Roundtable on Equity Market Development and Corporate Governance in Emerging Markets

- Meeting Agenda -

16 January 2014

Sabancı Center, Istanbul, Turkey
Background

The prime policy objective of the *OECD Principles of Corporate Governance* is to support a legal and regulatory framework that bridges the gap between finance and enterprise. This requires rules and regulations that make it attractive for growth companies to finance their investment with the help of the public stock market. It also requires credible and enforceable rules that define how investors can share in corporate wealth creation and how they can participate in the corporate decision-making process.

Against this background, the OECD Corporate Governance Committee launched the project *Corporate Governance, Value Creation and Growth* in early 2013. The objective is to support corporate governance reforms and improve the ability of equity markets to serve the needs of the real economy where companies need access to equity capital for growth and job creation.

As part of the *Corporate Governance, Value Creation and Growth* project, the Corporate Governance Committee has agreed to develop a special report on capital markets, corporate governance and growth in emerging markets written by a dedicated expert group. The report will give a detailed description of equity market structures and trading practices, ownership structure of listed companies and current corporate governance arrangements in emerging economies. The objective is to analyse how different approaches in terms of corporate governance policies may affect access to equity capital for growth companies in emerging markets. Ultimately, the fact-based analytical approach of the report would provide an input to the upcoming revision of *OECD Principles of Corporate Governance*.

Organisation of the meeting

The roundtable in Istanbul will be organised into two parts. The first part will include a keynote address on today’s stock market structure and corporate governance arrangements and a panel session on financing of business investment.

The second part of the meeting will be organised as a roundtable into four sessions. The roundtable will review the draft report on equity market development and corporate governance in emerging markets. The discussion will be structured in line with the structure of the report and inform the final report that will be presented to the March 2014 meeting of the OECD Corporate Governance Committee.
Background materials for the discussion at the roundtable include:

- *Institutional Investors as Owners: Who are they and what do they do?*, by Serdar Celik and Mats Isaksson

Each session of the roundtable will be briefly introduced by a lead discussant and then the floor will be open to all participants. The lead discussant will also structure the discussion along the issues addressed in the related chapter of the Group's Report and will keep the discussions interactive. The objective is to stimulate reflection and encourage the exchange of views and experience among all the participants.
8.45-9.15 Registration and coffee

9.15-10.00 Opening remarks

- Mehmet Göçmen, Chair, Corporate Governance Association of Turkey
- Marcello Bianchi, Chair, OECD Corporate Governance Committee; Director, CONSOB, Italy
- Bekir Safak, Acting Chair, Capital Markets Board of Turkey

10.00-10.20 Coffee break

10.20-12.00 Panel session: Financing of business investment and corporate governance

Considering the fundamental importance of business investment for sustainable growth, ensuring access to capital for growth companies plays a central role for innovation, job creation and growth. To finance their investments, corporations use different forms of capital. From a corporate governance and growth perspective it is important to understand that different forms of capital have different qualities and serve different purposes. A unique role is played by equity, or risk capital, which serves the function of residual claimant. This means that there is no pre-defined rate of return on the equity investment and that the shareholder can only be paid after all other stakeholders, such as creditors and employees have been paid.

There are a number of different sources of equity financing, including the entrepreneur’s own wealth, self-finance from retained earnings, private pools of capital in the form of private equity and venture capital firms and public equity markets where the company turns to general public and the broad spectrum of institutional investors to raise capital. When equity is provided through an organized public equity market, it allows for a separation between the investment horizon of an individual saver and the investment horizon of a project or the corporation. As equity shares can be traded, a promising research project or product innovation does not have to be abandoned if one of the shareholders is in immediate need of cash.

