

DCO-ZH393-20040200-amPP1

The Value and Challenges of Good Corporate Governance

OECD-World Bank Eurasian Corporate Governance Roundtable

Kyiv, Ukraine
May 2004

McKinsey & Company

CORPORATE GOVERNANCE REFORM IS A WORLDWIDE PHENOMENON

Corporate governance codes during the last decade

Date code published (latest code)

<p>Pre-1997</p> <ul style="list-style-type: none"> • Australia (2002) • Canada (2004) • France (2002) • Ireland (1999) • New Zealand (2000) • South Africa (2002) • Spain (2003) • Sweden (2001) • UK (2003) • US (2003) 	<p>1997</p> <ul style="list-style-type: none"> • Finland (2000) • Japan (2001) • Kyrgyz Republic • Netherlands (2003) • Sri Lanka • Thailand 	<p>1998</p> <ul style="list-style-type: none"> • Belgium (2000) • Greece (2001) • Germany (2003) • India (2003) 	<p>1999</p> <ul style="list-style-type: none"> • Brazil (2002) • China, Hong Kong (2001) • Italy (2002) • Kenya (2000) • Malaysia • Mexico • Portugal • South Korea 	<p>2000</p> <ul style="list-style-type: none"> • Denmark (2001) • Indonesia (2001) • Philippines (2002) • Romania (2002) • Singapore (2001) 	<p>2001</p> <ul style="list-style-type: none"> • Argentina • China, mainland • Czech Republic • Malta • Peru (2002) 	<p>2002</p> <ul style="list-style-type: none"> • Austria • Chile • Colombia • Pakistan • Poland • Russia • Slovakia • Switzerland 	<p>2003/2004</p> <ul style="list-style-type: none"> • Bangladesh • Cyprus • Mauritius • Oman • Turkey • Ukraine
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SCOPE OF REMARKS

- ▶ • Value of corporate governance to investors
- Progress in emerging markets
- Challenges facing emerging markets

KEY MESSAGES

- Investors are willing to pay a premium for a well-governed company, particularly in emerging markets
- Governance is now an established investment criterion
- Investors perceive corporate governance risks at three levels

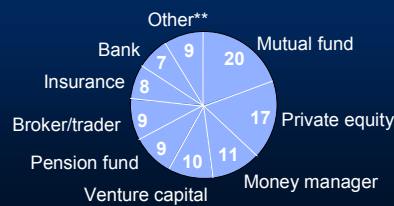
INVESTOR OPINION SURVEY DETAILS

Percent of respondents

Global Investor Opinion Survey, 2002

- 201 responses from professional* investors from institutions with an estimated USD 9 trillion assets under management (approximately USD 2 trillion AuM directly under their control)
- Covers 31 countries in Asia, Europe, Latin America, Middle East, Africa, and North America
- Undertaken in April/May 2002 in cooperation with the Global Corporate Governance Forum, using a questionnaire-based survey

Type of investor



* Addressed to key investment decision-maker, e.g., CEO, CFO, Fund Manager

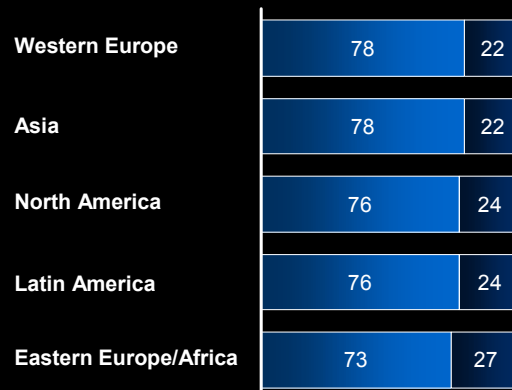
** Includes investment bank with asset management activities, family offices, holding companies

Source: McKinsey Global Investor and Emerging Market Policymaker Opinion Surveys on Corporate Governance, 2002

