Board Practices in Emerging Markets

-Reality and Challenges-

How the Private Sector Can Be Involved in the Development and Implementation of CG Standards

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Board Practices in Emerging Markets

Reality and Challenges

- The Effectiveness of Boards of Directors
- The Potential of Boards of Directors in Emerging Markets
- How to Introduce Changes: Reform Strategies
- Coercive and Participatory Reform of Boards
- Conclusions and Recommendations
- Involvement of the private sector in Macedonia

Boards of Directors

1. The Effectiveness of Boards:

- Recognition of the important role of directors in the governance of corporations
- Ultimate internal monitor
- Provide credibility and access to resources
- Best informed and positioned to protect investors
- Central to all corporate governance systems and legal systems
- No alternatives

Board Practices

Perceived Problems

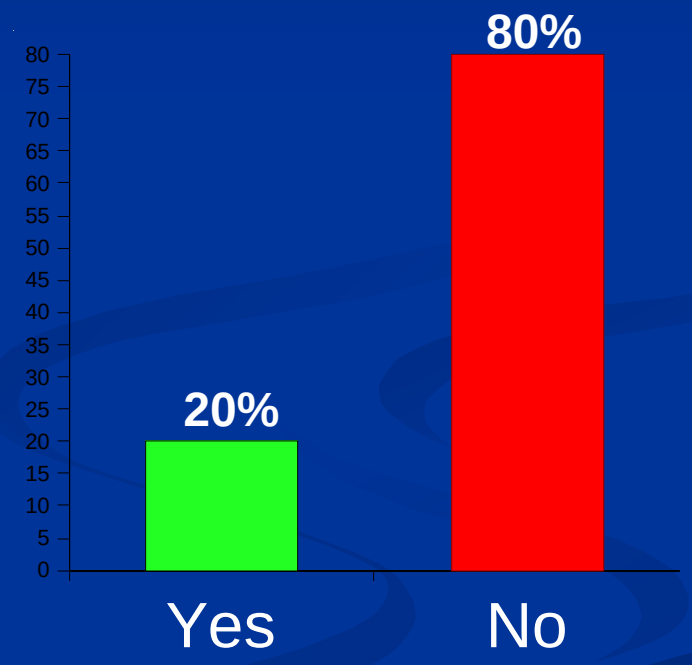
- Boards are in a crisis
- Poor reputation
- Low trust
- Too expensive
- Cronies of management
- Not independent
- Increasing liabilities – D&O insurance
- No longer a career goal for seasoned managers

Board Practices

Low Trust After Financial Scandals

“Directors of large companies can be trusted to tell the truth.”

Four in five people in Britain did not trust directors in 2003.



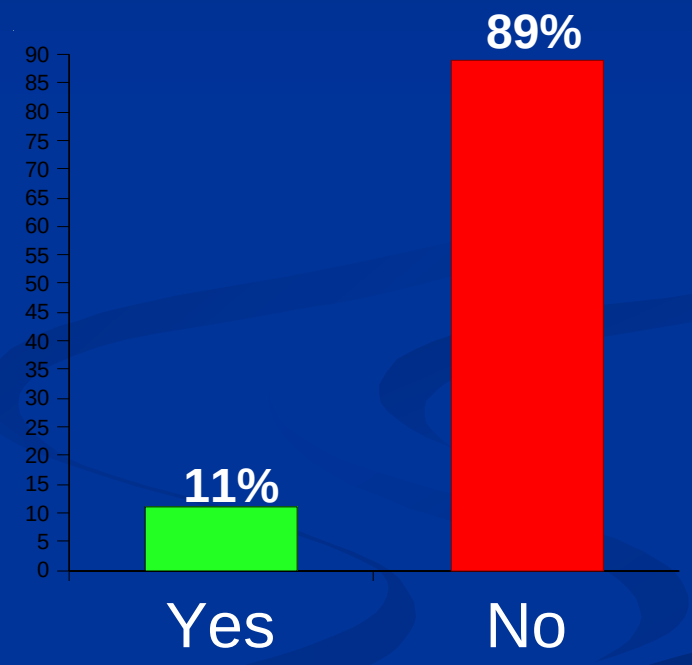
Source: Mori Research (2003).

Board Practices

Low Trust Before Financial Scandals

"I trust and believe what the directors of my company say."

89 percent of all workers in the UK in 1999 said "No!"



Source: Mori Research (1999).

Board Practices

Too Expensive?

"Inequality between the shop floor and the executive suite is at an all-time high.