However, stock markets in many OECD economies do not provide risk capital for new growth companies anymore and small and medium-sized companies keep disappearing from many markets. In addition, emerging market companies are highly dependent on short term bank lending for financing their investment with an average of less than three years maturity. Moreover, speculative short-term trading dominates the stock markets around the world. Stock markets are fragmented, new trading techniques and investment strategies are ever more complex and investment chain has lengthened with new actors.
This section will discuss the role of public equity markets as a source of funding for business investment. It will also discuss the original public service function of stock exchanges as a bridge between savers and corporations. Considering the fundamental changes in financial markets and corporate sector over the last decades, is there a need to challenge the conventional concepts and the relevance of current corporate governance framework?

**Moderator:** Mats Isaksson, Head of Division, Corporate Affairs, OECD

**Keynote Address:** Mary Schapiro, Managing Director and Chairman of the Governance and Markets Practice, Promontory Financial Group; former Chair, U.S. Securities and Exchange Commission

**Panellists:**
- Burcin Yurtoglu, Professor, Chair of Corporate Finance, WHU – Otto Beisheim School of Management, Germany
- Carmine Di Noia, Professor, Deputy Director General, Assonime, Italy
- John Plender, Columnist, Financial Times
- José Luiz Osorio, Founding Partner, Jardim Botanico Asset Management; former Chair, Securities and Exchange Commission of Brazil

**12.00-13.00 Lunch for roundtable participants**

**13.00-18.00 Expert Roundtable on Corporate Governance in Emerging Markets**
(by invitation only)

The roundtable will review the draft report on *Equity Market Development and Corporate Governance in Emerging Markets* by the OECD Expert Group on Equity Markets and Corporate Governance in Emerging Markets. Each session of the roundtable will be briefly introduced by a lead discussant and then the floor will be open to all participants.

**Opening remarks** by Bekir Sitki Safak, Acting Chair, Capital Markets Board of Turkey; Vice Chair, OECD Corporate Governance Committee
13.00-14.15 Growth, investment and equity markets

During the last decade, the global economy has been characterized by an extensive shift in wealth towards emerging economies driven by an increasing contribution by emerging economies to global GDP growth. In year 2000 emerging and developing economies’ share of global GDP was 40%. In 2010, it had reached 49% and in 2030 it is expected to be 57%. The increased contribution to global GDP from emerging markets has been coupled with an increase in total investment. For instance, in China gross fixed capital formation as a percentage of GDP increased from 34% to 45% and in India the increase was from 25% to 30%. During the same period, the average total investment in OECD economies actually decreased from 21% to 18% of GDP.

There are a number of different sources of financing for investment, including equity capital. Equity may be in the form of entrepreneur’s own wealth, self-finance from retained earnings, private pools of capital such as private equity and venture capital funds and public equity. The role of public equity markets have substantial increased in emerging market economies over the last decade. However, the depth of equity markets, which is typically measured as the stock market capitalization as per cent of GDP, in emerging economies is still lower than in most developed economies.

This means that emerging markets may still have a lot to gain from the development of sound equity markets that effectively can perform the fundamental function of channelling household savings to companies that need long-term risk capital for innovation and growth. There will estimated to be an amount of USD 10 trillion shortage of equity gap in emerging market over the next decade. Closing this gap and reducing the reliance of short-term credits, will require improvements in the intermediation between savings and corporate needs, including the framework for corporate governance. Only then will emerging markets be able to ripe the full benefits from domestic entrepreneurship and the growth potential of existing companies.

This section will discuss the role of public equity markets as a source of funding in emerging economies. It will also discuss the determinants and measures of the level of development of equity markets in emerging markets economies compared to developed economies.

Lead discussant: José Luiz Osorio, Founding Partner, Jardim Botanico Asset Management; former Chair, Securities and Exchange Commission of Brazil

14.15-15.30 Equity market structure and investors

Stock market landscape in developed economies has experienced fundamental changes during the last two decades, both in terms of the stock market structure and practices in the investor community. In terms of market structure, the stock exchanges have demutualised and themselves become listed companies. There has also been a high degree of consolidation through mergers of
regulated exchanges both at national and international level. At the same time, however, new venues for trading have emerged; such as alternative trading venues, multilateral trading facilities and dark pools. In terms of investment practices, new investment strategies, trading techniques and equity-based instruments have increased dramatically in importance. Today, computer-based algorithmic trading dominates many markets and exchange-traded funds have emerged as an important component of new investment strategies.

