



3rd Meeting of the Eurasian Corporate Governance Roundtable

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SHAREHOLDER RIGHTS, EQUITABLE TREATMENT AND THE ROLE OF THE STATE

Regional Corporate Governance Enforcement Efforts

By

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**The Global
Corporate
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- Good Afternoon.
- Thank you Mr. Geiger for your leadership in OECD's corporate governance program. Your guidance of this vital effort has truly set the standards by which the corporate world steers its affairs.
- And, importantly, congratulations to you, the speakers and participants, in this highly stimulating corporate governance conference. It has been very rewarding to listen to you and hear of the progress that has been achieved in the region in terms of legal and regulatory measures, programs initiated by the securities markets themselves, and the efforts of enlightened enterprises. Of course, progress has been fitful. There have been a number of problems with enterprises not following corporate governance norms. We heard of examples of various infractions in the areas of share dilution and asset stripping yesterday and today.
- Having worked in this region for seven years on financial sector development with corporate governance being one of my principal objectives, I appreciate your insights, experience, and plans presented yesterday and today encourage me.
- I would like to share with you a few of my own insights on the issue of corporate governance enforcement. Enforcement is definitely a matter of government oversight and court decisions but enforcement has other aspects, at the enterprise level, at the bank and securities firm level, at the self-regulatory organization level, as well as at the government level.

Enforcement

- **Enforcement at the enterprise level.** Enterprises themselves, their directors, managers and shareholders, will elevate their corporate governance practices, and improve them out of self-interest. To do so increases the opportunities for and terms of finance.
- **Enforcement by the market.** Banks, securities firms, insurers, funds and investors reward and penalize enterprises according to the level of corporate governance they practice. Financial institutions want to protect themselves against unsuspected actions by their client enterprises, reduce their financial risks, and increase their profitability. Good corporate governance ensures responsive, fair-minded management and it increases the quality of financial disclosure to the market. A survey conducted by McKinsey & Company found that investors are willing to pay a premium for companies that demonstrate sound corporate governance. The attached table indicates the size of those premiums - - investors surveyed are willing to pay an additional 18 percent to 27 percent for good corporate governance.
- **Enforcement by market associations.** Self-regulatory organization such as stock exchanges, clearing depositories and registrars require certain corporate governance standards from their

members and clients. For enterprises and financial intermediaries wanting the liquidity and depth of market for their securities will adhere to the CG standards of these associations.

- **Enforcement by the state through regulators and courts.** We look to the securities regulators, the central banks, and the courts to uphold the laws protecting shareholders and creditors. These institutions represent the public conscience. If they work well investors, small and large, will have the confidence to participate in the capital market.
- Naturally, we accept that the financial market regulators and the courts have a central role in upholding good corporate governance practices. Lately, we have been able to see empirically how precisely laws and enforcement impact the development of the financial sector.
- Please look at the attached table that summarizes one part of the work of professors La Porta, Lopez de Silanes, Schleifer and Vishny in the U.S. Their work confirms that the legal environment – both the legal rules and their enforcement - - varies considerably from country to country with regard to the protection available to shareholders. From the table you can see that countries that have extensive protections based in law and an efficient judicial system (in which rules of fair play and contracts are upheld) have larger capital markets.
- On the panel this afternoon, Mr. Gorlick presented the World Bank's Corporate Governance Country Assessment for Georgia. These assessments are exactly what are needed to guide our efforts to shape the legal environment and judicial response for corporate governance. And, they help us fill in the missing data for the table you see here.
- Professors Bhattacharya and Daouk reported in their study "The World Price of Insider Trading" (Journal of Economic Literature, January 2000) that 83 of 103 countries that have securities markets ban such activity. Yet, only 38 countries enforced the laws that prohibit the practice. Further they found that the enforcement of insider trading laws is a significant determinant of liquidity and cost of capital, over and beyond the "mere existence" of insider trading laws. Good laws are unproductive without good enforcement.
- Enforcement is a matter of public policy and reflects the wishes and demands of the financial industry, the private sector and the voting population. As a matter of public policy, the government should place enforcement of good corporate governance as a high priority.

