term of office of the director whom he or she replaced. However, in appointing a director, the board of directors should clearly specify the powers of the director in operating the businesses of the company. (Ch. 2: 2.7)</p> <p>In binding the company, the position of director shall be effective when a shareholders' meeting passes a resolution appointing a person as a director.</p> <p>However, for binding a third party, the position of director shall be effective when such a director has been registered by the registrar in the Ministry of Commerce. (Ch. 2: 2.8).</p> <p>See The Code, 4.3.3 ([Directors should a]void any other positions or jobs that may lead to conflicts of interest.)</p>



GM Board Guidelines	CACG Guidelines (International)	IBGC Code of Best Practice (Brazil)	Hong Kong Stock Exchange Code / Guide (Hong Kong)
<b>5. Separation of Chairman and CEO</b>			
<p>The Board should be free to make this choice [of whether or not to separate the role of CEO from that of board chair-person] any way that seems best for the Company at a given point in time.</p> <p>Therefore, the Board does not have a policy, one way or the other, on whether or not the role of the Chairman and Chief Executive should be separate and, if it is to be separate, whether the Chairman should be selected from the non-employee Directors or be an employee. (Guideline 4)</p> <p>See Guideline 5 (The Chairman of the Executive Committee will be an independent director and will not concurrently be the chairman of any of the standing committees of the Board of Directors but will be an <i>ex officio</i> member of each standing Committee of the Board. When the Chairman of the Board is an independent director, the Chairman of the Board will serve as the Chairman of the Executive Committee.).</p>	<p>The board should ensure that no one person or a block of persons has unfettered power and that there is an appropriate balance of power and authority on the board which is, <i>inter alia</i>, usually reflected by separating the roles of the chief executive officer and Chairman, and by having a balance between executive and non-executive directors. (Principle 9)</p> <p>The firm and objective leadership of a Chairman, preferably non-executive, who accepts the duties and responsibilities which the post entails, should provide the direction necessary for an effective board. (Commentary on Principle 1)</p> <p>See Commentary on Principle 9 (Where the roles of Chairman and chief executive officer are combined, it is important to ensure that the non-executive directors are of sufficient calibre to bring an independent judgment to bear on issues of strategy, performance, resources and standards of conduct and evaluation of performance.).</p> <p>See also Commentary on Principle 11 ([T]he other members of the board should ensure that the Chairman's effectiveness is appraised annually. In practice, non-executive directors may take a lead role in this appraisal process.).</p>	<p>It is a typical situation of conflict of interest if you supervise and control yourself. Consequently, one should avoid situations when the same person is both officer and board member.</p> <p>One should try to avoid situations where the same person is the chairman of the board and chief executive officer. The logic here is the same as the case above when the same person is both officer and board member.</p> <p>In the case when the chairman of the board and the chief executive officer is the same person, it is vital that there be a strong independent board member who is respected by colleagues and by the industry and who can serve as a lead director to counterbalance the power of the chairman/CEO. (p. 4)</p>	<p><i>Not covered.</i></p>

Indian Confederation Code (India)	Charter of a Shareholding Society (Kyrgyz Republic)	Report on Corporate Governance (Malaysia)	Reserved
<b>5. Separation of Chairman and CEO</b>			
<p>Any listed companies with a turnover of Rs. 100 crores and above should have professionally competent, independent, non-executive directors, who should constitute:</p> <ul style="list-style-type: none"> <li>▪ at least 30 percent of the board if the Chairman of the company is a non-executive director, or</li> <li>▪ at least 50 percent of the board if the Chairman and Managing Director is the same person.</li> </ul> <p>(Recommendation 2)</p>	<p>The members of the Board of Directors shall elect its Chairman, but the election may be overturned by a two-thirds majority of the votes of shareholders at a General Meeting of Shareholders. (17.17)</p> <p>The Chairman of the Management Board [<i>i.e.</i>, CEO] cannot be a member of the Board of Directors. (18.19)</p> <p>The Chief Executive Officer . . . has the right to attend and speak at all meetings of the Board of Directors but has no vote on it. When a vote is taken, he must withdraw from the meeting unless requested by the Board of Directors to remain. (17.6)</p>	<p>There should be a clearly accepted division of responsibilities at the head of the company, which will ensure a balance of power and authority, such that no one individual has unfettered powers of decision. Where the roles are combined there should be a strong independent element on the board. A decision to combine the roles of Chairman and Chief Executive should be publicly explained. (Best Practice AA.II)</p> <p>Given the importance and particular nature of the Chairman's role, it should in principle be separate from that of the Chief Executive. (Explanatory Note 4.20 on Best Practice AA.II at 82)</p>	

Code of Corporate Governance (Mexico)	King Report (South Africa)	Code of Best Practice (South Korea)	The SET Code and Guidelines (Thailand)
<b>5. Separation of Chairman and CEO</b>			
<i>Not covered.</i>	<p>The chair should, unless it is considered by the board not to be in the company's interests, be a non-executive director of the company and should not also be the chief executive. The non-executive directors have a particular responsibility to ensure that when the chair is an executive director that the chair encourages proper deliberation of all matters requiring the board's attention, and obtains optimum input from the other executive directors. (The Code, 3.1)</p>	<p><i>Not covered directly, but see Commentary on II.4.5 (Meetings for outside directors only shall be held regularly; a representative shall be appointed among the outside directors to supervise such a meeting and to handle important issues delegated to them.).</i></p>	<i>Not covered.</i>

GM Board Guidelines	CACG Guidelines (International)	IBGC Code of Best Practice (Brazil)	Hong Kong Stock Exchange Code / Guide (Hong Kong)
<b>6. Board Size</b>			
The Board in recent years has averaged 15 members. It is the sense of the Board that this size is about right. However, the Board would be willing to go to a somewhat larger size in order to accommodate the availability of an outstanding candidate(s). (Guideline 6)	<i>Not covered.</i>	The size of the board of directors should be as small as possible and, depending on the requirements of the company, should vary between 5 and 9 members. (p. 2)	<i>Not covered.</i>
<b>6. Board Size</b>			
Indian Confederation Code (India)	Charter of a Shareholding Society (Kyrgyz Republic)	Report on Corporate Governance (Malaysia)	Reserved
<b>6. Board Size</b>			
<i>Not covered.</i>	There shall be not less than three members of the Board of Directors. (17.4)  A quorum shall be set by the Board of Directors but shall not be less than two members of the Board of Directors. (17.31)	Every board should examine its size, with a view to determining the impact of the number upon its effectiveness. (Best Practice AA.XII)	
<b>6. Board Size</b>			
Code of Corporate Governance (Mexico)	King Report (South Africa)	Code of Best Practice (South Korea)	The SET Code and Guidelines (Thailand)
<b>6. Board Size</b>			
It is recommended that the Board of Directors consist of between 5 and 15 members. (Principle at 3)  It is recommended that there be no alternate Board members. However, if alternates are chosen, they can act only in place of their specific respective Director. In this case, it is recommended that each Director be able to propose his/her alternate. (Principle at 4)  Establishing a minimum number of Board members is necessary in order to generate a plurality of opinions among Board members. Establishing a maximum number is necessary in order to assure that Directors will be able to effectively express and discuss their points of view without the inefficiency that might result from having too many Board members. (Recommendation at 3)	<i>Not covered directly, but note that the Report states that there should be a balance of executive and non-executive directors, and also that there should never be less than two non-executive directors on the board in addition to the Chair who, by preference, should also be non-executive. (See Ch. 6, including 6:16, 6:17)</i>	There is no perfect number of directors appropriate for all the different circumstances of corporations. The reason lies with the many different factors that may influence the Board's size, e.g., the corporation's size, the business environment, and special characteristics. Nevertheless, the Board's size shall be such that it allows the discussions to be fruitful and the decisions made to be appropriate, swift and prudent.  For large public corporations, it is highly advised that the number of directors on the Board be appropriate for effectively managing internal committees. (II.2.1)	The number of directors comprising the board of directors of a company is set out in the Articles of Association as being no less than five directors. (Ch. 2: 2.2)

GM Board Guidelines	CACG Guidelines (International)	IBGC Code of Best Practice (Brazil)	Hong Kong Stock Exchange Code / Guide (Hong Kong)
<b>7. Mix of Inside and Outside Directors</b>			
<p>The Board believes that as a matter of policy, there should be a majority of independent Directors on the GM Board (as defined in By-law 2.12). The Board is willing to have members of Management, in addition to the Chief Executive Officer, as Directors. But, the Board believes that Management should encourage senior managers to understand that Board membership is not necessary or a prerequisite to any higher Management position in the Company. Managers other than the Chairman and Chief Executive Officer and the Vice Chairman currently attend Board meetings on a regular basis even though they are not members of the Board.</p> <p>On matters of corporate governance, the Board assumes decisions will be made by the independent Directors. (Guideline 7)</p>	<p>The board should ensure that through a managed and effective process board appointments are made that provide a mix of proficient directors, each of whom is able to add value and to bring independent judgment to bear on the decision-making process. (Principle 2)</p> <p>The board should ensure that no one person or block of persons has unfettered power and that there is an appropriate balance of power and authority on the board which is, <i>inter alia</i>, usually reflected by . . . having a balance between executive and non-executive directors. (Principle 9)</p> <p>The board should, preferably, be balanced as between executive and non-executive directors. The actual balance will depend on the circumstances and business of each enterprise, and may well be influenced by local law and regulations. (Commentary on Principle 1)</p>	<p>A majority of the board members should be independent. (p. 3; <i>see also</i> p. 4)</p> <p>The fundamental reason for the importance of independence is to avoid conflicts of interest. (p. 4)</p> <p>There are three classes of board members:</p> <ul style="list-style-type: none"> <li>▪ independent,</li> <li>▪ external (board members who do not work in the company but who are not independent), and</li> <li>▪ internal (board members who are employed by the company or its subsidiaries or associates).</li> </ul> <p>(p. 4)</p>	<p><i>Not covered directly, but see The Code, 12 which implies that the Hong Kong Stock Exchange has some requirement for service by non-executive or independent directors on the Board (If an independent non-executive director resigns or is removed from office, the Exchange should be notified of the reasons why.).</i></p>

Indian Confederation Code (India)	Charter of a Shareholding Society (Kyrgyz Republic)	Report on Corporate Governance (Malaysia)	Reserved
<b>7. Mix of Inside and Outside Directors</b>			
<p>Any listed companies with a turnover of Rs.100 crores and above should have professionally competent, independent, non-executive directors, who should constitute</p> <ul style="list-style-type: none"> <li>▪ at least 30 percent of the board if the Chairman of the company is a non-executive director, or</li> <li>▪ at least 50 percent of the board if the Chairman and Managing Director is the same person.</li> </ul> <p>(Recommendation 2)</p> <p>[T]he quality of the board – and, hence, corporate governance – improves with the induction of outside professionals as non-executive directors. (p. 2)</p> <p>The board should have a core group of excellent, professionally acclaimed non-executive directors. (p. 2)</p>	<p>Members of the Management Board and the Audit Commission cannot simultaneously be members of the Board of Directors. (14.5)</p> <p><i>See Topic Headings 4 and 5, above, and 15, below.</i></p>	<p>The board should include a balance of executive directors and non-executive directors (including independent non-executives) such that no individual or small group of individuals can dominate the board’s decision-making. (Principle A.II)</p> <p>To be effective, independent non-executive directors need to make up at least one-third of the membership of the board. (Best Practice AA.III)</p> <p>In circumstances where a company has a significant shareholder, in addition to the requirement that one-third of the board should comprise independent directors, the board should include a number of directors which fairly reflects the investment in the company by shareholders other than the significant shareholder. For this purpose, a “significant shareholder” is defined as a shareholder with the ability to exercise a majority of votes for the election of directors. (Best Practice AA.IV)</p> <p>In circumstances where the shareholder holds less than the majority but is still the largest shareholder, the board will have to exercise judgment in determining what is the appropriate number of directors which fairly reflects the investment in the company by the remaining holders of the shares. (Best Practice AA.V)</p>	

Code of Corporate Governance (Mexico)	King Report (South Africa)	Code of Best Practice (South Korea)	The SET Code and Guidelines (Thailand)
<b>7. Mix of Inside and Outside Directors</b>			
<p>Patrimonial Board members are those who are selected because they are significant stockholders or agents of significant stockholders. Depending on whether significant stockholders or their agents comply with the characteristics of an Independent member of the Board, they may be Patrimonial Directors, Independent Directors, or Related Patrimonial Directors. (Principle at 5)</p> <p>Related Directors are all other Directors who do not fall into the definitions mentioned above. (Principle at 5)</p> <p>It is suggested that Independent Directors and Patrimonial Directors jointly represent at least 40% of the Board of Directors. Furthermore, it is recommended that Independent Directors represent at least 20% of the total number of Board members. (Principle at 6)</p> <p>In order for the Independent Directors and Patrimonial Directors to fulfill their intended roles, it is necessary that they have a sufficient percentage of representation on the Board. (Recommendation at 5)</p>	<p>No board should have less than two non-executive directors of sufficient calibre that their views will carry significant weight in board decisions. (The Code, 2.2)</p> <p>A board needs to be balanced with at least an equal number of executive and non-executive directors. Obviously the chair plays a vital role and should be independent and non-executive. Where there is not such a chair, there should be at least two non-executive directors of such calibre and they would carry significant weight in that board's deliberations and resolutions. (Ch. 4: 9)</p>	<p>The Board shall include outside directors capable of performing their duties independently from management, controlling shareholders and the corporation. The number of outside directors shall be such that the Board is able to maintain practical independence. Particularly, it is recommended that financial institutions and large-scale public corporations gradually increase the ratio of outside directors to more than half of the total number of directors (minimum three outside directors). (II.2.2)</p> <p>To raise the transparency of corporate management and to improve corporate governance, stock-listed corporations shall appoint outside directors to fill a minimum one-quarter of the total; banks and public sector corporations, a minimum one-half.</p> <p>For outside directors to perform their functions properly, it is important that the number of outside directors appointed is sufficient for them to exercise real influence in the Board's decision-making process. Therefore, the proportion of outside directors shall be decided at the level where the Board would be able to maintain actual independence from management and controlling shareholders while exercising influential authority over management decisions. (Commentary on II.2.2)</p> <p>Outside directors shall be able to independently participate in important corporate management decision-making, and to supervise and support the management as Board members. (II.4)</p>	<p>[A]t least two . . . directors must be independent directors. Additional independent director(s) must be appointed within three months if there are ever less than two independent directors. (Ch. 2: 2.2)</p> <p>The Act [<i>i.e.</i>, the Public Limited Companies Act of 1992] does not provide for independent directors and their qualifications. It is the SET's regulations which require the board of directors of a listed company to comprise at least two independent directors. (Ch. 2: 2.4)</p>

GM Board Guidelines	CACG Guidelines (International)	IBGC Code of Best Practice (Brazil)	Hong Kong Stock Exchange Code / Guide (Hong Kong)
<b>8. Definition of "Independence"</b>			
<p>GM's By-law 2.12, defining independent Directors, was approved by the Board in January 1991. The Board believes there is no current relationship between any independent Director and GM that would be construed in any way to compromise any Board member being designated independent. Compliance with the By-law is reviewed annually by the Committee on Director Affairs. (Guideline 8)</p> <p><i>By-law 2.12 provides:</i></p> <p>"Independent Director" shall mean a director who:</p> <ol style="list-style-type: none"> <li>i. is not and has not been employed by the corporation or its subsidiaries in an executive capacity within the five years immediately prior to the annual meeting at which the nominees of the board of directors will be voted upon;</li> <li>ii. is not (and is not affiliated with a company or a firm that is) a significant advisor or consultant to the corporation or its subsidiaries;</li> <li>iii. is not affiliated with a significant customer or supplier of the corporation or its subsidiaries;</li> <li>iv. does not have significant personal services contract(s) with the corporation or its subsidiaries;</li> <li>v. is not affiliated with a tax-exempt entity that received significant contributions from the corporation or its subsidiaries; and</li> <li>vi. is not a spouse, parent, sibling or child of any person described by (i) through (v).</li> </ol>	<p>Non-executive directors, desirably, should be free from any business or other relationship which could interfere materially with the exercise of their independent judgment (Commentary on Principle 9)</p> <p><i>See</i> Commentary on Principle 3 (The board should be able to exercise objective judgment on the corporate affairs of the business enterprise, independent from management.)</p> <p><i>See also</i> Commentary on Principle 7 (A director should avoid conflicts of interests. Full and timely disclosure of any conflict, or potential conflict, must be made known to the board. Where an actual or potential conflict does arise, a director should at least refrain from participating in the debate and/or voting on the matter. In the extreme case of continuing material conflict of interest, the director should consider resigning from the board. Any director who is appointed to a board at the instigation of a party with a substantial interest in the corporation, such as a major shareholder or a substantial creditor, should recognize the potential for a conflict of interests and accept that their primary responsibility is to always act in the interests of the corporation.)</p> <p><i>See also</i> Topic Heading 7, <i>above</i>.</p>	<p>A board member is independent if he or she:</p> <ul style="list-style-type: none"> <li>▪ has no link to the company besides the board position and the possession of shares of the company,</li> <li>▪ has never been employed by the company or any of its subsidiaries or associate companies,</li> <li>▪ provides no services or products to the company,</li> <li>▪ is not employed by any firm providing major services or products to the company,</li> <li>▪ is not the spouse or first or second degree relative to any officer, manager or the ultimate controller of the company,</li> <li>▪ is not receiving any compensation from the company other than board remuneration and dividends, if a shareholder.</li> </ul> <p>(p. 4)</p> <p><i>See</i> p. 4 (The board member should work for the good of the company and consequently for <u>all</u> the shareholders. The board member should try to maintain maximum independence from the shareholder, shareholding group or interested party who might have indicated him or her for board membership.).</p>	<p><i>Not covered.</i></p>

Indian Confederation Code (India)	Charter of a Shareholding Society (Kyrgyz Republic)	Report on Corporate Governance (Malaysia)	Reserved
<b>8. Definition of "Independence"</b>			
<p><i>Although the Code calls for "professionally competent, independent, non-executive directors," it does not define the term "independent."</i></p>	<p><i>According to this Charter, anyone who is a member of either the Board of Directors, or the Management Board, or the Audit Commission may not, by definition, be a member of any of the others.</i></p> <p>An official should not use in personal interests opportunities opening in the sphere of the purposes of activity of the Society, without observance of conditions contained in this article. (20.2; for list of conditions, see 20.3-20.8)</p> <p>See 18.19 (The Chairman of the Management Board [<i>i.e.</i>, the CEO] cannot be a member of the Board of Directors.).</p>	<p>The term "independent" is defined under Rule 9 of the Listing Requirements as follows:</p> <p>The composition of the board of directors should reflect the ownership structure of the company. Every listed company should have independent directors, <i>i.e.</i>, directors that are not officers of the company; who are neither related to its officers nor represent concentrated or family holdings of its shares; who, in the view of the company's board of directors, represent the interests of public shareholders, and are free of any relationship that would interfere with the exercise of independent judgement.</p> <p>(Explanatory Note 4.23 on Best Practice AA.II at 82-83)</p> <p>There are two features to this definition that the Committee endorses:</p> <ul style="list-style-type: none"> <li>▪ First, that it incorporates an imprecise definition of independence. It is not practicable to lay more precise criteria of independence. It should be for the board to take a view as to whether a particular director is independent in the above sense. ...</li> <li>▪ Second, the term "independence" refers to two crucial aspects -- independence from management and independence from a significant shareholder.</li> </ul> <p>(Explanatory Note 4.24 on Best Practice AA.III at 83)</p> <p>See Explanatory Notes 4.70 - 4.77 on Best Practice CC (<i>interests represented by the board</i>).</p>	



Code of Corporate Governance (Mexico)	King Report (South Africa)	Code of Best Practice (South Korea)	The SET Code and Guidelines (Thailand)
<b>8. Definition of “Independence”</b>			
<p>Independent Directors are persons selected for their abilities, experience and professional recognition, and who at the time of their designation are <u>not</u>:</p> <ol style="list-style-type: none"> <li>i. employees or officers of the corporation;</li> <li>ii. stockholders of the corporation having authority over officers of the corporation;</li> <li>iii. consultants to the corporation . . . whose incomes depend significantly on such contractual relationships;</li> <li>iv. clients, suppliers, debtors or creditors of the corporation . . . ;</li> <li>v. employees of a charitable institution, university or entity that receives significant contributions from the corporation;</li> <li>vi. the <i>Director General</i> or a high-ranking officer on the Board of Directors of another corporation in which the <i>Director General</i> or a high-ranking officer of this corporation is/are Directors; or</li> <li>vii. family to any of the persons mentioned above.</li> </ol> <p>(Principle at 4-5)</p> <p>To comply with its purpose, it is recommended that the Board have members who are not involved in the daily operations of the corporation and who may contribute with an external and independent vision. (Recommendation at 2)</p> <p>[I]t is important to create the concept of the Independent Director. The term Independent Director is used to identify such persons as are not related to the management team of the corporation. They are called to be Directors because of their personal and professional recognition. Their main duty is to contribute with an impartial vision to the corporation’s strategies, planning and other duties of the Board. (Recommendation at 4)</p>	<p>Non-executive directors should bring an independent judgment to bear on issues of strategy, performance, resources, including key appointments and standards of conduct. (The Code, 4.1)</p> <p><i>Non-executive directors should be:</i></p> <ul style="list-style-type: none"> <li>▪ [I]ndependent of management and . . . not [receive] any benefits from the company other than their fee. This is not intended to exclude . . . non-executive director[s] who have a contractual nexus with the company for reward or to prevent a non-executive director from acquiring shares in the company by means independent from the company;</li> <li>▪ Directors and managers of the company’s holding company, or major investor, who have no executive responsibilities in the company;</li> <li>▪ Former executive directors who are no longer employed on a full-time basis but nevertheless are capable of giving valuable input to the board arising from their past experience;</li> <li>▪ Senior executive directors of major listed subsidiaries and associates of the holding company, who have no executive responsibilities in the holding company.</li> </ul> <p>(The Code, 4.2.1 – 4.2.4)</p>	<p><i>Not covered directly, but see II.4.1</i> (Outside directors shall hold no interests that may hinder their independence from the corporation, management or controlling shareholder. The outside director shall submit a letter of confirmation, which the corporation shall disclose, stating that he holds no interests affiliated with the corporation, management or controlling shareholder at the time of his consent to the appointment.)</p> <p><i>See also</i> Korean Stock Exchange Listing Regulation, Article 48-5 (<i>listing requirement for outside directors to comprise at least one-quarter of the board members; persons who do not qualify as “outside directors” include: controlling shareholders; a spouse or a family member of a director who is not an outsider; current or recent officers and employees of the company, its affiliates, or of corporations that have “important business relations” with the corporation; and persons who serve as outside directors on three or more listed companies.</i>).</p>	<p>Independent directors must be independent of any major shareholder and not involved in the day-to-day operations of the listed company. (The Code, 5.1)</p> <p>[A]n independent director must meet all of the following requirements:</p> <ol style="list-style-type: none"> <li>i. Be independent from the major shareholders of the company or any shareholder in their group.</li> <li>ii. Not be an employee, staff member or an adviser receiving a regular salary or other regular benefit from the company or its affiliated company, associated company or related company.</li> <li>iii. Have no shares in their own name, or in a related person’s name, representing more than 0.5% of the respective paid-up capital of the company, an affiliated company, associated company or related company.</li> <li>iv. Be able to protect the interests of all shareholders of the company equally.</li> <li>v. Be able to prevent conflicts of interest between the company and its management or major shareholders or other companies which have the same management group, or major shareholders, as the company.</li> <li>vi. Be able to attend board meetings to make decisions on significant company activities.</li> </ol> <p>(Ch. 2: 2.4, <i>citing</i> SET Notification Governing Qualifications of Independent Directors dated 28 Oct. 1993)</p> <p><i>See also</i> Ch. 2: 7.2(a) <i>regarding conflicts of interest.</i></p>

