

**Conference on:
Corporate Governance in Asia: A Comparative Perspective
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The Importance of Corporate Governance in OECD and non-OECD Economies. The Draft OECD Principles

**Opening remarks
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In opening this workshop, I would first of all like to thank the Government of Japan, the Korea Development Institute and the World Bank for co-sponsoring this conference. I also would like to thank the government officials, academics and private sector executives from Asian countries -- both OECD Members and non-Members -- as well as from other OECD countries for coming and for contributing such carefully prepared papers. Your presence and efforts attest to the importance of the issues we are here to consider.

Market-oriented economies of the OECD and the rest of the world are at a watershed, as they rely increasingly on the strength of the private sector in what is rapidly becoming a world market. OECD economies, as well as many others, rely on the corporation as the engine, worldwide, for participation in the global market -- to raise capital, create jobs, earn profits and divide the value-added among those contributing to its success.

The increased role of the private sector in the modern economy is one of the reasons for the increased focus on corporate governance in countries throughout the world. Other reasons include the increased international interdependence of countries and companies, and the new competitive circumstances for companies.

Many of today's fast-growing and highly successful enterprises deviate quite radically from the traditional image of smokestack or bluechip corporations. They are often more human-capital-intensive and highly dependent on intangible assets, such as brand names, patents, strategic alliances and organisational know-how. They may also operate under more flexible contracts with employees, business partners and other constituents.

Interest in corporate governance in OECD countries first arose because investors became increasingly concerned that in companies with dispersed ownership -- particularly characteristic of the United States and the United Kingdom -- management was pursuing objectives other than long-term returns to shareholders, while at the same time, managers were able to raise their own compensation in spite of poor company performance. The concern was especially acute among institutional investors, who account for a growing share of equity ownership in OECD countries.

In continental Europe and Japan, ownership concentration was greater, and yet it became evident to investors that equally serious problems were present in these countries. In particular, controlling shareholders -- often allied with management -- were able to pursue interests other than profitability. The use of off-balance sheet funds and other devices that could shield management from accountability to shareholders were even more prevalent than in the so-called Anglo-Saxon countries.

Despite these concerns, the means available to minority shareholders to influence management often were ineffective, and disclosure requirements for companies often were equally weak. Thus, much of the discussion in OECD countries over the past two decades has focused on the means to align the interests of management with those of the shareholders and to find ways to assure that management will act in the interest of shareholders -- who are, after all, the owners of the company. As companies in markets around the world have increasingly turned to the capital markets for outside funds, they have been obliged to become more attentive to shareholder value.

What is Corporate Governance?

What do we mean when we talk about corporate governance? In a narrow sense, corporate governance involves a set of relationships between a company's management, its board of directors, shareholders, and other stakeholders. These relationships, which involve various rules and incentives, provide the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Key aspects of good corporate governance include the transparency of corporate structures and operations; the accountability of managers and boards to shareholders (including foreign shareholders); and corporate responsibility towards employees, creditors, suppliers, and the local communities where the corporation operates.

In a broader sense, however, good corporate governance -- the extent to which companies are run in an open and honest manner -- is important for overall market confidence, the efficiency of international capital allocation, the renewal of countries' industrial bases, and ultimately nations' overall wealth and welfare. Countries wishing to attract private investment, notably from abroad, are now placing a greater emphasis on the way that corporations are operated and the way that they respond to the needs and demands of investors, wherever those investors may be located. This consideration is particularly important in the effort to attract the more patient, long-term capital that is so crucial for establishing the basis for sustainable growth and job creation.

While the emphasis on good corporate governance is not new, the financial crisis that began in Asia in mid-1997 persuaded policymakers world-wide of the need for better corporate governance standards, with increasing emphasis on the problems of non-OECD countries. The absence of effective monitoring mechanisms may have contributed to the excesses that contributed to the crisis. In particular, prevailing governance mechanisms in Asia and elsewhere often did not encourage management to use resources efficiently. Firms could and often did pursue objectives other than profitability, including conglomeration and the expansion of market share, while at the same time building up excessive debt. In addition, governance systems tended to protect the interests of controlling investors at the expense of minority investors, including foreign investors.

