

Eurasian Roundtable on Corporate Governance

Kiev, 19-20 October 2000

NOTE TO THE AGENDA

Objectives

Good corporate governance practices have become an essential prerequisite for companies to attract and retain the financial resources needed for sustainable growth. Recent emerging market crises have highlighted the importance of good corporate governance not only for individual companies but also for the economy as a whole. Against this background, the OECD has developed Corporate Governance Principles, endorsed by the OECD Ministers in May 1999. These Principles have quickly gained international acceptance. The Financial Stability Forum has notably included them among the key international standards that all countries should follow. Promoting the use of internationally accepted corporate governance principles has thus become a key priority worldwide.

In increasingly global capital markets, such efforts will greatly benefit from a qualified international dialogue. The OECD and the World Bank Group have therefore agreed to co-operate in efforts to improve corporate governance in emerging and transition economies. One important outcome of this agreement is the establishment of Regional Corporate Governance Roundtables, in which the OECD has taken the lead, in co-operation with the World Bank Group and with the support of regional partners and other international organisations. The overarching objective of this activity is to encourage good corporate governance in those countries through an international policy dialogue involving both the public and private sectors, using the OECD Principles as a conceptual framework.

Regional Roundtables have been created in Asia, Latin America and Russia, and, in response to the increasing interest in better corporate governance in Eurasian countries, it has been decided to establish a new Roundtable in the Eurasian region. In order to facilitate full Eurasian access to the ongoing international dialogue on corporate governance, the first Eurasian corporate governance meeting will be held in Kiev with the financial support of the US Agency for International Development, the Japanese Government, the World Bank-OECD Global Corporate Governance Forum, the International Finance Corporation and the Canadian International Development Agency.

The main objectives of the Eurasian corporate governance roundtable will be to:

- Create a forum for policy-makers and private sector decision makers to exchange views and experience in improving corporate governance in the region;
- Invite experts from the OECD countries and international organisations to provide advice on the steps to promote good corporate governance practices in the Eurasian countries; and thereby
- Serve as a central vehicle in the process of identifying, in Eurasian countries, key areas for improvement both in the regulatory domain and in private practice.

Invited Eurasian countries include Ukraine, Moldova, Kazakhstan, Uzbekistan, Kyrgyzstan, Georgia and Mongolia. While these countries are at different stages of economic development, they all share the same past, and are going through an often difficult transition period, but are currently undertaking steps to reform their corporate governance regimes and their legal and institutional framework in order to support long-term economic growth.

Structure of the meeting

The Kiev Roundtable meeting will survey the corporate governance practices in the Eurasian region and identify the most relevant issues with a view towards setting the stage for future in-depth meetings. The meeting is divided into three broad areas plus a concluding session. The first session will address, both from a public and private perspective, the issues and policy implications of corporate governance and their relevance to transition countries.

The second session will provide an empirical overview of the current Eurasian corporate ownership landscape. The next three sessions will be devoted to discussing the major pillars of the corporate governance framework in the Eurasian context, using the OECD Principles as a benchmark.

Throughout the meeting there will be special attention placed on the host country, Ukraine. Nonetheless, given the regional nature of the Roundtable, other Eurasian countries are invited to participate actively.

Procedure of the meeting

After a brief introduction by the chairperson, each session will include one or more 15 minute presentations, followed by 10 minute commentaries by each designated discussant. The floor will then be opened to general discussion, in which all participants are encouraged to take part. One of the objectives of the Roundtable is to create an open and active dialogue in a collegial atmosphere between the public and the private sector, as well as between Eurasian countries and the international community.

Corporate governance and its relevance to Eurasian transition countries

Session 1

The first session will provide an overview of the basic corporate governance mechanisms in OECD countries, together with their legal and regulatory underpinnings. It will also highlight recent developments in the international corporate governance debate and highlight relevance to transition countries.

Part 1: Corporate governance from a policy perspective

Part 1 will discuss the importance of corporate governance from a policy perspective. In the past, corporate governance was primarily viewed as a private sector matter, in order for companies to achieve maximum competitiveness. However, in OECD economies, building good corporate governance has been an integral part of developing a sound private sector basis for general economic growth. Policymakers and regulators play an important role in shaping corporate governance practices as they design the legal and regulatory framework in which individual companies establish their practices. While OECD countries and companies exhibit certain differences, notably regarding the degree of ownership concentration, they tend to share fundamental characteristics in the governance of their enterprises.

Furthermore, the institutionalisation and internationalisation of equity ownership provides new investment opportunities and better access to capital for companies. However, for countries to reap the full benefits of these opportunities, governance arrangements must be credible and well-understood across borders. In order to develop a well-functioning market economy, it is indispensable to establish effective corporate governance mechanisms, starting from introducing the basic legislation for corporations such as the Company Law.