GM Board Guidelines	CACG Guidelines (International)	IBGC Code of Best Practice (Brazil)	Hong Kong Stock Exchange Code / Guide (Hong Kong)
<b>9. Number, Structure and Independence of Committees</b>			
<p>The current Committee structure of the Company seems appropriate. There will, from time to time, be occasions in which the Board may want to form a new Committee, depending upon the circumstances. The current seven Committees are Audit, Capital Stock, Director Affairs, Executive, Executive Compensation, Investment Funds and Public Policy. Except for the Investment Funds Committee, committee membership will consist only of independent Directors as defined in By-Law 2.12. (Guideline 22)</p> <p><i>See Topic Heading 8, above.</i></p>	<p>It is good practice for boards to create and maintain relevant board committees and to determine their terms of reference, life span, role and function. In doing so, the board should establish, maintain and develop appropriate reporting procedures and proper written mandates or charters for committees, such as the executive or management committee which usually oversees the day-to-day implementation of board policy and decisions, the remuneration committee which reviews executive and top management remuneration arrangements, the environmental committee where the corporation's operations warrant such a committee, and the audit committee which reviews amongst other things the internal audit function.</p> <p>.....</p> <p>The board should implement a formal internal audit function. An audit committee should be established to keep under review the scope and effectiveness of the audit (both internal and external) and its relative cost efficiencies. (Commentary on Principle 10)</p>	<p>Many of the activities of the board of directors need detailed analysis that is not possible to do during the board meetings. Committees should therefore be formed with a few board members each, for example, committees for nominations, audit, remuneration, etc. Each committee studies its area and prepares proposals for decisions. Only the full board of directors can make decisions. (p. 1)</p>	<p><i>Not covered.</i></p>

Indian Confederation Code (India)	Charter of a Shareholding Society (Kyrgyz Republic)	Report on Corporate Governance (Malaysia)	Reserved
<b>9. Number, Structure and Independence of Committees</b>			
<p>Listed companies with either a turnover of over Rs.100 crores or a paid-up capital of Rs.20 crores should set up Audit Committees within two years. (Recommendation 8.1)</p> <p>By fiscal year 1998-99, listed companies satisfying [the criteria in 8.1] should have in place a strong internal audit department, or an external auditor to do internal audits; without this, any Audit Committee will be toothless. (Recommendation 8.7)</p> <p>Securing . . . non-executive directors does not necessarily require the institutionalizing of nomination committees or search committees. (p. 2)</p> <p>[There is no] necessity of any formalized remuneration committee of the board. (p. 3)</p> <p>Audit Committees ensure long-term goodwill through transparency. (p. 5)</p> <p><i>See Topic Heading 10, below.</i></p>	<p>[The Audit Commission] is formed at the General Meeting of Shareholders consisting of shareholders to control financial and economic activity of the Society. (14.4)</p> <p>Members of the Management Board and the Audit Commission cannot simultaneously be members of the Board of Directors. (14.5)</p> <p>[The Management Board] carries out current management of the Society and is subject to the General Meeting of Shareholders and to control by the Board of Directors and the Audit Commission. (18.1)</p> <p>The Management Board is competent to decide all questions related to the Society not given into the exclusive competence of the General Meeting of shareholders, the Board of Directors or the Audit Commission. (18.8; <i>see also</i> 14.3)</p> <p>[T]he Audit Commission shall comprise up to 5 shareholders. The Audit Commission is the control organ of the Society. (19.1)</p>	<p>The board of every company should appoint a committee of directors composed exclusively of non-executive directors, a majority of whom are independent, with the responsibility for proposing new nominees for the board and for assessing directors on an ongoing basis. The actual decision as to who shall be nominated should be the responsibility of the full board after considering the recommendations of such a committee. (Best Practice AA.VII)</p> <p>Where the board appoints a committee, it should spell out the authority of the committee, and in particular, whether the committee has the authority to act on behalf of the board or simply has the authority to examine a particular issue and report back to the board with a recommendation. (Best Practice AA.XXIII)</p> <p>Boards should appoint remuneration committees, consisting wholly or mainly of non-executive directors, to recommend to the board the remuneration of the executive directors in all its forms, drawing from outside advice as necessary. Executive directors should play no part in decisions on their own remuneration. Membership of the remuneration committee should appear in the directors' report. (Best Practice AA.XXIV)</p> <p>The board should establish an audit committee of at least three non-executive directors, a majority of whom are independent, with written terms of reference which deal clearly with its authority and duties. The Chairman of the audit committee should be an independent non-executive director. (Best Practice BB.I)</p>	

Code of Corporate Governance (Mexico)	King Report (South Africa)	Code of Best Practice (South Korea)	The SET Code and Guidelines (Thailand)
<b>9. Number, Structure and Independence of Committees</b>			
<p>It is recommended that, in order to make more informed decisions, the Board of Directors shall perform evaluation, compensation, audit, finance and planning functions (as further defined in the Code) through one or various intermediate bodies. (Principle at 7)</p> <p>It is recommended that the following principles should apply to the intermediate bodies:</p> <ul style="list-style-type: none"> <li>▪ one or more may be created when they have a clear purpose and their members avoid conflicts of interest; . . . .</li> <li>▪ they consist of a minimum of three, and a maximum of seven, members; . . . .</li> <li>▪ the Chairman may invite to meetings those officers of the corporation whose duties are related to the operations of the intermediate body;</li> <li>▪ each Independent Director, in addition to fulfilling his/her basic Board duties, is urged to become involved in at least one intermediate body; and</li> <li>▪ the intermediate body in charge of auditing shall be presided over by an Independent Director.</li> </ul> <p>(Principle at 7-8)</p> <p>It is recommended that there a mechanism that lends support to the Board in verifying compliance of the audit function, assuring that internal and external audits are performed with the highest objectivity possible and that the financial information is useful, trustworthy and accurate. (Recommendation at 12-13)</p> <p>It is recommended that there be a mechanism to assist the Board in its finance and planning function, especially for the evaluation of the long-term business strategy and the main policies on investment and finance. (Recommendation at 18)</p>	<p>Director's remuneration . . . should be the subject of recommendations to the board by a remuneration committee. Its membership should comprise persons who are competent to determine the appropriate remuneration of senior executives, with the majority of its members (including the chair) being non-executive directors. (The Code, 6.1)</p> <p>The board should establish an Audit Committee with written terms of reference confirmed by the board. It should consist of at least two non-executive directors, of whom one should act as chair. (The Code, 10.3)</p> <p>As a result of the skills shortage in South Africa it is difficult enough to find a non-executive director of calibre to take an appointment to a board. In consequence, to recommend a nomination committee made up of non-executive directors in the majority would be impractical. (Ch. 9: 2)</p> <p>The board of directors might find it useful to establish sub-committees such as an agenda or a chair's committee. (Ch. 11: 1)</p> <p>The authority of such a committee should be in writing from the board setting out the parameters and context within which such powers are conferred. Strictly, this authority should also be incorporated in the corporation's Articles of Association. (Ch. 11: 3.3)</p>	<p>The Board may mandate its authority to an internal committee or to a respective director. Excluded, however, are key matters as stated in the articles of incorporation and the Board Operating Regulation. (II.1.2)</p> <p>The Board may, if necessary, establish internal committees . . . such as Audit, Operation and Remuneration Committees. (II.6.1)</p> <p>It is advised that a committee be established and managed for the fair nomination of directors. The committee shall be organized such that the fairness and independence of the nomination process are ensured. (II.3.1)</p> <p>At least half of the nomination committee members should be outside directors. (Commentary on II.3.1)</p> <p>[A]n internal committee may evaluate the Board, and its results may be tendered to the Board for examination. (II.9.3)</p> <p>Internal auditing bodies, such as audit committees and auditors, shall perform auditing operations faithfully by maintaining independence from management and controlling shareholders. (III.1)</p> <p>The Boards of large public corporations, government-invested institutions and financial institutions shall establish an audit committee as an internal committee. A corporation establishing an audit committee shall not employ auditors. (III.1.1)</p> <p>An audit committee shall be composed of the following: a minimum of 3 Board members; a minimum two-thirds, including the committee chairperson, shall be outside directors; and one member shall be a person possessing professional knowledge of auditing. A corporation without an audit committee shall employ at least one standing auditor. (III.1.2)</p>	<p>[Each board of directors should e]stablish an Audit Committee, Nominating Committee, and Remuneration Committee in the listed company. (The Code, 4.2.3)</p> <p>[E]stablishment of an executive committee, to whom the board will delegate some of its duties, is recognized and, unless expressly provided otherwise under the Articles of Association, allowed under the Act. [i.e., the Public Limited Companies Act of 1992]. (Ch. 2: 3.1)</p> <p>[A] general meeting of shareholders must decide on the director, or directors, authorized to bind the company by his or her signatures (the "authorized directors"). (Ch. 2: 4.2)</p> <p>The SET regards it as good practice for the board of directors of a listed company to establish an audit committee and a remuneration committee for internal control purposes. (Ch. 8: 3.1)</p> <p>An audit committee should be composed solely of the independent directors of the company. (Ch. 8: 3.2)</p> <p>The remuneration committee should be composed solely of the independent directors of a company. (Ch. 8: 3.3)</p> <p>Special emphasis has been placed on the need for all listed company boards to establish audit committees to ensure the effective and efficient control and review of a company's administration, internal audit procedures, the preparation of financial statements and the general disclosure of material information to investors and shareholders. (Message from the President of the SET, pp. iv-v)</p>

GM Board Guidelines	CACG Guidelines (International)	IBGC Code of Best Practice (Brazil)	Hong Kong Stock Exchange Code / Guide (Hong Kong)
<b>10. Committee Meeting Frequency, Length and Agenda<sup>13</sup></b>			
<p>The Committee Chairman, in consultation with Committee members, will determine the frequency and length of the meetings of the Committee. (Guideline 24)</p> <p>The Chairman of the Committee, in consultation with the appropriate members of Management and staff, will develop the Committee's agenda.</p> <p>Each Committee will issue a schedule of agenda subjects to be discussed for the ensuing year at the beginning of each year (to the degree these can be foreseen). This forward agenda will also be shared with the Board. (Guideline 25)</p>	<p>The board should determine a policy for the frequency, purpose, conduct and duration of its meetings and those of its committees. (Commentary on Principle 10)</p>	<p>[The] audit committee (if one exists) negotiates with the independent auditors in order to establish the scope of the audit, time schedule and price. (p. 2)</p> <p>When there is a change in the main occupation, the board member should resign. The nominating committee should analyze the suitability of a re-election. (p. 3)</p>	<p><i>Not covered directly, but The Code notes that certain issues, such as conflicts of interest, should not be dealt with in committees. See The Code, 11.</i></p>

<sup>13</sup> See also ABA Guidebook at 20, 25 ("Time at . . . committee meetings should be budgeted carefully. A balance should be sought between management presentations and discussion among directors and management. Written reports that can be given concisely and effectively in advance should be furnished. . . . The full board should satisfy itself that its committees are following an appropriate schedule of meetings and have agendas and procedures to enable them to fulfill their delegated functions. Furthermore, the full board should be kept informed of committee activities. This includes periodic reports at board meetings and circulation of committee minutes and reports of meetings to all directors.").

Indian Confederation Code (India)	Charter of a Shareholding Society (Kyrgyz Republic)	Report on Corporate Governance (Malaysia)	Reserved
<b>10. Committee Meeting Frequency, Length and Agenda<sup>14</sup></b>			
<p>The executive committee could demonstrate its efficient management of the company, for example, by setting sound and reasonable objectives for the firm's business affairs. (Ch. 1: Statement of Objectives)</p> <p>To be effective, the Audit Committees should have clearly defined Terms of Reference and its members must be willing to spend more time on the company's work vis-à-vis other non-executive directors. (Recommendation 8.3)</p> <p>Audit Committees should assist the board in fulfilling its functions relating to corporate accounting and reporting practices, financial and accounting controls, and financial statements and proposals that accompany the public issue of any security -- and thus provide effective supervision of the financial reporting process. (Recommendation 8.4)</p> <p>Audit Committees should periodically interact with the statutory auditors and the internal auditors to ascertain the quality and veracity of the company's accounts as well as the capability of the auditors themselves. (Recommendation 8.5)</p> <p>For Audit Committees to discharge their fiduciary responsibilities with due diligence, it must be incumbent upon management to ensure that members of the committee have full access to financial data of the company, its subsidiary and associated companies, including data on contingent liabilities, debt exposure, current liabilities, loans and investments. (Recommendation 8.6)</p>	<p>The Management Board shall act on behalf of the Society and in particular has the authority, unless otherwise proscribed, to:</p> <ol style="list-style-type: none"> <li>i. represent the Society;</li> <li>ii. conclude transactions on behalf of the Society;</li> <li>iii. determine the allocation and use of all resources/assets owned or controlled by the Society.</li> </ol> <p>(18.9)</p> <p>The organization of effective and authentic bookkeeping and reporting is determined by the Management Board. (21.4)</p> <p>The Chairman of the Management Board of the Society and the chief accountant bear personal responsibility for the running and reliability of bookkeeping and reporting. (21.5)</p> <p>Where the increase in nominal value is claimed to be justified by an increase in the value of the Society's property or the volume of its services, then the new value of shares must correspond to the new value of the property or increased volume of the services provided by the Society. It must be estimated by an independent valuer or auditor. The Audit Commission of the Society shall review the value of the property or services and shall certify whether it was equal to the new nominal value of the shares issued. (6.6)</p> <p>The Audit Commission shall carry out an audit of the performance and activities of the Society at least once a year. (19.4)</p> <p>An audit may cover any aspect of financial and business activities of the Society which the Audit Commission deems appropriate. (19.9)</p> <p><i>For a list of matters for which the Management Board is responsible, see 18.10.</i></p>	<p>The duties of the audit committee should include the following:</p> <ol style="list-style-type: none"> <li>(i) To consider the appointment of the external auditor, the audit fee and any questions of resignation or dismissal;</li> <li>(ii) To discuss with the external auditor, before the audit commences, the nature and scope of the audit, and ensure co-ordination where more than one audit firm is involved;</li> <li>(iii) To review the half-year and annual financial statements of the board, focusing particularly on: <ul style="list-style-type: none"> <li>▪ Any changes in accounting policies and practices;</li> <li>▪ Significant adjustments arising from the audit;</li> <li>▪ The going concern assumption;</li> <li>▪ Compliance with accounting standards and other legal requirements;</li> </ul> </li> <li>(iv) To discuss problems and reservations arising from the interim and final audits, and any matter the auditor may wish to discuss (in the absence of management where necessary);</li> <li>(v) To review the external auditor's management letter and management's response;</li> <li>(vi) Where an internal audit function exists, to ensure that it is adequately resourced and has appropriate standing within a company, and to review the internal audit program;</li> <li>(vii) To consider any related party transactions that may arise within the company or group;</li> <li>(viii) To consider the major findings of internal investigations and management's response;</li> <li>(ix) To consider other topics as defined by the board.</li> </ol> <p>(Best Practice BB. II; <i>see also</i> Best Practices BB.III – V)</p> <p><i>For a description of nominating committee functions, see Best Practices AA.VII, AA.X.</i></p>	

<sup>14</sup> See also ABA Guidebook at 20, 25 ("Time at . . . committee meetings should be budgeted carefully. A balance should be sought between management presentations and discussion among directors and management. Written reports that can be given concisely and effectively in advance should be furnished. . . . The full board should satisfy itself that its committees are following an appropriate schedule of meetings and have agendas and procedures to enable them to fulfill their delegated functions. Furthermore, the full board should be kept informed of committee activities. This includes periodic reports at board meetings and circulation of committee minutes and reports of meetings to all directors.").

Code of Corporate Governance (Mexico)	King Report (South Africa)	Code of Best Practice (South Korea)	The SET Code and Guidelines (Thailand)
<b>10. Committee Meeting Frequency, Length and Agenda</b>			
<p><i>It is recommended that the mechanism for assisting the Board with evaluation and compensation of executives:</i></p> <ul style="list-style-type: none"> <li>(i) suggest procedures to propose the <i>Director General</i> and high-level officers;</li> <li>(ii) propose evaluation criteria for the <i>Director General</i> and high-level officers;</li> <li>(iii) analyze and submit for approval any proposal made by the <i>Director General</i> re: management structure and salaries.</li> </ul> <p>(Principle at 11)</p> <p><i>It is suggested that the mechanism for assisting the Board with the audit process:</i></p> <ul style="list-style-type: none"> <li>(i) recommend candidates for external auditors of the corporation;</li> <li>(ii) recommend terms and conditions upon which external auditors are hired;</li> <li>(iii) supervise the compliance of the audit;</li> <li>(iv) channel communications between the Board and the external auditors, as well as assure the independence and objectivity of such auditors;</li> <li>(v) review . . . auditing reports, and inform the Board accordingly;</li> <li>. . . . .</li> <li>(viii) help draft general guidelines for the internal control system and its evaluation;</li> <li>(ix) coordinate and evaluate the annual programs of the internal audit;</li> <li>(x) coordinate the performance of the external auditor, internal auditor and Statutory Auditor;</li> <li>(xi) verify compliance by the corporation of all applicable legal provisions.</li> </ul> <p>(Principle at 13)</p> <p><i>For additional audit/finance-related Principles and Recommendations, see pp. 12, 14-18.</i></p> <p><i>Re: duties of the mechanism for assisting the Board in the finance and planning function, see Principles and Recommendations at 18-20.</i></p>	<p>The [Audit] committee meetings should be attended by the head of internal audit, the external audit partner and the financial director. (The Code, 10.3)</p> <p>A chair's or executive committee can meet more often than the whole board, and the benefit is that senior management and senior directors can discuss and agree on matters rather than management taking major decisions on their own. The board can delegate some of its functions to a chair's committee. Thus decisions can be taken when necessary without waiting for a board meeting. (Ch. 11: 3.2)</p>	<p>A committee's resolution on a matter mandated by the Board shall hold the same effect as the Board's resolution, and the committee shall report such resolutions to the Board. (II.6.2)</p> <p>If a committee centered on outside directors is established within the Board, then that committee may make decisions [regarding executive remuneration]. (II.9.1)</p> <p>Audit committees and auditors shall perform at least the following functions:</p> <ul style="list-style-type: none"> <li>▪ Audit the appropriateness of the manager's execution of operations;</li> <li>▪ Review the soundness and reasonableness of financial activities and the accuracy of the corporation's financial reports;</li> <li>▪ Review the adequacy of major accounting standards . . . . ;</li> <li>▪ Evaluate internal control systems;</li> <li>▪ Approve appointment/dismissal of persons heading internal auditing divisions;</li> <li>▪ Evaluate the auditing activities of external auditors;</li> <li>▪ Recommend . . . external auditors;</li> <li>▪ Check measures on those matters corrected as a result of auditing.</li> </ul> <p>(III.1.3)</p> <p>The audit committee shall hold meetings at least once each quarter and, if the need arises, may allow the attendance of management, financial officers, the chairperson of an internal audit division or external auditors. (III.1.5)</p> <p>The audit committee shall draft minutes of proceedings each time a meeting is convened. (III.1.6)</p>	<p>[T]he executive committee shall be appointed by a resolution of the directors' meeting. The scope of the executive committee's power must also be clearly specified. (Ch. 2: 3.2)</p> <p>The audit committee should be the informed, vigilant and effective overseers of the company's financial reporting process and internal controls. In general, the audit committee should be responsible for reviewing a wide range of financial matters including the annual and half-year profit figures, financial statements and accompanying reports. It should also monitor the controls which are in force to ensure the integrity of the financial information reported to the company's shareholders.</p> <p>The audit committee should have explicit authority to investigate any matters within its duties, the resources which it needs to do so, and full access to information. The audit committee should also be able to obtain outside professional advice, if necessary, at the company's expense. (Ch. 8: 3.2)</p> <p>The remuneration committee is responsible for determining the remuneration and other benefits for ordinary directors, members of the executive committee and top executives of the company. (Ch. 8: 3.3)</p>

