Corporate governance reform is a worldwide phenomenon
Corporate governance codes during the last decade

Date code published (latest code)

Pre-1997
- Australia (2002)
- Canada (2004)
- France (2002)
- Ireland (1999)
- New Zealand (2000)
- South Africa (2002)
- Spain (2002)
- Sweden (2001)
- UK (2003)

1997
- Finland (2000)
- France (2002)
- Korea Republic (2003)
- Sri Lanka
- Thailand

1998
- Belgium (2000)
- Greece (2001)
- Germany (2003)
- India (2003)

1999
- Brazil (2002)
- China, Hong Kong (2001)
- Italy (2002)
- Kenya (2000)
- Malaysia
- Mexico
- Portugal
- South Korea

2000
- Denmark (2001)
- Indonesia (2001)
- Philippines (2002)
- Singapore (2001)

2001
- Argentina, China, mainland
- Czech Republic
- Malta
- Peru (2002)

2002
- Austria
- Chile
- Denmark
- Korea
- Mexico
- Portugal
- South Africa
- Switzerland

2003-2004
- Bangladesh
- Cyprus
- Denmark
- Oman
- Turkey
- Ukraine
SCOPE OF REMARKS

- Value of corporate governance to investors
  - Progress in emerging markets
  - Challenges facing emerging markets

KEY MESSAGES

- Investors are willing to pay a premium for a well-governed company, particularly in emerging markets
- Governance is now an established investment criterion
- Investors perceive corporate governance risks at three levels
INVESTOR OPINION SURVEY DETAILS

Global Investor Opinion Survey, 2002
- 201 responses from professional* investors from institutions with an estimated USD 9 trillion assets under management (approximately USD 2 trillion AuM directly under their control)
- Covers 31 countries in Asia, Europe, Latin America, Middle East, Africa, and North America
- Undertaken in April/May 2002 in cooperation with the Global Corporate Governance Forum, using a questionnaire-based survey

Type of investor
- Bank
- Insurance
- Broker/trader
- Pension fund
- Venture capital
- Mutual fund
- Private equity
- Money manager
- Other**

A SIGNIFICANT MAJORITY OF INVESTORS SAY THEY ARE WILLING TO PAY A PREMIUM FOR A WELL-GOVERNED COMPANY

% of investors

<table>
<thead>
<tr>
<th>Region</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Western Europe</td>
<td>78</td>
<td>22</td>
</tr>
<tr>
<td>Asia</td>
<td>78</td>
<td>22</td>
</tr>
<tr>
<td>North America</td>
<td>76</td>
<td>24</td>
</tr>
<tr>
<td>Latin America</td>
<td>76</td>
<td>24</td>
</tr>
<tr>
<td>Eastern Europe/Africa</td>
<td>73</td>
<td>27</td>
</tr>
</tbody>
</table>

* Addressed to key investment decision-maker, e.g., CEO, CFO, Fund Manager
** Includes investment bank with asset management activities, family offices, holding companies

PREMIUM INVESTORS WOULD PAY FOR A WELL-GOVERNED COMPANY VARIES BY COUNTRY

Average premiums of those investors willing to pay premium

THE PREMIUM INVESTORS WOULD PAY FOR A WELL GOVERNED COMPANY VARIES BY REGION

Premium in 2002

- Eastern Europe/Africa: 30
- Latin America: 22
- Asia: 22
- Western Europe: 14
- North America: 13
CORPORATE GOVERNANCE IS NOW AN ESTABLISHED INVESTMENT CRITERION

How does corporate governance affect your investment decision?

% of investors selecting this option; multiple responses possible

- Avoidance of certain companies: 63%
- Decrease/increase holdings in certain companies: 57%
- Avoidance of certain countries: 31%
- Decrease/increase holdings in certain countries: 28%

"Our investment group would never approve an investment in a company with bad governance" – US Investment Manager, US$2 billion Private Equity Fund

"Good governance is a qualitative cut-off criterion" – Analyst, US$62 billion European Asset Manager

"I simply would not buy a company with poor corporate governance" – CFO, US$3 billion European Private Bank

GOVERNANCE OFTEN AS IMPORTANT AS FINANCIALS, PARTICULARLY IN EMERGING MARKETS

How important is corporate governance relative to financial issues – e.g., profit performance and growth potential – in evaluating the companies in which you invest?

