ENHANCEMENT OF CORPORATE GOVERNANCE THROUGH PRIVATIZATION

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Abstract

The convergence of global economies towards market-based systems has put the modern corporation in the centre of economies around the world. It is becoming increasingly recognized that companies should be managed to reflect the interests of society at large rather than for purely private interests. The positive and negative externalities of the separation of management and ownership in the modern corporation makes corporate governance an important issue. This leads to a number of issues related to efficient control of the assets of corporations in the interest of all stakeholders. Corporate governance is also important for state-owned enterprises (SOEs). Not only do good governance practices increase productivity in and competitiveness of SOEs, they also help to ensure that public funds invested in these enterprises are not mismanaged and are spent effectively. By creating more transparent and economically viable SOEs, corporate governance also helps to ensure that services are actually delivered to the public. Further, as state enterprises often provide a bulk of employment in some emerging markets and a variety of essential public services, good governance helps to prevent failures with devastating social impact. In many countries, corporate governance has been used as a means of not only improving the efficiency of SOEs, but also as a mechanism to improve their attractiveness to investors, thus increasing state income from privatization.

Corporate governance plays an important role in transforming business and state relations. As financial crises in Asia and Russia have shown, a murky relationship between government officials and private sector companies can undermine the economy and lead to economic collapse. The lack of transparency in business-state interactions often leads to preferential legal and regulatory treatment, asset stripping, wasting resources, and corruption that undermines the competitiveness of national economies while benefiting a few insiders. Corporate governance helps to address these problems and is an effective solution to corporatism, cronyism, and favoritism.

Privatization is a good example of the corporate governance solution. Within SOEs scheduled for privatization introducing good corporate governance can play an important role in preparing companies for the new challenges brought about by private ownership.

When examining the legacy of privatization in developing and transition economies during the 1990s, much of the corruption, shareholder abuse, and self-dealing that resulted can be directly tied to the failure of the state to

establish and require effective governance mechanisms within privatizing firms. Corporate governance, therefore, has a crucial role to play not only in readying firms for privatization, but in preventing the potential market mayhem that can occur when firms privatize without effective internal controls, reporting mechanisms, and shareholder protections.

Instituting sound internal corporate governance measures into state-owned firms prior to privatization is crucial to ensuring a smooth transition to private ownership both prior to and after the privatization process. Good internal accounting and controls contribute to effective evaluation and can enhance value by reducing investor costs associated with transitioning accounting practices and building internal control systems. Establishing a model of board governance and management accountability prior to privatization also facilitates a smooth transition to private ownership/governance models.

In implementation of successful privatizations, good corporate governance is important in balancing shareholder expectations and rights with the needs of majority owners seeking to restructure and reorganize firms. Additionally, improved transparency and good board/stakeholder relations help negotiate conflicts that may occur as a result of these efforts. The values of fairness, accountability, responsibility, and trust that are hallmarks of good corporate governance are central to developing privatization models that ensure value, ease the privatization transaction, protect stakeholder and shareholder interests, and allow for more efficient post-privatization restructuring.

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List of Acronyms

ADSs	-	American Depository Shares
CIPE	-	Center for International Private Enterprise
DPC	-	Development Policy Centre
ILO	-	International Labour Organisation
IPO	-	Initial Public Offering
ITN	-	National Transparency Index (ITN for initials in Spanish)
KLM	-	KLM Royal Dutch Airlines
KQ	-	Kenya Airways
MNCs	-	Multinational Corporations
NITEL	-	Nigeria Telecommunications Limited
NSE	-	Nairobi Stock Exchange
NYSE	-	New York Stock Exchange
OECD	-	Organisation for Economic Co-operation and Development
PFS	-	Partners for Financial Stability
SAUR	-	French water utility (SAUR for initials in French)
SODECI	-	The Côte d'Ivoire Water Distribution Company (SODECI for initials in French)
SOEs	-	State Owned Enterprises
TSCL	-	Tema Steel Company Limited
USAID	-	United States Agency for International Development

1. Definition of Corporate Governance

The need for corporate governance arises because of the separation of management and ownership in the modern corporation. In practice, the interest of those who have effective control over a firm can differ from the interests of those who supply the firm with external finance. The 'principal-agent' problem is reflected in management pursuing activities which may be detrimental to the interest of the shareholders of the firm. The agency problem can usually only be mitigated through the protections derived from good corporate governance.