GM Board Guidelines	CACG Guidelines (International)	IBGC Code of Best Practice (Brazil)	Hong Kong Stock Exchange Code / Guide (Hong Kong)
<b>11. Content and Character of Disclosure</b>			
<i>Not covered.</i>	<p><i>Not covered directly, but see</i> Commentary on Principle 6 (Shareholders and potential investors require access to regular, reliable and comparable information in sufficient detail for shareholders and potential investors to assess the stewardship of management to enable them to make informed investment decisions. . . .</p> <p>[I]n many circumstances, the requirements for communication with shareholders will be prescribed by statute and/or regulation. Regardless of the effectiveness or otherwise of such regulations, directors nevertheless have a responsibility to ensure that a corporation's communication is in the spirit outlined.)</p>	<p>The shareholder has the right to get timely and transparent information about the company in which they have invested. (p. 5)</p> <p>The efficiency of the capital market depends on transparent information on listed companies. (p. 5)</p>	<p>All directors, executive and non-executive, are entitled to have access to board papers and materials. Where queries are raised by non-executive directors, steps must be taken to respond as promptly and fully as possible. (The Code, 4)</p> <p>Full minutes shall be kept by a duly appointed secretary of the meeting and such minutes shall be open for inspection at any time in office hours on reasonable notice by any director. (The Code, 5)</p> <p>If, in respect of any matter discussed at a board meeting, the independent non-executive directors hold views contrary to those of the executive directors, the minutes should clearly reflect this. (The Code, 8)</p> <p>If an independent non-executive director resigns or is removed from office, the Exchange should be notified of the reasons why. (The Code, 12)</p> <p>Fair disclosure requires disclosure of information in such a way that it does not place any person in a privileged dealing position or result in share prices which do not reflect the latest available information. (Guideline B.2.1)</p>



Indian Confederation Code (India)	Charter of a Shareholding Society (Kyrgyz Republic)	Report on Corporate Governance (Malaysia)	Reserved
<b>11. Content and Character of Disclosure</b>			
<p>Under "Additional Shareholder's Information," listed public companies should give data on:</p> <ul style="list-style-type: none"> <li>▪ High and low monthly averages of share prices in a major Stock Exchange where the company is listed for the reporting year.</li> <li>▪ Greater detail on business segments, up to 10% of turnover, giving share in sales revenue, review of operations, analysis of markets and future prospects.</li> </ul> <p>(Recommendation 9)</p> <p>For all Companies with paid-up capital of Rs.20 crores or more, the quality and quantity of disclosure that accompanies a GDR Issue should be the norm for any domestic issue. (Recommendation 12)</p> <p>A listed company must give certain key information on its divisions or business segments as a part of the Directors' Report in the Annual Report. This should encompass (i) the share in total turnover, (ii) review of operations during the year in question, (iii) market conditions, and (iv) future prospects. For the present, the cut-off may be 10% of total turnover. (p. 6)</p> <p>The disclosure on debt exposure of the company should be strengthened. (p. 6)</p> <p>[The] greater the quality of disclosure, the more loyal are a company's shareholders. (p. 7)</p>	<p>If, at the end of the second year and each following financial year, the value of the Society's net assets is less than the amount of its charter capital, then in compliance with legislation of the Kyrgyz Republic the Society must inform all its creditors of this fact and at the Annual General Meeting of Shareholders at which these financial results are announced. The Society shall announce a reduction of its charter capital and shall register this fact in the prescribed form. (7.1)</p> <p>A reduction in capital is possible only after all creditors are informed by letter . . . . Such creditors shall . . . have rights to demand early performance or termination of the obligations of the Society or compensation for losses and, if these requirements are not fulfilled, a general meeting of creditors of the Society must be called in order to decide upon its liquidation. (7.3)</p> <p>The Society has the right to purchase its own shares on the securities markets, provided that it makes a public announcement of this fact immediately after the purchase (and, if it purchases shares which are traded on the stock exchange, the rules of the exchange allow such purchases). (7.4)</p>	<p>The board should present a balanced and understandable assessment of the company's position and prospects. (Principle D.I)</p> <p>The board should disclose, in an informative way, details of the activities of audit committees, the number of audit meetings held each year, and details of attendance of each individual director in respect of meetings. (Best Practice BB.VI)</p> <p>[Principle D.I] is not limited to the statutory obligation to produce financial statements. The wording refers mainly to the annual report to shareholders, but the principle also covers interim and other price-sensitive public reports and reports to regulators. (Explanatory Note 4.13 on Principle D.I at 77)</p>	

Code of Corporate Governance (Mexico)	King Report (South Africa)	Code of Best Practice (South Korea)	The SET Code and Guidelines (Thailand)
<b>11. Content and Character of Disclosure</b>			
<p>It is suggested that the annual report presented by the Board of Directors distinguish between Independent Directors and Patrimonial Directors, indicating for the latter the category to which they belong. (Principle at 6)</p> <p>It is suggested that the annual report presented by the Board of Directors should include a brief résumé of each member of the Board as of the date of such report. (Principle at 6)</p> <p>It is suggested that the Board of Directors include in its annual report to the Stockholders Meeting the relevant aspects of the tasks of each intermediate organism. It is suggested that all reports by each organism submitted to the Board be available to the stockholders together with all the materials for the Stockholders Meeting, with the exception of such information of a confidential nature as may affect the competitiveness of the corporation. In addition, it is recommended that the annual report include the names of the members of each intermediate organism. (Principle at 22)</p> <p>It is suggested that each corporation have policies, mechanisms and responsible parties to inform investors, in order to maintain communication channels with stockholders and potential investors. (Principle at 22)</p> <p>Lack of participation by all stockholders in the Stockholders Meeting, and the limitations of such meetings as a communication forum of the corporation with its investors, justify additional efforts to create other communication instruments which may allow investors and the general public to obtain required information in connection with the corporation. (Recommendation at 22)</p>	<p>It is the board's duty to present a balanced and understandable assessment of the company's position in reporting to stakeholders. The quality of the information must be based on the guidelines of openness and substance over form. Reporting should address material matters of significant interest and concern to all stakeholders. (The Code 9.1)</p> <p>The directors should report on the following matters in their annual report:</p> <ul style="list-style-type: none"> <li>▪ The directors' responsibility to prepare financial statements that fairly present the state of affairs of the company as at the end of the financial year and the profit or loss for that period.</li> <li>▪ The auditor is responsible for reporting on the financial statements.</li> <li>▪ The maintenance of adequate accounting records and an effective system of internal controls.</li> <li>▪ The consistent use of appropriate accounting policies supported by reasonable and prudent judgments and estimates.</li> <li>▪ Adherence with applicable accounting standards or, if there has been any departure in the interests of fair presentation, it must not only be disclosed and explained but quantified.</li> <li>▪ There is no reason to believe the business will not be a going concern in the year ahead or, an explanation of any reasons otherwise.</li> </ul> <p>(The Code, 9.5)</p>	<p>Shareholders shall be provided with all necessary information . . . from the corporation in a timely manner, and the corporation shall not show partiality to certain shareholders by providing undisclosed information. (I.2.2)</p> <p>The corporation shall disclose material information in a timely and accurate manner. (V.2)</p> <p>Corporations shall disclose any information, not limited only to what is required by law, that may materially influence the decision-making of shareholders and other stakeholders. (V.2.1)</p> <p><i>For a list of information to be disclosed in the annual report, see V.2.2.</i></p> <p>Corporations shall prepare and disclose semi-annual reports, apart from annual reports. If one corporation is in fact under the control of . . . another corporation, consolidated financial statements and combined financial statements, as determined by law, shall additionally be disclosed. (V.2.4)</p> <p>Corporations shall make timely and accurate disclosure when matters of importance have been decided. . . . If the decision has been made through a resolution of the Board, details on the attending directors and voting results shall also be disclosed. (V.2.5)</p> <p>Corporations shall prepare items for disclosure that may be easily understood, and shall assist so that access to them is possible at minimal cost. (V.2.6)</p> <p><i>See V.2. Disclosure, Commentary at 33-36.</i></p> <p><i>See also I.2.3 (Shareholders shall be protected from . . . insider trading and self-dealing.).</i></p>	<p><i>Directors should:</i></p> <p>Ensure management's accountability to shareholders, preserve their rights and interests, [and] clearly and fully disclose information. (The Code, 2.3)</p> <p>Clearly report all details, providing reasonable explanations and calculations to support the results of the company's business operations, policies, future trends and opportunities as well as risks and dangers. (The Code, 7.1)</p> <p>Understand the company's main businesses and not intervene in the objectives and work of any external auditors. (The Code, 7.2)</p> <p>If any external auditor resigns or is dismissed, [the board must] fully explain the reasons why to the SET. (The Code, 7.3)</p> <p><i>See Ch. 4, General Disclosure Requirements, including the following:</i></p> <p>Listed companies are required to disclose all necessary information to allow the general public to make informed investment decisions. Such disclosures also enable the SET to indirectly supervise the business activities of listed companies. The disclosed information must be correct, sufficiently detailed and promptly released to ensure active, fair and orderly trading on the SET. All investors must be provided with equal access to such information. (Ch. 4: 2.1)</p> <p><i>See also Ch. 5, Connected Transactions; SET Regulation Governing Rules, Conditions, and Procedures for the Disclosure of Information and Other Actions of Listed Companies ("Disclosure Regulation") dated 12 March 1993, amended 15 Sept. 1995; SET Notification Governing Guidelines for Practices in the Disclosure of Information ("Disclosure Guidelines") dated 30 April 1993.</i></p>

GM Board Guidelines	CACG Guidelines (International)	IBGC Code of Best Practice (Brazil)	Hong Kong Stock Exchange Code / Guide (Hong Kong)
<b>12. Disclosure Regarding Compensation and Director Assessment</b>			
<i>Not covered.</i>	<i>Not covered.</i>	Many foreign codes of best practice recommend that the number of shares and the remuneration of each board member and officer be made public in the annual report. (p. 5)	The directors' fees and any other reimbursement or emolument payable to an independent non-executive director shall be disclosed in full in the annual report and accounts of the issuer. (The Code, 6)

Indian Confederation Code (India)	Charter of a Shareholding Society (Kyrgyz Republic)	Report on Corporate Governance (Malaysia)	Reserved
<b>12. Disclosure Regarding Compensation and Director Assessment</b>			
Financial disclosures recommended [include] details of each director's remuneration and commission [which] should form a part of the Directors' Report . . . . (p. 6)	<p>The Annual Accounts of the Society shall record the total cost of remuneration and expenses of the Board of Directors. (17.22)</p> <p>Full details of the form and level of the total remuneration of the Management Board members shall be presented to the AGM of Shareholders. (17.30)</p>	<p>Companies should establish a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors (Principle B.II)</p> <p>The company's annual report should contain details of the remuneration of each director. (Principle B.III)</p> <p>We endorse the view that it is the board's responsibility to appoint new directors and the shareholders' responsibility to re-elect them. Re-election at regular intervals not only promotes effective boards but affords shareholders the opportunity to review the directors' performance in turn and where necessary to replace them. (Explanatory Note 4.5 on Principle A.V at 76)</p> <p><i>See Explanatory Notes 4.6 - 4.10 on Principles B.I, B.II and B.III at 76-77 (directors' remuneration).</i></p>	

Code of Corporate Governance (Mexico)	King Report (South Africa)	Code of Best Practice (South Korea)	The SET Code and Guidelines (Thailand)
<b>12. Disclosure Regarding Compensation and Director Assessment</b>			
<p>It is suggested that the annual report presented by the Board of Directors contain disclosure on the policies used, and the terms and conditions that form, the salary packages of the Directors, the <i>Director General</i>, and the high-level officers of the corporation. (Principle at 12)</p> <p>It is recommended that the existence of the mechanism [for executive compensation] be disclosed, and its operations should be transparent, in order to increase investor confidence in the management of the corporation. (Recommendation at 11)</p> <p>[R]emuneration policies established by the Board of Directors should be disclosed to the market. (Recommendation at 12)</p>	<p>There should be a separate full and clear disclosure of the total of executive and non-executive directors' earnings. Separate figures should be given for salary, fees, benefits, share options and bonuses. (The Code, 6.2)</p> <p>The shareholders are entitled to openness and disclosure in regard to directors' earnings so that they can see that the directors are being fully rewarded. They need consistent reports so that they can compare the year [to] year remuneration and a breakdown of the earnings. (Ch. 8: 8)</p>	<p>Activities and evaluation results of outside directors shall be disclosed. (II.9.2)</p> <p>Activities of the Board shall be evaluated fairly, the results of which shall be disclosed. (II.9.3)</p> <p>[The] activities and the evaluation results of the Board shall, through disclosure, assist in the decision-making by shareholders and shall be reflected in the business manager human resources market. Such disclosures presented in the annual report are also advisable. (Commentary on II.9.3)</p>	<p>The remuneration of directors as approved by a shareholder meeting should be fully disclosed in the company's annual report. (The Code, 4.4)</p> <p>See Ch. 6, Securities Dealings by Directors and Executives.</p>

GM Board Guidelines	CACG Guidelines (International)	IBGC Code of Best Practice (Brazil)	Hong Kong Stock Exchange Code / Guide (Hong Kong)
<b>13. Disclosure Regarding Corporate Governance</b>			
<p><i>Not covered in the Guidelines, but the Guidelines are published by the company and widely available.</i></p>	<p><i>Not covered directly, but see Commentary on Principle 14 (Generating economic profit so as to enhance shareholder value in the long-term, by competing effectively, is the primary objective of a corporation and its board. The framework of good corporate governance practices in a corporation must be designed with this objective in mind, while fulfilling broader economic, social and other objectives in the environment and circumstances in which the corporation operates.</i></p> <p><i>These factors – business risk and key performance indicators – should be benchmarked against industry norms and best practice, so that the corporation’s performance can be effectively evaluated.).</i></p>	<p>The system for the evaluation of the board of directors, the individual board members, the chief executive officer and the officers should be explained in the annual report. (p. 5)</p> <p>The annual report should inform about which code of best practice has been used by the company and explain any deviation by the company from said code. (p. 5)</p> <p>It is important that the minutes reflect both the spirit and the letter of the proceedings. (p. 6)</p>	<p>Commencing with the directors’ report and annual accounts and interim reports for periods ending on or after 31st December, 1995, all listed companies must include in their annual and interim reports a statement of compliance with the Code of Best Practice. (Guideline 16.2)</p> <p>The statement to be included in the annual report should clearly indicate whether the company has complied with the Code of Best Practice during the accounting period covered and, if the company has not complied with any part of the Code of Best Practice, reasons must be given to explain the failure to comply. (Guideline 16.3)</p> <p>The statement to be included in the interim report must state whether any of the directors is aware of information that would reasonably indicate that the company is not, or was not for any part of the accounting period covered by the interim report, in compliance with the Code of Best Practice. (Guideline 16.4)</p>

Indian Confederation Code (India)	Charter of a Shareholding Society (Kyrgyz Republic)	Report on Corporate Governance (Malaysia)	Reserved
<b>13. Disclosure Regarding Corporate Governance</b>			
<p><i>Non-financial disclosures recommended:</i></p> <ul style="list-style-type: none"> <li>▪ Comprehensive report on the relatives of directors. . . .</li> <li>▪ [A] register which discloses interests of directors. . . .</li> <li>▪ [T]he existence of the directors' shareholding register . . . should be explicitly stated in the notice of the [Annual General Meeting] of all listed companies.</li> <li>▪ Details of loans to directors. . . .</li> <li>▪ Appointment of sole selling agents for India will require prior approval . . . of shareholders. The board may approve the appointment of sole selling agents in foreign markets, but the information must be divulged to shareholders. . . .</li> <li>▪ [T]here should be a Secretarial Compliance Certificate forming a part of the Annual Returns . . . which would certify . . . that the secretarial requirements under the Companies Act have been adhered to.</li> </ul> <p>(pp. 5-6)</p> <p>To nurture and strengthen [investors'] loyalty, our companies need to give a clear-cut signal that the words "your company" have real meaning. That requires well functioning boards, greater disclosure, better management practices, and a more open, interactive and dynamic corporate governance environment. (p. 12)</p> <p>See Topic Heading 11, above.</p>	<p>The Society conducts accounting and operational reporting and also the statistical accounts and provides documentation required by the legislation of the Kyrgyz Republic to the appropriate state bodies in the established manner. (21.1)</p> <p><i>See also 20.2</i> (The officials [Board of Directors, Management Board, and Audit Commission] are obliged to work in the interests of the shareholders. An official should not use, in personal interests, opportunities opening in the sphere of the purposes of activity of the Society, without observance of conditions contained in this article.) (<i>For the list of conditions, see 20.3-20.8.</i>)</p>	<p>The board should disclose on an annual basis whether one-third of the board is independent and, in circumstances where the company has a significant shareholder, whether it satisfies the requirement to fairly reflect, through board representation, the investment of the minority shareholders in a company. The board should disclose its analysis of the application of the best practices . . . to the circumstances of the board. (Best Practice AA.VI)</p> <p>The board, through the nominating committee, should annually review its required mix of skills and experience and other qualities, including core competencies which non-executive directors should bring to the board. This should be disclosed in the annual report. (Best Practice AA.IX)</p> <p>The board should disclose the number of board meetings held per year and the details of attendance of each individual director in respect of meetings held. (Best Practice AA.XIV)</p> <p>Directors should be required to disclose the number of audit committee meetings held each year, and the details of the attendance of each individual director, to enable shareholders to evaluate the commitment of a particular director. . . . [T]he obligation to disclose the activities of the audit committee lies with the board as a whole and not the audit committee separately. (Explanatory Note 4.66 on Best Practice BB.VI at 95)</p> <p><i>See Principles and Best Practices for Other Corporate Participants, III</i> (When evaluating companies' governance arrangements, particularly those relating to board structure and composition, institutional investors and their advisers should give due weight to all relevant factors drawn to their attention.).</p>	

Code of Corporate Governance (Mexico)	King Report (South Africa)	Code of Best Practice (South Korea)	The SET Code and Guidelines (Thailand)
<b>13. Disclosure Regarding Corporate Governance</b>			
<p>It is suggested that the annual report presented by the Board of Directors distinguish between Independent Directors and Patrimonial Directors, indicating for the latter the category to which they belong. (Principle at 6)</p> <p>It is recommended that the annual report by the Board of Directors disclose applicable information regarding the professional profile of the Statutory Auditor. (Principle at 15)</p> <p>In order for the market to be in a position to evaluate the membership of the Board of Directors, it is necessary that the corporation disclose information in connection with the background and category to which they belong. (Recommendation at 6)</p>	<p>[In the annual report, directors should report whether] The Code of Corporate Practices and Conduct has been adhered to or, if not, in what respects there has not been adherence. (The Code, 9.5.7)</p>	<p>The corporation shall, by disclosing nominated directors prior to the general shareholder meeting, ensure that shareholders [possess] information on the nominees. (II.3.4)</p> <p>[S]hould there be any change in the information stated in the letter [which a nominee for outside director is required to present confirming his or her independence] following inauguration into office, the outside director shall immediately submit a corrected letter, which the corporation shall disclose. (II.4.1)</p> <p>In the annual report, a public corporation shall explain any differences between its corporate governance and this Code, and the reasons for such; any plans for future changes should also be explained. (V.2.3)</p> <p>Corporations holding a significant portion of shares to enable foreigners to participate in corporate governance are advised to make disclosures in both English and Korean for audit reports and material timely disclosure. (V.2.7)</p> <p>The corporation shall designate a person to oversee disclosure matters. (V.2.8)</p> <p>Corporations shall disclose detailed information on the share ownership status of controlling shareholders and on persons of special relation to them. (V.2.9)</p> <p>See II.1.4 (Matters concerning the authority, responsibility and operation of the audit committee or auditors shall be stated in the corporation's by-laws.).</p>	<p><i>Directors should:</i></p> <p>Implement a Code of Corporate Conduct and Code of Ethics to be guidelines for the company. (The Code, 4.2.4)</p> <p>Ensure that an announcement of the precise time of [each independent director's] appointment is disclosed in the listed company's annual report. Their reappointment will not be automatic. (The Code, 5.2)</p> <p>Present a full statement on the responsibilities of the company's directors in the annual report together with the audited financial statements. (The Code, 7.4)</p> <p>The main aim [of the SET Code and guidelines] is to make the management of all the companies listed on the SET more transparent, efficient and effective, and so increase the confidence of all investors in the securities of every listed company. (Message from the President of the SET, p. v)</p> <p>See Ch. 6, Securities Dealings by Directors and Executives, and Ch. 8, Company Inspections and Internal Controls.</p>

GM Board Guidelines	CACG Guidelines (International)	IBGC Code of Best Practice (Brazil)	Hong Kong Stock Exchange Code / Guide (Hong Kong)
<b>14. Accuracy of Disclosure/Liability</b>			
<i>Not covered.</i>	<p>The board should regularly review processes and procedures to ensure the effectiveness of its internal systems of control, so that its decision-making capability and the accuracy of its reporting and financial results are maintained at a high level at all times (Principle 10)</p> <p>The board should ensure that all communications with shareholders, employees and other relevant stakeholders are timely and accurate. Communication should be understandable and based on the guidelines of openness, with substance prevailing over form. The information provided should be reliable, frank and robust in times of crisis. The communication must enable the reader to evaluate the situation with all the facts in order to take appropriate action. (Commentary on Principle 6)</p>	<p>The board of directors should designate only one person to serve as the spokesman of the company in order to avoid the risk of having contradictions between declarations by the chairman, the chief executive officer and others. The executive who serves as a liaison with the capital market has powers delegated from the spokesman. (p. 5)</p> <p>The information distributed by companies should be balanced. They should cover both good and bad news in order for the reader to be able to evaluate the company correctly. (p. 5)</p> <p>The board of directors and the spokesman of the company have to make sure that the information to the shareholders and the capital market is truthful. The company may suffer punishment for false information. (p. 5)</p>	<p>Directors must be clear that they are individually and collectively responsible for the company's compliance with the Listing Rules. (Guideline A.2)</p> <p>Since every director accepts responsibility for the accuracy of all information contained in [listing] document(s), each director should ensure he is satisfied with the contents of the document. Every director should read the document in its entirety, consider each statement and satisfy himself that it has been the subject of sufficient verification to afford reasonable grounds to believe that the stated information is true, accurate and not misleading, and that no material information has been omitted. (Guideline B.8.3)</p>