% of investors, 2002

<table>
<thead>
<tr>
<th>Region</th>
<th>Less important</th>
<th>Equally important</th>
<th>More important</th>
</tr>
</thead>
<tbody>
<tr>
<td>Eastern Europe/Africa</td>
<td>15</td>
<td>45</td>
<td>40</td>
</tr>
<tr>
<td>Latin America</td>
<td>16</td>
<td>66</td>
<td>18</td>
</tr>
<tr>
<td>Asia</td>
<td>18</td>
<td>61</td>
<td>21</td>
</tr>
<tr>
<td>North America</td>
<td>43</td>
<td>50</td>
<td>7</td>
</tr>
<tr>
<td>Western Europe</td>
<td>44</td>
<td>41</td>
<td>15</td>
</tr>
</tbody>
</table>
INVESTORS IDENTIFY ISSUES AT THREE LEVELS THAT IMPACT ON THEIR INVESTMENT DECISIONS

% of investors who think that factor is very important for investment decision; top ten factors listed

Corporate factors
- Accounting disclosure: 71%
- Shareholder equality: 47%
- Market regulation and infrastructure: 43%
- International accounting standards: 42%
- Market liquidity: 37%
- Property rights: 46%
- Pressure on corruption: 32%
- Insolvency and bankruptcy regulation: 32%
- Fiscal environment: 31%
- Banking system: 30%

Capital market factors

Broad country level factors

INVESTORS IDENTIFY GOVERNANCE PRIORITIES FOR POLICYMAKERS

What are the top reform priorities for policymakers?

% of investors listing change; Top 4 listed

Investors selecting this option; multiple responses possible

- Strengthen shareholder rights: 33%
- Improve accounting standards: 32%
- More effective disclosure: 31%
- Stronger enforcement: 27%

- "Give shareholders significant rights to look after their investments" – Fund Manager, US $5 billion European Private Equity Fund
- "Simple, clear accounting and reporting rules" – Fund Manager, US $5 billion European Private Equity Fund
- "Enforcement of fiduciary duties" – Senior Counsel, US $50 billion US Money Manager
SCOPE OF REMARKS

- Value of corporate governance to investors
- Progress in emerging markets
- Challenges facing emerging markets

POLICYMAKER OPINION SURVEY DETAILS

Percent of respondents

Emerging Market Policymaker Opinion Survey, 2002
- 44 responses from leading policymakers and academics
- Covers 20 countries in Asia, Eastern Europe, and Latin America
- Undertaken in April/May 2002, using a questionnaire-based survey

POLICYMAKERS HIGHLIGHT SIGNIFICANT CORPORATE GOVERNANCE CHANGES IN RECENT YEARS

% of respondents; Top 5 changes

1. Enhanced disclosure 44
2. Adoption of best practice code 38
3. Improved corporate legislation 35
4. Strengthened shareholder rights and enforced activism 29
5. Improved and enforced capital market regulation 26

“Enhanced enforcement powers of regulators and the penalties applicable for breaches of securities law”
– Director, Asian Market Regulator

“The comprehensive review of the legal framework and its specific recommendations”
– Law Reform Manager, Asian Market Regulator

“Increased protection, and board and general meeting representation, for minority shareholders”
– Chief Advisor, Latin American Market Regulator

POLICYMAKERS BELIEVE IMPLEMENTATION HAS BEEN RELATIVELY SUCCESSFUL, BUT WITH ROOM FOR IMPROVEMENT

% of respondents

Very successful

Somewhat unsuccessful

Somewhat successful

How successful has your country been in implementing corporate governance reform?
Policymakers Identify Significant Barriers to Future Corporate Governance Success

% of respondents

<table>
<thead>
<tr>
<th>Barrier</th>
<th>% of Respondents</th>
<th>Source</th>
</tr>
</thead>
<tbody>
<tr>
<td>Core owners/concentrated ownership</td>
<td>32</td>
<td>“No strong local institutional investment industry” – Head of Listings, Latin American Stock Exchange</td>
</tr>
<tr>
<td>Poor enforcement*</td>
<td>30</td>
<td>“Successful lobbying by effected and influential people” – Vice Chairman, Latin American Market Regulator</td>
</tr>
<tr>
<td>Other vested interests, e.g., political interference</td>
<td>27</td>
<td>“Change in corporate culture is evolutionary in nature” – Deputy President, Asian Stock Exchange</td>
</tr>
<tr>
<td>Cultural difficulties</td>
<td>24</td>
<td>“Mindset that the company belongs to me (as the dominant shareholders) even though there are many other shareholders” – Head of Regulation, Asian Ministry of Finance</td>
</tr>
<tr>
<td>Inactive shareholders</td>
<td>22</td>
<td></td>
</tr>
</tbody>
</table>

* Including lack of trained personnel


Example: Russia

Progress in some areas

- Strengthened protection to minority shareholders under revised Law on Joint Stock Companies
- New code of corporate governance
- Asset stripping less pervasive
- Some progressive companies adopting international best practice

... but

- Weak equity culture
- Infringement of shareholder rights still common
- Poor enforcement of laws and regulations
  - Lack of financial and human resources
  - Corruption
  - Inefficient judiciary
- Accounting standards do not fully conform to IAS
EXAMPLE: THE ASIA REGION

Many reforms since 1997–1998
- Government led initiatives
  - Enhanced authority for regulators
  - Strengthened board independence
  - Improved disclosure standards
  - Stopping auditing/consulting linkage
- Private sector activities
  - Thailand: Institutional Investor Alliance
  - Singapore: Securities Investors Association
  - Individual companies: Infosys and others

