How to Plug CG Implementation Gap?

A. CG Implementation Gap:

Using Pakistan as an example, I see the following persistent hurdles in ensuring effective implementation of CG:

1. Ambiguous CG Codes/Laws: Regulating CG has always been a challenge since some aspects of CG do not easily lend themselves to "objective monitoring and/or evaluation". Resulting codes or laws suffer from this inherent lack of specificity in certain CG areas. For example, board independence is intuitively understood but often difficult to encapsulate in an all-encompassing definition that a board could rely upon for determining which members are truly independent.

2. Cost of CG improvement: While some CG reforms are cost effective, others can involve sufficient expenditure. Similarly, the level of CG improvement also determines the cost for such intervention. For instance, the lower a company on the governance ladder, the more the cost of improving its corporate governance! This is another reason for companies to shy away from effective implementation of good CG practices. To compound this problem further, the pay off from good CG is not always easy to attribute back. In a dynamic business or organizational environment, several factors can be at play to ensure "positive results" thus making CG-related efficiencies hard to measure as a stand alone factor.

3. Capacity of Regulators: While most of its principles stem from ethical and moral values of accountability, responsibility, transparency and fairness, CG has its share of technical rules and procedures that demand a through understanding of the CG regime. A regulator that isn't well-equipped to ensure compliance with a CG code or law risks the effective implementation of CG regime.

4. Lack of Specialized Codes: CG isn't one-size-fits-all. A family owned enterprise is likely to face different governance challenges than a state-owned company, for instance. Or at least the priority for various CG improvements may vary with these two types of organizations. Yet both these companies may be subject to a CG code that uses a paradigm of a listed company as it basic reference point.

5. Board at the Centre of the Implementation Debate: The board remains at the centre of the implementation debate. A board that hasn't fully embraced its role as a "front-line regulator" for ensuring effective implementation of CG of an organization encourages "creative compliance" by these companies. CG should remain self-regulated for it to succeed notwithstanding national CG codes or laws.

6. Lack of investors' sophistication: Minus pressure from right-aware minority shareholders, a company is more likely to indulge in "box-ticking" as opposed to implementing good CG practices in spirit.

B. What Needs to be Done to Plug CG Implementation Gap?

The following measures can be taken to ensure effective implementation of CG:

1. Ambiguous CG Codes/Laws: CG Regulations need to be preceded by more public consultation and followed by elaborate guidelines to further interpret various provisions. Statutory definitions (of difficult concepts such as board independence) that are hard to amend (without going through a time-consuming legislative process) must be avoided by relying more on industry examples.

2. Cost of CG improvement: Business case for good CG must be developed for the board and the senior management. National codes must set out the over-arching objectives spelling out cross-cutting policy objectives to appeal to the business interests of the core constituencies. The perceived value of improving CG is an important factor. Some CG improvement criteria are more important than others. Organizations feel that it is not worth improving CG in all areas therefore improvement is seen as expensive and not urgent. Consequently, customized solutions need to be developed for different categories of companies (e.g., small, medium, large, family owned, listed companies and SOEs) as opposed to wholesale CG improvement programs. This would help improve the cost benefit equation and help attribute clear benefits to specific CG-related improvements.

3. Capacity of Regulators: In Pakistan Stock Exchanges have CG Code as part of their listing regulations. Their capacity-building is needed to ensure effective implementation of these regulations. Helping Stock Exchanges (where they act as the regulators) re-tool is likely to improve implementation of CG codes and the impact of regulation.

4. Lack of Specialized Codes: Specialized codes for segments of the market that merit tailor-made solutions.

5. Board at the Centre of the Implementation Debate: In order to encourage board’s ownership of CG, regulation should lay out the benefits of good CG practices to businesses. Moreover, directors can be made personally liable for certain decisions. Their continuous capacity building in addition should be a priority.

6. Lack of investors’ sophistication: Where shareholder activism is scant, there is a need for minority shareholders to group and protect their rights as a class. In Pakistan, the court-sectioned process for the protection of minority interests needs to be improved by increasing capacity of judges and amending relevant laws.

C. How can OECD contribute to effective compliance with CG laws/codes?

OECD can work closely with non-OECD governments in ensuring that their capacity is sufficiently built in both drafting CG codes and implementing them. It can also work toward ensuring that statutory regimes are robust in communicating and protecting minority shareholders’ rights in these countries.