A related problem of corporate governance in Asia was present in banks, which on balance were not capable of engaging in basic credit analysis or of restraining the often unsustainable expansion plans of the corporate sector. While Asian banks were hardly alone in making such misjudgements, shortcomings in corporate governance systems in the banking sector, as well as problems in the prudential supervision of banks, probably impeded the ability of banks in this region to monitor the corporate sector and to be sufficiently aware of the impending crisis. It is important to add, however, that the shortcomings of foreign lenders in the Asian financial crisis, including their failure to monitor performance and to assess the level of risk before extending loans to often highly leveraged companies, also has come in for appropriate criticism.

As a policy matter, corporate governance is largely about establishing a legal and regulatory framework that promotes the emergence of credible and effective governance practices for the benefit of economies and society as a whole. Beyond that, the actual design -- and certainly the implementation -- of particular governance arrangements is best left to the various market participants. Good corporate governance should provide proper mechanisms for monitoring of management by the board and monitoring of the board by shareholders. Effective disclosure and monitoring will encourage management to pursue policies that provide competitive returns to shareholders, thereby encouraging firms to use resources more effectively. This, in turn, will help strengthen the competitive position of the firm.

While the corporate governance framework by itself is an important element affecting the long-term prosperity of companies, it is only part of the larger economic, social and legal environment in which firms operate. On the broadest level, the quality of macroeconomic management and the state of competition in product and factor markets have a powerful impact on firm performance. The state of market competition in turn is influenced by a range of government policies in areas such as trade, investment (both short-term and long-term) and competition policy. The legal system, accounting standards, labour market policies and patterns of equity ownership also have a strong bearing on corporate performance. Finally, business ethics and corporate awareness of the environmental standards and other societal interests of the communities in which they operate -- sometimes called "good corporate citizenship" -- also can have an impact on the reputation and long-term success of a company.

OECD Principles of Corporate Governance

In response to the growing interest in corporate governance in OECD countries, and sparked in particular by the Asian financial crisis, OECD Ministers last year asked the OECD to develop a set of corporate governance principles that could be useful to OECD Members and non-Member countries alike. To fulfil this task, the OECD in June 1998 established an Ad Hoc Task Force on Corporate Governance, which I chair. It includes representatives from all Member governments and key international organisations, including the World Bank; as well as a number of private sector and labour representatives with special expertise in corporate governance. The Task Force has sought maximum transparency in elaborating the Principles through a wide consultative process, which has included many private sector and other non-governmental organisations, as well as representatives of non-Member countries. Some of you in this room today joined us on the occasion of our most recent consultation meeting in January, and we greatly appreciate your contributions. The draft Principles also are available on the OECD Website (<http://www.oecd.org/daf/governance/principles.htm>). Because we wish to take into account a broad spectrum of views, I would urge those of you who are interested to send us your comments either via the Internet or in writing. Following this latest round of comment and consultation, the Task Force will meet again in early April to make its final recommendations to OECD Ministers, who will meet in Paris at the end of May. We hope for and expect approval of the Principles at that meeting.

Let me turn now to the substance of the Principles. At a very early date, the Task Force decided not to attempt to develop a detailed international code of conduct or set of "best practices", which is best left to each country's legislators, regulators and private sector bodies. Instead, the Task Force decided to delineate those basic principles that can serve as a reference point for governments and private sector participants as they evaluate and refine their own legal, institutional, regulatory and company-specific frameworks. The draft Principles build upon the experience of Member and selected non-Member countries, private sector experience, and on previous OECD work in this area.

Although the Principles are primarily aimed at governments, they also will provide guidance for stock exchanges, investors, private corporations and national commissions on corporate governance as they elaborate best practices, listing requirements and codes of conduct. The Principles refer mainly to publicly traded companies, including financial institutions, but the general concepts embodied in them may have some application to small and medium-sized enterprises and to closely-held firms. The Principles will be non-binding and will not give detailed prescriptions for national legislation.

A Preamble to the Principles explains what the Principles are designed to accomplish. We specifically state that there is no single model of good corporate governance; rather, we seek to delineate basic Principles that will be compatible with many systems. We also recognise that corporate governance practices are constantly evolving and improving with time. Thus, the Principles, too, must evolve over time; and they almost certainly will have to be reviewed in the future after some experience has been gained with their practical application. However, with these caveats, we do believe that the draft Principles establish an important benchmark for action by governments and the private sector.