There is not a universally accepted definition of corporate governance. Defined broadly, "corporate governance" refers to the private and public institutions, including laws, regulations and accepted business practices, which in market economy, govern the relationship between corporate managers and entrepreneurs ("corporate insiders") on one hand, and those who invest resources in corporations, on the other (Oman, 2001). Other writers like Cochran and Warwick (1988) define corporate governance as: "...*an umbrella term that includes specific issues arising from interactions among senior management, shareholders, boards of directors, and other corporate stakeholders.*"

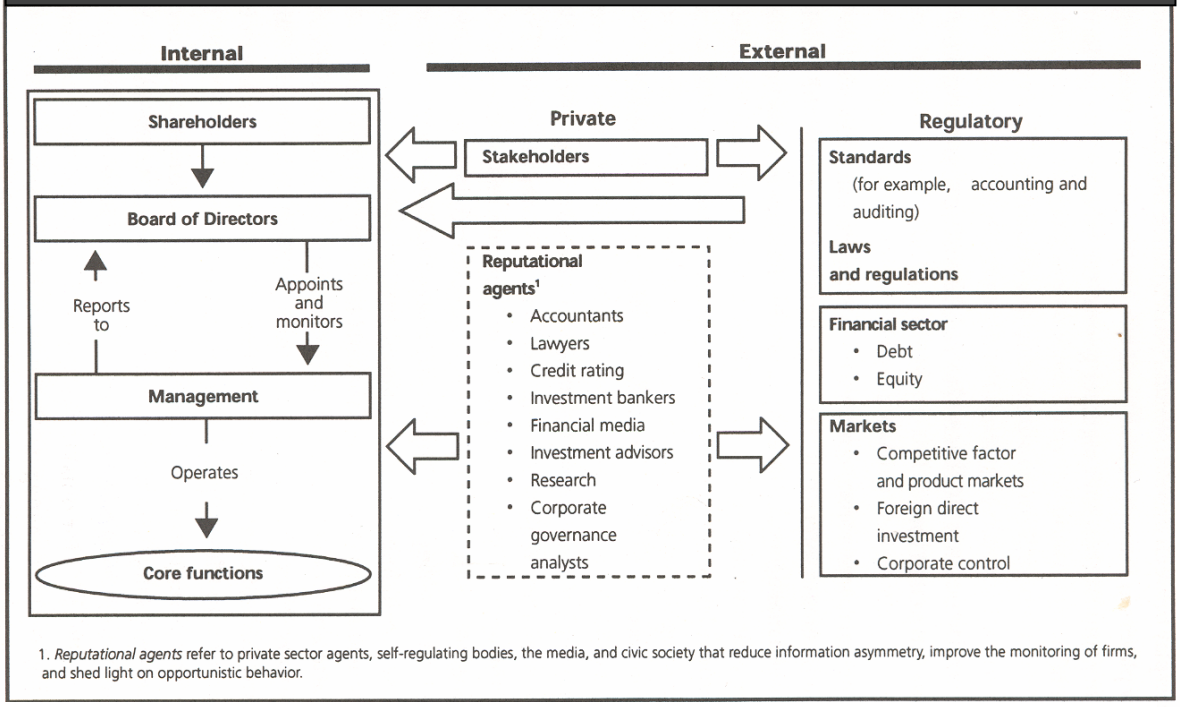
It is concerned with creating a balance between economic and social goals and between individual and communal goals while encouraging efficient use of resources, accountability in the use of power and stewardship and aligning the interests of individuals, corporations and society. It also encompasses the establishment of an appropriate legal, economic and institutional environment that allows companies to thrive as institutions for advancing long-term shareholder value and maximum human-centered development while remaining conscious of their other responsibilities to stakeholders, the environment and the society in general.

Corporate governance is concerned with the processes, systems, practices and procedures as well as the formal and informal rules that govern institutions, the manner in which these rules and regulations are applied and followed, the relationships that these rules and regulations determine or create, and the nature of those relationships. It also addresses the leadership role in the institutional framework. Corporate Governance, therefore, refers to the manner in which the power of a corporation is exercised in the stewardship of the corporation's total portfolio of assets and resources with the objective of maintaining and increasing shareholder value and satisfaction of other stakeholders in the context of its corporate mission.

