



The Global Corporate
Governance Forum

4th Meeting of the Eurasian Corporate Governance Roundtable

*“The Responsibilities of Boards of Directors and the Role of
Stakeholders in Corporate Governance”*

hosted by

**The Corporate Development Centre (CDC)
and The State Commission on Securities Markets
of the Kyrgyz Republic
and
The Asian Development Bank**



Synthesis Note

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The fourth meeting of the Eurasian Corporate Governance Roundtable took place on 29-30 October 2003 in Bishkek, Kyrgyz Republic. It was hosted by the Corporate Development Centre (CDC) and the State Commission on Securities Markets of the Kyrgyz Republic and the Asian Development Bank.

The meeting brought together a group of over 80 highly qualified senior policy-makers and private sector experts and practitioners from a number of countries: Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyz Republic, Ukraine, Uzbekistan, Japan, Netherlands, Poland, Russia, United Kingdom, and the United States. Participants from international organisations included experts from the OECD secretariat, the Asian Development Bank, the European Bank for Reconstruction and Development, and the IFC, as well as the Center for International Private Enterprise.

The meeting was opened by Mr. Joomart Otorbaev, Vice Prime Minister and Special Advisor to the President, Kyrgyz Republic; Mr. Rainer Geiger, Deputy Director of the Directorate for Financial, Fiscal and Enterprise Affairs at the OECD; and Mr. Jürgen Conrad, Principal Officer, Asian Development Bank. The opening remarks emphasised the many steps that the Kyrgyz Republic and other countries in the region had taken to improve corporate governance, and the critical importance of continuing the reform process.

Discussions and Main Conclusions

The meeting dealt with two main topics: The responsibilities of the board, and the role of stakeholders. Two sessions dealt specifically with boards: Creating the conditions for effective and accountable boards in Eurasia; and improving board accountability; and one session with stakeholders that was divided into two panels, one focusing on the role of employees, and one on the role of creditors.

Each session included presentations by, and discussions among, regional and OECD country experts. There was general agreement on the importance of strengthening boards; and the need to clarify the role and protect the rights of employees, creditors and other stakeholders. Specific issues highlighted in the discussions include:

1. The critical importance of improving the underlying legal and institutional environment for corporate governance in Eurasia;
2. The important role of the board in overseeing the company;
3. The need to increase the accountability and professionalism of board members;
4. The need to better protect the rights of employees and creditors

1) Overview of the legal framework and practices of boards in Eurasia

The board should play a central role in developing the strategy of the company and overseeing its management. However, boards in Eurasia seem to play a limited role at best in corporate governance. This reflects the factors that have dominated other aspects of governance in region: a still developing legal frame-work, other institutional weaknesses, and the resulting dominance of companies by their controlling shareholders.

Open joint stock companies (JSC) in Azerbaijan, Georgia, Moldova, and Ukraine have dual board structures with both supervisory boards and management boards. In Kazakhstan, companies can opt for a dual structure. In addition, open JSCs in all of these countries but Georgia have an audit commission or audit board of statutory auditors. Hence none of these countries have a simple unitary board structure. On the other hand, very little use, if any, is made of specialised committees such as remuneration committees.

Board members in the region generally have an equivalent of the duty of care—to act in goodwill, reasonably, etc.—as well as a duty of loyalty. The company law of some countries explicitly mandates

that board members act in the interest of shareholders. In other countries, it mandates that board members act in the interest of the company, but under the authority of the general meeting of shareholders.

Kazakhstan requires that half of the board be independent, where independence is defined to exclude current or past executives of the company or current or former consultants or auditors to the company or their relations. Other countries in the region have no explicit independence requirements outside of the restriction that members of the supervisory board generally cannot be executives of the company.

Provisions to specifically protect minority shareholders are limited. Cumulative voting, which can normally allow minority shareholders to pick a certain fraction of the board, is required in Armenia, Kazakhstan and Moldova, but does not seem to be used elsewhere. Perhaps most importantly, the legal requirements for board members with respect to related party transactions are minimal in most Eurasian countries.

2) The critical importance of improving the underlying legal and institutional framework

Participants emphasised that to improve board performance, relations with stakeholders, or other elements of corporate governance, the underlying legal and institutional framework still needed substantial reform and improvement. The presence of supervisory boards may have dissuaded countries from implementing stronger requirements for independence and the treatment of related party transactions. While board member duties are present in company law, it is not clear that they are explicit enough given the current capacities of the legal systems in these countries. Even administrative duties of board members may not be detailed enough. This is especially true for supervisory boards, which frequently receive only minimal coverage in company law.

In addition to the important legal gaps remaining in company and securities law, regulators and especially courts remain under-funded and have limited political independence. In response many countries are again revising their company and securities law. To improve enforcement, the Kyrgyz Republic, with donor assistance, has established a system of private arbitration specialist based on international norms and training.

A related issue is the lingering effects of mass privatisation. Eurasian countries have thousands of what one participant described as “quasi” joint stock companies created from the privatisation process. The development of procedures to consolidate the ownership of these companies while protecting their small shareholders remains a significant challenge. Boards need to be particularly vigilant in this respect.

3) The important role of the board in overseeing the company

In OECD countries the responsibilities, and potential liabilities, of board members are greater than ever. Directors are increasingly required to take active steps to ensure transparency, protect the rights of shareholders and guarantee compliance with legislation. Independent directors on certain committees, especially the audit committee, may have even greater responsibility and liability.

