Corporate Governance, Value Creation and Growth

Keynote Address by Gabriela Ramos
Chief of Staff and G20 Sherpa
OECD

15th European Corporate Governance Conference

Milan, Italy - Tuesday 28th October, 2014
Minister, Ladies and Gentlemen,

It was inspiring to listen to Minister Padoan this morning, and I thank him for his leadership in the international economic debate, now as Finance Minister, but for many years in the global arena, including at the OECD. Indeed, this 15th European Corporate Governance Conference is a tribute to his efforts on both sides of the fence!

It is a great pleasure to be here in Milan to talk about the OECD work that lends its name to this conference: Corporate Governance, Value Creation and Growth, and to try to make a connection between a topic that has been rather abstract, and the thrust of what is needed to restore strong, sustainable and inclusive growth in Europe.

Recovery has been slower and more bumpy than anticipated

This is timely. As we reported in last month’s OECD interim economic assessment, the global economy continues to expand at a moderate pace, with the US and Asia gaining speed, while Europe lags behind with persistently weak economic performance.

There is no surprise, therefore, that the emphasis of the Italian Presidency of the European Union, and of the Commission, is to boost growth, jobs and investment. This will require more vigorous monetary stimulus from the ECB, as well as governments’ use of the available flexibility within EU fiscal rules.1

It will also require renewed efforts to “go structural”, as we say in the OECD, and to address the numerous bottlenecks in the competition, labour, education, innovation and regulatory areas that are holding back European economies.

The OECD has a strong track-record in measuring, comparing and monitoring the delivery of structural reforms, and we are ready to continue working with the Commission and our European members to advance much needed action in this area.

Better Corporate Governance is a means to an end

Resuming growth is also a question of trust. So Europe’s reform package also needs to take a hard look at the quality of the governance framework of our financial and non-financial enterprises.

The role of corporate governance rules and regulations is to provide a framework of trust, transparency and accountability that makes it possible for companies to raise outside capital by reassuring investors to part with their money. In this sense, a good corporate governance framework can be a bridge between high finance and the high street.
But, improving corporate governance is day to day work that needs to take into account changes in structures of ownership, in savings patterns, technological progress, as well as different investment strategies – including those of SOEs.

That is why we are reviewing the OECD Principles of Corporate Governance. We have already mapped some of the most important changes I mentioned earlier, and we are looking at how to better align the regulatory framework to support value creation and growth. I would like to present today some of the main findings, their implications and where we go from here.

The “eco system” of corporate finance is evolving

In the wake of the crisis, we are also seeing a gradual evolution in the “eco-system” of corporate finance, with four key trends in evidence:

1) a shift away from bank lending and stock market financing towards corporate bond issuance,
2) cash hoarding by some large corporates,
3) rapid growth of financial intermediation, and
4) the rise of State-Owned Enterprises.

Firstly, bank lending to non-financial corporates has been in retreat in Europe since the financial crisis, falling by almost 15% in five years. The fall in corporate bond rates has made it possible for some firms to largely replace bank borrowing by issuing bonds. The trend is particularly marked for non-financial firms, which for the first time in 2013 raised more money in the bond market than financial companies.

During the same period, however, many companies have abandoned or stayed away from the stock market. Stock exchanges in the European Union have lost almost 30% of their publicly traded companies in the last ten years. The drop has been even more dramatic in the US.

On a positive note, early 2014 has seen a partial recovery in terms of listings. In a time when stock exchanges are run increasingly as purely commercial entities, as standard setters, supervisory agents and enforcers should be emphasised so as to ensure the value of the public good they provide.

At the OECD, we are analysing the factors deterring SMEs from accessing risk capital through the stock markets. We have identified corporate governance compliance costs, as well as trading practices and investment strategies among the large institutional investors as some of the factors we need to look at.
A second development that has received great attention recently is ‘cash hoarding’ among large non-financial corporations. This trend emerged shortly after the turn of the century, but has accelerated in recent years.

One of the problems here, of course, is that existing remuneration systems create incentives for executives and asset managers to push up share prices via buybacks which add little value to the economy over the longer-term.

There is therefore an urgent need to revisit executive remuneration so that it can be better aligned with long-term investment objectives. As shareholders get a bigger say on the remuneration of their board members and key executives, they also need to have the tools to evaluate the impact of their decisions on long-term investment.