Governance is concerned with the processes, systems, practices and procedures – the formal and informal rules – that govern institutions, the manner in which these rules and regulations are applied and followed, the relationships that these rules and regulations determine or create, and the nature of those relationships. Essentially, governance addresses the leadership role in the institutional framework.

Corporate Governance, therefore, refers to the manner in which the power of a corporation is exercised in the stewardship of the corporation's total portfolio of assets and resources with the objective of maintaining and increasing shareholder value and satisfaction of other stakeholders in the context of its corporate mission. The diagram below provides a schematic interrelationship in mapping of a corporate governance system in an organization.

Figure 1: Mapping a Corporate Governance System through the interaction of both internal and external factors

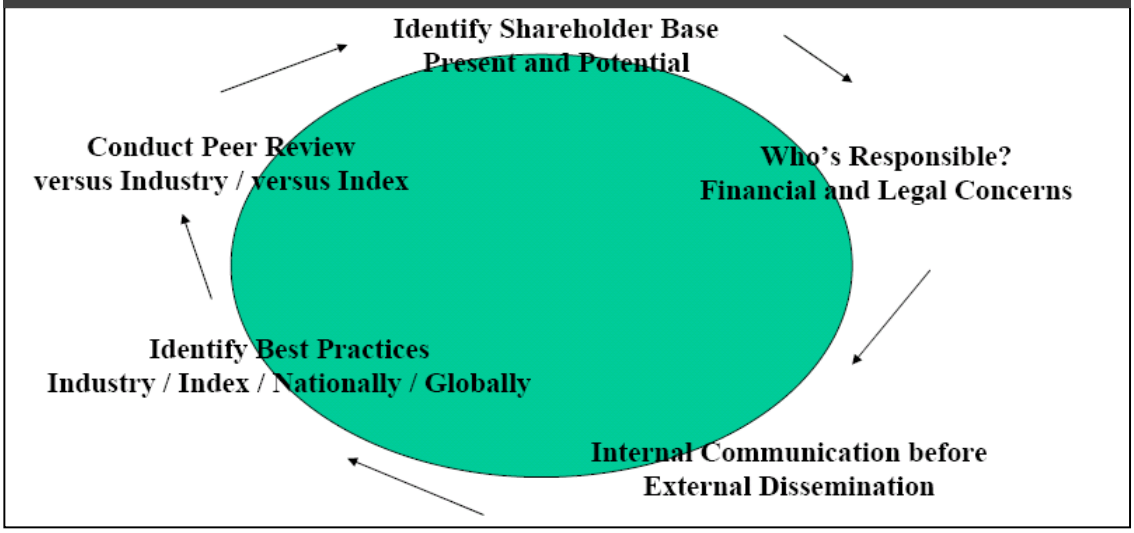


Source: The World Bank

Corporate governance implies that companies not only maximize shareholders wealth, but balance the interests of shareholders with those of other stakeholders, employees, customers, suppliers, and investors so as to achieve long-term sustainable value.

From a public policy perspective, corporate governance is an ongoing process aimed at continual improvement in managing an enterprise while ensuring accountability in the exercise of power and patronage by firms as illustrated in Figure 2 below.

Figure 2: Corporate Governance from the company's point of view – An ongoing process



Source: USAID Partners for Financial Stability (PFS) Programme, January 2009

Corporate governance is concerned with creating a balance between economic and social goals and between individual and communal goals while encouraging efficient use of resources, accountability in the use of power and stewardship and as far as possible to align the interests of individuals, corporations and society.