Moreover, share ownership has shifted from individual direct owners to institutional owners. In most developed countries the majority of listed shares is today held by institutional investors. These institutions include traditional institutional investors, such as pension funds, mutual funds and insurance companies, and alternative institutional investors, such as sovereign wealth funds, private equity and hedge funds and external asset managers. Last but not least, the share of foreign portfolio investors has increased in most countries as a consequence of international integration of equity markets.

This session will explore how stock markets in emerging economies have been affected by the changes in market structure and trading practices in developed economies, such as algorithmic trading, the emergence of equity based instruments and market fragmentation. It will discuss the investment strategies and trading practices of traditional and alternative investors in public equity markets in emerging economies, including foreign institutional investors.

Lead discussant: John Plender, Columnist, Financial Times

15.30-15.45 Coffee break

15.45-17.00 Corporate ownership and control

Most corporate governance discussions have assumed that corporations have a dispersed ownership structure and focused on the problems that follow from a separation of ownership from control. With the exception of a few countries however, dispersed ownership has never been the dominant ownership pattern in publicly listed companies. Not in continental Europe and certainly not in emerging markets. It has even been argued that the assumption of dispersed ownership is overstated also for the United States. For instance, some of the best known large listed US companies, including Google, Berkshire Hathaway, Oracle, Zynga and Facebook all have large and often controlling owners.

Moreover, the shift in new listings towards emerging markets has, together with the large decrease in US and UK listed companies, led to a situation where the size of stock markets that have traditionally hosted companies with dispersed ownership has decreased by 30% - from 56% to 40% - of global market capitalization. As a consequence, it is probably safe to assume that worldwide, it is the rule rather than the exception that listed companies have a controlling owner.
Low free-float ratios, the portion of the company's outstanding stocks that is subject to regular trade, may be a first indicator of the importance of controlled companies in emerging markets. While the average free float ratios for US, UK and Australian listed companies is around 90%, it is less than 35% in China, India, Russia and Turkey. In Malaysia, Indonesia and Thailand it is less than 45%. However, even in the case of high free-float of shares, there might be concentration of control at company level. This is simply because dual class shares, voting agreements, special voting rules, pyramid structures and cross-shareholdings allow actual control without holding a majority of the share capital.

This session will focus on the corporate governance costs and benefits attributed to controlling shareholders. How can controlling ownership structure be maintained to support value creation at company level and still regulated to ensure equitable treatment and investor confidence?

**Lead discussant:** Erik Vermeulen, Professor of Business Law & Finance, Tilburg University Vice-President, Corporate Legal Dept., Philips International B.V.

**17.00-18.15 The corporate governance framework in emerging markets**

The corporate governance framework of rules and regulations of a country include relevant parts of company law, securities regulation, accounting, auditing standards and various kinds of mandatory and voluntary codes of conduct. In the ten years following the revision of the OECD Principles in 2004, many emerging market countries have improved their corporate governance frameworks. As new rules and regulations have been enacted, the corporate governance policy discussion has increasingly come to focus on the need to ensure that these rules and regulations are effectively implemented and enforced.

This session will focus on the developments with respect to corporate governance frameworks in emerging markets over the last decade. It will try to identify the priority areas, including shareholder rights, transparency, disclosure and enforcement for corporate governance public policy.

**Lead discussant:** Marcello Bianchi, Chair, OECD Corporate Governance Committee; Director, CONSOB, Italy

**18.15-18.30 Future work**

The participants will be invited to provide advice on the future direction of the work on equity market development and corporate governance in emerging markets.