... but
- Compliance with letter not spirit of law
- Focus on structure/process; less attention paid to changing behaviour
- Enforcement lagging
- Shareholders sell rather than challenge
- Lack of qualified professionals
- Uneven progress across the region

SCOPE OF REMARKS

- Value of corporate governance to investors
- Progress in emerging markets
- Challenges facing emerging markets
CONTROL MODEL GOVERNANCE CHAIN PREVALENT IN MOST EMERGING MARKETS

Institutional context
- Shareholder environment
- Concentrated ownership
- Reliance on family, bank and public finance
- Under-developed new issue market
- Limited takeover market

Capital market liquidity
- ‘Insider boards’
- Incentives aligned with core shareholders
- Limited disclosure
- Inadequate minority protection

Institutional context (cont.)
- Transparency and accountability

Corporate context
- Independence and performance

Note: Examples can also be found in Asia, Latin America, and many Continental European countries
Source: McKinsey

These characteristics present considerable challenges to policymakers attempting to foster good corporate governance
Policymakers must address reforms in both the corporate and institutional contexts

CONTROL MODEL GOVERNANCE CONTRASTS SHARPLY WITH UK/US MARKET MODEL GOVERNANCE

Institutional context
- Shareholder environment
- Dispersed ownership
- Sophisticated institutional investment
- Active private equity market (incl. IPOs)
- Active takeover market

Capital market liquidity
- Non-executive majority boards
- High disclosure
- Shareholder equality

Corporate context
- Independence and performance

Note: Examples can also be found in Australia and Canada
Source: McKinsey

Policymakers should be mindful of the fundamental differences between the two models when contemplating adopting UK/US best practices
KEY CHALLENGE IN MANY EMERGING MARKETS IS BUILDING EFFECTIVE SUPPORTING INFRASTRUCTURE

How can you pursue ...

- Greater disclosure and transparency
- More independent directors
- Long-term outlook
- Foreign investment

When ...

- Regulators do not have sufficient human and financial resources
- Contracts are difficult to enforce
- Corruption is rife
- Judicial system not working

TWIN-TRACK APPROACH FOR GOVERNMENTS AND COMPANIES

Mindset change
- Realise importance of good corporate governance

Basic governance structure and processes
- Secure adequate board independence
- Create independent board committees
- Embrace strict accounting norms
- Institute risk management structures

Quality of rules and enforcement
- Disclosure/listing requirements
- Strong regulators and vigorous enforcement
- Protection of minority shareholders

World-class corporate governance
- Build a strategic, value-added board
- Constructive engagement with investors and stakeholders
- High quality of financial and non-financial disclosure

Market discipline
- Well-developed equity and bond markets
- Takeover market
- Enhanced remedies for shareholders

Stability and predictability
- Rule of law
- Corporate and securities legislation
- Check on corruption

Companies

Governments
PRACTICAL STEPS TO ENSURE EFFECTIVENESS OF GOVERNANCE MEASURES

- Enforce current laws and regulations vigorously
- Focus on the most critical tasks and maximise leveraging opportunities
- Do not over-regulate
- Employ both “sticks” and “carrots”
- Raise awareness among companies, shareholders, and the wider public
- Undertake training and development of directors
- Facilitate the flow of information to the public

The Value and Challenges of Good Corporate Governance

OECD-World Bank Eurasian Corporate Governance Roundtable

Kyiv, Ukraine
May 2004
**QUESTION: WILLINGNESS TO PAY A PREMIUM FOR A WELL-GOVERNED COMPANY**

1. Suppose you are considering investing in the following companies, A and B, in the same country. Past performance has been virtually identical and future market potential appears to be similar for both companies. However, they differ in board governance practices. B has put in place “good” board governance practices.

<table>
<thead>
<tr>
<th>Company A, “Poor” governance</th>
<th>Company B, “Good” governance</th>
</tr>
</thead>
<tbody>
<tr>
<td>* Minority of outside directors</td>
<td>* Majority of outside directors</td>
</tr>
<tr>
<td>* Outside directors have financial ties with management</td>
<td>* Outside directors are truly independent; no ties with management</td>
</tr>
<tr>
<td>* Directors own little or no stock</td>
<td>* Directors have significant shareholdings</td>
</tr>
<tr>
<td>* Directors compensated only with cash</td>
<td>* Material proportion of directors’ pay is stock-related</td>
</tr>
<tr>
<td>* Very unresponsive to investor requests for information on governance issues</td>
<td>* Formal director evaluation in place</td>
</tr>
<tr>
<td>* Very responsive to investor requests for information on governance issues</td>
<td></td>
</tr>
</tbody>
</table>

2. Questions:
   * In those countries for which you are the key investment decision-maker, would you be willing to pay more for company B’s stock compared to A’s?
   * If yes, what percentage premium do you estimate you would be willing to pay for B’s stock?

Notes: Practices used to define “good” governance are some of those championed by the investment community.