Corporate governance promotes:

- Fair, efficient and transparent administration of corporations to meet well-defined objectives;
- Systems and structures of operating and controlling corporations with a view to achieving long-term strategic goals that satisfy the owners, suppliers, customers and financiers while complying with legal and regulatory requirements and meeting environmental and society needs;
- An efficient process of value-creating and value-adding and ensure that:
  - The Board has set strategic objectives and plans and put in place proper management structures [organization, systems and people] to achieve those objectives and plans];

- The structures put in place function to maintain corporate integrity, reputation and responsibility towards all stakeholders;
- The Board acts as a catalyst, initiating, influencing, evaluating and monitoring strategic decisions and actions of management and holds management accountable;
- Ensuring that the Board is not a mere formality which takes a back seat, leaving management to make all strategic decisions;
- The Board has established and put in place mechanisms to ensure that the corporation operates within the objects established by shareholders, the mandate given to it by society, utilizes the resources entrusted to it efficiently and effectively in pursuit of the stated mandate, and meets the legitimate expectations of its various stakeholders.
- There are established mechanisms, processes and systems to constantly ensure that:
  - Governance practices are effective and appropriate;
  - There is transparency and accountability to the various stakeholder;
  - The corporation complies with legal and regulatory requirements;
  - There is disclosure of all pertinent information to stakeholders;
  - There is effective monitoring and management of risk, innovation and change;
  - The corporation remains relevant, legitimate and competitive; and
  - The corporation is viable, solvent and sustainable.

Corporate governance therefore refers to the establishment of an appropriate legal, economic and institutional environment that allows companies to thrive as institutions for advancing long-term shareholder value and maximum human-centered development while remaining conscious of their other responsibilities to stakeholders, the environment and the society in general.

2. Governance Issues that contribute to poor performance in State Corporations in Africa

This section of the paper highlights a number of corporate governance challenges in Africa that contribute to ill-equipped methodologies in implementing corporate governance to the levels which might be accepted in developed market economies. These constraints mainly arising from:

- The structure of ownership and control
- Interlocking relationships with government and the financial sector
- Weak civil and judicial systems
- Absent or underdeveloped monitoring institutions and
- Limited human resource capabilities

Some of these challenges are regulatory nature, some fall under enforcement, incentive regime, state capacity and responsible corporate citizenship as discussed below.

2.1 Lack of effective and sound regulatory framework.

There is a need for effective and sound regulatory framework for various aspects of corporate governance. There is a need for legislative enactment or decree that establishes a regulatory agency, and indicates its functions, including its enforcement powers. The regulatory process consists of setting the rules or standards, monitoring compliance and enforcement. The regulatory challenge relate to capital adequacy standards for international banks, accounting and auditing standards for corporations, regulations governing business practices etc. A particular difficulty in Africa, in designing and implementing appropriate regulatory, enforcement and incentive regime is the lack of skills and institutional capacity to do so.

The commitment of government and the leadership is an overriding factor in transition economies where environment conducive to corporate governance has to be created to ensure enterprise sustainability. Where there are companies with controlling shareholders the most effective governance mechanism is for the institution of a set of legal rules that control managerial behaviour and protect minority shareholders.

Rules on corporate governance are a good starting point in promoting sound corporate governance in Africa but they are not credible unless they are applied effectively. For this to happen, regulators must have sufficient authority and resources. Our review of the regulatory framework for capital markets indicates that in most cases, reasonable regulations have been put in place to

achieve the key objectives of corporate governance, particularly in the areas of board composition and disclosures. However, the effectiveness of these rules depend on the ability of the regulatory agencies to enforce, that is, to execute a process that provides restitution when the rules are broken. Anecdotal evidence indicates that enforcement of rules and regulations is increasingly challenged by weak judiciary systems making it difficult to obtain convictions when rules are violated. Thus, securities regulators can work hard to administer the law, identifying violators but the normal process of enforcement may not be equipped to apply the new laws.

In Nigeria, there generally are systems in place to provide laws (rights and obligations), processes (conduct of business) and penalties for violations. Yet the problem of the supervision and enforcement of such laws and processes still remains. Judicial means of supervision, including, the courts have failed in this regard. Extra-judicial systems for supervision including the registrar of companies and shareholders' associations, who could bring pressure to bear on directors, have also proved ineffective. A study conducted by the Development Policy Centre (DPC) to evaluate the standard of corporate governance in Nigeria, was based on 20 out of 31 questionnaires distributed, which were scored using the OECD corporate governance Assessment Instrument. The states surveyed were Abia, Bauchi, Kano, Lagos, Plateau and Rivers. The results showed that, to a large extent, the legal and institutional framework for effective corporate governance exists in Nigeria by virtue of laws such as those related to Companies and Allied Matters Decree of 1990 and the stock exchange rules for listed companies, among others. The problem, however, lies with compliance and enforcement, which appear to be weak or non-existent. Recommendations following the study include a strengthening of the enforcement mechanism of regulatory institutions and the judicial system, to restore shareholder confidence in the rule of law.

