



# 3rd Meeting of the Eurasian Corporate Governance Roundtable

President Hotel “Kyivsky”  
Kyiv, Ukraine  
17-18 April 2002

*SHAREHOLDER RIGHTS, EQUITABLE TREATMENT  
AND THE ROLE OF THE STATE*



## Summary Record

hosted by

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The Global  
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## **Summary record**

### **3<sup>rd</sup> Eurasian Corporate Governance Roundtable Kiev, Ukraine 17-18 April 2002**

#### **Introductory Remarks**

The 3<sup>rd</sup> meeting of the Corporate Governance Roundtable on Eurasia took place in Kiev on 17-18 April 2002. The meeting was co-hosted by the Securities and Stock Market Commission, the State Property Fund and the First Securities Trading System (PFTS) of Ukraine. It was organised with the support of the International Finance Corporation (IFC), the World Bank (WB), the OECD/WB Global Corporate Governance Forum (GCGF) and the government of Japan.

The meeting brought together approximately 130 participants from 18 countries from Eurasia (Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyz Republic, Moldova, Mongolia and Ukraine), the OECD (Belgium, Canada, Japan, Italy, Spain, Sweden, United Kingdom and the United States), as well as representatives of international organisations (WB, IFC, TACIS, GCGF).

The participants included senior government officials and policy makers from relevant ministries, securities market regulators, representatives of stock exchanges, corporate governance legal experts and professionals, as well as investors and representatives of the corporate sector in Eurasia (see attached participants list).

The Ukrainian Minister of Economy, Mr. Shlapak, opened the meeting. Mr. Shlapak stressed that corporate governance is emerging as a key priority for reforms in Ukraine and is recognised as such in a recently issued Presidential Decree. From this perspective, the third meeting of the Eurasian Corporate Governance Roundtable has a tremendous importance for Ukraine and its contribution to the current corporate governance debate in the country is expected with a great interest. The Ukrainian government is also taking important steps to enhance the framework of corporate governance and is currently revisiting existing legal acts. Amendments to the Law on corporatisation, a Draft Law on management of state assets and a Draft Law on joint stock companies, based on the OECD Corporate Governance Principles, have been prepared and some of them introduced in Parliament.

In their opening remarks, representatives of the partners supporting the Eurasian Roundtable stressed that changes do not take place overnight and expressed their wish to see the corporate governance dialogue in the region continue and materialise in more concrete country and/or regional programmes in 2003 and beyond. They also stressed that recent corporate events confirm the importance of good corporate governance practices world-wide. Thus, the meeting was considered as important for all participants -- from Eurasian as well as OECD countries -- who face different but equally urgent issues. Nowadays more than ever, investors all over the world expect tangible action leading to a better accountability of managers and board members, enhanced rights of shareholders and stakeholders, and improved corporate transparency and disclosure.

The topics for discussion at the meeting revolved around a core corporate governance issue, shareholders rights and equitable treatment. The agenda of the meeting (attached) was organised in five sessions, which focused on:

(1) Shareholder treatment and access to capital;

- (2) The state as a shareholder;
- (3) Shareholder expression;
- (4) Minority shareholder protection and
- (5) Shareholder awareness and legal redress.

The participants agreed that these topics are particularly relevant to their current corporate governance reform programmes. Indeed, important company law reforms are underway in Ukraine and Kazakhstan, while Azerbaijan, Kyrgyzstan and Georgia recognise the need to further improve their existing legal frameworks. The Roundtable also agreed that the enforcement of the existing rules, regulations and legal acts constitutes another important common issue, which requires particular attention and action by governments, as well as technical assistance.