A SIGNIFICANT MAJORITY OF INVESTORS SAY THEY ARE WILLING TO PAY A PREMIUM FOR A WELL-GOVERNED COMPANY

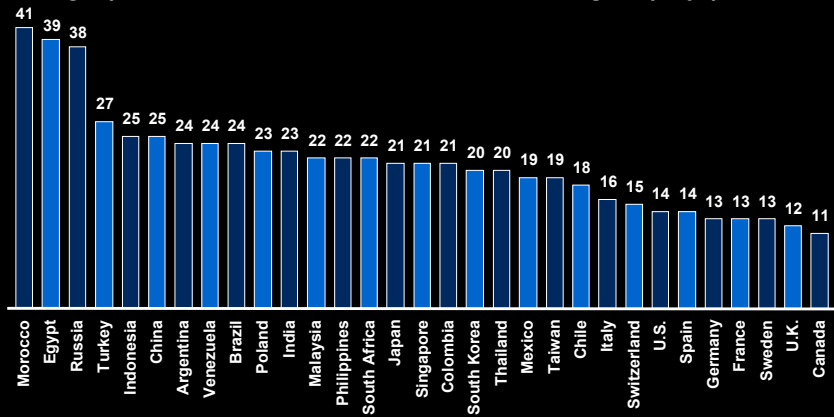
Yes
No

% of investors



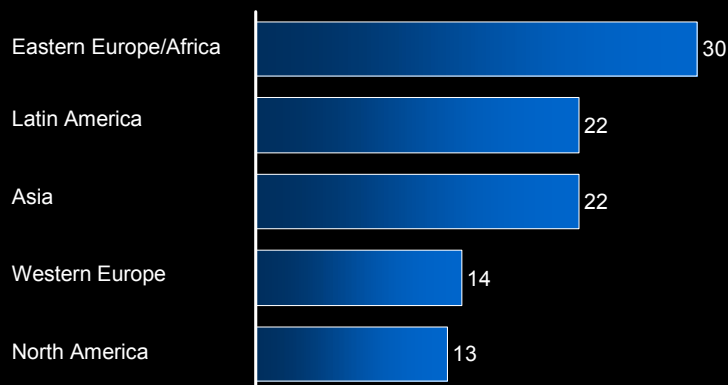
PREMIUM INVESTORS WOULD PAY FOR A WELL-GOVERNED COMPANY VARIES BY COUNTRY

Average premiums of those investors willing to pay premium



THE PREMIUM INVESTORS WOULD PAY FOR A WELL GOVERNED COMPANY VARIES BY REGION

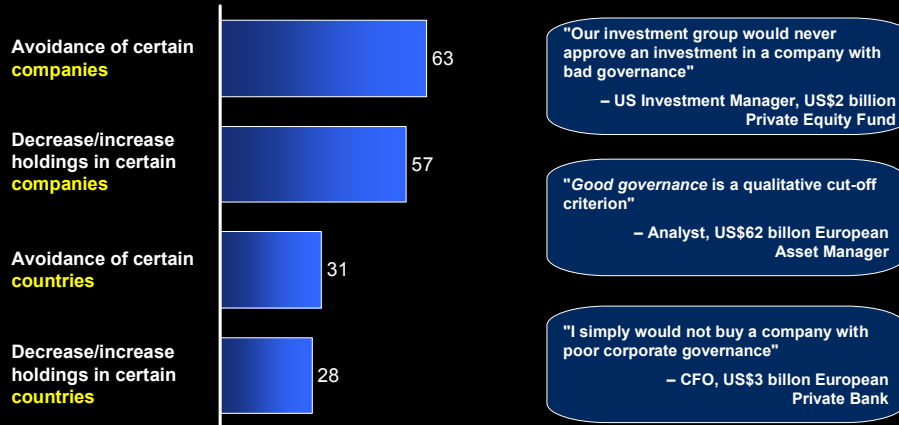
Premium in 2002



CORPORATE GOVERNANCE IS NOW AN ESTABLISHED INVESTMENT CRITERION

How does corporate governance affect your investment decision?