In Ghana, constraints facing corporate governance include an inadequate legal framework, mainly dominated by the Companies Code of 1969. The Institute of Directors in the country, hence recommends the development of laws that demand more transparency, clarify governance roles and responsibilities, the enactment of competition and solvency laws and strengthening of enforcement mechanisms. Other setbacks in Ghana include government interference in the operations of state-owned enterprises, inadequate management information systems, ignorance on the part of shareholders, and lack of enforcement of relevant laws.

Some of the constraints in implementing good governance policies include the following factors:

(1) Lack of political will on the part of governments
This can manifest itself in two ways. First, and most directly, the level of political will can be measured by the governments' commitment to monitoring process – time and money. Secondly, the alignment of governments with the interests of multinational companies (MNCs). This is reflected in either a reluctance to hold the MNCs to account or support for MNCs which become embroiled in allegations of corruption. The close connection between economic power and political influence is generally recognized. The successful resistance of public enterprises to privatization programs is an example that has been encountered over a wide spectrum of cultural and economic environments, ranging from Ghana to Nigeria and Kenya.

(2) Position of companies operating in Africa
Companies operating in Africa are in a difficult position – even if they want to do the right thing and publish what they pay in bribes to governments officials, they face immediate reprisals from those with a vested interest in the status quo. The announcement of a policy of transparency by British Petroleum operating in Angola brought a spirited response from the Angolan State oil company, Sonangol, in a letter published by Global Witness (2002) which shows Sonangol's apparent contempt for the issue. It is clear that a single company cannot make such a move alone, support is needed from a broad international coalition.

(3) Regulating payment disclosure
There is an urgent need for multinational companies to adopt a policy of full transparency in Africa.

A legal obligation for companies to publish what they pay to all national governments solves a number of inter-related problems that have so far thwarted voluntary attempts at transparency.
Mandated payment disclosure would:

(1) Level the playing field between competitors, preventing more principled and transparent companies from being undercut by their less scrupulous competitors.
(2) Eliminate concerns about confidentiality clauses gagging companies publishing payment data. Such contracts contain a 'get-out' clause exempting information that must be disclosed due to regulatory requirements from confidentiality.
(3) Address the problem of non-transparency in all countries of operation. Non-transparency will be a growing problem as natural resource

operations become increasingly located in less developed countries where civil society and government transparency are proportionately weaker.

(4) Depoliticise the issue of payment disclosure in authoritarian regimes and allow companies greater freedom of responsible behaviour. Publishing what is paid to such regimes is likely to have a knock-on effect of encouraging greater transparency and fiscal governance by default.

(5) Eliminate a major international double standard between levels of transparency in the North and South.

(6) Involve negligible associated costs. Companies already know what they pay for internal accounting purposes.

(7) Incorporate all the major and super-major players in the resource sector – it is improbable that (and would be very telling if,) a major company would delist from an international exchange to avoid transparency.

2.2 Challenges posed by the business environment

2.2.1 The Preponderance of Small Firms in Africa

In African countries, there is a preponderance of closely-held family owned and managed businesses. In Nigeria, the informal nature of most businesses and the high level of government ownership of enterprises pose challenges to the practice of corporate governance. The vast majority of Africa's enterprises are not large. The Enterprise Africa programme is developing an additional way for these companies to raise funds outside the traditional exchanges. This "private placement initiative" will enable well-managed, solid, smaller companies in strategic sectors to issue shares or notes to investors with the help of financial intermediaries. This initiative should ultimately benefit African exchanges by providing smaller firms with capital until they become large enough to be listed.

2.2.2 Informal Nature of Enterprises

In Africa, indigenous companies, which tend to be small and medium-sized, so far have made relatively little use of stock exchanges, in part because they lack experience and resources for issuing shares, but also because their managers fear losing control after going public. There is a serious problem of tax evasion and the dumping of cheap imported products into the local market by these companies, a situation that reflects the pursuit of short-term private enterprise goals and undermines good corporate governance.