All presentations generated a lively discussion and provided the audience with a perspective on important issues, which are likely to shape corporate governance developments in Eurasia in the future. A number of conclusions, drawn from the above presentations, panel interventions and the general discussion that ensued, are summarised below:

### **Shareholder Treatment and Access to Capital**

- Respect of shareholder rights and equitable treatment of shareholders correlate with greater access to capital. The continuing need for attracting equity capital to finance corporate growth is one of the most important incentives to enhance shareholder treatment and corporate governance practices in general. The existence of alternative sources of low priced capital and the dominance of shadow economies have been preventing market incentives for good governance to develop in Eurasia. Policy makers need to focus on concrete measures to bring the shadow economy in the mainstream, to level the playing field between the private and state sectors and to promote market disciplines by reducing and targeting subsidisation, preferential financing schemes and state orders.
- The existence of liquid and well functioning capital markets constitutes in itself an incentive to improve shareholder treatment in order for corporations to access this alternative source of finance. However, in Eurasian transition economies, capital markets are still under-developed and do not play a major role in financing the corporate sector. Privatisation programmes, largely based on non-traditional approaches, such as mass privatisation schemes, did not yield the expected results in terms of market development. Privatisation funds and other market intermediaries did not become effective players in an emerging primary market.
- Equity markets in Eurasia can become a primary source of long-term corporate finance on the basis of a solid regulatory framework and explicit and consistent government policies for their development. Regulators from the region felt that in the future, international financial institutions and bilateral donors can play a greater role in supporting such policies. Pension reform together with the design and creation of new liquid financial instruments could also play a role in this respect.
- Governments have an important role to play in enhancing corporate governance. They should establish comprehensive legal framework that could provide a basis for effective regulations, rules and codes of conducts. Legislation on joint stock companies is one of the pillars of good governance. Eurasian countries lagged behind other transition economies in terms of company law reforms and many of them are currently discussing major changes of the existing frameworks. In this particular context, the Roundtable message to Ukraine and Kazakhstan is that the adoption of their joint-stock company legislation needs to be accelerated in order to provide the corporate sector with a predictable and modern legal framework for its functioning.

- At the same time, it is crucial to take this opportunity and address the gaps of the legislation still in place and ensure that the necessary concepts and provisions preventing shareholder rights violation are introduced. In the Ukrainian case, for example, among the areas requiring particular attention are: prohibition of related party transactions, enforcement of pre-emptive rights in order to prevent share dilution, introduction of cumulative voting and provisions against conflicts of interests, better provisions with respect to shareholders meetings (e.g. on meeting notifications).
- Existing provisions on shareholders rights and equitable treatment of all shareholders, including minority and foreign, need to be properly enforced in order for corporations to retain investors confidence. Governments should empower regulators to enforce the existing laws and rules and ensure that adequate means for legal redress are in place.

### **The state as a shareholder**

- It is recognised that private ownership makes a great difference and correlates strongly with better economic performance. Following the implementation of large-scale privatisation programmes in Eurasia, the volume of state assets in the region has significantly decreased. However, the state is still the largest shareholder in most of the countries and therefore it is important that its role in the governance of its assets is clearly defined. In Ukraine, for example, the state holds an estimated 46 per cent of the assets and controls more than one third of the joint-stock companies. As it stems from the Ukrnafta example and the general discussions, it does not act as an efficient owner and the scope for improvement is vast.
- The experience of OECD economies, in which the state has kept significant holdings in various businesses, utilities and infrastructure, is of relevance to Eurasian countries. The Swedish Ministry of Industry has been very active in designing and implementing policies enhancing the role of the state as a shareholder. Value creation has been defined as the overriding goal in the management of state stakes in Sweden. To ensure operation in accordance with this goal and its underlying principles of transparency and focus on core business, the Swedish government has separated regulatory policy from ownership/shareholder functions and for the latter employed a number of professionals with a background in business restructuring and corporate finance. Important methods to create value in the Swedish case are business streamlining, incorporation of public utilities and asset restructuring. Disclosure of financial and other results, as well as periodical reporting are considered essential to this process. Enhancing the effectiveness of Boards of Directors in which the state is represented, together with independent directors and private nominees, is another element of the Swedish policies.
- In principle, the governance rules applicable to state-owned companies, at least those belonging to the competitive sector, should not be different from the ones applicable to any other company. In fact, the situation of the state vis-à-vis a company in which it holds significant interest is much more complex than that of a dominant private shareholder. Arms-length, profit-oriented management of state assets is difficult to achieve in both OECD and Eurasian economies. The state as an owner has, sometimes, conflicting objectives and in the Eurasian setting, where market institutions and the private sector are still developing, the challenge is even greater. This is why it was felt that this topic needs to be further discussed in the framework of the Roundtable.
- Meanwhile, refraining from intervention by state institutions in day-to-day operation of businesses and enhanced transparency of related state decisions, together with enhanced market incentives and disciplines, as well as macroeconomic stability will greatly contribute to value creation in the state sector. Usual techniques of businesslike management should also be called upon, such as independent