% of investors selecting this option; multiple responses possible

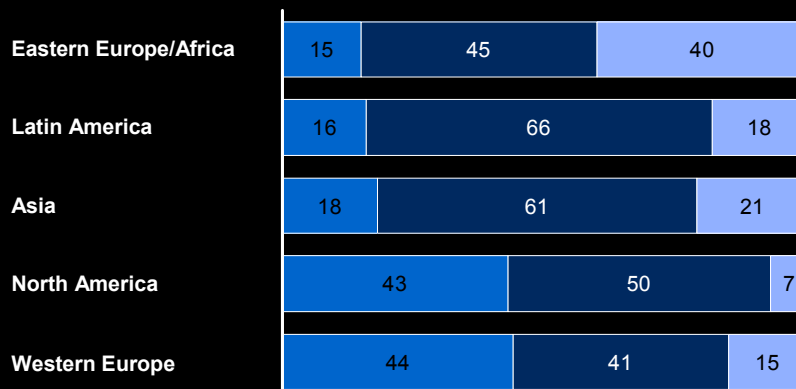


GOVERNANCE OFTEN AS IMPORTANT AS FINANCIALS, PARTICULARLY IN EMERGING MARKETS

■ Less important
■ Equally important
■ More important

How important is corporate governance relative to financial issues – e.g., profit performance and growth potential – in evaluating the companies in which you invest?

% of investors, 2002



INVESTORS IDENTIFY ISSUES AT THREE LEVELS THAT IMPACT ON THEIR INVESTMENT DECISIONS

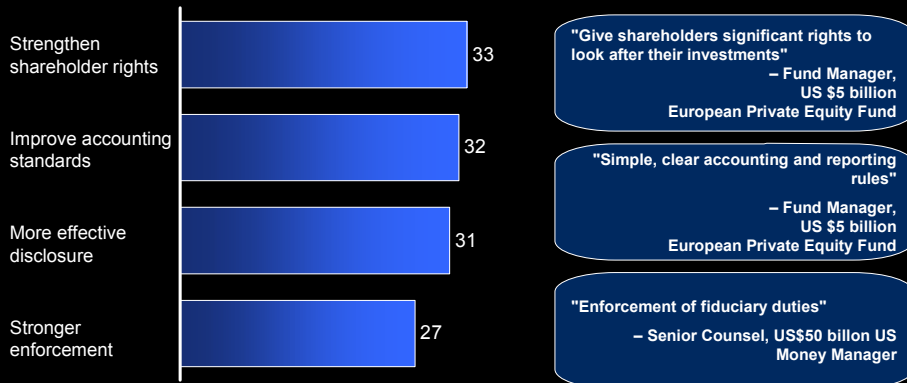
% of investors who think that factor is very important for investment decision; top ten factors listed



INVESTORS IDENTIFY GOVERNANCE PRIORITIES FOR POLICYMAKERS

What are the top reform priorities for policymakers?
% of investors listing change; Top 4 listed

Investors selecting this option; multiple responses possible



SCOPE OF REMARKS

- Value of corporate governance to investors
- • **Progress in emerging markets**
- Challenges facing emerging markets

POLICYMAKER OPINION SURVEY DETAILS

Percent of respondents

Emerging Market Policymaker Opinion Survey, 2002

- 44 responses from leading policymakers and academics
- Covers 20 countries in Asia, Eastern Europe, and Latin America
- Undertaken in April/May 2002, using a questionnaire-based survey

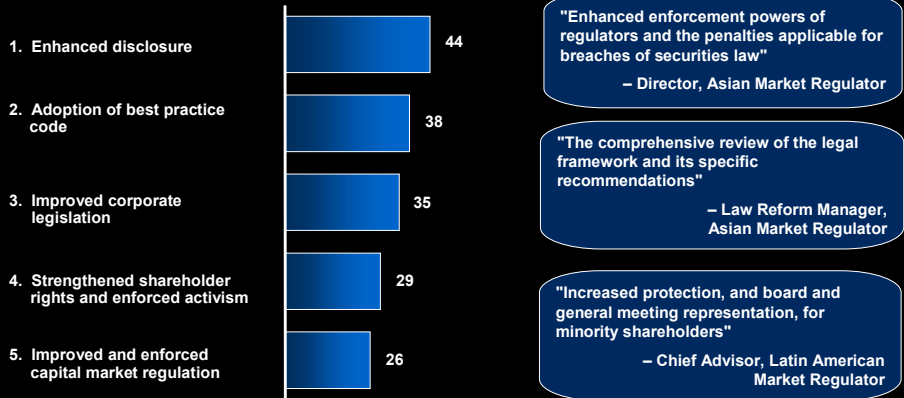
Type of policymaker



Source: McKinsey Global Investor and Emerging Market Policymaker Opinion Surveys on Corporate Governance, 2002