Indian Confederation Code (India)	Charter of a Shareholding Society (Kyrgyz Republic)	Report on Corporate Governance (Malaysia)	Reserved
<b>14. Accuracy of Disclosure/Liability</b>			
<p>[Major Indian stock exchanges should gradually insist upon a compliance certificate, signed by the CEO and the CFO, which clearly states that:</p> <ul style="list-style-type: none"> <li>▪ The management is responsible for the preparation, integrity and fair presentation of the financial statements and other information in the Annual Report, and which also suggest that the company will continue in business in the course of the following year.</li> <li>▪ The accounting policies and principles conform to standard practice, and where they do not, full disclosure has been made of any material departures.</li> </ul> <p>The board has overseen the company's system of internal accounting and administrative controls systems either directly or through its Audit Committee. . . . (Recommendation 11)</p> <p>See Recommendations 8.4, 8.5 &amp; 8.6 (re: <i>Audit Committees</i>).</p> <p>See also Topic Heading 10, above.</p>	<p>The Society shall be legally liable for its obligations within the limits of its registration with the authorities responsible for state registration and is considered established from the moment of such state registration. (2.4)</p> <p>All accounting statements must be compiled in accordance with the authorized standard accounting principles. (17.36)</p> <p>The Management Board shall prepare an annual report, balance sheet and an income (profit and loss) statement for submission to the Board of Directors and to the Audit Commission and the AGM. The documents prepared by the Management Board for submission to the General Meeting must be signed by all its members, and also by all members of the Board of Directors and the Audit Commission. (18.12; <i>see also</i> 17.35)</p> <p>The Management Board, in carrying out its duties, may involve the services of independent professional auditors to confirm the correctness of financial statements. (18.14)</p> <p>The Audit Commission may use the services of independent auditors, valuation or other experts in carrying out its duties, but the Audit Commission remains responsible to ensure the accuracy of the report in any case. (19.10)</p>	<p>The board should maintain a sound system of internal control to safeguard shareholders' investment and the company's assets. (Principle D.II)</p> <p>The board should establish formal and transparent arrangements for maintaining an appropriate relationship with the company's auditors. (Principle D.III)</p> <p>The external auditors should independently report to shareholders in accordance with statutory and professional requirements and independently assure the board on the discharge of its responsibilities . . . in accordance with professional guidance. (Principles &amp; Best Practices for Other Corporate Participants, IV)</p> <p>[Principle D.II] covers not only financial controls but operational and compliance controls, and risk management, since there are potential threats to shareholders' investment in each of these areas. (Explanatory Note 4.14 to Principle D.II at 78)</p> <p>The duties of the audit committee required by the Listing Requirements should include keeping under review the scope and results of the audit and its cost effectiveness, and the independence and objectivity of the auditors. (Explanatory Note 4.15 to Principle D.III at 78)</p>	

Code of Corporate Governance (Mexico)	King Report (South Africa)	Code of Best Practice (South Korea)	The SET Code and Guidelines (Thailand)
<b>14. Accuracy of Disclosure/Liability</b>			
<p>Directors are legally responsible for the performance of their duties. Lack of knowledge of their obligations does not release Directors from their duties. (Recommendation at 9)</p> <p>It is recommended that there be a mechanism that lends support to the Board in verifying compliance of the audit function, assuring that internal and external audits are performed with the highest objectivity possible and that the financial information is useful, trustworthy and accurate; that is, that the information presented to the Board, to shareholders and the general public is transparent, sufficient, and adequately reflects the financial position of the corporation. (Recommendation at 12-13)</p> <p>[T]he Statutory Auditor of a corporation is designated by the stockholders and is charged, among other duties, with reviewing the financial statements as well as enforcing the accounting policies. (Recommendation at 14)</p>	<p>A director should not be liable for a breach of the duty of care and skill if they have exercised a business judgment in good faith in a matter in which the following three criteria are satisfied:</p> <ul style="list-style-type: none"> <li>▪ That the decision is an informed one based on all the facts of the case; and</li> <li>▪ That the decision is a rational one; and</li> <li>▪ That there is no self-interest.</li> </ul> <p>[The Committee believes] that such an approach would encourage the competitiveness of South African companies and the standing Advisory Committee on Company Law should consider amending the Companies Act to provide that the duty of care and skill should be so limited by statute. (Ch. 5: 3.4)</p>	<p>When a director has violated the law or the articles of incorporation, or has neglected his duties, he may be liable for damages to the corporation or a third party. But managerial decisions by a director that are based on due process and also faithful and rational decision-making, shall be respected. (II.8)</p> <p>The corporation, to ensure the effectiveness of holding directors accountable and to attract competent persons as directors, may purchase, at its own expense, coverage for the directors with liability insurance. (II.8.3)</p> <p>Audit committees and auditors shall [review] the accuracy of the corporation's financial reports. (III.1.3)</p> <p>External auditors are liable for damages incurred from negligent accounting audit to the corporation concerned and to other information users. (III.2.3)</p> <p><i>See</i> Commentary II.3.3 ([T]he term of office of director - appointed through due process at a general shareholder meeting - shall be respected [unless] the director is found liable for any illegal act.).</p>	<p>[Directors should e]xamine all documents relating to all matters that concern the board of directors. If something is suspected, management must be asked to explain as quickly and clearly as possible. (The Code, 4.1.5)</p> <p>[T]he company [will] be held liable to third parties for the actions of its directors and executive committee, if they act within the scope of the authority given to them. (Ch. 2: 4.1)</p> <p>Any action by a director, or any member of the executive committee, which is beyond the scope of his/her authority does not bind the company, unless the company has ratified such action. (Ch. 2: 4.3)</p> <p>In disclosing information in any documents to be filed with the registrar, directors must not present information which is false, or does not accurately reflect the information contained in the accounts, registers, or other company documents. (Ch. 2: 7.2(g))</p> <p>Directors must make sure that the balance sheets, profit and loss statements and minutes of shareholders' and board of directors' meetings do not contain any false information. (Ch. 2: 7.2(h))</p> <p>Directors are jointly liable for any damage to shareholders, or third parties concerned, caused by a breach of the duty of loyalty. Ch. 2: 8.3)</p> <p><i>Regarding "good practice" for the preparation of financial statements, see</i> Ch. 2: 16.</p> <p><i>For discussion of the duty of care incumbent upon directors, see</i> Ch. 2: 5-6, 9, 11-12, 15.</p> <p><i>For discussion of the duty of loyalty incumbent upon directors, including the handling of conflicts of interest, see</i> Ch. 2: 7-9; 13-15.</p>

GM Board Guidelines	CACG Guidelines (International)	IBGC Code of Best Practice (Brazil)	Hong Kong Stock Exchange Code / Guide (Hong Kong)
<b>15. Shareholder Voting Practices (Cumulative &amp; Confidential Voting, Broker Non-Votes, One Share/One Vote)</b>			
<i>Not covered.</i>	<i>Not covered.</i>	<i>Not covered.</i>	<i>Not covered.</i>

Indian Confederation Code (India)	Charter of a Shareholding Society (Kyrgyz Republic)	Report on Corporate Governance (Malaysia)	Reserved
<b>15. Shareholder Voting Practices (Cumulative &amp; Confidential Voting, Broker Non-Votes, One Share/One Vote)</b>			
<p><i>Not covered.</i></p>	<p>All ordinary shares have one vote each. (5.1)</p> <p>The non-property rights of shareholders include . . . to vote by the principle of one share-one vote, except for the cases where cumulative voting is provided by this Charter. (9.3)</p> <p>The shareholders shall decide by majority vote of those attending an AGM whether to adopt majority voting for the election of members of the Board of Directors or cumulative voting. (17.8)</p> <p>If the AGM decides to adopt majority voting, the following rules shall apply.</p> <ul style="list-style-type: none"> <li>i. Each Major shareholder (<i>i.e.</i>, those individually holding more than 10% of the voting shares) shall have the right to appoint one member of the Board of Directors. Any shareholder holding more than 30% of the voting shares of the Society shall have the right to appoint two members, and a majority shareholder shall have the right to appoint three members.</li> <li>ii. Minor shareholders (<i>i.e.</i>, those individually holding less than 10% of the voting shares) shall together vote to elect members to the Board of Directors. If their total percentage holding of the voting shares is between 30% and 50%, they shall elect two members; if between 50% and 70%, they shall elect three members; and if more than 70%, they shall elect four members. If there are no Major shareholders holding more than 50% of shares, the Minor shareholders shall elect five members.</li> </ul> <p>(17.9)</p> <p><i>See 4.1.1 (state as majority owner), 10.1 (issuance of preferential shares), 16.13, 16.14, 16.15 (AGM and voting).</i></p>	<p><i>Not covered directly, but see Principles &amp; Best Practices for Other Corporate Participants, I (Institutional shareholders have a responsibility to make considered use of their votes.).</i></p>	

Code of Corporate Governance (Mexico)	King Report (South Africa)	Code of Best Practice (South Korea)	The SET Code and Guidelines (Thailand)
<b>15. Shareholder Voting Practices (Cumulative &amp; Confidential Voting, Broker Non-Votes, One Share/One Vote)</b>			
<p>It is suggested that, through a form containing detailed information and possible voting alternatives for the items on the agenda, stockholders be able to instruct their representatives how to vote on each item at the stockholder meeting. (Principle at 21)</p>	<p><i>Not covered.</i></p>	<p>Shareholders shall hold fair voting rights according to the type and number of shares possessed, and all shareholders shall equally be in possession of corporate information. (I.2)</p> <p>Shareholders shall hold the right to one vote per share, and there shall be no infringement on basic shareholder rights. However, voting rights for certain shareholders may be somewhat restricted, as indicated by law. (I.2.1)</p> <p>The opinions of shareholders other than the controlling shareholder shall also be reflected when appointing directors. For this purpose, it is recommended that a cumulative voting system be adopted. (II.3.2)</p> <p>It would . . . be best to adopt the cumulative voting system, not just to ensure the independence of directors or to reflect the shareholders' diverse opinions when appointing directors, but also in consideration of the significant influence that controlling shareholders yield on management. To encourage adoption of this system, disclosure of whether it has been adopted by the corporation shall be made mandatory. (Commentary on II.3.2)</p>	<p>The Act [<i>i.e.</i>, the Public Limited Companies Act of 1992] prescribes that directors shall be elected at a shareholders' meeting in accordance with the rules and procedures as prescribed in the Articles of Association. If the Articles of Association do not provide the rules and procedures for the appointment of directors, the Act states that cumulative voting should be applied. (Ch. 2: 2.7)</p>

GM Board Guidelines	CACG Guidelines (International)	IBGC Code of Best Practice (Brazil)	Hong Kong Stock Exchange Code / Guide (Hong Kong)
<b>16. Shareholder Voting Powers</b>			
<i>Not covered</i>	<i>Not covered.</i>	<i>Not covered.</i>	<i>Not covered.</i>

Indian Confederation Code (India)	Charter of a Shareholding Society (Kyrgyz Republic)	Report on Corporate Governance (Malaysia)	Reserved
<b>16. Shareholder Voting Powers</b>			
<p><i>Not covered.</i></p>	<p><i>The following is a summary of 9.3:</i></p> <p><i>The rights of shareholders include:</i></p> <ul style="list-style-type: none"> <li>▪ <i>attendance at, and vocal participation in, General Meetings of Shareholders;</i></li> <li>▪ <i>exercise of voting rights of shares held;</i></li> <li>▪ <i>entitlement to dividends per shares held;</i></li> <li>▪ <i>to demand convocation of an Extraordinary General Meeting of Shareholders if one holds not less than 20% of shares;</i></li> <li>▪ <i>to require that any issue relevant to the operations of the Society be put on the agenda of an Annual General Meeting of Shareholders;</i></li> <li>▪ <i>to receive objective information about the activities of the Society, including minutes of General Meetings, and to review accounting reports and other documents at any General Meeting of the Society;</i></li> <li>▪ <i>to demand that an independent audit of the financial and economic activities of the Society be carried out, provided that holders of at least 10% of the voting shares give notice of this demand in writing to the Society's Secretary;</i></li> <li>▪ <i>to contest in court decision taken by the Society where the shareholders claims that any such decision contravenes the founders' agreement or the legislation of the Kyrgyz Republic.</i></li> </ul> <p>Any shareholder, through the Society's Secretary, has the right to inspect the latest accounts of the Society, together with a list of all members of the Board of Directors and MBD. (16.16)</p> <p><i>For lists of issues and transactions that fall within the exclusive jurisdiction of the General Meeting of Shareholders, see 16.4 and 16.6.</i></p>	<p><i>Not covered directly, but see Best Practice AA.IV ([A] "significant shareholder" is defined as a shareholder with the ability to exercise a majority of votes for the election of directors.).</i></p>	

Code of Corporate Governance (Mexico)	King Report (South Africa)	Code of Best Practice (South Korea)	The SET Code and Guidelines (Thailand)
<b>16. Shareholder Voting Powers</b>			
<i>Not covered.</i>	<i>Not covered directly, but see Ch. 12: 6 (If institutional investors, who are not controlling shareholders and represented on the board, endeavor to play a more proactive role by having regular meetings with management and discussing strategy, performance, etc., two risky situations evolve. Firstly, management runs the danger of being guilty of giving superior information to one shareholder and, secondly, the institution could be guilty of insider trading if it deals in the company's shares. It is a matter that has to be approached with the agility of a trapeze artist. These factors have to be kept in mind if institutional shareholders try to play a more constructive role as owners.)</i>	<p>Shareholders shall receive all necessary information prior to exercising their rights, and shall be able to exercise their rights through proper procedure. (I.1)</p> <p>Shareholders, as owners of the corporation, possess basic rights including the following:</p> <ul style="list-style-type: none"> <li>▪ A right to participate in profit sharing;</li> <li>▪ A right both to attend and to vote at general shareholder meetings;</li> <li>▪ A right to obtain relevant corporate information in a timely and regular manner.</li> </ul> <p>(I.1.1)</p> <p>Shareholders shall be able to exercise their voting rights, either directly or indirectly, in the simplest manner possible. (I.1.5)</p> <p><i>See I.3.1, I.3.2 (shareholders shall endeavor to exercise their vote in the best interests of the corporation).</i></p>	<p>A board of directors holds the power to manage the business of the company. Shareholder approval is, however, required for certain crucial decisions. These decisions are set out in the Act [<i>i.e.</i>, the Public Limited Companies Act of 1992] and the Articles of Association. These include, among others, authorizing an increase or decrease in capital, appointment or removal of directors, sale of major assets or transfer of business, the purchasing or acquiring of another listed company's or private company's business, entering, amending or ceasing a major leasing agreement, authorizing other people to manage the company's business, the payment of dividends, the issuance of debentures, a merger with another company, an amalgamation with another company and a company's dissolution. (Ch. 2: 2.1)</p> <p><i>See Ch. 2: 10:1 ([1]Independent directors are expected to, in general, guard against any acts by the board of directors which may prejudice the interests of the company's minority shareholders.)</i></p>



GM Board Guidelines	CACG Guidelines (International)	IBGC Code of Best Practice (Brazil)	Hong Kong Stock Exchange Code / Guide (Hong Kong)
<b>17. Shareholder Meetings</b>			
<i>Not covered.</i>	Ultimately the shareholders, as owners of the capital of the corporation, have the jurisdiction and discretion to appoint or remove directors, but this should always be done through a transparent process at properly constituted meetings. (Commentary on Principle 2)	<i>Not covered.</i>	<i>Not covered.</i>

Indian Confederation Code (India)	Charter of a Shareholding Society (Kyrgyz Republic)	Report on Corporate Governance (Malaysia)	Reserved
<b>17. Shareholder Meetings</b>			
<p><i>Not covered.</i></p>	<p>The General Meeting of Shareholders is the supreme body of governance with the right to make decisions on all issues of the Society. (16.1)</p> <p>The General Meetings of Shareholders consists of shareholders or their representatives. Any shareholder, including non-voting preference shareholders or other shareholders without voting shares, may attend. (16.4)</p> <p>The General Meeting of Shareholders has the right to decide on any other matters not within the exclusive jurisdiction of the General Meeting, and to overrule (cancel) the decisions of any other governing body of the Society . . . by a simple majority of shareholders present at the General Meeting. (16.7)</p> <p>A General Meeting of Shareholders is valid if shareholders or their representatives holding over 60% of the votes given by the total issued fully paid-up voting shares have registered their attendance at the meeting. (16.18)</p> <p>Every member of the Management Board must be nominated by either a Major shareholder, two or more Minor shareholders, or any member of the Board of Directors, and shall be elected by a General Meeting of Shareholders. (17.23; see 18.2)</p> <p><i>See also</i> 6.1, 6.7, 7.2, 8.2, 11.1, 11.2, 12.1, 14.1, 16.12 and Topic Heading 16, above.</p> <p><i>For lists of issues and transactions that fall within the exclusive jurisdiction of the General Meeting of Shareholders, see 16.4 and 16.6.</i></p>	<p>Companies should use the AGM to communicate with private investors and encourage their participation. (Principle C.II)</p> <p>Private investors are able to make little contribution to corporate governance. The main way of achieving greater participation is through improved use of the AGM. (Explanatory Note 4.12 on Principle C.II at 77)</p> <p><i>For recommendations for improving the quality of AGMs, see Explanatory Note 4.78 on Best Practice CC.I at 98-99.</i></p>	

Code of Corporate Governance (Mexico)	King Report (South Africa)	Code of Best Practice (South Korea)	The SET Code and Guidelines (Thailand)
<b>17. Shareholder Meetings</b>			
<p>It is suggested that the agenda of a Stockholders Meeting should avoid grouping different matters as a single item. (Principle at 21)</p> <p>It is suggested that all information on each item on the agenda of the Stockholders Meeting should be available 15 days prior to the date of the meeting. (Principle at 21)</p> <p>It is suggested that, through a format containing detailed information and possible voting alternatives for the items on the agenda, stockholders be able to instruct their representatives how to vote on each item at the stockholder meeting. (Principle at 21)</p> <p>It is suggested that information provided to shareholders include the proposal of the formation of the Board of Directors and a brief professional profile of the candidates. (Principle at 21)</p> <p>It is suggested that the Board of Directors include in its annual report to the Stockholders Meeting the relevant aspects of the tasks of each intermediate organism. It is suggested that all reports of each organism submitted to the Board be available to the stockholders together with all the material for the Stockholders Meeting, with the exception of information of a confidential nature which could affect the competitiveness of the corporation. In addition, it is recommended that the annual report include the names of the members of each intermediate organism. (Principle at 22)</p> <p>It is important that shareholders receive [prior to the annual meeting] all information in connection with the candidates to be Directors of the corporation, specifically, a brief résumé, in order to be able to evaluate their backgrounds and proceed with a more informed vote. (Recommendation at 21)</p>	<p>At the AGM the chair of the remuneration committee should be present to motivate remuneration decisions. (Ch. 8: 6)</p> <p>While distinction between owners and managers is clear, a large company with thousands of shareholders and no controlling shareholder really does not have an owner who can exercise rights of ownership in their discretion. The right of ownership of the company in such a case is diluted by the democracy in the company and the need to call a shareholders meeting to exercise the rights of the owners. With a single or controlling shareholder the right and power of ownership vests in them. It is true that technically they have to act through a shareholders meeting to appoint, for example, a new director but once it is known that they will carry the vote they have the power to nominate and ensure the appointment of that new director. (Ch. 12: 4)</p> <p>The AGM must be properly used by shareholders by asking questions on the accounts and reports presented. Forms in annual reports should be provided on which shareholders could send in written questions in advance of the meeting. If matters of importance and substance are raised at the AGM a summary should be sent to shareholders. (Ch. 12: 11)</p> <p>The Annual Report, Interim Report and AGM are the main links between the company and shareholders. (Ch. 16: 1.1)</p> <p>Shareholders should be welcomed at Annual General Meetings and encouraged to ask questions. A form could be included in the Annual Report for written questions to be sent to the company secretary. (Ch. 16: 1.3)</p>	<p>To protect to the utmost the rights of shareholders, the following matters which cause fundamental corporate changes and shareholder rights shall be decided at the general shareholder meeting:</p> <ul style="list-style-type: none"> <li>▪ Amendments to articles of incorporation;</li> <li>▪ M&amp;A and business transfer;</li> <li>▪ Corporate disbanding and dissolution;</li> <li>▪ Capital reduction and others.</li> </ul> <p>(I.1.2)</p> <p>Resolutions from the general shareholder meeting shall be made through transparent and fair proceedings. Also, shareholders shall receive sufficient prior notice including the time, location and agenda of the meeting; such time and location shall be set so as to allow maximum shareholder participation. (I.1.3)</p> <p>Shareholders may submit items for the meeting agenda to the board of directors; they may raise questions and demand explanations as part of the agendas at the meetings. The corporation shall ensure that shareholders' opinions are sufficiently reflected at the general shareholder meetings. (I.1.4)</p> <p>[T]he term of office of director – appointed through due process at a general shareholder meeting – shall be respected so that the director's functions as managing agent for all shareholders may be performed dutifully. (Commentary on II.3.3)</p> <p>The corporation shall, by disclosing the nominated directors prior to the general shareholder meeting, ensure that shareholders exercise their voting rights with information on the nominees. (II.3.4)</p> <p>External auditors shall attend the general shareholder meeting and answer any shareholders' question on audit reports. (III.2.2)</p>	<p>The remuneration of directors as approved by a shareholder meeting should be fully disclosed in the company's annual report. (The Code, 4.4).</p> <p>[A] general meeting of shareholders must decide on the director, or directors, authorized to bind the company by his or her signatures (the "authorized directors"). (Ch. 2: 4.2)</p> <p>If the Articles of Association do not provide for the directors' remuneration, a shareholders' meeting of the company may fix the directors' remuneration. (Ch. 2: 7.2(e))</p> <p>[B]alance sheets and the profit and loss statements must be audited by the company's auditor and, thereafter, submitted to the shareholders at the annual general meeting of shareholders for their consideration and approval. (Ch. 2: 16.1)</p> <p>The issuing of new shares requires a special resolution from a shareholders' general meeting. (Ch. 3: 2.1)</p> <p>Dividends are declared by an ordinary resolution from a shareholders' general meeting. (Ch. 3: 5.2)</p> <p>[Acquisitions, takeovers and amalgamations require] a special resolution of a shareholders' general meeting. (Ch. 7: 3.1, 3.2)</p> <p>The Listed Target [<i>i.e.</i>, a company listed on the SET and the object of a takeover bid] must obtain approval from a general meeting of its shareholders. (Ch. 7: 5.4(ii))</p> <p>The chairmen of the audit committee and the remuneration committee should be available to answer questions . . . at the annual general meeting of shareholders of the company. (Ch. 8: 3.2, 3.3)</p>

# Partial Listing of Corporate Governance Guidelines and Codes of “Best Practice”

### International organizations

- Centre for European Policy Studies (CEPS), *Corporate Governance in Europe—Recommendations* (June 1995).
- Commonwealth Association for Corporate Governance (CACG), *CACG Guidelines: Principles for Corporate Governance in the Commonwealth* (final version, November 1999).
- European Association of Securities Dealers Automated Quotation (EASDAQ), *Rule Book* (October 1998).
- European Bank for Reconstruction and Development (EBRD), *Sound Business Standards and Corporate Practices: A Set of Guidelines* (September 1997).
- International Corporate Governance Network (ICGN), *Statement on Global Corporate Governance Principles* (final draft, adopted July 9, 1999).\*
- Organisation for Economic Co-operation and Development (OECD) Ad Hoc Task Force on Corporate Governance, *OECD Principles of Corporate Governance* (April 1999).

