Corporate Governance Innovation and value Creation, Istanbul 1 February 2012-02-08

Mats Isaksson, OECD, Opening Comments

Ladies and Gentlemen,

This meeting is a good reminder, that all those corporate governance rules, practices and regulations that we talk about are *not goals in themselves*. Be it minority rights, mandatory bid rules or the demand for independent directors -- the rules are there to serve a purpose. And it is against this purpose or these objectives the quality of any rules and corporate governance system should be evaluated. In order to get it right, we need a frame of mind – an analytical benchmark if you want – which we can use whenever we contemplate new regulation or when we evaluate the efficiency of existing rules.

And from an economic perspective there are 3 core criteria to which we can always return:

First of all, the rules shall make sure that new business opportunities get *access to capital.* It should be credible enough to make investors take money out of their mattresses and invest in equity. But it must also encourage company founders and entrepreneurs to expand their businesses by open up to external investors. Because, just like investors may keep their money in the mattress – founders and entrepreneurs may hesitate to take their companies to the public market and rather keep their businesses in the garage. It takes two to tango and the corporate governance framework must be attractive for both parties. Both investors and companies.

The second criteria is that the corporate governance rules shall ensure that capital is *efficiently allocated* among corporations. That is to say that the rules shall reward investors who *contribute to new information and knowledge to society* and they should *discourage rent-seeking*.

And finally; a good corporate governance system shall reward *competent monitoring* of corporate operations. Something that requires both long-term commitment and talent.

When you frame the public policy objective of corporate governance this way, it becomes very clear that the quality of corporate governance rules and regulations affects every aspect and step of a country's investment process:

- In the first stage it is about access to capital.
- At the second stage it is the key function of efficient allocation.
- And at the third stage it is about competent monitoring.

And it is this key role in the investment process that constitutes the strong link between the quality of corporate governance, innovation and economic growth. Because there is nothing more important for economic growth than the quantity and quality of investments.

Moreover, this approach illustrates very well that from a public policy perspective, corporate governance can never be seen as a static zero-sum game, The main objective is *not to* regulate how different parties should split a set of *given* assets or a given *result*. That is for lawyers to fight about. From an economic perspective, the prime focus is to provide a regulatory framework that promotes the dynamic process of value creation and growth itself.

This dynamic and growth oriented way of thinking about corporate governance is well reflected in the 3 sessions of today's seminar.

The first session will address the process of value creation within the corporation and discuss how this process may be influenced by different financial and contractual structures. Importantly it will also analyse the merits of contractual freedom and the balance between strictly mandatory rules and a more enabling corporate governance system. In this discussion it is important to always keep in mind that both capital markets and corporate structures constantly are evolving. And what is an efficient corporate governance rule at a certain point in time may no longer be efficient when circumstances in capital markets or corporate structures have change. Such outdated rules may even be counterproductive.

One obvious example is the somewhat outdated way that we traditionally look at shareholders and companies. In essence, most company law stands on the assumption that shareholders and companies look like they did 150 years ago when much of the modern company law came into place: Direct owners of fixed assets. But we obviously know that this is not today's reality. For example, today most shareholders are institutional investors managing other people's money for a profit. High frequency trading dominates many markets and increasingly equity investments are made through electronically traded funds. We also have growing private pools of capital that constitute a viable alternative to public listings. As for corporations and their structures, the traditional concept of a corporation with fixed and "captured" assets is only part – and perhaps shrinking part of the story. With an increase in intellectual assets, stronger dependence on organisational know how, strategic alliances, etc. The boundaries of the corporation are becoming less clear. What is it that the owners actually own. And how can they contract to control and get a return on these assets?

In the second session we will focus more closely on the role owners. And in particular controlling owners that hold large stakes in individual companies that they actively monitor: And sometimes at considerable costs.

Here, we must keep in mind that in the very early works on corporate governance by Berle and Means, controlling owners were seen as something like the ultimate solution to the corporate governance problem. But this is a section in their book that is seldom – if ever - quoted. And don't' ask me why. Because, if we look around the world today, companies with controlling owners is the rule rather than the exception. And some of them are both large and very successful. So it is obvious that the shaping of corporate governance rules and regulations need to take the incentives and dynamic contributions of controlling owners into account. And I am glad that we have some of the best practitioners and scholars to discuss this issue.

Last but not least, a growth oriented approach to corporate governance obviously takes us to the emerging markets with their often unique corporate structures and saving patterns.

Here we need to be aware, that demographic trends, regulatory changes and the ongoing global shift in wealth are pointing towards a future shortage of equity capital in emerging markets. In a recent report, the McKinsey Global Institute estimates this "*equity gap*" in emerging markets to reach no less than $10 trillion in 2020: a deficit that amounts to almost the entire market value of all companies currently listed on the New York Stock Exchange.

Such a shortfall of equity will have severe consequences. Not only for individual companies but also for the emerging economies at large. If it happens, it will impose severe constraints on all those entrepreneurs and companies in emerging markets that in the coming decade will need external capital for their ability to innovate and expand. And as a consequence, these economies will experience less innovation, lower growth and fewer well paid jobs. Moreover, foreign portfolio investors will miss important investment opportunities that will help even out demographic and growth imbalances between countries and regions.

How to avoid this will be discussed in the last session. It will address the particular needs of businesses in emerging markets and how companies that are often semi-informal and privately held can gain from adopting a more institutional structure without losing their entrepreneurial spirit and flexibility.

This may not be the corporate governance speech you are used to hear. And it wasn't meant to be. Because this is not the corporate governance conference that you are used to attend.

This is an exploratory future looking meeting where we want new facts and ideas on the table. We should not pretend we have the final answers. But more importantly, I am pretty sure that we will be able to ask the right questions. It should be seen as an opportunity to exchange new ideas and past experiences. By doing this, you will provide extremely important input to the content and the direction of OECD's future work in this area. And for that, I want to thank you all in advance. And I look forward to a very productive discussion.