These efforts are not an end in themselves: they are part of a more far-reaching objective to support the efficient use of resources and the facilitation of investment. This is especially relevant for Eurasian countries, which need to establish a framework for the swift growth of an efficient corporate sector in order to address inherent institutional weaknesses and increase long term investment from both domestic and foreign sources.

Key issues for discussion:

- Why should policymakers and regulators pay attention to corporate governance in the economy? In general, what is their role in promoting better corporate governance practices?
- What are the principal instruments that governments can use in their efforts to promote better corporate governance practices? In the experience of the OECD countries, what were the most important legal and regulatory cornerstones for developing good (or bad) corporate governance practices? What is the role of the OECD Principles in promoting better corporate governance?
- How relevant are the OECD Corporate Governance Principles to the Eurasian countries? Are the Principles applicable to these countries as a benchmark for good corporate governance as they are? How can Eurasian governments promote better corporate governance practices?

Part 2: Corporate governance from a private sector perspective

While policymakers and regulators should establish an adequate legal and regulatory framework, it is the business community that should actually develop effective corporate governance practices. In a broad sense, the function of corporate governance is to co-ordinate the various interests of different constituencies related to a corporation. Better co-ordination contributes to strengthening the competitiveness of the corporation, leading to its business success.

The aim of the second part of this session is to understand investors' expectations and concerns regarding corporate practices in enterprises, and to what extent the interaction between the public and private sectors is important in developing sound corporate governance practices. This is especially important for Eurasian countries: the corporate sector has little experience in operating within a market mechanism and weak corporate governance has emerged as a serious obstacle to domestic and foreign investment in all Eurasian economies.

Key issues for discussion:

- Why is good corporate governance important from the perspective of individual companies? How relevant is this in the Eurasian context? What are the incentives for Eurasian enterprises to enforce good corporate practices: low level of foreign and domestic investments, non-liquidity in inter-firm transactions, increase of company value, etc.?
- How important is good corporate governance from the investor's perspective? What are the main efforts undertaken by the private sector to improve corporate governance? What are the implications of the rapid integration of financial markets on corporate governance, particularly of the Eurasian companies?

Corporate governance: the Eurasian landscape

Session II

Reflecting different social, political, economic and legal heritage, the corporate governance patterns vary among countries. Session II will provide an empirical overview of the Eurasian corporate governance landscape for an effective dialogue towards better practices in the Eurasian countries. Governance practices correspond to a given environment. There is no one-fits-all solution. Each economy should find its own fittings, though there are some basic prerequisites for good practices.

Part 1: Corporate ownership structure

Radical shifts in corporate ownership and control structures since reforms started in the Eurasian region have resulted in significant changes in the way companies and their management view their shareholders, set their objectives and prospects for the future. Differences in ownership structure in Eurasian countries have developed from diverse approaches to privatisation. In diverse Eurasian countries the privatisation process is at a very different stage of progress. While Ukraine is trying to shift to exclusively cash-based sales, after years of voucher privatisation, other countries have already introduced tender privatisation. As a result, corporate ownership is still dispersed in Ukraine, while more concentrated in countries where the privatisation method of trade sale led to significant ownership by strategic investors. In most countries, rapid changes in ownership structure have followed the first stage of privatisation, although, many large-scale companies are still to be privatised.

Managers have, at the first stage of privatisation, often acquired ownership of their companies through mass privatisation programmes that required little cash payments but good connections and buy-out techniques.

The first part of the second session will therefore examine the main characteristics of Eurasian corporate ownership and control structures through selected country specific presentations.

Key issues for discussion:

- What are the main characteristics of corporate ownership and control structures in Eurasian countries? What are the determining factors that shape these characteristics? What is the ownership and control situation in large companies? What impact does ownership structure have on the governance of an enterprise? What measures can be taken to minimise inefficiency of different ownership structures?
- How important is foreign shareholding? Do foreign investors tend to acquire the majority or to remain minority shareholders? What are the roles of foreign shareholders in corporate governance practices in the Eurasian countries?
- Are there any changes taking place in the ownership patterns of the Eurasian countries? If so, why and how are such changes taking place? What are the incentives for these changes?

Part 2: Particularities of the Eurasian corporate environment

Part 2 will analyse some particularities of the Eurasian economic environment, and their implications on corporate behaviour and governance. In particular, problems related to weak financial discipline and to the restructuring of the Soviet heritage distort the corporate governance patterns in the Eurasian countries.