In West Africa, all three exchanges have been trying to attract more companies by setting up "over the counter" markets and secondary and tertiary markets with less strict listing requirements. They also have given increasing attention in the last year or so to educational and promotional programmes to attract more investors. The failure of larger owned private companies to go public is

traceable to the lack of trust, suspicion and fear that listed companies are manipulating their records and that they are not transparent.

2.2.3 Restricted competition in markets for goods and services

Among developing countries, a more prevalent constraint arises from restricted competition in the market for goods and services. Impediments to competition are diverse, ranging from anti-competitive practices by firms to policy restrictions on ownership and entry. Frequently, entry barriers are disguised as regulation purportedly designed to serve the "public interest." In fact, these policies usually give the preferred producers and service providers profits in excess of competitive returns. Such profits, however, come from distorted prices - a hidden tax on consumers.

The lack of competition also accentuates ownership concentration. Owners of incumbent firms have an incentive to retain control of profitable domestic operations. They may choose to remain a private firm or may go public, but without giving up control, by retaining a controlling stake or issuing non-voting shares.

2.3 Challenges related to low financial intermediation

2.3.1 Challenges related to Firm Financing in Africa

The commercial advantages of large incumbent firms are not lost on banks, which play a predominant role in financial intermediation in developing countries. Banks maintain cozy relationships with established and often well connected businesses - a natural outcome in a protected and profitable business environment in which both the borrowers and the lenders operate. In some countries, commercial firms also own and control major domestic banks, creating business conglomerates with "in-house" sources of easy financing for themselves. Moreover, bank lending is often determined by political directives, which generally favour large incumbent firms.

More generally, preferred access to bank credit significantly reduces the need of incumbent firms to rely on securities markets where external financiers often demand transparency and accountability of corporate insiders.

2.3.2 Challenges relating to Capital Market development

In many African countries, the majority of listed companies are subsidiaries of foreign multinationals and a minority of shares with a local float for domestic investors. Under these circumstances, public investors are unable to use voting power to enforce corporate governance and there is no effective corporate control because of the limited float. Widespread ownership makes it difficult for management to be monitored and controlled or replaced.

Except for the Johannesburg exchange, most African exchanges share other impediments to their growth and development: notably, too few indigenous companies, small average company size, and low liquidity levels (the value of shares traded in relation to total market capitalization). The number of companies listing shares generally is low, and trading in one or just a few stocks often dominates total trading activity. Because stock exchanges in developing countries are generally less well regulated and more poorly organized than their counterparts in developed countries, they are more prone to high volatility. Also, information about listed companies is not as copious as is found in the more developed markets. Also, the regulatory systems are not very well established. In some countries like Nigeria, the practice of sharia law (which forbids interest payment) is an obstacle to accessing funds from the capital market.

Capital controls in South Africa artificially inflated stock prices and thus, by raising the cost of solving managerial inefficiencies by control changes, contributed to the survival of the group structure. However, in the long run, the stock price performance of the five largest mining houses all belonging to the conglomerates and which are themselves structured as groups has been roughly in line with the JSE's All Share Index, and vastly superior to domestic inflation. Moreover, they show that the mining houses provided significantly higher returns than those that a small investor could have obtained by holding the same portfolio of individual listed shares.

In South Africa with its pyramid or group system, controlling shareholders are often able to control companies via a series of "holding companies". Very often all shares in these companies have identical cash flow and voting rights, however, control is vested in a particular individual, family or coalition of individuals or families.

Where ownership and voting rights are concentrated, the situation affects the balance between preserving and transferring control rights. In the presence of large block holders, transfers and control can only take place with their agreements, whereas markets in control are possible when ownership is dispersed. The incentives for owners to monitor and control are greater where ownership is concentrated and concentrated owners can display a greater degree of commitment to other stakeholders than dispersed shareholders. Conglomeration reduces the value of controlled assets to shareholders.

2.4 Challenges relating to the prevalence of corrupt practices

2.4.1 Challenges due to prevalence of corrupt practices

A World Bank survey of government and civil society representatives in 60 developing nations found agreement that corruption was the single greatest obstacle to economic growth and development in these countries. Another World Bank survey of 400 entrepreneurs in 69 countries found corruption to be one of the three most significant obstacles to conducting business in developing countries. Corruption and bribery are particularly problematic for the development of small to medium enterprises, whose very existence may depend on winning a single contract. By diverting investment into unproductive dead-ends and blocking business growth, corruption and bribery make it more difficult for people to move out of poverty into consumerism.