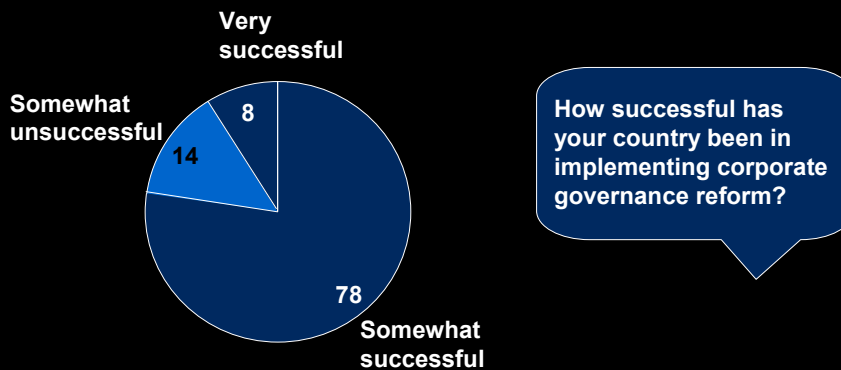
POLICYMAKERS HIGHLIGHT SIGNIFICANT CORPORATE GOVERNANCE CHANGES IN RECENT YEARS

% of respondents; Top 5 changes



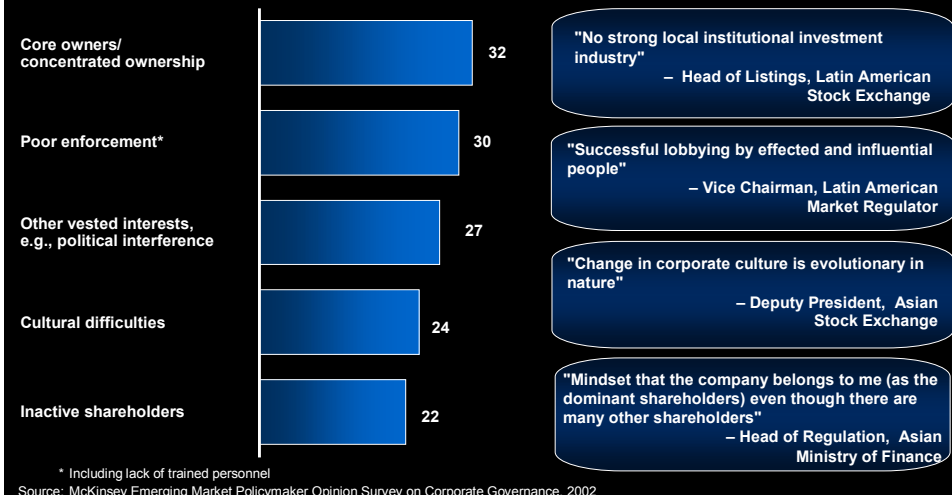
POLICYMAKERS BELIEVE IMPLEMENTATION HAS BEEN RELATIVELY SUCCESSFUL, BUT WITH ROOM FOR IMPROVEMENT

% of respondents



POLICYMAKERS IDENTIFY SIGNIFICANT BARRIERS TO FUTURE CORPORATE GOVERNANCE SUCCESS

% of respondents



* Including lack of trained personnel
Source: McKinsey Emerging Market Policymaker Opinion Survey on Corporate Governance, 2002

EXAMPLE: RUSSIA



Progress in some areas

- Strengthened protection to minority shareholders under revised Law on Joint Stock Companies
- New code of corporate governance
- Asset stripping less pervasive
- Some progressive companies adopting international best practice