boards of directors, acting in the interest of the company, clear definition of the role of the state appointee directors, nomination of directors on the basis of their capabilities and regardless of political allegiance, creation of board committees, special rules for dealing with conflicts of interests, special accounting procedures for the public services activities of the firm, if any, etc.

## **Shareholder Expression**

- Annual general meetings (AGMs) have an important role to play in ensuring shareholder participation in decision-making on key company matters, and in providing shareholders with information on fundamental corporate changes. Shareholder culture is a prerequisite for AGMs to become an effective corporate governance instrument; however, it takes time to develop. In reality, the large majority of individual shareholders in Eurasia developed as a result of mass privatisation programmes in which shares were distributed quasi gratuitously and in a relatively short period of time. Thus, raising the awareness of shareholders about their rights is important for effective and informed shareholder expression. Securities Commissions, shareholder and business associations should contribute to this process.
- From a legal perspective, shareholder expression needs to be better defined. The right of shareholders to participate and vote in AGMs is formally granted in all the countries from the region, however, national frameworks differ in the way they address the minimum requirements for calling and conducting AGMs. Certain gaps, which need to be tackled, were discussed at the meeting. In Ukraine for example, they include duration of meetings, notification procedures, and access to registries. It was also reported that the independence of registrars constituted another impediment to effective AGMs.
- Regulators can play an important role in improving the existing framework in a timely fashion. In Kyrgyzstan, the State Securities Market Commission developed and passed rules on conducting AGMs in Kyrgyz joint-stock companies, which regulated *inter alia* the procedures on preparing meeting agendas, the conditions under which minority shareholders can propose items for discussion, the procedures related to extraordinary meetings.
- Securities Commissions should be instrumental in ensuring compliance with the procedures regulating shareholder expression. The experience of Ukraine and Kyrgyzstan suggest that the cases of non-compliance are numerous and most often concern irregularities in meeting notifications, proxy voting, insufficient information on issues discussed at the meeting, on future changes in share capital, independence of registrars. In addition to active Securities Commissions, the capacity of courts to provide competent judgements on related disputes is key. Training of lawyers and judges, specialisation of judges and the publication of court opinions and decisions were cited among the measures, which need to be taken in the near future in order for the judicial system to fulfil its role in improving corporate governance.

## **Minority Shareholders Protection**

- To enhance the investment climate in Eurasia, policy makers need to focus on ensuring credible investor protection from misuse or misappropriation by corporate managers, board members or controlling shareholders. The legal framework of shareholder rights needs to be better defined in most countries of the region, together with adequate enforcement mechanisms and remedies against violation. Moreover, it needs to ensure equitable treatment of shareholders, including minority and foreign. Equitable treatment without preventing the company's governing bodies from taking the necessary decisions requires a balance between the protection of minority and majority shareholders.