State enterprises have traditionally provided many social services to employees, which diverted them from their core activities, raised their costs and kept them from being competitive. How to deal with these social assets is a major problem in post privatisation restructuring. Workers who are described as employed but are actually on unpaid administrative leave remain in order to retain access to social infrastructures provided by the enterprise. Although it would reduce the costs and the administrative burden of the company, divestiture of social assets is frequently postponed or blocked. Large, mostly insolvent, companies providing social services use these facilities as bargaining power to delay bankruptcy procedures and gain new subsidies. Moreover, managers use the hidden unemployment within their companies to enforce their insider control over the company's assets. Control over company assets often takes priority over the effective attraction of new investment.

Most enterprises are also known to run up arrears by not paying taxes or suppliers and inter-enterprise indebtedness remains substantial in all Eurasian countries, whether the companies are healthy or not. This is a heritage from the Communist period, when payments to other enterprises or tax authorities were made only on a book basis and did not accompany real cash transfer. Naturally, credit relationship between companies becomes complicated and they tend to be heavily indebted. Many companies in Eurasia are technically insolvent but not closed, partly due to lack of effective bankruptcy. Addressing weak financial discipline remains a major policy challenge in a region where it is still considered better to be a debtor than a creditor. In order to avoid paying heavy taxes, controlling managers are known, often against the interests of shareholders and other stakeholders, to divert cash flows for personal gain instead of maximising company value.

Key issues for discussion:

- Do large companies in the Eurasian countries still carry out various social functions for employees and the communities? If so, why do they do so? How do these functions affect corporate governance practices in the countries?

- In what way does low payment/financial discipline affect corporate governance practices? What measures have been taken to address this problem? How are heavily indebted companies dealt with? What are the implications on corporate governance?

Corporate governance: the Eurasian framework

Session III

Shareholder rights and investor confidence

Shareholders are legally owners of a corporation and providers of capital. When a company is developing, the introduction of external capital is often of significant necessity. However, investors will not provide capital to the company that does not conduct good corporate governance practices. Good corporate governance is, therefore, an important requirement for the development of companies.

In return for the risk they assume as residual owners, shareholders are entitled to certain basic rights. These include rights to secure ownership, transfer shares, shares in residual profits and participation in important corporate decisions. If the exercise of these rights is not assured, investor confidence would be rapidly lost and the development of equity markets would be more difficult and thus could create difficulties for companies in raising capital. This is why proper protection of shareholder rights is a central policy concern in attracting investment to the corporate sector for its development.

Proper protection of shareholder rights requires first, an adequate legal framework, and second, its effective enforcement. In Eurasian countries, however, both requirements are often not satisfied: corporate laws do not establish sufficient legal rights for shareholders, and even when they do, enforcement mechanisms and remedies against violations of shareholder rights are inadequate or even non-existent.

This session will identify the basic shareholder rights that and the necessary prerequisites for their enforcement and protection. Attention should be given to the protection of minority shareholders, which has direct impacts on the capital market development and foreign investment promotion. In this context, the role of the state will also be examined, as in many Eurasian countries the state still retains a significant portion of shares particularly for large, strategic companies.

Key issues for discussion:

- What are the important rights that shareholders are entitled to? Are they legally established in the Eurasian countries? Are they properly enforced?
- Are different shareholders treated equitably in the Eurasian? How should minority shareholders be protected? What are the legal and regulatory cornerstones in this regard? Are there effective regulations on related-party transactions and self-dealing?
- To what extent are capital markets seen as a mean to enforce good corporate practices in Eurasia? What roles should stock exchanges and securities commissions play in strengthening the protection of shareholder rights?
- What are the remedies available to shareholders against the violation of their rights? What have been the main issues faced by courts related to shareholder protection? How is implementation of judicial decisions being enforced? Are alternative dispute settlement mechanisms used?

Session IV

Transparency and disclosure

Transparency and disclosure are pivotal issues for corporate governance. Corporate governance is a mechanism of interactions between corporate insiders and outsiders, and when the latter cannot conduct themselves appropriately without sufficient information on affairs of the company, the mechanism will not function properly. Moreover, lack of sufficient disclosure is perceived as an increased risk by outside investors and therefore leads either or both to increase capital costs for a company and to reduce investment in it. In contrast, the enforcement of effective disclosure will make corporate insiders more exposed to external pressure and thereby enhance the effectiveness of corporate governance mechanism on one hand, and strengthen investor confidence and develop capital markets on the other hand.

Disclosure can be a powerful tool for influencing the behaviour both of companies and investors. Shareholders and potential investors require access to regular, reliable and comparable information in sufficient detail for them to make informed decisions about the acquisition, ownership and sale of shares. It also helps to improve public understanding of the structure, activities and policies of enterprises.