The Warioba Commission Report in corruption in Tanzania finds that one of the principal sources of corruption in the country is the close relationship existing between political leadership and private business. Companies that engage in bribery and corruption often discover that these practices boomerang into their own internal structures with damaging effect. As noted by Transparency International (TI), once sales staff become schooled in off the-books accounting and ways to flout country laws, an "ethic of corruption" is imported into the organization. TI's research on company experience in Tanzania suggests that as much as 20 percent of corporate money meant for bribery never reaches its intended destination, ending up instead in the pockets of employees.

2.4.2 Corporate Governance and Monitoring State-owned Enterprises

In many African countries, the capacity to support the implementation of good corporate governance is undermined by the existence of weak monitoring and watchdog organizations. Government Ministries responsible for actively monitoring state-owned enterprise boards in particular, and other mechanisms such as independent regulators, do not as yet fulfil their role as overseers. Many are generally weak and subject to external influence by politicians. Community watchdog organizations such as consumer bodies are not well developed in Africa.

Even if a State-owned firm operates in a competitive market and the government tries to enforce an objective of profit maximization on its management, problems of corporate governance could still emerge thereby causing inferior performance.

2.5 Challenges emanating from privatisation of state-owned enterprises

2.5.1 Crony Capitalism challenges

Privatization is expected to improve managerial incentives and raise corporate efficiency. However, in Africa many examples of the inherent conflicts and problems associated with the corporate governance debate have been found to occur in immediately pre and/or post privatization. There has been an apparent lack of independence and sizeable cronyism in the sale of enterprises, appointments of state enterprise boards.

2.5.2 Valuation of state-assets for privatisation

The determination of the value of the firm during privatization is essential for fixing the price and for avoiding overvaluation or under-valuation. If an enterprise is sold at its fair market value, it can result in improved benefits to the society at large. A free disposal or heavy discounted selling of state-owned enterprises will only benefit the new owners and is inconsistent with equitable sharing of national wealth. Determining the value of an enterprise for sale is not easy in a transition economy because there are no mature market mechanisms to rely on. The issue of how to evaluate companies and which method to use is essential for successful and transparent privatization of enterprises. The saleability of companies to be privatised depends upon the profitability or potential for profit, productivity, strategic buyer and specific characteristics of the individual company. The ultimate goal of transition to a market economy is to transform from a highly distorted economy with many loss-making firms to a "normal" market economy in which the overwhelming majority of firms are profitable. Unfortunately, privatization approaches run into difficulties in countries, like those in Africa, where stock markets are either non-existent or unable to mobilize the interest of "small investors" especially those who have no access to loans to buy the shares reserved for them. On occasions African governments have attempted to extend loan funds for the purpose.

Another corporate governance problem of privatization in Africa is that of possible abuse of corporate authority, especially in enterprises that are slated for privatization. Such an abuse of corporate authority includes the sudden augmentation (sometimes quadrupling) of executive pay in the period leading to privatization. In Nigeria investigations revealed that an upfront payment of N70 million was made to a company, being 70 per cent of N100 million commission charged on a proposed sale of African Petroleum Plaza for N1 billion, without due process, and for a sale which was not consummated.

2.5.3 Challenges due to boardroom composition

Institutional investors typically view a well-governed company as one that has a majority of outside directors with no management ties to its board, undertakes formal evaluations of directors, and is responsive to requests from investors for information on governance issues. Directors should also hold significant shareholdings in the company, and a large part of their pay should come in the form of stock options.

KPMG completed a survey on how corporate governance is conducted or perceived in South Africa by JSE listed companies. The survey shows that three quarters of the investors say that board practices are at least as important as financial performance when they evaluate companies for performance. In addition, of the survey respondents, 85% believe corporate governance was of "utmost importance" to "important" in contributing to investor confidence in the company. Almost as many rated it just as highly in contributing to a company's performance. The survey establishes that South African company directors believe that the adoption of sound corporate governance practices is significant for the continued success of their business. The survey found that there are on average 5 non-executive directors to 4.1 executive directors on a board, and that board composition and leadership were together rated the 4th highest area for future increased emphasis. Although management performance and effectiveness was rated the 2nd highest area for increased emphasis in the future, board accountability, remuneration and performance ranked only 12th.