- OECD Business Sector Advisory Group on Corporate Governance, *Corporate Governance: Improving Competitiveness and Access to Capital in Global Markets*, Report to the OECD (Millstein Report) (April 1998).

### Australia

- Australian Investment Managers Association (AIMA), *Corporate Governance: A Guide for Investment Managers and Corporations* (2d ed., July 1997).\*
- Working Group representing Australian Institute of Company Directors, Australian Society of Certified Practising Accountants, Business Council of Australia, Law Council of Australia, The Institute of Chartered Accountants in Australia and The Securities Institute of Australia, *Corporate Practices and Conduct* (Bosch Report) (3d ed., 1995).

### Belguim

- Federation of Belgian Companies, *Corporate Governance Principles* (1998).

- Brussels Stock Exchange, *Report of the Belgium Commission on Corporate Governance* (Cardon Report) (1998).

### Brazil

- Instituto Brasileiro de Governança Corporativa (IBGC), formerly Instituto Brasileiro de Conselheiros Administração (IBCA), *Code of Best Practice of Corporate Governance* (May 6, 1999).
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\* Investor viewpoint.

# International Accounting and Auditing Standards

### Context

The adoption of high quality international accounting and auditing standards by the corporate sector directly impact transparency and disclosure by the corporation to shareholders, creditors and other stakeholders.

### *International accounting standards*

International accounting standards are developed by due process by the International Accounting Standards Committee (IASC), an independent private sector body, based in London and founded in 1973. The objectives of IASC are to:

- Formulate and publish in the public interest accounting standards to be observed in the presentation of financial statements and to promote their worldwide acceptance and observance.
- Work generally for the improvement and harmonization of regulations, accounting standards and procedures relating to the presentation of financial statements.

The list of published standards is continuously being updated to reflect the changing

needs of business transactions that affect the financial statements of business enterprises. The framework sets out the concepts that underlie the preparation and presentation of financial statements for external users. The framework deals with:

- The objective of financial statements including financial position and performance and underlying assumptions of accrual basis and ongoing concern.
- The qualitative characteristics that determine the usefulness of information in financial statements which include the notions of understandability, relevance (including materiality, reliability, faithful representation, substance over form, neutrality, prudence and completeness) and comparability (consistent accounting policies, and so on).
- The definition, recognition and measurement of the elements from which financial statements are constructed.
- Concepts of capital adopted by enterprises in preparing their financial statements (primarily equity) and therefore of capital maintenance (financial or physical).



International accounting standards have made a considerable contribution toward improving and harmonizing financial reporting around the world. They are used:

- As a basis for national accounting requirements in many countries.
- As an international benchmark by countries which develop their own requirements (including major industrialized countries as well as an increasing number of emerging countries including China and many other countries in Asia and Eastern and Central Europe).
- By stock exchanges and regulatory authorities which allow foreign or domestic companies to present financial statements in accordance with international accounting standards.
- By supra-national bodies such as the European Commission, which announced in 1995 that it is relying heavily on IASC to produce results that meet the needs of capital markets.
- By a growing number of companies themselves.

#### ***International auditing standards***

The International Federation of Accountants (IFAC) serves as a catalyst of all sectors of the accounting profession to act consistently in the best interest of the public and to provide high quality services. IFAC also has an Ethics Committee responsible for the code of Ethics for Professional Accountants, a bench mark in the development of the international accountancy profession which services as the foundation for all codes of ethics developed and enforced by IFAC member bodies. IFAC also actively supports the efforts of IASC to create uniform worldwide standards to be observed in financial accounting and reporting. However, its key standard setting role is in the area of international standards of auditing through its International Auditing Practices Committee (IAPC).

IFAC's IAPC works to improve the quality and uniformity of standards for auditing and

related services throughout the world by issuing benchmark pronouncements on a variety of audit and attest functions. Its codification program has made the standards more accessible to a wider audience. The format that includes both general and specific guidance, follows the conduct of an audit from planning, through field work, to conclusion and reporting. International standards of auditing also provide extensive guidance on the responsibilities of management and the auditor with respect to financial statements and the audit itself. Harmonizing standards for auditing and related services helps to ensure that auditors are using common principles when dealing with multinational companies and transactions. A set of consistently applied benchmark standards used by auditors reporting on financial statements can facilitate decision making and contribute to the operation of more efficient capital markets.

- *Accounting standards and financial disclosures.* The days of having opaque, country-specific accounting standards and financial disclosure norms are coming to an end (Mercado 1996). Increasingly, international investors are rating listed companies according to their quality of disclosure, and whether these conform to global standards such as the generally accepted accounting principles (GAAP) or international accounting standards. Moreover, even domestic companies that are not at present accessing the international capital market are being required to upgrade their standards. There are three relevant issues:
  - Desirability of conforming to internationally prescribed accounting standards.
  - Need for disclosures that go beyond such standards.
  - Need to use principles of financial consolidation for corporate groups.
- *International accounting standards.* The benefits of opting for disclosure in accordance with internationally prescribed accounting standards are obvious. Commonly under-

stood treatment of accounts promotes greater transparency, and allows investors and analysts anywhere in the world to get an unambiguous picture of the financial health of a company. Unfortunately, there are huge discrepancies in accounting standards even within OECD countries.

Table A5.1 is a very abridged list. There are significant differences in the treatment of cash flows, contingent liabilities, effects of changes in foreign exchange rates, investments, transactions with subsidiaries, associate companies and joint ventures, and even the treatment of revenue.

- *Additional voluntary disclosures.* It is a fact that, all other things being equal, the greater the quality of disclosure, the more loyal are a company's shareholders and debt-holders. Better governed, large listed corporations voluntarily offer additional disclosures. Given below is an illustrative list of some of these disclosures.
- *Consolidation and presentation of group accounts.* Over time, international investors will insist upon consolidated accounts for any corporation that has subsidiaries and associated group companies. Consolidation

eliminates misleading reporting of intra-group transactions, balances, investments and unrealized profits, and therefore gives a much clearer picture of the financial state of a corporation, its subsidiaries and associated companies. It is useful to give a brief description of what consolidation entails, so as to appreciate how much greater transparency it brings about in terms of disclosing financial information to shareholders:

- *Minimal definition of group.* It should include the parent company, its subsidiaries (where the reporting company owns over 50 per cent of the voting stake), its 'related' or 'associated' companies (where the parent owns between 25 per cent and 50 per cent of voting stake) and its 'joint ventures' (where the reporting company has a contractual agreement with one or more parties to undertake an economic activity that is subject to joint control, and could include a partnership firm where the reporting company is a partner).
- *Group accounts.* involve consolidated financial statements of the group as

**Table A5.1. A few of the many international accounting standards that are only partially followed globally**

<i>Presentation of financial statements</i>	<i>International accounting standards</i>
Components and format of financial statements	Complete set of financial statement includes balance sheet, statement of income-expenditure, statement of nonowner movements in equity, cash flow statement, and notes to financial statements. Encouraged to present a review of management of financial and operating activities outside the financial statement . Clear statement of compliance with relevant accounting standards, either international accounting standards or GAAP. If not, why and where not.
Going concern assumption	Any significant uncertainties about the entity's ability to continue as a going concern must be disclosed.
Disclosure of accounting policies	Disclose the measurement basis used in preparing the financial statements and each specific accounting policy that is necessary for an understanding of the financial statements. Should be presented as a separate component of the financial statements or in notes to the financial statements.

Source: Deloitte Touche Tohmatsu 1997.

## A list of voluntary disclosures

Listed companies should make every effort to divulge information on these heads.

*Treatment of debt.* East Asia has emphasized its criticality. Companies should disclose total debt and its composition and maturity, the foreign exchange component of debt and its tenure, servicing and hedging costs, the ratio of free cash flow to debt, the interest coverage ratio, and the multiple of earning to all fixed charges.

*Free cash flow.* This is rarely disclosed to shareholders. It tells shareholders of the cash remaining in operation after satisfying a company's business reinvestment opportunities. It should either be allocated for specific investments, or returned to shareholders through buy-back of shares or higher dividends.

*Statement on economic value added,* or the return on capital employed less the cost of capital employed. If positive, a company has gained corporate value.

*Financial details on business segments or divisions,* up to 5 per cent of turnover, giving share in sales revenue, share in contribution, review of operations, analysis of markets and future prospects.

*Foreign currency management.* There should be a detailed note explaining the company's objec-

tives of foreign currency management, instruments used and their gains and losses, exposures taken, and the quantity and proportion of hedged transactions.

*High and low monthly averages of share prices* in the Stock Exchanges where the company is listed for the reporting year, and how these compare with the country's stock index and other companies in the industry.

*Data on distribution of shareholding* according to categories such as controlling interests, directors and their families, other companies, foreign institutional investors, financial institutions, mutual funds, and individuals.

*End-use of public funds.* Where a company has raised funds by issuing shares, debentures or other securities, it should give a separate statement showing the end-use of such funds — how much was raised, how much has been utilized in the project for which it was raised, and where are the residual funds, if any, invested and in what form.

*Detailed report on stock option activity,* if any—outstanding, granted, exercised, exercisable and forfeited/expired.

*Report on all major outstanding litigation* and their progress during the year.

defined above. In preparing these statements:

- Intragroup balances, transactions and resulting unrealized profits are eliminated.
- Uniform accounting policies are used for all elements of the group; if this is not practicable, then it is disclosed wherever relevant, along with a note on what accounting principle has been used.
- Minority interests are presented separately from liabilities and the parent company's shareholders' equity;

minority interests in the income of the group are also presented separately.

- Investments in the group are presented separately for subsidiaries, associated companies, and joint ventures.
- Regarding joint ventures that use the vehicle of partnerships, there is a clear enunciation of the reporting company's share of jointly controlled assets (suitably classified), liabilities incurred, share of any liabilities incurred jointly, its share of income from and expense toward the joint venture.

### Consolidation of group accounts

In the interest of transparent financial accounting, corporate groups should adopt consolidation under international accounting standards or GAAP, provided that the country's banks, financial institutions and corporate tax laws recognize groups as corporate entities. In the first instance, this should be voluntary. However, the progress of consolidation should be reviewed after five years to consider whether there is a case for making it mandatory.

- There are disclosures listing all subsidiaries, associate companies and joint ventures, their addresses, proportion of voting power held and line of business, and the nature of relationship with its associated companies and joint ventures; in addition, wherever applicable, there are disclosures about the reasons for not consolidating any subsidiary, associated company or joint venture.
- *Compliance certificate for listed companies.* One of the most appealing features of the Cadbury Committee Report is the Compliance Certificate that has to accompany the annual reports of all companies listed in the London Stock Exchange. This created a healthy milieu for corporate governance. An appropriate annually produced compliance certificate ensures that minimal principles of corporate governance are being followed by listed companies. And there are good reasons for focusing on listed companies. These are financed largely by public money (be it equity or debt) and, hence, need to follow codes that make them more accountable and value-oriented to their investing public. Moreover, they have strong externalities: good corporate

### Compliance certificate for listed companies

Major stock exchanges should gradually insist upon a compliance certificate, signed by the chair, the CEO and the chief finance officer, which should clearly state:

- That the board of directors is responsible for the proper maintenance of adequate accounting records in compliance with the country's corporate laws, for safeguarding the assets of the company, and for preventing and detecting fraud and other irregularities.
- That the management is responsible for the preparation, integrity and fair presentation of the financial statements and other information in the annual report, and also indicate whether the company will remain in business in the course of the following year.
- That the accounting policies and principles conform to standard practice, and where they do not, full disclosure has been made of any material departures.
- The composition of the board: how many are members of the company's management, how many are nonexecutive directors, and which of the nonexecutives are independent directors.
- That the board has overseen the company's system of internal accounting and administrative controls through its audit committee, which consists of nonexecutive directors. The audit committee has met regularly with the statutory auditors, management and internal audit staff to satisfy themselves that proper norms were followed. The financial statements and all financial disclosures have been reviewed by the audit committee.

governance of listed companies has long term beneficial effects for the financial sector and stock markets; conversely, poor governance leads to investors escaping to greener pastures.

## The current situation

While substantial improvements have been made in recent years in developing countries in improving accounting and auditing standards, one of the key lessons from the Asian crisis is the importance of transparency in the financial regulatory system, good governance and the need for reliable accounting and reporting. There is thus considerable work to be done to move the corporate sector to adopt accounting standards developed by the IASC as well as international standards of auditing developed by IAPC. Clearly, until such time as these standards, or their equivalent, are adopted by a large segment of the private corporate sector in these countries, the best institutional disclosure policies will be undermined with consequences, amongst other things, on accessing commercial banks or capital markets.

## Role of the World Bank

The Bank has in recent years improved its external support to international accounting and auditing institutions both public and private. Specifically, it has provided funding in excess of \$2 million through its Special Grants Program to support:

- IASC in the development of international accounting standards for agriculture which is in its final stages.
- IFAC's Public Sector Committee in the development of international public sector accounting standards.
- International Organization of Supreme Credit Institutions (INTOSAI) for the development and provisions of "train the trainers" programs for Auditors-General Offices.
- The ISAR Group (Intergovernmental Group of Experts in Standards of Accounting and Reporting) to develop approaches to environmental financial accounting and reporting.

The Bank is a catalyst and "guardian" of transparency, and as a precondition for markets to flourish, it has a vested interest in the introduction of standards that can help to bring transparency—both at the macro and micro level and in both the public and private sectors. Its lending instruments provide it with an ideal opportunity to ensure that both countries and individual corporate borrowers strive to meet internationally accepted accounting and auditing standards thereby also facilitating possible access to international capital markets.

**Annex 5b. Comparison of International Accounting Standards and  
US Generally Accepted Accounting Principles**  
Merrill Lynch Accounting Bulletin 21 by David Hawkins

International Accounting Standards Number	Title	International Accounting Standards	US Generally Accepted Accounting Principle
1. (Rev.)	Presentation of financial statements	Financial statements should fairly present the financial position, financial performance and cash flows of an enterprise in accordance with all of the requirements of International Accounting Standards (IAS). In rare cases, departure from IAS is permitted.	Similar (“similar” should be interpreted to mean similar in concept and thrust to IAS, but not necessarily identical in all respects US GAAP). No override of US GAAP is permitted.
2. (Rev.)	Inventories	Inventories should be valued at the lower cost or net realizable value. FIFO, LIFO, and weighted average cost methods is permitted.	Similar.
4.	Depreciation Accounting	The cost or revalued amount of depreciable assets should be allocated on a systematic basis to each accounting period during the asset’s useful life.	Similar, except depreciation based on asset’s cost.
5.	Information to be disclosed in financial statements.	All material information necessary to make financial statements clear and understandable should be disclosed.	Similar.
7. (Rev.)	Cash flow statements	A cash flow statement reporting cash flows classified by operating, investing, and financing activities should be included as an integral part of the financial statements. Interest paid and received may be classified as operating, investing or financing activities. Dividends paid may be classified as operating or financing activities.	Similar. Interest paid or received is classified as an operating activity. Dividends paid is classified as a financing activity. Dividends received is an operating activity.
8. (Rev.)	Net profit or loss for the period, fundamental errors and changes in accounting policies	Extraordinary items arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise. A correction of a fundamental error and the cumulative effect of a change in accounting policy can be reported by either restatement of prior period financial statements or in the current	Similar, except changes in accounting policy accounted for in current period only and corrections of fundamental errors accounted for the restatement only.

International Accounting Standards Number	Title	International Accounting Standards	US Generally Accepted Accounting Principle
		period financial statements. A change in an accounting estimate is reported in the change period.	
10.	Contingencies and events occurring after the balance sheet date (superseded in part by 27)	Adjust financial statements for post balance sheet events that provide evidence of the enterprise's condition as of the balance sheet date.	Similar.
11. (Rev.)	Construction contracts	Percentage of completion method should be used to recognize revenue when the outcome of the construction contract can be estimated reliably. When the outcome cannot be estimated reliably, revenue should be recognized only to the extent of contract costs incurred. Expected losses on a contract should be recognized immediately.	Similar with respect to percentage of completion method. When outcome cannot be reliably estimated, completed contract method is used.
12. (Rev.)	Income taxes	Provide for all deferred taxes resulting from temporary differences using the liability method. Recognize deferred tax assets only if it is probable that taxable profits will be available against which the deferred tax asset can be realized.	Similar.
13.	Presentation of current assets and current liabilities	Each enterprise should determine whether or not to present current assets and current liabilities in its financial statements.	Similar.
14. (Rev)	Segment reporting	Disclose business and geographic segment data, providing more comprehensive disclosures about primary segment of the two. A business segment is a distinguishable component of an enterprise that is subject to risks and returns that are different from those of other business segments. Uses annual report accounting policies for measurement purposes.	Similar, but segments must reflect internal reporting structure. Internal accounting practices used for measurement purposes.
15.	Information reflecting the effects of changing prices (15 superseded 6)	Entities are encouraged (but not required) to disclose in supplemental statements fixed assets, depreciation, cost of sales and monetary item data using an accounting method	Similar, but current cost/ constant dollar method specified.

International Accounting Standards Number	Title	International Accounting Standards	US Generally Accepted Accounting Principle
		reflecting the effects of changing prices.	
16. (Rev.)	Property, plant and equipment	Use historical cost or revalued amount. Revaluation gains credited to owners' equity. Revaluation losses that offset previous revaluation gains recognized for an asset charged to owners' equity until gains eliminated then charge to income. Revaluation of the entire class of assets required when an asset is revalued.	Historical cost only.
17. (Rev.)	Accounting for leases	A lease is classified as a finance lease if it transfers substantially all the risks and rewards incident to ownership. A lease is classified as an operating lease if substantially all risks and rewards incident to ownership are not transferred. In the case of lessees, a finance lease gives rise to a depreciable asset and a periodic depreciation charge as well as a lease obligation and a periodic finance charge. The charge to income under an operating lease is the rental expense for the accounting period. In the case of lessors, an asset held under a finance lease should be recorded at an amount equal to the net investment in the lease. Finance income should be recognized over the lease period based on a pattern reflecting a constant periodic rate of return on the lessor's net investment outstanding in the finance lease. Profits or losses should be recognized on sale type leases in accordance with the policy normally followed by the enterprise for outright sales. Operating lease rental income should be recognized over the lease term.	Similar with more explicit criteria for determining when a lease is a financing or a capital lease.



International Accounting Standards Number	Title	International Accounting Standards	US Generally Accepted Accounting Principle
18. (Rev.)	Revenue	Revenue from sales or service transactions should be recognized when the enterprise has performed as evidenced by the transfer of the significant risks and rewards of ownership to the buyer and no significant uncertainties exist with respect to collection, future obligations and returns.	Similar.
19. (Rev.)	Employee benefits	In a defined contribution pension scheme, employers' contribution applicable to the period should be charged against income in that period. In a defined benefit pension scheme, the defined benefit obligation is determined using a specified actuarial method incorporating assumptions about future benefits due to salary increases and a discount rate equal to the high quality corporate bond yield. Plan assets are measured at their fair value. The components of the pension expense are the current service cost, interest cost, expected return on plan assets, recognized actuarial gains and losses, past service cost, plan curtailments and settlements, and amortization of transition obligation. Similar accounting is used for other post-retirement and post-employment benefits. Disclosure of employee stock compensation plan data is required. Standard does not require recognition of employee stock option compensation costs.	Similar, with respect to employee retiree benefits. Employee stock compensation costs measured at the election of the entity in one of two ways. The intrinsic value method measures the cost as the difference between the option's strike price and the market price of the stock at the grant date. The fair value method measures the cost as the fair value of an option at the grant date. Both methods recognize any cost as a charge to income over a period of time, such as the vesting period.
20.	Accounting for government grants and disclosure of government assistance	Government grants should be recognized in income over the period necessary to match them with the related costs which they are intended to compensate on a systematic basis provided there is a reasonable assurance that the enterprise will comply with the grant's conditions and that the grant payments will be	Similar.

