• What is corporate governance and why is important?
• What can be done to improve corporate governance?
• How can the World Bank help?
Key World Bank strategic pillar: improve the investment climate

- A conducive investment climate is crucial for economic growth and poverty reduction
- Considerable effort is focused on improving the competitiveness of the small and medium enterprise sector, and formation of new companies...
- Corporate governance affects the “portfolio investment climate” – how investors view the risks and returns of investing in companies and in markets.
« Corporate governance is the system through which a company is directed and controlled. The system consists of checks and balances on, oversight of, and appropriate input into, the management of the company, which is conducted by its senior executives »
The value of improved corporate governance ...

- **For shareholders** (including pension beneficiaries):
  - Protection from abuse
  - Increased shareholder value
- **For companies:**
  - improved access to finance (both equity and debt)
  - Higher valuations
  - Better decision-making
- **For regulators and supervisors:**
  - A first line of prudential defense
  - Increased financial stability
- **For markets and economies:**
  - Higher market capitalization and liquidity
  - More “champion” companies that can compete and grow internationally
  - Higher economic growth
The value of improved corporate governance ...

ECONOMIC GROWTH

- Development of Capital Markets
- Job Creation
- Improved Access to Credit
- Private Sector Growth
- Financial Sector Development
- Financial Stability
Value for shareholders

Good governance both protects and builds shareholder value

Net Present Value of Cash Flows (“Intrinsic Value”)

• Political risk
• Corporate Governance Risk
• Board “guides” corporate strategy
• Transparency and disclosure
• Shareholder rights
• Equitable treatment
• Role of Board

Shareholder Value (“Extrinsic Value”)

Investors’ Confidence in Ability to Determine and Enjoy Cash Flows

X
Research supports the value of improved corporate governance.

Regression: Shareholder Value Destruction on Bad Corporate Governance

* In actual/potential market capitalization)
** Statistical significance (t = -7.63)
Shareholder value destruction from bad corporate governance

Shareholder Value Destruction in 16 Leading Russian Companies 1999*
US$ billions

Intrinsic Value

Extrinsic Value

$2,650 billion, or 99%, of shareholder value destroyed

* Adjusted for political risk
Source: Bernard Black
International Consensus: the OECD Principles of Corporate Governance

• Certain basic principles apply in all countries:
  – The Rights of Shareholders
  – The Equitable Treatment of Shareholders
  – The Role of Stakeholders
  – Disclosure and Transparency
  – The Responsibilities of the Board

• Designed to apply to companies listed on stock exchanges

• Focus on outcomes, not specific rules

• Adopted by international institutions one of twelve international standards underpinning financial stability
Key issue: protecting minority investors from the majority

- Controlling investors play a valuable role as entrepreneurs and as monitors of management
- But: who watches the watchers? Controlling investors can legally expropriate assets through:
  - Transfer pricing / related party transaction mechanisms
  - Takeovers and mergers
  - Insider trading
  - Other actions taken by the company that favor some shareholders over others
- Controlling owners can be foreign investors, financial industrial groups, or the State
Evolution towards public interest entities

- Listed Companies
  - Financial Institutions
  - SOEs
  - Others
Banking sector governance now high on the agenda

• Basel II: new focus on operational risk
• Basel Committee on Banking Supervision issued *Enhancing Corporate Governance for Banking Organisations* in February 2006.
• Corporate governance is now “first line of defense” to many regulators.
• Many rating agencies (Moody’s / Fitches) are carrying out bank corporate governance assessments
Key elements of the Basel Committee Guidelines

1. Fundamental Underpinnings
2. Role of owners in promoting sound governance, “fit & proper”
3. Board qualifications, priorities
4. Board Audit Committee members independence & qualifications
5. Corporate values, professional conduct
6. Disclosure & transparency
What can be done to improve corporate governance?
Improving corporate governance

• Companies can take action to improve their corporate governance
• But what can regulators and policymakers do to improve the corporate governance framework in their country?
Tools for corporate governance reform

Corporate Governance Framework

- Awareness raising
- Legal and regulatory reform
  - Company law
  - Securities law
  - Secondary regulation
  - Listing rules
  - Codes of Best Practice ("soft law")
- Court and judicial reform
- Institutional reform and capacity Building
  - Securities Commission
  - Stock exchanges
  - Central depositories
  - Company registrars
  - Audit oversight bodies
  - Institutes of Directors
  - Shareholder Associations
- Accounting and audit reform
- Company-level training and other interventions