... but

- Weak equity culture
- Infringement of shareholder rights still common
- Poor enforcement of laws and regulations
 - Lack of financial and human resources
 - Corruption
 - Inefficient judiciary
- Accounting standards do not fully conform to IAS

EXAMPLE: THE ASIA REGION

Many reforms since 1997–1998

- Government led initiatives
 - Enhanced authority for regulators
 - Strengthened board independence
 - Improved disclosure standards
 - Stopping auditing/consulting linkage
- Private sector activities
 - Thailand: Institutional Investor Alliance
 - Singapore: Securities Investors Association
 - Individual companies: Infosys and others

... but

- Compliance with letter not spirit of law
- Focus on structure/process; less attention paid to changing behaviour
- Enforcement lagging
- Shareholders sell rather than challenge
- Lack of qualified professionals
- Uneven progress across the region

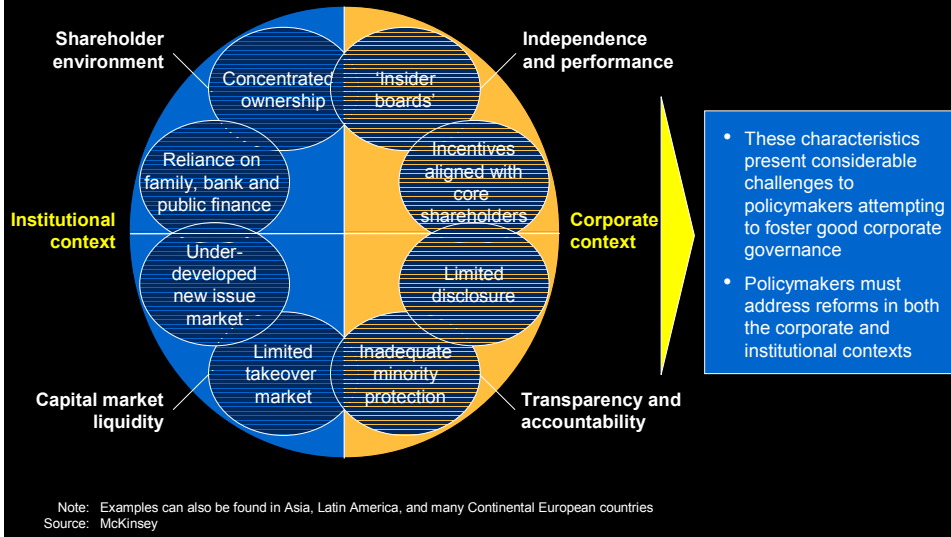
SCOPE OF REMARKS

- Value of corporate governance to investors
- Progress in emerging markets

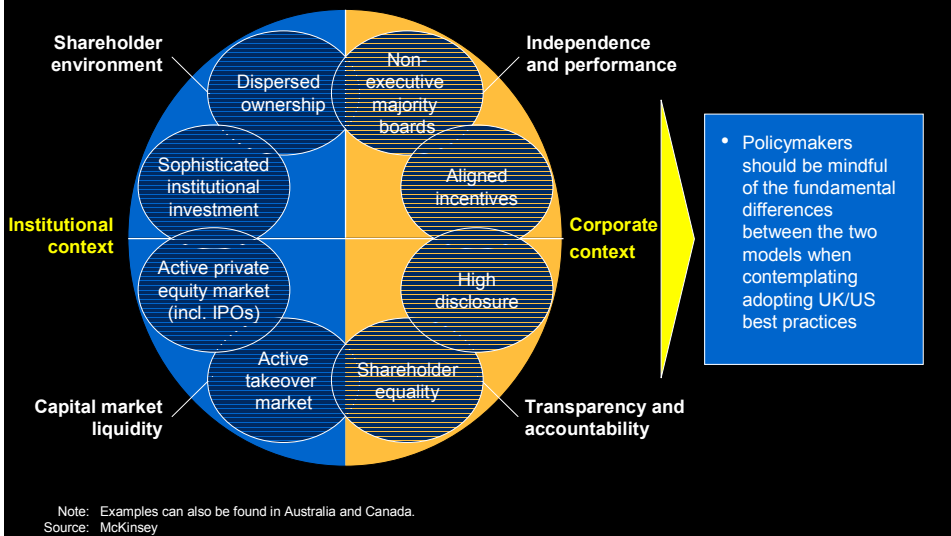


- **Challenges facing emerging markets**

CONTROL MODEL GOVERNANCE CHAIN PREVALENT IN MOST EMERGING MARKETS



CONTROL MODEL GOVERNANCE CONTRASTS SHARPLY WITH UK/US MARKET MODEL GOVERNANCE



KEY CHALLENGE IN MANY EMERGING MARKETS IS BUILDING EFFECTIVE SUPPORTING INFRASTRUCTURE

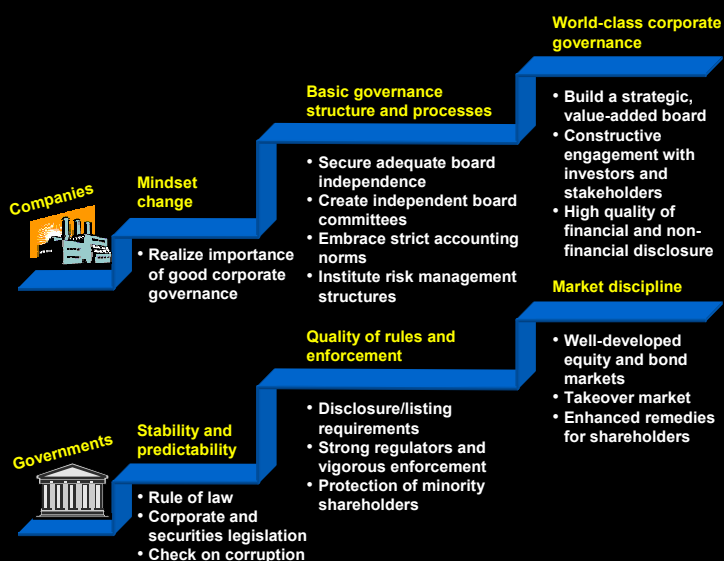
How can you pursue ...

- Greater disclosure and transparency
- More independent directors
- Long-term outlook
- Foreign investment

When ...

- Regulators do not have sufficient human and financial resources
- Contracts are difficult to enforce
- Corruption is rife
- Judicial system not working

TWIN-TRACK APPROACH FOR GOVERNMENTS AND COMPANIES



PRACTICAL STEPS TO ENSURE EFFECTIVENESS OF GOVERNANCE MEASURES

- Enforce current laws and regulations vigorously