The Principles themselves fall under five broad headings, with each basic Principle supplemented by explanatory annotations. These are:

1) **The rights of shareholders.** The protection of the rights of shareholders and the ability of shareholders to influence the behaviour of the corporation are key pillars of effective corporate governance. Therefore, those rights which shareholders should expect to be able to enjoy in all jurisdictions are specified in the Principles, such as the right to secure ownership and registration of shares, as well as the right to share in the residual profits of the company. The ability to participate in basic decisions concerning the company, chiefly by participation in general shareholder meetings, is set forth as an important right. The Principles call for disclosure of corporate structures and devices that redistribute control over the company in ways that deviate from proportionality to ownership. Another important right of shareholders is that transfers of controlling interest of the company should take place under fair and transparent conditions and that anti-takeover defences not be used to shield management from accountability. Finally, investors are urged to consider using their voting rights. This latter point is a very important, because shareholders -- even large

shareholders -- can have no effective role in shaping major decisions affecting the corporation, if they fail to vote.

2) **The equitable treatment of shareholders.** In many cases, controlling shareholders, boards and management use their control over the corporation and over information to the detriment of non-controlling and foreign investors. This section of the Principles stipulates that board members, management and controlling shareholders should deal fairly with all shareholders. It also states that insider trading and self-dealing should be prohibited. The Principles call for maximum transparency regarding the distribution of voting rights among categories of shareholders and the ways in which voting rights are exercised.

3) **The role of stakeholders.** This Principle states that the corporate governance framework should recognise the legal rights of stakeholders and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises. This issue is more important than the relatively short text devoted to it might suggest. Certainly, we all recognise that one key aspect of corporate governance is ensuring the flow of outside capital to firms. However, a good corporate governance structure also has to be concerned with finding ways to encourage the various stakeholders in the firm to make much-needed investment in human and physical capital. As we point out in the Annotation to this Principle, the competitiveness and ultimate success of a corporation is the result of teamwork that brings contributions from a range of different sources, including not only investors, but employees, creditors, and suppliers as well. It is ultimately in the long-term self-interest of firms to recognise that their employees and other stakeholders constitute a valuable resource for building competitive and profitable companies, whether or not those employees or other stakeholders have a legal place in the corporate governance structure, as they do in some countries.

4) **Disclosure and transparency.** A strong disclosure regime is widely recognised as a central and indispensable element of an effective corporate governance system. The Principles provide that timely and accurate information should be disclosed on all material matters regarding the financial situation, performance, ownership, and governance of the company; and further, that this information should be prepared in accordance with high quality standards. The Principles also call for an annual independent audit, in order to provide an external and objective control on the way in which financial statements have been prepared and presented.

5) **The role of the board.** The board is the main mechanism for monitoring management and providing strategic guidance. OECD countries have a number of different board structures; and nuances can be found in the relative weight that the board should place on monitoring the conduct of management versus that of providing a broader strategic vision for the corporation. Nevertheless, the accountability of the board to the company and its shareholders is a basic tenet of sound corporate governance everywhere. The Principles make it clear that it is the duty of the board to act fairly with respect to all groups of shareholders, to deal fairly with stakeholders and to assure compliance with applicable laws. Among the responsibilities of boards are: reviewing corporate strategy and planning; overseeing management (including remuneration); managing potential conflicts of interest; and assuring the integrity of accounting, reporting and communication systems. The Principles also stress the need for board members being able to exercise objective judgement on corporate affairs, independent of management.

Next Steps

That provides a brief description of the draft Principles as they have evolved to date, as well as the process and timetable we will follow to develop a final product to be submitted to Ministers in May. But what are the steps we hope to take after our May Ministerial meeting? While our Ministers will have the final say on the work we do in the future, let me outline our own thinking to date on this important question. Concerning the implementation of the Principles, it is clear that our work must involve intensive collaboration with non-Member countries from the very start. Thus, we foresee an ongoing policy dialogue between OECD countries and non-Member countries, in co-operation with other international organisations -- including those represented at this conference. In this connection, I would like to particularly note the World Bank, with which we already have developed a close and complementary relationship.

The meeting we are holding today is only the beginning of a process that we hope will continue. The OECD Principles could be just one part of a wider dialogue on various aspects of corporate governance, in workshops or conferences that could be organised on a regional basis or possibly in some other ways. We are very open-minded as to the ways in which further dialogue with countries beyond the OECD membership might proceed. Whatever form this co-operation may take, strengthening the corporate governance framework in countries around the world is now recognised as one key element in laying a strong foundation for the resumption of economic growth in Asia and elsewhere and for a more stable international economic system. We greatly look forward to working with you and others who are not able to be with us today on this very important issue.