International Accounting Standards Number	Title	International Accounting Standards	US Generally Accepted Accounting Principle
21. (Rev.)	The effects of changes in foreign exchange rates	received. The method of translating the financial statements of foreign operations is determined by the operating and financial characteristics of the operations. In the case of foreign operations determined to be an integral part of the parent's operations, non-monetary assets and liabilities are translated at the exchange rate when the relevant transaction or revaluation occurred. Income statement items are translated at exchange rates that correspond with the dates of underlying transactions. Exchange rate differences arising from these procedures are taken into income of the period. In the case of foreign entities that operate substantially in the local currency, both monetary and non-monetary assets and liabilities are translated at the balance sheet date's exchange rate. Income statement items are translated at the transaction date exchange rate. Exchange rate differences arising from the effect of these procedure's on the parent's opening net investment in the foreign entity are taken to stockholders' equity.	Similar.
22. (Rev.)	Business combinations	A business combination should be accounted for under the purchase method, except in the rare circumstances when it is deemed to be a uniting interest in which case the pooling of interest method is appropriate. A business combination is considered to be a uniting of interest when there is no clear acquirer. Positive goodwill arising in a purchase transaction should be amortized to income on a systematic basis over a period not to exceed 20 years or a longer period if justified.	Similar, except that 12 specific tests must be met before pooling of interest accounting can be used. Positive goodwill must be charged to income over a period not to exceed 40 years.

International Accounting Standards Number	Title	International Accounting Standards	US Generally Accepted Accounting Principle
23. (Rev.)	Borrowing costs	An enterprise that has incurred borrowing costs and incurred expenditures on assets that take a substantial period of time to get them ready for their intended use or sale should adopt a policy of either expensing or capitalizing the borrowing costs for those assets.	Similar, but interest capitalization is required.
24.	Related party disclosures	Transactions between related parties should be disclosed. Related party relationships where control exists should be disclosed irrespective of whether there have been transactions between related parties.	Similar.
25.	Investment (partly superceded by 39)	Investments not in the form of financial assets classified as current assets should be carried at either market value or the lower of cost and market value. Those classified as long-term assets should be carried at either cost, revalued amounts or, in the case of equity securities, the lower of cost and market.	Similar, except revaluations are not permitted for current and long-term investment assets not in the form of financial assets.
26.	Accounting and reporting by retirement plans	Retirement benefit plan investments should be carried at fair value. The plan report should show the net assets available for benefits and, in the case of defined benefit plans, the actuarial present value of promised benefits (distinguishing between vested and non-vested benefits) using either current or projected salary levels. Other disclosures required include the nature of the plan, changes in plan net assets available for benefits, and a summary of significant accounting policies.	Similar.
27.	Consolidated financial statements and accounting for investments in subsidiaries (27 superceded 3)	Consolidate all entities controlled by votes or dominant influence, unless long-term restrictions on ability to transfer funds to parent or held for near-term sale.	Similar. Control is based on majority voting control (6).

<b>International Accounting Standards Number</b>	<b>Title</b>	<b>International Accounting Standards</b>	<b>US Generally Accepted Accounting Principle</b>
28.	Accounting for investments in associates (28 superceded 3)	Equity method for 20 percent plus interests in associates. Equity method or proportional consolidation for joint ventures.	Similar. Proportional consolidation is rarely used.
29.	Financial reporting in hyperinflationary economies	The financial statements of an enterprise that reports in the currency of a hyperinflationary economy, whether they are based on historical cost or on current cost approach, should be stated in terms of the general price level index at the balance sheet date. Gains or losses on the enterprise's net monetary position should be included in net income. The statement does not establish an absolute rate at which hyperinflation is deemed to arise. A cumulative inflation rate over 3 years approaching or exceeding 100 percent is suggested as an indication of hyperinflation.	No comparable rule.
30.	Disclosures in financial statements of banks and similar financial institutions	Disclosure required of accounting policies; contingent commitments and other off balance sheet items; maturity of assets and liabilities; concentration of assets; liabilities and off balance sheet items; losses on loans and advances; general banking risks; trust activities; and related party disclosures.	Similar.
31. (Rev.)	Financial reporting of interests in joint ventures	In its consolidated financial statements, a venturer should report its interests in a jointly controlled entity using proportionate consolidation or the equity method.	Equity method principally.
32.	Financial instruments: disclosure and presentation	Enterprises should disclose information about all types of recognized and unrecognized financial instruments including fair values of these instruments.	Similar.
33.	Earnings per share	Basic and diluted earnings per share should be disclosed.	Similar

<b>International Accounting Standards Number</b>	<b>Title</b>	<b>International Accounting Standards</b>	<b>US Generally Accepted Accounting Principle</b>
34.	Interim financial reporting	An enterprise should apply the same accounting policies in its interim financial reports as are applied in its annual financial statements. Interim tax expense is accrued using expected annual period tax rate.	Similar, except some annual financial reporting policies may be modified for interim reporting purposes so that the interim financial reports are not misleading as to the annual results.
35.	Discontinued operations	Information about discontinuing operations should be segregated from information about continuing operations and disclosed in the notes or on the face of the financial statements.	Similar, but must be disclosed on the face of the financial statements.
36.	Impairment of assets	Assets should be written down when their recoverable amount is less than their carrying value. Recoverable amount is the higher of the present value of the projected estimated cash flows from the asset's use or the asset's net selling price. Revaluation of impaired assets is permitted.	An asset intended to be sold is impaired if its carrying amount is less than its net selling price. An asset intended to be used by the enterprise is impaired if the undiscounted sum of the projected cash flows from its use is less than its carrying amount. Impairment loss is the difference between the impaired assets' carrying amount and its fair value. Revaluation of impaired assets is not permitted.

International Accounting Standards Number	Title	International Accounting Standards	US Generally Accepted Accounting Principle
37.	Provisions, contingent liabilities and contingent assets	A provision should be recognized when an entity has a present obligation (legal or constructive) as a result of a past event, it is probable that a transfer of economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. Unless these conditions are met, no provision should be recognized. Where the effect of the time value of money is material, the amount of the provision should be the present value of the amount expected to settle the obligation. Contingent gains should not be recognized.	Similar, except present value measurement of the provision is seldom used.
38.	Intangible assets (38 supercedes 9)	An intangible asset should be recognized if, and only if, it is probable that the future economic benefits that are attributable to the asset will flow to the enterprise, and the cost of the asset can be measured reliably. An intangible asset can be revalued only if its fair value can be determined by reference to an active market. Amortize over a period not to exceed 20 years unless a longer period can be justified. Research cost should be expensed as incurred. Development costs should be capitalized and amortized if certain recoverability criteria are met, otherwise they are expensed as incurred.	Similar, with respect to intangible assets, except the maximum amortization period is 40 years and revaluation is not permitted. Similar with respect to research costs. Development costs should be expensed as incurred, except for recoverable costs incurred in the development of software for sale and internal use software.

## World Bank Lending Operations

**A**lthough corporate governance is a recent subject, the Bank has been engaged in this area for decades now—working indirectly on several related issues. However, previously, its involvement had been mostly piecemeal and largely on the macro level, which did not directly effect the corporate sector. Moreover, reform activities within a particular sector were independent of activities in other sectors instead of being conducted in a concerted method to address the issue of corporate failures due to poor corporate governance practices.

More recently, corporate governance, as laid out in the framework of this paper, has gathered an extensive number of previous reform activities within different sectors under one umbrella. Corporate governance reform activities today entail structural adjustments and all legal, financial, and corporate aspects of an economy. This compilation of World Bank lending operations not only includes the recent projects on corporate governance, but also highlights other projects with corporate governance components.

The selection criteria for this compilation of Bank projects with corporate governance components is as follows:

- It covers projects starting in 1990.
- It is based on the broader definition of corporate governance as laid out in the framework of this paper.
- It covers not only projects that address issues of “internal” corporate governance—such as transparency, accounting, board of directors—but also factors that are “external” to a company and yet have a significant impact on good governance practices within a company. These factors include legal and judicial reforms, financial sector reform including capital markets and banking sector reforms, and the like.

However, not all projects within each sector have been included. For instance the projects selected under the banking sector have been limited to those that focus either on the disciplinary effect of debt on corporations or markets or on other prudential regulations of the banking system, that directly affect the corporate sector. Similarly, for legal and judicial reform, projects have

been limited to those that deal with setting up better legal infrastructure for the businesses or with protecting stakeholders' and the company's interests through effective business laws; strengthening court systems and establishing business tribunals for timely dispute settlement; training of judges and lawyers in business related case law and curricula; and so on.

- State-owned enterprises that are undergoing privatization or are working toward corporatization are also included.

Further information on these projects, including short general descriptions of the corporate governance component, can be found on the World Bank Corporate Governance Web site at <http://www.worldbank.org/html/fpd/privatesector/cg/index.htm>.

#### **List of projects with corporate governance component (as of June 30, 1999)**

##### ***Africa***

- Cameroon—Privatization and Private Sector Technical Assistance Project, 1996.
- Gambia—Enterprise Development Project, 1988 (Project Completion Report No. 15954, 1997).
- Mali—Private Sector Assistance Project, 1992. C2432.
- Mauritania—Capacity Building Project for the Development of the Private Sector, 1995.
- Tunisia—Public Enterprise Reform Loan Project, 1995.

##### ***East Asia***

- China—Accounting Reform and Development Project, 2/1999 CN-PE-51856.
- Indonesia—BEPEKA Audit Modernization Project, 1997.
- Indonesia—Policy Reform Support Loan Project, 1998.
- Indonesia—Second Policy Reform Support Loan Project 4/99. L4470.
- Indonesia—Second Accountancy Development Project, 1994. 12883-IND L3810.

- Indonesia—Accountancy Development Project, 1988.
- Korea, Republic of—Financial and Corporate Restructuring Assistance Project, 1998. KRPE56796 L4385.
- Korea, Republic of—Structural Adjustment Loan Project, 1998.
- Malaysia—Economic Recovery and Social Sector Loan Project, 1998. ID 58031 L4347.
- Mongolia—Ulaanbaatar Services Improvement Project, 1997.
- Thailand—Economic and Financial Adjustment Loan I, 1998. P-7240-TH L4372.
- Thailand—Economic and Financial Adjustment Loan II, 1999. TH-PE-58536 Report P-7271.
- Thailand—Second Gas Transmission Project, 1994.

##### ***Europe and Central Asia***

- Azerbaijan—Rehabilitation Credit, 1996.
- Armenia—Second Structural Adjustment Credit (SATAC II), 1997. C 2981.
- Armenia—Institution Building Loan Project, 1993. L3585.
- Bulgaria—Telecommunication Project, 1993. L 3592.
- Bosnia Herzegovina—Enterprise and Bank Privatization Adjustment Credit (Board date June 1999). BAPE48461.
- Croatia—Technical Assistance Project for Institutional and Regulatory Reform for Private Sector Development. L4460.
- Croatia—Enterprise and Financial Sector Adjustment Loan, 1997.
- Hungary—Enterprise Reform Loan, 1994.
- Kazakhstan—Legal Reform Project 4/1999. KZ-PE-46046.
- Latvia—Structural Adjustment Loan (SAL), 1997.
- Macedonia—Economic Recovery Loan/Credit, 1994. L3703.
- Poland—Enterprise and Financial Sector Adjustment Loan Project, 1993. L3599.
- Romania—Private Sector Adjustment Loan Project (July 1999). P7313.



- Romania—Financial and Enterprise Sector Adjustment Loan, 1997.
- Russian Federation—Management and Financial Training Project, 1994.
- Russian Federation—SAL, 1997. (L4180) RU-PE-49203.
- Russian Federation—SAL III, 1998. (L 4382).
- Russian Federation—Capital Market Development, 1996. L4029.
- Ukraine—Private Sector Development Loan (PAD 6/19990) UAPE54966.
- Morocco—Policy Reform Support Loan (PRES), 1998. PID6870.
- Jordan—Second Economic Reform and Development Loan, 1996. L4115 17919-JOR.
- Yemen—Financial Sector Adjustment Credit, 1997. P-7164-YEM 43101-YEM.

#### **South Asia**

- Sri Lanka—Private Finance Development. C2484.
- Pakistan—Financial Sector Deepening. L3808.
- Pakistan—Banking Sector Adjustment Loan, 1997. L4257.
- India—Container Transport Logistics Project, 1994. L3753.

#### **Latin America and Caribbean**

- Argentina—Public Sector Management Technical Assistance Project, 1986.
- Colombia—First Santa Fe Water Supply and Sewerage Rehabilitation Project, 1995.

#### **Middle East and North Africa**

- West Bank and Gaza—Legal Development Project, 1997. T7133.
- West Bank and Gaza—IFC Capital Market Development (no one specific project, but a number of related nonproject activities).

#### **International Finance Corporation**

- Chile—Corporate Governance/Take-over Reform.
- Ukraine—Corporate Governance. 1998–ongoing.
- Armenia—Corporate Governance. Ongoing.

## World Bank Lending Operations

Africa	Project Name	External Incentives	Internal Incentives	Description of Corporate Governance Components	General Description
Cameroon	Privatization and Private Sector Technical Assistance Project, 1996 C2882	Competition Policy Banking Reform Liquidation Accounting	PE -corporatization - ownership - bank enterprise nexus	Implementation of the General Statute for Public Enterprises which deals with the operating rules of PEs and their supervision by Government and dispositions regarding liquidation of PEs. Components on corporate governance cover: PEs ( other than those non-commercial affairs or branches of central government ) to be subject to corporate law - even if private sector is a minority shareholder; statutory organs such as the Board of Directors and shareholders' meetings are sovereign bodies and the Government as shareholder, to intervene exclusively through these channels; financial reporting requirements; Improve legislation on debt recovery and strengthen Creditors Rights.	The project objectives are to: 1) put in place an adequate and transparent institutional framework for privatization/liquidation and implement a broad privatization program; 2) improve the regulatory and business environment in a limited number of well targeted areas complementary to the privatization program; 3) reorganize the loan recovery agency and support the restructuring of two banks; and 4) provide preliminary support to the judiciary system to initiate a program of reforms over the next few years.
Gambia	Enterprise Development Project, 1988 (Project Completion Report No. 15954, 1997.)		PE -corporatization	To improve the overall parastatal performance through: clarifying enterprise/Government responsibilities and providing incentives for improved performance; settle cross debts between Government and other PEs; and to revise the legal and institutional arrangements to enhance managerial autonomy in the day-to-day operations by incorporating commercially oriented PEs under the Companies Act.	The project supports the Government's policy of scaling down the public enterprise (PE) sector and strengthening the private sector. The third component of the project is a public enterprise reform component which will support the Government's PE reforms through : (i) technical assistance to the National Investment Board (NIB) to strengthen its role in monitoring PEs and the PE divestiture program, and implementation and supervision of performance contracts for the six largest PEs; and (ii) improvements in accounting, management and computer systems in selected PEs.
Mali	Private Sector Assistance Project, 1992. C2432	Accounting Corporate Law Bankruptcy		Upgrading of the national accounting plan for enterprises; modernization of legal texts on corporate rights and bankruptcy. The institutional support component is targeted to: a) non-financial private enterprises (technical and management assistance, training); b) financial intermediaries (external independent audits, financial and institutional development programs and training); c) professional associations (assistance in revision of statutes, office technology, management information systems, training); and d) government agencies (revamped information systems, legal and regulatory framework for privatization, training).	Two of the four components of the project relate to corporate governance. The first, regulatory component aims at completing implementation of recent policy and regulatory reforms essential to private sector performance (enlargement of the role of the guichet unique; upgrading of the national accounting plan for enterprises; modernization of legal texts on corporate rights and bankruptcy). The institutional support component is targeted to get better corporate performance through institutional and human capacity development in the related fields of corporate governance.
Mauritania	Capacity Building Project for the Development of	Banking Reform		Strengthen information system pertaining to credit and arrears in banking systems. Review the status of accounting professions and	The project finances the following three subcomponents: 1) upgrading of credit risk and borrower arrears information; 2) training in

## World Bank Lending Operations

Africa	Project Name	External Incentives	Internal Incentives	Description of Corporate Governance Components	General Description
	the Private Sector, 1995.	Accounting & Auditing  Bankruptcy		upgrade the existing accounting plan - taking into consideration changes in other countries and realities of the Mauritanian economy; ensuring transparent, reliable accounting rules; and ensuring comparability of statements. Strengthen the Chamber of Commerce. Update the commercial law, including the investment code, commercial and civil procedural law; bankruptcy proceedings; provide information on existing companies through the establishment of commercial register.	banking; and 3) study for the formulation of a strategy for the second phase of financial sector development. With respect to the private sector institutional and regulatory framework, the project will finance the following: 1) upgrade the accounting and auditing framework; 2) support to the Chamber of Commerce; 3) strengthen legal and judiciary framework; and 4) feasibility study of a tax free regime for exporters.
Tunisia	Public Enterprise Reform Loan Project, 1995		PE Corporatization	Implementation of the new law governing public enterprises (PE) through phased strengthening of Boards of Directors, introduction of performance contracts, abolition of ex-ante controls, and increased transparency in the budget allocation process.	The Public Enterprise Reform Loan Project supports the implementation of a comprehensive program of public enterprise reform which has been initiated by the Tunisian authorities. The loan supports: (i) the implementation of the new law governing public enterprises; (ii) the implementation of privatization decisions and the financing of the associated budgetary costs; and (iii) initiating the process of sub-sectoral restructuring of three major PEs in severe difficulty.

East Asia	Project Name	External Incentives	Internal Incentives	Description of Corporate Governance Components	Aspects of Corporate Governance Work
China	China Accounting Reform and Development Project, 2/1999 CN-PE-51856	Accounting		The project would develop accounting standards compatible to the IAS and also promulgate enterprise level standards. This transparent system of accounts is aimed to facilitate a) Banks to evaluate potential borrower's creditworthiness; and b) improve the governance of China's enterprise sector - providing for better evaluation of the performance of enterprises for the purposes of bankruptcy, mergers and acquisitions and restructuring.	The project comprises two related components. These are 1) continuing support of the Government's ongoing efforts to develop and promulgate accounting standards predicated upon internationally accepted accounting standards and 2) to support government efforts to familiarize, on a large scale, existing accountants with accounting, auditing and business administration principles and practices that are generally accepted in market economies.
Indonesia	Indonesia - BEPEKA Audit Modernization Project, 1997.	Accounting -institutional development		Skills Development Component will develop a core capacity in government auditing with a special emphasis on performance and financial audits by supporting i) overseas and in-country short-term programs to create a small but well-trained multi-disciplinary auditing team; audit BEPEKA's training center to develop a core curriculum and course material for	The project will: 1) support BEPEKA's efforts to remove existing audit scope limitations and other regulatory constraints and carry out full-fledged financial and performance audits; 2) promote user demand for such audits; 3) reduce internal supply constraints by upgrading technical and managerial skills; 4) build up the audit management information system; and 5) institutionalize international best practices.

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East Asia	Project Name	External Incentives	Internal Incentives	Description of Corporate Governance Components	Aspects of Corporate Governance Work
				maintaining and upgrading staff skills. Support BEPEKA implementation of the proposal to introduce general audit guidelines for all public sector entities. To improve legal and regulatory environment through passage of legislation to i) expand legal authority to do performance audits; and ii) remove limitations o financial audits	
Indonesia	Indonesia - Policy Reform Support Loan Project, 1998  Banking & Corporate Restructuring	Banking Reforms  Competition Policy  Accounting  Bankruptcy	Transparency	Corporate Governance components include: all corporations required to publish audited financial accounts annually; modify and strengthen bankruptcy laws to provide adequate protection to debtors and creditors; and to adopt transparent rules for evaluating the reorganization plans and for liquidation procedures.	The objective of the Policy Reform Support Loan is to provide balance of payments to the Republic of Indonesia to support policy reforms designed to overcome the present economic crisis and restore rapid growth, while protecting the poor. The components include: a) actions to increase public sector efficiency and transparency; b) financial sector reform and principals for a framework for restructuring corporate debt; c) structural policy reforms to increase private sector efficiency, improve governance and protect the environment; and d) action to protect the poor and to continue priority investments in basic education and health.
	Indonesia - Second Policy Reform Support Loan Project 4/99 L4470	Banking Reforms  Competition Policy  Accounting  Bankruptcy		Improve governance and bank supervision and strengthen the policy , regulatory and institutional infrastructure for banking through rebuilding a bank supervision dept. in line with international standards and reinforcement of bank supervision dept. Strengthen bankruptcy and debt restructuring provisions through review of early experience with the commercial Court set up under INDRA, appointments, training and review of the performance of the ad hoc judges. Reform State owned enterprises to increase efficiency through privatization. Improve corporate governance by increasing private sector disclosure and management oversight through review of accounting and auditing standards to ensure consistency with international standards. BAPEPAM to review method of improving corporate governance in order to further strengthen the securities market and work with other agencies to review issues related to minority shareholder rights and foreign ownership and develop suggestions, issue a report recommending actions to improve corporate governance and to develop options for improving the Company Law, including aspects related to mergers and acquisitions.	The Second Policy Reform Support Loan Project focuses on three objectives: 1) re-enforcing the social safety net to protect Indonesia's poor and preserve human assets during the difficult times; 2) supporting efforts to stabilize the economy by helping restore banks and businesses to financial health, maintain physical assets, and resume growth; and 3) strengthening institutions to support sustainable growth. It will deepen and build policy reforms that have been undertaken since the initial Policy Reform Support Loan in July, 1998. The project will contribute to economic stabilization, subsequent recovery, and renewed poverty-reducing growth.