- Focus on the most critical tasks and maximise leveraging opportunities
- Do not over-regulate
- Employ both “sticks” and “carrots”
- Raise awareness among companies, shareholders, and the wider public
- Undertake training and development of directors
- Facilitate the flow of information to the public



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QUESTION: WILLINGNESS TO PAY A PREMIUM FOR A WELL-GOVERNED COMPANY

1 Suppose you are considering investing in the following companies, A and B, in the same country. Past performance has been virtually identical and future market potential appears to be similar for both companies. However, they differ in board governance practices. B has put in place "good" board governance practices

Company A, "Poor" governance	Company B, "Good" governance
<ul style="list-style-type: none">• Minority of outside directors• Outside directors have financial ties with management• Directors own little or no stock• Directors compensated only with cash No formal director evaluation process• Very unresponsive to investor requests for information on governance issues	<ul style="list-style-type: none">• Majority of outside directors• Outside directors are truly independent; no ties with management• Directors have significant shareholdings• Material proportion of directors' pay is stock-related• Formal director evaluation in place• Very responsive to investor requests for information on governance issues

3 Questions:

- In those countries for which you are the key investment decision-maker, would you be willing to pay more for company B's stock compared to A's?
- If yes, what percentage premium do you estimate you would be willing to pay for B's stock?

Notes: Practices used to define "good" governance are some of those championed by the investment community
Source: McKinsey Global Investor Opinion Survey on Corporate Governance, 2002