Regional and International Cooperation on Corporate Governance

- From this conference, we can see that corporate governance is a priority for the financial markets of Eurasia. There is no question among us that the growth of the enterprise sector in the region will depend, significantly, on progress made in instituting corporate governance reforms. The active, consistent and focused participation on this matter by international organizations present today - - the OECE, IFC, CIPE, World Bank, EBRD, and USAID - - is testimony to the importance that we attach to this subject.
- USAID has worked for over eight years in Eurasia on the matter of developing and strengthening securities commissions as well as the securities market self-regulatory

organizations for registering, trading, clearing, and settling securities transactions; aided in judicial reform; supported the passage of good laws on corporate governance, accounting and auditing, bankruptcy, and creditors' rights. We have worked at all levels of the corporate governance enforcement ladder – enterprise level, market level, market association level, and the court and the state regulation level

Conclusion

- We all benefit – either in business, as a financier, a policy maker, or an officer of an international development institution - - by pressing corporate governance reform and advancing the enforcement programs that ensure success with the reform effort. As laid out here this afternoon, to accomplish this the enforcement agenda has to be approached at four levels – at the enterprise level, the market level, the market association level, and at the government level.
- I have no doubt we will make significant progress on all fronts this coming year. I wish you all success in this endeavor.
- Thank you.

Table 1

McKinsey & Company's Investor Opinion Survey

| Country | Would you be willing to pay a premium – percent answering yes | The average premium that would be paid |
|-------------|---|--|
| | | |
| Korea | 91 | 24.2 |
| Mexico | 90 | 21.5 |
| Thailand | 89 | 25.7 |
| Brazil | 89 | 22.9 |
| Taiwan | 89 | 20.2 |
| Indonesia | 88 | 27.1 |
| Malaysia | 88 | 24.9 |
| U.S. | 84 | 18.3 |
| U.K. | 84 | 17.9 |
| Argentina | 82 | 21.2 |
| Chile | 82 | 20.8 |
| Japan | 82 | 20.2 |
| France | 82 | 19.8 |
| Spain | 82 | 19.2 |
| Sweden | 82 | 18.2 |
| Switzerland | 82 | 18.0 |
| Germany | 79 | 20.2 |
| Belgium | 79 | 19.6 |
| Netherlands | 79 | 18.5 |
| Venezuela | 78 | 27.6 |
| Columbia | 78 | 27.2 |
| Italy | 71 | 22.0 |

Source: Investor Opinion Survey, McKinsey & Company, London, U.K., June 2000

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Table 2

Investor Protection and Capital Market Development - Selected Countries

| 1 | 2 | 3 | 4 | 5 |
|-------------|----------------------------------|---------------------------------|------------------------------|---|
| Country | Shareholder Protection (max = 5) | Judicial Enforcement (max = 10) | Domestic Firms to Population | Market Capitalization of Listed Companies as % of GDP |
| Argentina | 4 | 5 | 5 | 20 |
| Armenia | | | | 1 |
| Canada | 4 | 10 | 41 | 91 |
| Chile | 3 | 7 | 20 | 96 |
| Croatia | | | | 20 |
| Estonia | | | | 23 |
| Finland | 2 | 10 | 13 | 60 |
| France | 2 | 9 | 8 | 48 |
| Germany | 1 | 9 | 5 | 39 |
| Greece | 2 | 6 | 22 | 28 |
| India | 2 | 4 | 8 | 31 |
| Japan | 3 | 9 | 18 | 53 |
| Kazakhstan | | | | 6 |
| Pakistan | 4 | 3 | 6 | 18 |
| Philippines | 3 | 3 | 3 | 38 |
| Poland | | | | 8 |
| Russia | | | | 30 |
| South Korea | 2 | 5 | 16 | 9 |
| Sweden | 2 | 10 | 13 | 115 |
| Switzerland | 1 | 10 | 34 | 225 |
| Thailand | 3 | 6 | 7 | 16 |
| Turkey | 1 | 10 | 34 | 32 |
| Ukraine | | | | 7 |
| U.K. | 4 | 9 | 36 | 151 |
| U.S. | 5 | 10 | 30 | 137 |
| | | | | |

Source: Columns 1-4 are from “Legal Determinants of External Finance” by Rafael LaPorta, Florencio Lopez-de-Silanes, Andrei Schleifer and Robert W. Vishny, NBER Working Paper No. 5879, January 1997 (“LLSV Working Paper”); and, Column 5 is from the World Bank’s World Development Indicators for 1997. Column 1 is a set of 17 countries from the 45 presented in LLSV Working Paper plus six countries from Central Europe and Eurasia for reference. Column 2 is an index of how well the legal framework protects equity investors. This index is equal to five when 1) shareholders are allowed to vote by mail; 2) shareholders are not required to deposit shares in advance of a meeting; 3) cumulative voting is allowed; and, 4) when the minimum percentage of share capital required to call a meeting is less than 10 percent. Column 3 is an index of the quality of judicial enforcement ranging from 1 to 10 (best) that accumulates sub-indexes measuring 1) the efficiency of the judicial system; 2) rule of law; 3) corruption; 4) risk of

expropriation; and, 5) risk of contract repudiation. Column 4 is the number of domestic publicly traded corporations per 10 million in population. Column 5 is the capital market valuation of listed companies measured as a percentage of GNP. Data are from 1995-1997.

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