According to Business Week/AFLCIO, the average CEO made 42 times the average blue-collar worker's pay in 1980, 85 times in 1990 and a staggering 531 times in 2000 (in the US)."

Source: AFLCIO (2002).

Boards of Directors

2. The Potential of Independent Directors

The Potential is Enormous

In the Russian Federation > 50,000 JSCs (open and closed)

≥ 50 shareholders art. 64, clause 1 -> Board of Directors is required
>1,000 shareholders art. 66, cl.3 -> minimum of 7 directors
>10,000 shareholders art. 66, cl.3 -> minimum of 9 directors

Hundreds of thousands of directors in a given year

How to reach out and enforce standards?

Source: Russian Law on Joint Stock Companies.

Boards of Directors

3. Reform Strategies

Enforcement	Acceptance: Low	Acceptance: High
High	**I** Shock Therapy Sarbanes-Oxley Act	**II** Implementation Company Law reform Bill
Low	**III** Education 2004 Company Law - Macedonia	**IV** Self-Regulation Corporate Governance Codes

Source: Maassen and van de Coevering (2005).

Boards of Directors

4. Coercive Reform Strategies to Develop Boards

- Director and officer disqualification
- Increase civil and criminal liabilities of directors
- Impose significant financial penalties
- Who wants to be a director?

"Shock therapies" require substantial resources for enforcement, severe consequences for non-compliance and clear cut rules

Often not available in emerging markets

Boards of Directors

Problems

- Regulators are underfunded + limited authority
- Understaffed + weak judicial system

Focus is on drafting legislation in emerging markets – not on implementation + enforcement

- The problem of legal transplants
- The problem of exclusion
- The problem of ignoring costs: impact analyses
- The problem of conflicting standards
- The problem of partial approaches to reform

Boards of Directors

5. Participatory Reform Strategies to Develop Boards

- Demand driven reform
- Built upon incentives: attracting funds – risk management – improving internal control

"Implementation" requires substantial resources in education and self-regulation

First Step: Involve the private sector

Source: Maassen and van de Coevering (2005).

Boards of Directors

Reform Strategies for Emerging Markets

Enforcement	Acceptance: Low	Acceptance: High
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Low	**III** Education Company Law Macedonia	**IV** Self-Regulation Corporate Governance Codes

Source: Maassen and van de Coevering (2005).

Be Inclusive

Open Process (27 Debates)

2003 Law — May 2003

D1

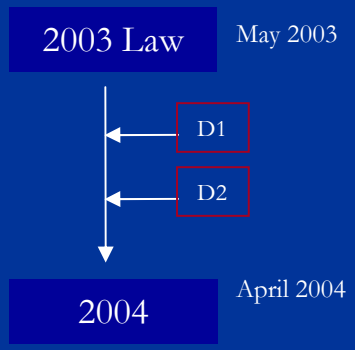
D2

2004 — April 2004

Source: USAID CG&CL Project (2005).

Be Inclusive

Open Process (27 Debates)



Source: USAID CG&CL Project (2005).

Boards of Directors

Participatory Reform Strategies to Develop Boards

- Universities to develop new generations of leaders
- Self-regulation through IoDs or universities
- Accreditation of directors as a minimum requirement (business services industries)
- Media programs (radio, TV, article placements)
- Develop shareholder rights' awareness
- Peer to peer networks
- Continuing education

Conclusions

6. Reality and Challenges

- Paradigm shift from legislation to implementation
- Ensure the involvement of the private sector
- Refine legislation
- Improve enforcement
- Focus on incentives

We need strategies and resources to reach out to large groups of directors, managers, shareholders, legislators …..

Involvement of the private sector in Macedonia

CG Council

- Established in January 2004
- Platform for discussion and coordination
- Activities and events organized and sponsored by the CG Council

CG Code

- The Process of Drafting the Code

- Starting Grounds for Drafting the Code
  - The new Company Law (May 2004)
  - OECD documents (OECD principles and the SEE White Paper on Corporate Governance)
  - EU Action plan for CG
  - The Macedonian Code of Business Conduct prepared by the CGC
  - Codes of good CG from other countries (Holland and others)

- Structure, Content
  - Contains ten sections that include different subject areas
  - Every section contains principles (15)
  - The principles are followed by a certain number of best practise provisions applicable for the companies (84)

- The public debate will also include the status of the Code:
  - Voluntary acceptance of the Code
  - Mandatory acceptance of the Code - "apply or explain"
  - Combination of the previous two

Other

- Akcioner
- MBLA
- PEP