## World Bank Lending Operations

East Asia	Project Name	External Incentives	Internal Incentives	Description of Corporate Governance Components	Aspects of Corporate Governance Work
Indonesia	Indonesia - Second Accountancy Development Project, 1994.  12883-IND L3810	Accountancy Capital Markets	Transparency - accounting Business Laws	The project would support technical assistance for drafting accounting and auditing standards compatible to the IAS. Enforcement of these standards would be achieved through the provisions of the company and commercial law. The project would also support formulation of: special accounting and disclosure rules for public companies; securities industry regulations; and development of organizational plans, systems and procedures for capital market regulatory operations. It would also provide effective coordination among the law and decree making, standard-setting, capital market rule-making and professional accountants licensing and supervision activities.	The project is comprised of two major components: 1) the modernization of governmental accounting; and 2) private and public sector enterprise accounting and auditing standard-setting and enforcement.
Indonesia	Indonesia - Accountancy Development Project 1988.	Accounting Capital Markets		The private sector accounting component is designed to assist the Indonesian Institute of Accountants to lead the accountancy profession in Indonesia and provide support for the ongoing efforts to: i) formulate a number of accounting and auditing standards; ii) develop a program of professional education for accounting practitioners and iii) establish a code of ethics and a quality control mechanism for accountants in public practice. The accounting standards will form the basis for more consistent financial reporting by private sector businesses and harmonization with IAS. Strengthen confidence in the market by codification of regulations concerning company listing, stock issuance, reporting and related matters and tightening their enforcement by the Capital Market Executive Agency.	The Accountancy Development Project will finance the improvement of accounting practices in both the public and private sectors by supporting the development of technical standards and code of ethics for the accountancy profession; and by supporting the Government's program to raise the quality of accounting faculty and teaching staff. The project will also help the future expansion of accountancy education and training.
Korea	Korea- Financial and Corporate Restructuring Assistance Project, 1998  KRPE56796 L4385	Capital Markets  Bankruptcy & Insolvency  Audit and Accounting	Internal Oversight - Board of Directors  Stakeholders -shareholders rights  Transparency	The Corporate Governance Framework of the project would: study the role and functions of boards of directors as users of corporate financial information for policy-making purposes and to monitor managerial performance; change laws to strengthen the duties of directors to act in the best interest of the company and to reduce or eliminate barriers to the exercise of minority shareholder rights; study of the possibility of introduction of class action law suits by shareholders of listed companies. Conduct a workshop on Corporate Governance. Develop an enhanced	The Financial and Corporate Restructuring Assistance Project aims to provide technical assistance to support reforms in Korea's financial and corporate sectors and for sustained strong and stable growth. There are 6 main components. The first aids financial sector supervision and crisis management by providing institution building for the Financial Supervisory Commission (FSC), strengthening the financial institutions crisis resolution strategy and implementation, and developing methodologies and data generation. This component develops FSC strategies, policies, procedures, and capabilities; trains staff to become experts in new and complex financial fields; improves technical analysis capabilities;

## World Bank Lending Operations

East Asia	Project Name	External Incentives	Internal Incentives	Description of Corporate Governance Components	Aspects of Corporate Governance Work
				program for all qualified accountants and education of accountants with respect to the role of corporate governance, including audit committees and effective internal audit and expanding the scope of external audit to include government-run enterprises. Provide technical assistance to build a more reliable corporate insolvency system that ensures a balance of stakeholder interests.	upgrades accounting systems; and redesigns regulatory reports. Component 2 reforms the regulatory framework for securities markets, rationalizing and clarifying market rules, roles, and policies, and studying in-depth the demand side of bond markets; improves efficiency of government bond markets; and improves the transparency of accounting and audit practices. Component 3 improves debt management by strengthening professional capability, organizational arrangements, and information and communication systems. Component 4 financially restructures Korea's large business groups (chaebols) while Component 5 focuses on legal and regulatory reform of the corporate insolvency system and the corporate governance framework. Component 6 trains staff of the Korea Fair Trade Commission.
Korea	Korea - Structural Adjustment Loan Project, 1998.	Banking Reform  Competition Policy  Capital Markets Development  Accounting  Bankruptcy	Internal Oversight -board of directors  Stakeholders - minority shareholders  Accountability -board of directors	Promote effective monitoring of corporate performance by board of directors and shareholders through: strengthening the internal control structure of listed companies and all joint stock companies and the related responsibility of the oversight of the internal audit function and selection of external auditors; making the Boards of directors of listed companies and large corporations effective decision-making bodies responsible for acting in the best interest of the company; and having directors to be responsible to companies and shareholders for their actions. Strengthen shareholder rights through amendment of the appropriate laws. Improve the quality of financial information provided by corporations to regulators and shareholders through amendment of Law on External Audit and revising accounting and auditing standards to make them consistent with international best practice. Promote stronger institutional investor base which would simulate capital market development and contribute to improved corporate governance. Introduction of efficient market-based bankruptcy procedures.	The project will help Korea deal with the immediate foreign exchange crisis as well as support a major program of structural reforms in the financial and real sectors. The structural reform program spans four important areas: a) financial sector restructuring and development; b) corporate sector reform, including reform of corporate governance and competition policies; c) labor market reform and the strengthening of social safety nets; and d) institutional reform in economic policy management.
Malaysia	Malaysia - Economic Recovery and Social Sector Loan Project, 1998.  ID 58031 L4347	Banking Reforms  Competition Policy  Accounting	Transparency -accounting  Business Law -securities Ex laws - companies law	Companies required to disclose on a quarterly basis financial results, shareholding structure and borrowing positions. The accounting standards to be made compatible to the IAS and make KLSE responsible to implement these requirements. KLSE would review its policies, guidelines and requirements for listing from the standpoint of strengthening	The Loan Project is designed to support the implementation of the Government's program of preemptive measures. The Government will implement a series of structural reforms which are focused on four key areas: 1) Maintaining sound macroeconomic policy with flexibility in the light of uncertainties in the economic environment. 2) Strengthening the financial sector in the light of the regional crisis including

## World Bank Lending Operations

East Asia	Project Name	External Incentives	Internal Incentives	Description of Corporate Governance Components	Aspects of Corporate Governance Work
		Bankruptcy Capital Markets		provisions on corporate governance. Securities Commission to review the current code on Takeovers and Mergers 1987, promote high standards of corporate governance and disclosure in transactions between listed companies and related and interested parties; and protect interests of minority shareholders.	consolidation of finance companies and pre-emptive recapitalization of viable banking institutions. 3) Improving competitiveness by strengthening corporate governance, enhancing transparency and disclosure of information.
Mongolia	Mongolia - Ulaanbaatar Services Improvement Project, 1997.		Accounting PE -corporatization	Design and implement conversion to the new accounting system with supporting rules and procedures consistent with IAS. Incorporation of USAG Articles according to requirements of the Company Law. Amendments of the Articles of Association to clarify: role of the owner and the governing board; the legal responsibility, whether limited liability company or a State-owned enterprise; procedure for establishing the governing board and selecting its members, as well as its duties, powers and responsibilities.	The general objectives of the project include assisting the Government to develop more efficient and autonomous, performance-oriented institutions, with a view to eventual privatization. The Project will develop the water and sanitation company of Ulaanbaatar's (USAG's) capabilities for financial and operational management and convert it into a self-financing commercially-oriented public utility.
Thailand	Thailand - Economic and Financial Adjustment Loan, 1998  P-7240-TH L4372	Bankruptcy  Accounting -internal -external auditors	Transparency -accounting  Internal Oversight -Board of Directors	Introduce transparency by developing accounting, external auditing and disclosure standards more in line with best international practices; rationalize the regulatory framework for enforcement of laws and regulations for public companies; strengthen financial oversight role of the board of directors of corporations by requiring the establishment of audit committees.; strengthen the internal control structure of listed companies, banks, and financial institutions and the related responsibility for oversight of internal audit function and selection of external auditors; strengthen the effectiveness and monitoring role of the board of directors and enhance shareholder rights; amend the Bankruptcy Act.	The Economic and Financial Adjustment Loan is part of a two-year program of structural adjustment of the economy. The first loan series, the Finance Companies Restructuring Loan (FCRL), supported measures toward the resolution of the suspended finance companies and committed the Government to comprehensive reform of the financial sector over the next two years. The proposed loan, while further deepening the restructuring of the financial sector supports measures to strengthen the corporate sector. The project supports the Government's program to restore growth by deepening structural reform in the financial sector and facilitating corporate revival through removing impediments to restructuring, balancing creditor and debtor interests in bankruptcy and foreclosure; to create incentives for informal workouts; expediting adoption of international standards for corporate governance; and consolidation reform of public enterprises.
Thailand	Thailand - Economic and Financial Adjustment Loan II Project  Report No. P7271-TH	Accounting  Legal reforms and enforcement	Internal Oversight -Board of Directors	Rationalize the institutional framework for setting standards and regulating accounting and auditing practices; Improve the quality and reliability of key financial and non-financial information provided by public corporations by preparation and audit of financial statement prepared in accordance with international standards; improve accountability of boards of directors and management, and increase minority shareholder rights of public corporations; Strengthen the financial oversight role of	This loan tracks reform in the financial and corporate sectors, seeks to strengthen the competitive foundations of the economy, and supports the Government's proposed fiscal stimulus, especially programs that shore up social protection. In the short-term, the fiscal stimulus will strengthen aggregate demand, provide employment opportunities and substantially bolster social protection. The medium term benefits include the consolidation of the structural reform program that began with the Finance Companies Restructuring Loan and deepened with the first Economic and Financial Adjustment Loan. The loan program will strengthen the

## World Bank Lending Operations

East Asia	Project Name	External Incentives	Internal Incentives	Description of Corporate Governance Components	Aspects of Corporate Governance Work
				boards of directors of listed corporations through revision of guidelines on the code of best practice; Rationalize the regulatory framework and improve enforcement of laws and regulations for public corporations	legal, institutional, and incentive framework for decision-making by financial institutions and corporates.

Europe and Central Asia	Project name and ID	External Incentives	Internal Incentives	Description of Corporate Governance Components	General Description
Azerbaijan	Azerbaijan - Rehabilitation Credit, 1996  C2773	Competition Policy Financial Discipline - lending policies Banking Reforms  Bankruptcy - enforcement of La	SOEs Corporatization Business Law Transparency Internal oversight	Corporate Governance components of this project includes the following: Corporatization of all SOEs ( with the exception of some defense and solely budget financed non-commercial enterprises); implementation of the 1994 Joint Stock Companies law, and legislation of accounting law (establishing international accounting standards), company law, and regulations for public utilities; increase transparency of the SOEs by the introduction of the accounting standards; increase performance and internal oversight, by appointing a particular government agency to represent the state's interest as owner and separating the policy and regulatory functions from actual operation and management of public utilities.	The objective of the Rehabilitation Credit Project is to support the Government's program of economic stabilization and structural reform. Emphasis is placed upon reform of the enterprise sector, including privatization, enterprise restructuring and corporate governance, private sector development, pro-competition and anti-monopoly policies, and the banking sector.
Armenia	Armenia - Second Structural Adjustment Credit (SATAC II) 1997  C 2981	Pension Reforms Banking Sector reforms  Capital Markets development - Institutional development  Accounting	Transparency -Accounting - Public information strategy	The corporate governance components of the project includes: (i) Introduction of IAS for the Banking and Energy sectors, and (ii) Preparation of Capital Markets Development (CMD) Strategy. The CMD strategy would include an assessment of all existing capital market institutions and an action plan to address issues related to : regulatory authority; stock exchanges; institutional investors; Government securities markets; and depository institutions.	The program consists of nine components: a) resource mobilization - assisting State Tax Inspectorate and Customs Department computerization; b) energy sector - facilitating energy enterprise privatization, strengthening the Energy Regulatory Commission capacity, and introducing International Accounting Standards transaction accounting in power sector companies; c) public information and judicial - developing a public information strategy and supporting judicial reforms; d) privatization - supporting a pilot privatization program through Initial Public Offerings (IPOs); e) capital markets development - including preparing assessments and establishing a National Depository Institution (NDI); and f) financial sector - providing training and advisory services to banks' accounting department staff, and process overseeing assistance to the Central Bank of Armenia (CBA).
Armenia	Armenia - Institution Building Loan Project (1993) L3585	Legislative and Regulatory Framework - training Labor Markets	PE - Corporatization	Support for Public Sector Enterprises. For enterprises remaining in the public sector and those to be privatized in the medium and longer term, the loan will finance experts to strengthen corporate governance capacities of	This project will help the Armenian government in four critical areas for its future development: (a) economic management; (b) resource mobilization; (c) enterprise reform, which includes strengthening corporate governance capacities of the government and the



## World Bank Lending Operations

Europe and Central Asia	Project name and ID	External Incentives	Internal Incentives	Description of Corporate Governance Components	General Description
		Banking Reforms Commercialization		the government and to help deepen commercial practices. This would be achieved through implementation of the following principles: provide autonomy to management; establish greater accountability; enforce performance requirements; establish adequate management information systems; and clarify the role and responsibility of the governmental ministries and agencies vis-à-vis the public enterprises	deepening of commercial practices; and (d) financial sector reform. The project will provide for advisory services, studies, training and equipment to support economic reform.
Bulgaria	Bulgaria - Telecommunication Project, 1993.  L 3592			Provide Technical assistance for a Corporate Development Program of Bulgarian Telecommunications company (BTC), including establishment of management functions, i.e. accounting, auditing, financial management, planning, etc.	The project comprises: a) implementation of a digital overlay network for the Bulgarian Telecommunications Company (BTC) for the period 1993-1997, including digitalization of the trunk routes and renewal/expansion of the network; b) design and implementation of a computer-based operational support system/management information system for BTC; and c) technical assistance for the corporate development of BTC, including establishment of management functions, i.e. accounting, auditing, financial management, planning, etc.
Bosnia Herzegovina	Bosnia Herzegovina-Enterprise and Bank Privatization Adjustment Credit (Board date June 1999)  BAPE48461	Banking Reform - prudential regulation  Enterprise Privatization	Capital Markets	Bank Strengthening and Privatization through a) increased strictness in licensing standards required for banks and a gradual rise in the minimum capital requirement is planned so as to rationalize the banking system b) The design and implementation of laws in each entity that allow for the realization of bank privatization, the establishment of supervision agencies, and a rational and transparent banking system consistent with international banking standards is an on-going process c) Liquidation of insolvent banks d) Deposit insurance and e) Bank privatization.  With donor assistance, a comprehensive set of capital market laws has been passed by parliaments in both Entities, but further progress, namely in the form of a securities commission that will regulate the issuance and trading of claims, shares, and vouchers, is planned and supported by the project.	The proposed Enterprise and Bank Privatization Credit builds on BiH's achievements to date in establishing the required legal and institutional framework for privatization of enterprises and banks, and supports further progress in institution-building and policy reforms in private sector development.
Croatia -	Croatia - Technical Assistance Project for Institutional and	Competition Law  SOE corporatization		The Technical Assistance Project for Institutional and Regulatory Reform for Private Sector Development supports the encouragement for private sector development, as specified by the Country Assistance Strategy (CAS), through creation	This project will develop the private sector and to reform the institutional regulatory system in Croatia. The loan will also support improvements in the business-enabling environment for private sector growth and will finance consultant services, training, and equipment. In addition, the project will:

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Europe and Central Asia	Project name and ID	External Incentives	Internal Incentives	Description of Corporate Governance Components	General Description
	Regulatory Reform for Private Sector Development  L 4460			of regulatory and institutional frameworks for public utilities, development of detailed regulations, to assist the Office for the Restructuring and Economics of State-owned Enterprises (ORESE); strengthening of the Agency for the Protection of Market Competition (APMC), to be accomplished through the provision of advisory services, for the development of secondary legislation for the 1995 Competition Law; institutional strengthening assistance will be provided to financial and statistical agencies, as well as for bank privatization activities.	Support the creation of an appropriate regulatory and institutional framework for public utilities; Support further development of the regulatory and institutional framework for market competition; Support further strengthening of the institutional framework for capital market development; Assist in the modernization of the registries system; Assist in the restructuring and modernization of the statistical agency; and Support the ongoing efforts to complete the privatization of the three largest State banks.
Croatia	Croatia -Enterprise and Financial Sector Adjustment Loan, 1997.	Pension Reforms Labor Law  Bankruptcy/liquidation  Security Markets Development  Accounting PE & Bank	Stakeholders - Bank Supervision  Transparency - Bank-Enterprise nexus	Developing core prudential regulations for the Banking sector (lending to related parties, capital adequacy rule) and accounting standards (principles of loan classification and provisioning) and of interest recognition and suspense, revised to conform to EU standards. Establishing Securities and Exchange Commission. Formulation of new regulations to limit bank aggregate lending to their significant shareholders	The Enterprise and Financial Sector Adjustment Loan supports an overall Technical Assistance Project. The principal objective of the project is to support Croatia's efforts to implement effective reform of its enterprise and banking sectors. The main components of the enterprise and financial sector reform program include: (1) accelerating the privatization of the former socially-owned enterprises; (2) restructuring and privatizing public enterprises; (3) rehabilitating and privatizing the banking system; (4) providing key elements of the enabling environment for enhanced corporate and bank governance; and (5) supporting the above reforms with fiscal measures.
Hungary	Hungary, Enterprise Reform Loan, 1994.	Bankruptcy/liquidation Framework  Accounting	PE -corporatization - ownership reform  Internal Oversight	The overall objective of the reform of SE ownership and governance is to introduce responsible ownership oversight into all enterprises - including those that are privatized or those remaining public - through the following measures: transform all state enterprises into modern company form; establish policy and overall development of the ownership and organizational framework for the exercise of SE ownership; implementation of accounting and auditing standards in line with international practices. Monitor the effectiveness of the Liquidation and Banking Law.	The project supports the Government's enterprise reform program aimed at accelerating sharply the privatization, commercialization and restructuring of the state enterprise (SE) sector. The program has three main components: (i) the rapid privatization of SEs through a multi-track approach with appropriate oversight, and with the target of reducing the share of SEs to less than 50 percent of the assets of the competitive sector by the end of 1994; (ii) rapid transformation of all SEs into corporate form under Hungary's company law, thereby placing them on the same legal basis as private enterprises, and specific measures to strengthen corporate governance; and (iii) support and encouragement for restructuring processes, together with an improved bankruptcy and liquidation framework.
Kazakhstan	Kazakhstan - Legal Reform Project 4/1999  KZ-PE-46046		Legal and Judicial reforms	The project components are: 1) to assist in the legal drafting field, providing quality and consistency to laws and regulations and proper enforcement provisions. Technical assistance will provide a functional review of the Ministry of Justice (MOJ), with training to improve drafting skills; 2) to support the	The objectives of the Legal Reform Project in Kazakhstan are to strengthen the legal and judicial systems, and those of selected institutions, in support of the ongoing economic reform program. The project is consistent with the overall reform policies in the country, as well as with the Country Assistance Strategy (CAS) framework, which promotes private sector

## World Bank Lending Operations

Europe and Central Asia	Project name and ID	External Incentives	Internal Incentives	Description of Corporate Governance Components	General Description
				judicial training institute, through the improvement of court administration and case management; 3) to enhance legal information and public awareness, allowing accessibility to reliable legal information, through the support of electronic systems, towards the development of the rule of law and legal institutions; and, 4) to manage and supervise the implementation of the project.	development through the improvement of the legal system as necessary to attain competitive markets.
Latvia	Latvia - Structural Adjustment Loan (SAL), 1997.	Pension Reforms Land reforms Banking reforms Bankruptcy law	Bank-enterprise nexus Business Law Ownership Reforms	Enforcing financial discipline on the banks and indirectly on enterprises by increasing the care banks take in extending loans through: (i) enforcement of the Law on Credit Institutions (1995) which includes tighter limits on insider trading, credit concentration, connected lending. Foreign exchange exposure and an increase in minimum capital requirement ; (ii) adoption of a strategy for the Saving Banks that includes: performing due diligence on potential merger partners; and ensure all prudential regulations of the Bank of Latvia are met; (iii) and amend accounting auditing legislation and regulations which require general adoption of International Accounting standards. Other corporate governance measures relate to: Legislation of a new bankruptcy law, that protects the rights of secured creditors; and the adoption of an Investment Fund Law.	Among the main policy areas to be supported by the SAL is the encouraging of efficient growth by expediting privatization, enforcing financial discipline on banks and enterprises, and improving market efficiency.
Macedonia	Macedonia - Economic Recovery Loan/Credit, 1994. L3703	Competition Pension Funds Banking sector reforms Bankruptcy Law	SOE - corporatization	Legislate a law on public utilities and services which would transform enterprises - both state and privately owned, into companies under the commercial code. Improve governance of the SOE in public services and separate the government's ownership function from its policy and regulatory roles	The loan/credit will support initial measures to launch the reforms in four key areas: a) fiscal restructuring and retrenchment; b) banking sector reform; privatization, enterprise restructuring and private sector development; and c) freeing the labor market and adjusting the social safety net.
Poland	Poland - Enterprise and Financial Sector Adjustment Loan Project, 1993. L3599	Banking Reforms Labor Reforms Bankruptcy Law & procedures	SOE -ownership -corporatization Stakeholders - banks as creditors	Clarify how the state would exercise its ownership function - i.e. effective assignment of the ownership rights on the SOEs to the relevant Government Agencies, based on applicable legislation. Introduction of a legislation to determine the role of the trade unions for enterprise commercialization and privatization. SOCBs, as main enterprise creditors, to be granted the right to conduct and conclude "conciliation procedures" by a special time bound enabling legislation - (a commercial bank lead Chapter Eleven).	This loan supported the Government Enterprise and Bank Restructuring and Privatization (EBRP) Program. The EBRP Program is an integrated attempt at: a) dealing simultaneously with the debt overhang of state-owned enterprises (SOEs) and the portfolio problem in the banking system; and b) resolving the root cause of the SOE crisis, i.e., the unclear structure of enterprise ownership and governance.