- Investors perceive abusive related party transactions and asset stripping through self-dealing to be among the most significant and common abuses of shareholder rights in Eurasia. Controlling interests, such as majority shareholders and management, repeatedly use such transactions in order to extract value from the company at the expense of minority shareholders. The consequences of such practices can reach considerable proportions, as it appeared from the presentation of Hermitage Capital Management. Auditors can, under certain circumstances, facilitate abusive transactions; therefore, credible sanctions against fraudulent, negligent or reckless audits need to be defined and implemented together with provisions preventing audits by parties providing companies with non-auditing services.
- The discussion focused extensively on possible ways to prevent abusive self-dealing. Two basic approaches were examined, one depending on detailed regulation and the other on principles, such as fiduciary duty. The legal and regulatory frameworks in many Eurasian countries suffer from certain weaknesses in this respect, including the absence of clear and/or workable definition of related party transactions, clear procedures on sanctions and their approval, sufficient provisions on disclosure of conflicts of interests and related party transactions. The second approach necessitates proper training and education for all related players, public and private alike. Several remedial measures to the conflicts of interests between majority and minority shareholders were also suggested, which included exit, take-over bids and squeeze-outs.
- One view expressed at the Roundtable was that because Eurasian countries were unwilling/unable to protect minority investors, mechanisms should be established for the redemption of minority-owned shares and the de-listing of the companies involved. From the perspective of economic development, it was argued, it is more important that an enterprise have unified manager/owner with an interest in growing the business than that the enterprise have a capital structure which in theory could more easily attract equity finance from numerous, geographically dispersed investors.

### **Shareholder awareness and legal redress**

- Participants felt that mass privatisation programmes have contributed to certain weaknesses of the Eurasian corporate governance landscape. Shareholders came to existence without realising the related implications and without clear understanding of their rights. In addition to the lack of equity culture, the small stakes held by individual shareholders are another disincentive for them to play a greater role in corporate governance. Thus, educational and public awareness programmes need to be carried out in order to allow for a better understanding of corporate governance issues by the numerous individual shareholders of countries in Eurasia. The emerging institutional investors, including foreign, should also be encouraged to formulate and publicise their ownership policies.
- The judicial system of the countries in the region has not developed sufficient capacity to address corporate governance cases. Settlement and enforcement of commercial disputes is largely inefficient. Specialised courts are being established very slowly and only in certain countries. Policy makers need to recognise and address the need for strengthening the judicial system. Training of lawyers and judges, adequate remuneration of judges and court personnel, publication of court written opinions and decisions are only a few of the urgent measures, which need to be put in place. Arbitration mechanisms and low cost collective action through shareholders associations or other collective institutions constitute alternative options of redress, which need to be developed.
- The role of stock exchanges and securities regulators in preventing and sanctioning abuse and fraud was also examined. It appears that administrative enforcement is problematic in most countries of the region. Regulatory agencies lack the authority, resources and sometimes expertise necessary to fulfil

their role. Lack of transparency of decisions, accountability and independence also impede on the capacity of the regulators to perform their tasks. There is a scope for private initiatives, such as codes for best practices, which are complementary to the legal and regulatory framework of corporate governance. Stock exchanges should also be more active in ensuring market integrity and greater corporate governance standards.

## **Future Work**

The Eurasian Roundtable will convene in the spring of 2003 to discuss the role of boards of directors and stakeholders. Given the interest and perceived urgency of other related topics, such as enforcement and the role of the state in the management and governance of state assets, it was suggested that these issues are discussed in special sessions of this meeting. Representatives of Kyrgyzstan invited the Roundtable to hold its next meeting in Bishkek; the participants welcomed the proposal.

Participants encouraged the preparation of a Review of corporate governance frameworks and practices in the region and underlined that it needs to discuss main priorities for reforms. This was recognised as a challenging task, the success of which will greatly depend on the contribution on country inputs and on the support of the Roundtable partners.

Finally, participants and Roundtable partners stressed the importance of the Roundtable as a central vehicle in identifying key areas of donor support to corporate governance reforms. They also voiced their support for country specific programmes on corporate governance.