At the heart of a disclosure regime is proper accounting and auditing. Efforts are being made in the Eurasian region to bring accounting and audit standards in line with international standards but in many cases auditors are still directly or indirectly dependent on management. Difficulties generally remain to embrace international reporting standards. Managers are frequently concerned about the possible tax implications of restating their accounts under a new system.

Non-financial disclosure in corporate groups is particularly relevant to understand ownership and control arrangements. Management, often in alliance with controlling shareholders, has superior access to information and can manipulate the decision making process of the company to the disadvantage of minority shareholders. The lack of transparency and non-financial disclosure deters especially foreign investors.

Eurasian stock exchanges tend to promote good governance practices and have taken the lead in introducing international standards and practices, both in terms of regulation and enforcement. They are taking an active role in promoting disclosure by introducing more stringent trading rules. However, their influence is still limited as the markets are still in their infancy.

This session will articulate the importance of transparency and disclosure for good corporate governance, and identify the major areas for improvement in the Eurasian countries. It will also discuss practical steps towards better disclosure practices in the region.

Key issues for discussion:

- Is the level and quality of disclosure satisfactory in the Eurasian countries? What are the key elements for disclosure, other than the basic items in financial statements? To what degree do the existing disclosure channels provide users with timely, accurate and relevant information? What areas require improvement, especially from the perspective of foreign investors?

- Is the management of Eurasian companies generally reluctant to disclose information? If so, what would be the main reasons? How could good disclosure practices be promoted? What are the stringent sanctions attached to misleading or inaccurate reporting?
- Are the current accounting and audit standards in the Eurasian countries comparable to the internationally accepted ones? To what extent are they effectively implemented? How is the level of auditing in these countries? What are the major challenges for the improvement of accounting and auditing practices?

Session V

Responsibilities of the boards and the role of stakeholders

The board of directors is a key constituent in any corporate governance mechanism. It decides the strategic direction of the company and monitors the affairs of executive management. Members of the board are appointed by shareholders and are accountable to them. In carrying out its tasks, the board is expected to act in the best interest of all shareholders, while balancing various competing interests in the company and ensuring fair treatment of shareholders and stakeholders. Depending upon the legal framework, actual board structure varies among OECD countries, and also among the Eurasian states. It is important that the role and responsibility of the board is clearly defined and understood, which is not always the case in Eurasia. Although potential investors are concerned about vesting sufficient powers in the boards, the general understanding of the functions of the board is slow. Management is often unwilling to recognise the body which supervises its activities and many established joint stock companies do not have operating boards of directors.

The competitiveness and ultimate success of any business corporation depend on the contributions from a wide range of constituencies, such as capital providers, employees, suppliers, customers and the communities in which the corporation operates, in addition to the management. It is therefore in the benefit of the company to acknowledge the contributions of different stakeholders and to take their interests into account in running the business. Corporate governance is concerned with finding ways to encourage the various stakeholders to undertake socially efficient levels of investment in human and physical capital. It is important that the corporate governance framework recognise that the interests of the corporation are served by recognising the interests of stakeholders and their contribution to the long-term success of the corporation. However, their interests differ significantly, given the diverse natures of stakeholders and different legal environments. In Eurasia, employees, who have reportedly been inactive in decision-making, despite often holding large stakes, are generally not taken into account by boards whether as shareholders or stakeholders.

This session will discuss the responsibility and accountability of the board to the company and shareholders, and will examine the legal framework and practical functions of the boards in the Eurasian countries. The session will also address the role of stakeholders in the governance process, the potential merits for their involvement, especially in the Eurasian context, and the possible mechanism to achieve this.

Key issues for discussion:

- What are the basic tasks of the board of directors? What are the main responsibilities of the board and of its members? Are these issues clearly defined in the Eurasian legislation? Is there any gap between the legal norms and the real practices?

- How can the monitoring role of the board be conducted effectively? To what extent are the boards of the Eurasian companies independent from the management? To what extent are the boards independent from controlling shareholders in Eurasia? How do the boards balance the interest of minority shareholders against those of controlling ones? What is the role of the state in appointing boards? Have changes in corporate ownership resulted in changes in the way boards operate?
- Who are the major stakeholders in the Eurasian corporate governance context? What are their roles in the corporate governance practice? How are they involved in the corporate governance mechanism? How could their contributions to corporate development be optimised?

Concluding session

Shaping the future of corporate governance in Eurasia

This session will review the main findings in the proceeding sessions and discuss the future work of the Eurasian Corporate Governance Roundtable.