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Europe and Central Asia	Project name and ID	External Incentives	Internal Incentives	Description of Corporate Governance Components	General Description
Romania	Romania - Private Sector Adjustment Loan Project (July 1999) P7313	Banking Reform	SOE privatization  Accounting and Auditing standards	The project would introduce a more effective and efficient system of bankruptcy and liquidation to assist in restructuring the private sector and with non-performing enterprises. Implement sound internationally recognized accounting standards and financial audit requirements. Privatize SOE using case by case method.	The Private Sector Adjustment Loan aims to: 1) accelerate state-owned enterprise (SOE) privatization, enforce hard budget constraints on remaining SOEs, and implement an action plan to stimulate private sector development and streamline the business environment; 2) gradually strengthening the banking system, ensure that state banks are restructured, develop further the government securities market; 3) create income support program for displaced workers, improve employment services for displaced workers.
Romania	Romania - Financial and Enterprise Sector Adjustment Loan, 1997.	Banking -privatization - restructuring  Capital Markets Development	Stakeholders - creditors rights Accounting	Clarification and enforcement of the creditors' rights against delinquent debtors and development of an orderly market of inter-enterprise credit; Implement sound IAS in enterprises and banks; Establish Capital Markets including the Bucharest Stock Exchange and National Securities Commission; Establish and activate a system for registration and trading in shares.	The principal objectives of the reform program are: 1) a sharp acceleration of the privatization of state-owned enterprises; 2) the enforcement of hard budget constraints and discipline on remaining state-owned enterprises; 3) the elimination of constraints to private sector development; 4) the restructuring and privatization of state-owned banks; 5) the strengthening of the supervisory and surveillance capacity of the National Bank of Romania; and 6) the development of capital markets.
Russian Federation	Russian Federation - Management and Financial Training Project, 1994	Accounting Standards Training		Financial Sector - provide training in accounting, and adoption of international accounting and auditing standards. Management development - provide assistance in the areas of: enterprise based management development; policy framework and quality standards for management development; management consulting; and networking information	The purpose the project is to increase the quality and supply of skills needed to support the transition to a market economy in such areas as enterprise restructuring, the financial sector reforms and privatization. The project has three principal objectives: 1) to train practitioners in three core fields of management, financial sector, and public finance; 2) to develop an intermediary institution to mobilize and channel resources for high priority training investments; and 3) to implement pilot projects in other key market areas and establish the basis for a broader second-phase investment.
Russian Federation	Russian Federation SAL (L4180)  RU-PE-49203 (1997)	Competition Policy Banking reform	SOE privatization/corporatization	The operation supports economy-wide structural reforms that (a) advance competitive enterprise and market development and impose financial discipline on the enterprise sector; and (b) have a major direct impact macro- fiscal stability. It also focuses on private sector development, natural monopoly regulation and restructuring, banking reforms, and fiscal management.	The operation supports economy-wide structural reforms that (a) advance competitive enterprise and market development and impose financial discipline on the enterprise sector; and (b) have a major direct impact macro- fiscal stability. It also focuses on private sector development, natural monopoly regulation and restructuring, banking reforms, and fiscal management.
Russian Federation	Russia - Third Structural Adjustment Loan Project L 4382 7/1998	Competition Policy Banking Reforms	Protection of Minority shareholders rights	It will focus on fiscal management reform, private sector development, reform of infrastructure monopolies, and banking reforms. The reforms supported will increase efficiency across a range of sectors by helping create a more competitive and open private	The Third Structural Adjustment Loan (SAL3) will support economy-wide structural reforms that a) advance competitive enterprise and market development and impose financial discipline on the enterprise sector; and b) have a major direct impact on macroeconomic stability. It will focus on fiscal

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Europe and Central Asia	Project name and ID	External Incentives	Internal Incentives	Description of Corporate Governance Components	General Description
				sector-oriented economy.	management reform, private sector development, reform of infrastructure monopolies, and banking reforms. The reforms supported will increase efficiency across a range of sectors by helping create a more competitive and open private sector-oriented economy.
Russian Federation	Russian Federation- Capital Market Development 1996  L4029	Capital Markets development	Transparency  Stakeholders - shareholder training	Adopt policies and promulgate regulations for : licensing market institutions; including exchanges, clearing organizations and registrars; public offer and secondary market trading of securities, periodic disclosure requirements for public companies; mergers and acquisitions including acquisition of a controlling interest in a public company; public offer and secondary market trading a derivative instruments such as options and futures.  Establish six shareholder training centers.	The project has the following general objectives: facilitate gains in capital accumulation and allocation; strengthen market incentives for improved corporate governance; and meet international prudential and fidelity standards to attract foreign institutional investors. In support of these broad capital market objectives, the project has four specific objectives: (i) build a comprehensive policy and legal framework; (ii) build core institutional capacity in regulation and self regulation; (iii) improve the efficiency, transparency and systemic stability of market architecture; and (iv) ensure the efficient issuance, service, and registration of Russian Federation debt securities, the largest segment of Russia's Capital Market.
Ukraine	Ukraine-Private Sector Development Loan (PAD 6/19990) UAPE54966	Capital Markets development	Accounting Standards  Bankruptcy	International accounting standards will be introduced. Streamlining the regulatory processes (deregulation) and creating a simpler, more transparent taxation system will encourage new business start-ups. Exit mechanisms will be improved with the creation of a modern framework and process for bankruptcy. The capital markets will be developed to mobilize new investment capital for enterprises and to facilitate ownership transfer in the secondary markets.	The main objectives of the PSD Loan are to provide the Government of Ukraine (GoU) with the assistance to develop a strategy for the development of the private sector in addition to providing oblast level technical assistance to help operationalize that strategy. The first phase of the PSD program is to lay the groundwork for the development and expansion of the private sector in Ukraine by creating successful restructured private enterprises, local advisory services for Ukrainian enterprises, and a robust legal and institutional environment through enterprise restructuring, training of personnel, and improvements in the legal and regulatory environment for business. Key performance indicators for the first phase project include: - Increase the number of commercially viable and competitive private enterprises. - Provide Ukrainian managers with first-hand experience of successful foreign enterprises operating in a market environment. - Remove regulatory barriers against the development of the private sector, particularly as relating to new start up firms and foreign direct investment (FDI). - Improve corporate governance of privatized companies by strengthening the rights of external owners and creditors (including state budget).

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Latin America and Caribbean	Project Name & ID	External Incentives	Internal Incentives	Description of Corporate Governance Components	General Description
Argentina	Argentina - Public Sector Management Technical Assistance Project, 1986.		PE - Gov/PE relationship	Implementation of reforms determining the Government /Public enterprise relationships, through i) simplification of reporting and control systems, with a move from day-to-day intervention to evaluation and reward of performance; ii) reform of the role and composition of Board of Directors; iii) modifications in the legal structure of public enterprises enabling greater autonomy and accountability for results. Secretariat of Public Function to support systemic and firm level changes by providing training to 400 PE managers and government officials to facilitate implementation of reforms and to increase managerial capabilities in key areas of finance, accounting, and general management.	One of the major components of the proposed project is the public sector management component to define the relationship of public enterprises with the Government to day to day controls with a system of accountability, improve management supervision, and strengthen the institutional aspects of the public management efforts.
Colombia	Colombia - First Santa Fe Water Supply and Sewerage Rehabilitation Project, 1995.		PE -Accountability	Improve the operational capacity of EAAB to through the following measures: a) formalize, by internal decree, all procedures and job responsibilities, to overcome weak management control; The Internal Control Unit to control effectiveness of procedures; managerial team to provide a corporate strategic plan; and consolidate cost accounting system, update the value of its assets and automatize accounting fully.	The key objective of the First Santa Fe Water Supply & Sewerage Rehabilitation Project is to support and consolidate the transition of Empresa de Acueducto y Alcantarillado de Bogota (EAAB) from a technically capable but operationally inefficient public service agency to a commercially-run public utility company, sensitive to the demands of the market, and with a corporate culture based on professional responsibility and accountability. The project will enhance operational efficiency, provide broader managerial autonomy and responsibility, reduce political interference, and increase public accountability of municipal utilities such as EAAB.

Middle East and North Africa	Project Name	External Incentives	Internal Incentives	Description of Corporate Governance components	General Description
West Bank and Gaza	Legal Development Project, 1997 T7133	Legal Reform		Modernization of economic, business and financial laws, including laws on banking, insurance and capital markets. Strengthening of the judiciary system. (This project has no specific focus on the financial or the corporate sector; it rather strengthens the local capacity to draft and enforce law, no matter in which specific area)	The objectives of the Legal Development Project will be to assist the Palestinian Authority in (a) starting the process to put in place a legal framework adequate to support a modern market economy and to encourage the growth of the private sector; and (b) increasing the efficiency and predictability of the judicial process. The project's five components are to: (1) unify and develop the existing legal framework by financing studies and the services of outside experts to help draft legal texts and give substantive advice; (2) improve the judiciary's administrative and case management procedures, and reduce the case backlog; (3) introduce selected training programs for judges, develop a

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Middle East and North Africa	Project Name	External Incentives	Internal Incentives	Description of Corporate Governance components	General Description
					<p>judicial education structure, curriculum, and standards, establish a resource center, train judicial educators, develop a long-range training plan, establish internal and external programs, developing teaching materials, and a code of ethics; (4) expand the use of alternative dispute resolution mechanisms within the judiciary; and (5) disseminate legislation and court precedents to the legal, judicial, academic, and business communities, and the public at large by enhancing law libraries to serve as reference centers, support the publication and dissemination of court decisions and laws, and of bench manuals, support a legal information connection to assist the Ministry of Justice in legal research, and establish a legal database to support law dissemination.</p>
West Bank and Gaza	<p>IFC Capital Market Development (no specific project, but a number of related non-project activities)</p>		Capital Markets	<p>Securities law, insurance Law, mutual fund regulation, establishment of a capital markets regulatory authority and of its legal basis.</p>	
Morocco	<p>Policy Reform Support Loan (PRES), 1998 PID6870</p>	<p>Public Enterprise Reform and Privatization</p> <p>Competition Policy</p> <p>Judicial Reform</p> <p>Banking System</p>		<p>Components and sub-components related to CG are:</p> <p>1) Judicial Reform, including the enhancement of the capacity to handle commercial litigation;</p> <p>2) Redefining the relations between the state and the public enterprises, by signing new "strategic" program contracts (including a thorough review of the country's past performance with that instrument) and by strengthening the board of directors;</p> <p>3) Improve the framework for the financial management of public enterprises by introducing legislation regarding the reciprocal financial obligations of public enterprises and the government, as well as through upgrading the financial management systems in public enterprises.</p> <p>4) liquidation of uneconomic public enterprises, especially in the mining sector, through the modernization of the legal framework for liquidation and through the introduction of commercial courts to the</p>	<p>The objective of the PRSL is to advance the <i>alternance</i> Government's broad-based economic and social reform program, which aims to accelerate GDP and employment growth, and to increase access to basic services and reduce poverty. Under this program, the Government is giving a public commitment to pursue sound macroeconomic management, initiate public sector reform, encourage private sector development, and address the country's social development agenda. It has already taken key actions to bolster the program's credibility and initiate its implementation. The program, together with Bank support through the PRSL, will send an important signal to the investor community, and demonstrate that political opening and economic reform are going hand-in-hand in Morocco.</p>

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Middle East and North Africa	Project Name	External Incentives	Internal Incentives	Description of Corporate Governance components	General Description
				<p>Moroccan legal landscape;</p> <p>3) Demonopolization and Private Participation in Infrastructure:</p> <p>4) Business Environment, including a legal framework to foster competitive business practices;</p> <p>6) Improvement of prudential regulation, including rigorous application of a limit of credit exposure to a single borrower to 15% of bank capital;</p> <p>7) Introduce new bank accounting standards and improve bank reporting requirements in line with international practice.</p>	
Jordan	Second Economic Reform and Development Loan, 1996 L4115 17919-JOR	Capital Market		<p>Components related to CG are:</p> <p>1) Adoption of a modern and comprehensive securities law (June 1997) allowing for the separation of the regulatory functions from the technical side of the Amman Financial Market. Under the law, a Securities Commission was established which reports to the Council of Ministers and has well-defined powers. The law also mandates the establishment of an association to represent the private sector in the securities industry.</p> <p>2) Preparation of a new draft banking law that strengthens prudential requirements and the Central Bank's authority to intervene in problem banks.</p> <p>3) Improvements in the investment law abolishing limits on foreign equity ownership of companies in the Amman Financial Market in certain sectors for which foreign ownership had previously been restricted.</p>	<p>An important policy direction supported by the Second Economic Reform and Development Loan (ERDL-II) is the removal of remaining trade and investment barriers, paving the way for higher economic growth and export earnings, a closer trade relation with the European Union and accession to the World Trade Organization. Further objectives are: to broaden and deepen financial intermediation, to provide an enabling business environment and increase the private sector's economy share. Furthermore, the loan will provide Jordan with short-term balance of payments support in order to strengthen its international reserves position. The ERDL-II supports trade and investment policy reforms to: a) further reduce anti-export bias, to foster integration with world market, and reduce administrative obstacles; b) improve banking competition and the efficiency of financial intermediation; c) improve viability of financial institutions and eliminate special privileges; d) encourage long-term saving and promote development of new financial instruments and markets; e) encourage entry, improve incentives, and offer national treatment to foreign investors; f) modernize a broad range of business laws; and g) improve opportunities for Private sector firms, increase competition, allow the Government to concentrate on its core functions, and achieve greater efficiency through privatization and restructuring.</p>



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Middle East and North Africa	Project Name	External Incentives	Internal Incentives	Description of Corporate Governance components	General Description
Yemen	Financial Sector Adjustment Credit, 1997 P-7164-YEM 43101-YEM	Banking System  Accounting and Auditing Standards		1) Legal reform: amend the banking law to ensure to specify criteria for bank licensing (including qualifications of management and Board of Directors); introduce accountability of individual directors and set penalties for non-performance. 2) Regulatory Framework: amend prudential regulations on loan classification and provisioning as well as on foreign exchange exposure, regulation on credit risk concentration and insider lending, regulation of external auditing, including terms of reference, for commercial and specialized banks in accordance with international standards, revise banking accounting standards. 3) Strengthening of the supervision capacity of the central bank; 4) Enforcement of new standards 5) Resolving public enterprise debt (non-performing loans) no relation to liquidation 6) Establish an Accounting Standards Board to set and enforce standards for the non-bank corporate sector (details available from the Task Manager, Judith Brandsma, who will be back on April 29)	The FSAC proposes to support reforms to strengthen the currently fragile banking sector and improve the sector's service efficiency. These reform measures are aimed at: (a) improving the enabling legal and regulatory framework; (b) increasing compliance with international standards of capital adequacy and loan loss provisioning; (c) strengthening the monitoring, supervision, and enforcement functions of the Central Bank of Yemen (CBY); (d) improving the accounting and auditing standards of banks; (e) improving the governance of banks and accountability of their Boards of Directors; (f) introducing measures to improve bank loan recovery; (g) undertaking diagnostic reviews of public sector banks; (h) taking urgent steps to reduce the risk exposure of two main public sector banks and privatizing one of them; (i) establishing an Accounting Standards Board to improve the timeliness and quality of the financial statements of borrowers; and (j) creating the legal and regulatory framework for developing financial leasing.

South Asia	Project Name	External Incentives	Internal Incentives	Description of Corporate Governance Components	General description
Sri Lanka	Private Finance Development C2484	Banking Reform	Corporatization	The project has four objectives: (a) to improve the efficiency of financial intermediation in Sri Lanka by supporting policy and regulatory reforms in the financial sector; (b) to assist in Domestic resource mobilization for long-term investment by stimulating the development of local bond markets; (c) to enable the private sector to respond to the changing economic environment by providing investment finance; and (d) to help deepen the financial system and strengthen the key players. environmental industrial standards.	Major elements of the project are to: (a) improve the policy and regulatory framework, especially in areas affecting mobilization of domestic resources for term investment through commercial channels; (b) a credit component for financing private sector investments; and (c) a technical assistance component to: (i) provide assistance for the preparation and implementation of various policy reforms including establishing a viable bond market; (ii) prepare the state-owned commercial banks for restructuring and recapitalization; (iii) provide support for implementing new accounting and auditing standards; (iv) operationalize debt recovery courts; (v) enhance banking supervision at the Central Bank of Sri Lanka; and (vi) support implementation of the new-----
Pakistan	Pakistan Financial Sector Deepening	Capital markets		Assist government and financial institutions in developing a better framework of credit	The Financial Sector Deepening and Intermediation Project will continue and expand the reform process

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South Asia	Project Name	External Incentives	Internal Incentives	Description of Corporate Governance Components	General description
	L3808	Non-bank financial institutions		delivery to the private sector, reform of capital market and insurance regulations and technology. Preparation for the privatization of certain state-owned financial Institutions	started under the Financial Sector Adjustment Loan and support the Government of Pakistan's strategy for macroeconomic and financial sector reforms, focusing on: assisting the private sector to respond to the changing economic environment by providing non-subsidizing resources for investments and helping to deepen the financial system, promote new financial instruments and strengthen the State Bank of Pakistan (SBP) and other financial institutions (FIs). The project will consist of: a) a line of credit through the Administrative Unit (AU) to eligible banking and non-bank financial institutions for on-lending to private enterprises requiring term finance for all economic activities except real estate, trading and certain consumer services; and b) technical training to: 1) the SBP for the enhancement of its regulatory functions and improvement of its operational systems; 2) the Corporate Law Authority and Controller of Insurance for institutional building; 3) Bankers Equity Limited for the establishment of an AU, implementation of various studies and enforcement of environmental standards; and 4) the Privatization Commission for the preparation of a number of FIs for privatization and/or restructuring and valuation of State Life Insurance Corporation.
Pakistan	Pakistan Banking Sector Adjustment Loan 1997 L4257	Banking privatization and regulation		To reform banking sector by improving governance and improving financial discipline through bank owners, bank regulators, markets and the courts.	The Banking Sector Adjustment Loan (BSAL) Project provides balance of payments assistance to Pakistan in implementing a stabilization program and structural reforms in a distressed banking sector. This operation supports implementation of major short-term reform measures in the banking sector that have arrested the flow of bad loans, curtailed loss-making, and conserved the assets of nationalized commercial banks and development finance institutions while they were being prepared for privatization. reforms measures include bringing prudential regulations and financial disclosure standards to international levels to increase transparency; reducing market distortions to increase the efficiency of financial intermediation; and strengthening legal and judicial processes to enable a more effective enforcement of financial contracts. The BSAL supports fiscal stabilization, improves the private sector's access to banking services, and helps protect those directly affected by the reform process. Moreover, the BSAL centers around the core issue of governance in banking.
India	India - Container Transport Logistics Project,		Internal oversight - Board of Directors	Strengthening of the commercial approach and operational capacity of CONCOR in increasingly competitive environment by: i)	The project will: a) improve the institutional framework for efficient and competitive container transport; and b) strengthen the commercial approach

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South Asia	Project Name	External Incentives	Internal Incentives	Description of Corporate Governance Components	General description
	1994 L3753		Stakeholders - customers -shareholders	diversifying shareholder base and strengthening the commercial orientation by divesting 5 percent of the Government's equity in CONCOR; ii) broadening the composition of the Board of Directors o to include non-official directors to improve the skill base of the Board; iii) reforming claim policy to meet customers demand; iv) provide technical assistance and training to improve its operational commercial, financial and general management capabilities	and operational efficiency of the Container Corporation of India (CONCOR) by diluting at least a 5 percent share of the Government's equity in CONCOR, broadening the composition of the Board of Directors, reforming the claim policy to customer needs, and providing technical assistance and training.

IFC - Project ID	Country	Project	Requested By	Start-end date/ESTD completion Time in FY 98	Staff/ Consultant	Project Description	Report Y/N	Current Status
502318	Chile	Corporate Governance/ Take-over Reform	Government of Chile	12/97	M. Lubrano C. Morganstein P. Tropper C. Jordan	Advise the Ministry of financial working group to prepare an amended company law and securities regulations in response to the Enersis scandal. IFC has met with market participants and with a working group to establish a strategic approach and time table for the proposed legislative initiatives; a work program has been established. Actual project work begun in 3 <sup>rd</sup> quarter (reported 3/98) of fiscal 1998. IFC has made comments on report of Hacienda Working Group to Congress. Congress is now considering legislative language, responsive law, likely to pass.	N	A
502477	Ukraine	Corporate Governance	Ukraine Securities Commission	1998 - Ongoing	A. Torre J. Rosenbaum M. Lubrano	Participate together with the Securities and Stock Market State Commission (SSMSC), USAID and others, in the Corporate Governance Task Force which function is to coordinate efforts aimed at converting Ukrainian enterprises into joint-stock companies and promoting an adequate legal framework for the management and finance of such enterprises. Also examine the possibility of establishing a "Help Desk" to provide advise to the IFC Project Team and SSMSC on proposed laws and regulations and specific problems as they arise.	N	A

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IFC - Project ID	Country	Project	Requested By	Start-end date/ESTD completion Time in FY 98	Staff/ Consultant	Project Description	Report Y/N	Current Status
	Armenia	Corporate Governance			A. Torre I. Nieder Berger M. Lubrano	Participate together with the Securities and Stock Market State Commission, USAID and others, in the Corporate Governance Task Force which function is to coordinate efforts aimed at converting Ukrainian enterprises into joint-stock companies and promoting an adequate legal framework for the management and finance of such enterprises. Also examine the possibility of establishing a "Help Desk" to provide advise to the IFC Project Team and Securities and Stock Market State Commission on proposed laws and regulations and specific problems as they arise.		



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