In practice, the role of the board in most Eurasian companies has been very limited, with important decisions generally made by management and controlling shareholders. Companies are very much dominated by their controlling shareholders, which is still the state in many companies. Boards seem to have little power or inclination to challenge the controlling shareholder, when actions are taken that are often not in the interest of the company.

One measure of the limited importance of boards is director compensation. Supervisory board members in Eurasia are frequently only reimbursed for meeting expenses and do not receive a salary. Participants also noted that qualified independent directors and board committees, both of which play a central role in the reform going on in OECD countries, are largely absent. The boards' role in overseeing management and

external auditors remains limited. In addition board members often do not acknowledge any duty to stakeholders, and do not see themselves as having a role in legal compliance.

4) The need to increase the accountability and professionalism of board members

Board members in many Eurasian companies often owe their position to controlling shareholders, and in many cases feel loyal to them, not to the company or shareholders at large. One response to this has been greater use of cumulative voting, which is being introduced to varying degrees in a number of Eurasian countries. This can allow minority shareholders to choose some directors, though it may exacerbate the sense that board members represent certain shareholders, not all shareholders. In any case the loyalty of directors to all shareholders must be also clarified and implemented.

Techniques to increase director professionalism were also discussed. There is a strong interest in the region in creating institutes of directors, in part to facilitate director training. Speakers from the British Institute of Directors and the Russian Independent Director's Association gave advice on how to create these institutes, and their role in promoting professional director behaviour.

International technical assistance organisations could play an important role in facilitating such efforts, as appropriate. Education and training programmes need to focus both on the improvement of the qualifications and performance of current directors, but also on the creation of a greater pool of candidates from which directors can be selected. It would be beneficial to include in such programmes not only basic legal and government duties of directors, but also substantive areas, such as financial literacy, understanding and monitoring internal control systems, developing business strategies, risk policies, etc.

The promulgation of voluntary codes of ethics for directors or codes of conduct, and the establishment of disciplinary procedures for members of institutes of directors and similar organisations, can also constitute important initiatives supporting the creation of a board culture in Eurasia. Such codes serve to educate both the directors and the investing community.

5) The need to better protect the rights of employees and creditors

With widespread employee ownership and the potential of bank credit as a source of external finance, employees and creditors as well as other stakeholders could play a constructive role in the governance of joint stock companies in Eurasia. However, based on the incomplete evidence available, the role of stakeholders in Eurasian corporate governance seems very limited.

Employee shareholders, who are numerous in the region as a result of mass privatisation, have faced significant challenges in exercising their rights as owners. They may be restricted from participating in the shareholders meeting, not be able to vote their shares, or have their shares voted for them by management. On the other hand, employees and their representatives may focus on their own interests and not those of the company.

Outside of ownership, there may also be other mechanisms through which employees can constructively participate in the governance of the company. These include worker councils, which are required for certain companies in Georgia, Kazakhstan, the Kyrgyz Republic, and the Ukraine. Unfortunately, information on these councils and the role of employees in governance more generally, is extremely limited. Participants indicated that, in general, employees have an even harder time exercising their ownership rights than other shareholders. Moreover, the perception on the role that works councils currently play in corporate governance is that it is minimal at best.

Information on the protection of creditor rights is also limited. The ratio of private credit to GDP in Eurasia ranges from 5%-10%, which is low compared to other emerging market economies (the average across the Roundtables is 36%, while in many OECD countries it is well over 100%). This would imply

that firm access to credit is extremely limited. Poor creditor protection may very well be one reason for this limited access.

What legal protection creditors have, stems from insolvency legislation. The legal framework in Eurasian countries addresses insolvency and provides basic protections for creditors. This is not always adequate, first because borrowers can take action to harm creditors that may not necessarily lead to insolvency (e.g. borrowing against a property from multiple creditors for more than its value). Probably more fundamentally, as in other transition economies, in practice insolvency is generally avoided at all costs, and courts may not uphold creditor rights with respect to effectively insolvent firms.

The weakness of the insolvency framework has certainly hindered the flow of capital to Eurasian companies. The panel on creditors also included a discussion of the Japanese “main bank” system, which had been one of the central parts of the Japanese Corporate Governance for the high growth period after the WWII. It was pointed out that the strong role of the main bank system had contributed to creating some of the Japanese Corporate Governance characteristics including silent shareholders, poor culture of disclosure, and weak bank governance. The lagged development of stock market and lack of equity culture in Japan had been also attributed to the banks’ dominance in the corporate finance. Lessons from the Japanese experience is to some extent relevant to the region where also banks are playing dominant role and sound development of capital market is a key for enhancing corporate governance.

Follow Up

The Roundtable also discussed potential follow up work. This included the Comparative Paper on Corporate Governance in Eurasia, which is to be finalised by early next year, and will be presented in Kyiv Ukraine. Other events at the national level may also be organized to present the Comparative Paper. After the Paper is distributed, representatives of Eurasian countries may meet again in working parties to discuss certain topics more in depth. Finally, in the future a general Eurasian meeting may be organized to discuss the ongoing corporate governance reform in the region.

Documentation from this and previous meetings of each Roundtable, including agendas, presentations, background papers, White Papers, and the forthcoming Comparative Paper, can be found on the OECD Corporate Affairs website at www.oecd.org/daf/corporate-affairs.

The Eurasian Corporate Governance Roundtable was established in 2000, and is organised by the OECD in co-operation with the World Bank and key regional partners to facilitate a policy dialogue that will lead to lasting improvements in corporate governance in the region. It is also receives financial support from the Government of Japan, the International Finance Corporation (IFC), and the Global Corporate Governance Forum.