Banks / Financial Institutions

- Capacity building and supervisory training
- Banking law reform
- Corporate governance regulations
- Corporate governance codes
- Bank-level training and other interventions

State-Owned Enterprises

- Capacity building of State ownership entities
- Supporting legal reform
- Development of ownership policies
- Training and other interventions
How can the World Bank help?
Who we are...
Corporate Governance Department

Global Corporate Governance Forum

- Multi-donor trust fund
- Technical assistance
- Toolkit development

Corporate Governance Policy Practice

- ROSC assessments
- IFA / OECD liaison
- Cross-support
- Input into operational work

EAP ECA LCR AFR MNA

IFC

- Evaluates client companies
- Recommends improvements
- Helps clients implement best practice
- Technical assistance
• Corporate governance is one of 12 standards and codes assessed by IMF and World Bank
• Standardized report (Report on Observance of Standards and Codes, ROSC) including policy recommendations
  – Benchmarks law and practice against the 66 OECD Principles of Corporate Governance
  – Country participation is voluntary
Overview of World Bank Corporate Governance ROSC Assessments

Published 46
Completed (not yet published) 12

Assessments by Year
Corporate Governance ROSC
Regional Overview

Assessments By Region

- Africa: 5
- East Asia: 9
- Latin America: 9
- Middle East: 4
- South Asia: 5
- ECA: 23

Recent ROSCs in AFR:
- Zimbabwe: 2001
- South Africa: 2002
- Mauritius: 2002
- Ghana: 2005
- Senegal: 2006
## Corporate Governance ROSC: History

<table>
<thead>
<tr>
<th></th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazil</td>
<td>Georgia</td>
<td>Mauritius</td>
<td>Egypt 2</td>
<td>Armenia</td>
<td>Uruguay</td>
<td></td>
</tr>
<tr>
<td>Croatia</td>
<td>Czech 2</td>
<td>Brazil 2</td>
<td>Slovenia</td>
<td>Poland 2</td>
<td>Bosnia</td>
<td></td>
</tr>
<tr>
<td>Czech Rep.</td>
<td>Lithuania</td>
<td>Hungary</td>
<td>Russia</td>
<td>Ghana</td>
<td>Senegal</td>
<td></td>
</tr>
<tr>
<td>Egypt</td>
<td>Bulgaria</td>
<td>Ukraine</td>
<td>India 2</td>
<td>Pakistan</td>
<td>Ukraine 2</td>
<td></td>
</tr>
<tr>
<td>India</td>
<td>Latvia</td>
<td>Korea</td>
<td>Peru</td>
<td>Thailand</td>
<td>Vietnam</td>
<td></td>
</tr>
<tr>
<td>Malaysia</td>
<td>Morocco</td>
<td>Hong Kong</td>
<td>Romania 2</td>
<td>Malaysia 2</td>
<td>Philippines 2</td>
<td></td>
</tr>
<tr>
<td>Philippines</td>
<td>Romania</td>
<td>Chile</td>
<td>Indonesia</td>
<td>Nepal</td>
<td>Bhutan</td>
<td></td>
</tr>
<tr>
<td>Poland</td>
<td>South Africa</td>
<td>Mexico</td>
<td>Jordan</td>
<td>Brazil 3</td>
<td>Senegal SOE</td>
<td></td>
</tr>
<tr>
<td>Turkey</td>
<td>Slovakia</td>
<td>Moldova</td>
<td>Macedonia</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Zimbabwe</td>
<td>Colombia</td>
<td>Panama</td>
<td>Azerbaijan</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Notes: Assessments in **bold** are in process. Assessments in *italics* have not been published.*
New specialized diagnostics: Banks and SOEs

**Banks**
- Team works with banking supervisor to review governance in the banking sector.
- Survey of banks and supervisory practices
- Confidential report benchmarking law and practice against Basel Committee Guidelines, including policy recommendations.
- 4 initial reviews completed, 3 underway

**SOEs**
- Team works with ownership entity to review governance of SOEs and the state ownership function.
- Survey of SOEs and legal requirements.
- Report benchmarking law and practice against OECD Guidelines for SOE Governance
- 4 initial reviews completed, 6 underway
Thank you!

Alex Berg
aberg2@worldbank.org
Corporate Governance Department
World Bank
Washington, DC
202-473-3687
202-522-1604