A third major trend with implications for corporate governance is the rapid growth in financial intermediation. In the last fifteen years, for example, institutional investors have more than doubled their total assets under management.

This trend has been accompanied by a surge in new types of investors, asset managers, service providers and investment strategies. The most immediate effect is a longer and increasingly complex investment chain where the actors may have different – and sometimes conflicting – incentives with respect to corporate governance.

There is also concern that the rise of high-speed electronic trading, for example, may have tilted the playing field to favour short-term traders over long-term investors and smaller savers.

To restore trust, market efficiency and the supply of risk capital to innovative entrepreneurs, we need to take these concerns seriously. The ongoing pilot project in the US to increase the tick size for certain growth company stocks is a concrete improvement, and something that has been advocated by the OECD.

Fourthly, it is hard to talk about corporate governance today without mentioning state-owned enterprises. 21 of the 100 world’s largest companies are state controlled, including some of the world’s largest listed companies. In part, this reflects shifting wealth – the rapid growth and convergence of emerging economies – and it presents both opportunities and challenges.

Investments by SOEs can play an important role in the development process, or as ‘patient capital’ for long term projects, like infrastructure or seed capital.
However, since we are talking about companies that ultimately belong to taxpayers, governments have a responsibility to make sure that they are run in an efficient, transparent and accountable manner.

The *OECD Guidelines on the Corporate Governance of SOEs competitive neutrality* outline the necessary steps in this direction. Over the next two years, moreover, we will host an international dialogue with the ultimate aim of levelling the playing field between SOEs and privately-owned companies.¹

**Inclusiveness and household participation in value creation**

When we talk about the evolving “eco-system” of corporate finance, or the longer and more complex investment chain, we must remember that most of the money involved ultimately belongs to ordinary working people.

It is estimated that Europeans between the ages of 35 and 65 allocate more than a third of their savings to the stock market.² This is partly the result of political decisions to transform pension systems towards more funded, defined contribution and private pillars. Such reforms may have their merits, but they come with a responsibility to provide households with fair and transparent financial markets, and the tools with which to navigate them.

While wide access to a variety of financial intermediaries has its benefits, we must also remember that each additional layer of intermediaries generates a cost. Between 1990 and 2007, it is estimated that the revenues of securities market intermediaries increased from 1% to 5% of GDP!³ Today, the evidence suggests that the benefits of increased financial intermediation are going disproportionately to higher-income households.⁴

Tackling the equity challenge is one of the central components to the OECD’s ongoing work on **Inclusive Growth**. The avenues we are exploring include:

- How to improve access to finance for smaller entrepreneurs.
- How to level the playing field for smaller, less sophisticated investors, and
- How to raise the level of financial literacy.

The over-arching aim is to harness the dynamism of financial innovation, while building bridges to the real economy, and making sure that the pursuit of profit at all costs on the financial markets does not needlessly put at risk the livelihoods of everyone else.

**In conclusion,**

In a changing, increasingly complex, interconnected world, we need new evidence-based economic thinking to underpin and improve public policy. We need to completely change the way we look at corporate governance issues. This is what our work on corporate
governance, value creation and growth is all about. And this is also the approach we are taking to the review of the OECD Principles.

To address the challenges I touched on today, importantly:

- We need to align the incentives and address conflicts of interest in the investment chain, so that households, investors and corporations are all focused on long term value creation.
- We will address the functioning of stock exchanges and their role in corporate governance regulation and supervision.
- We need to emphasise the role of price discovery in capital markets, to level playing field among investors and improve the allocation of capital.
- We need to make fee structures fully transparent so that both pension funds and households make fully informed decisions.
- And, finally, we need to ensure a level playing field between state and privately owned companies.

Ladies and gentlemen

I am so happy that we have such a strong panel today to chart the contours of the change we need to help managers, entrepreneurs and policymakers get the corporate governance framework right for long-term, productive investment to underpin stronger, inclusive growth.

I look forward to working with you all to make this a reality, to seeing the EU and the OECD continue at the forefront of the global corporate governance debate, and to hearing today your thoughts on the next steps.

Thank You!
OECD Interim Economic Assessment, September 2014.


World Bank World Development Indicators, number of listed domestic companies.


OECD’s first substantive report on this topic was published in 2012: Competitive Neutrality – Maintaining a Level Playing Field between Public and Private Business.


OECD (2014), All on Board: Making Inclusive Growth Happen.