The independence of directors and boards of state enterprises, in their various forms, in many emerging and transition economies, especially those in Africa, remains a challenge–not only for the directors themselves but also for those with whom such enterprises contract. There is a particular problem associated with the shortage of skills and lack of familiarity with board functions and fiduciary responsibilities. The lack of enforcement of existing regulatory measures, whether outdated or not, has contributed to poor corporate governance practices. In 2003, the former managing director of Nigerian Securities Printing and Minting Company (NSPMC) single-handedly awarded a contract of about N3billion without competitive bidding, reference to executive committee of the Mint, its Tenders Board, Board of Directors or the supervising ministry.

Many corporate board members in Africa, especially of state-owned companies, some private companies and management committee of cooperatives have limited understanding of their roles, and are usually open to manipulation by management, chairmen, or principal shareholders. Some are outright incompetent. Non-executive directors in Africa need to play any meaningful role in the governance of business enterprises. However many simply

act as rubber stamps for decisions taken outside the board. A Commission of Enquiry set up to investigate the Nigerian Telecommunications Limited (NITEL) found the leadership of the planning and operations department to be incompetent. In 2001, the management of Air Namibia and TransNamib (Namibia Transport company) were replaced due to poor performance and incompetence while the Managing Director of Uganda Railways Corporation was dismissed for mismanaging the corporation.

2.5.4 Diversity of the Board of Directors of Listed Firms

A board of directors is an essential mechanism that can enhance and create the coalitions with the stakeholders controlling resources required by a firm. Each director brings a collection of unique and different experiences, attachments and points of view to a board. A number of studies suggest a diversified and well-balanced board of directors can significantly enhance a firm's performance. For example, empirical results from a study of eighty-four South African publicly listed firms indicated a positive association between the percentage of female and non-white directors on the boards of directors of South African publicly listed status and a firm's intellectual capital performance. If members' perceptions, views and backgrounds are relatively homogenous in nature there is a higher likelihood decision-making strategies of this corporate governance mechanism will be single-minded, predictable and inflexible.

Boards with a more diverse mix of members will better enable it to address the challenges of an uncertain and dynamic business environment. Dissimilarities in the ethnic and gender backgrounds of directors can contribute different sociological perceptions and understandings to the decision-making process. As a result, a board is better able to instigate more comprehensive policies, strategies, activities and projects. Greater ethnic and gender diversity also enhances the board's flexibility in its decision-making process due to a wider set of perceptions and views. This will enable a firm to better facilitate strategic change. Consequently, a firm will be able to respond more rapidly to changes in the dynamic and uncertain business environment of the Information Age. Other research on corporate governance also suggests that a diversified and well-balanced board of directors can significantly enhance a firm's performance. Also, the presence of an independent director presenting a broad spectrum of stakeholders appears to contribute to the success of well-performing boards.

2.5.5 Audit Committees and integrity of company's financial statements

Under conditions prevailing in Africa, the authenticity of a company's financial statements could be questioned. A critical question is to what extent can one rely on audit reports as giving an accurate idea of the financial health of a company in a typical African setting. The Auditors of LeisureNet, a South African

company, were aware of the value-added tax evasion activities of company executives and endorsed such expenses on the company. They also endorsed the setting up of a sham office in Malta to gain tax advantages for the company. They advised the company to hold occasional meetings in South Africa but ideally the meetings should be held in a foreign country.

A question might be asked regarding who is ultimately responsible for integrity of the audited financial statements in Africa, whether it is the internal auditor who presents the false report or the external auditor who certifies it as true and fair? Related to this is the question of who enforces corporate governance at this level? External auditors can only express an opinion on the information made available to them by internal auditors.

Internal auditors may fail to expose wrongdoing in the company for fear of losing their jobs. Following the forced departure of the Mint managing director of the Nigerian Securities Printing and Minting Company (NSPMC) by the Federal Government, more revelations of financial impropriety culminating in a loss of over N500 million for 2002 fiscal year were discovered.

2.5.6 Equity analysts

It has been shown that in some instances managers are able to hide information from the investing public in order to facilitate consumption of private control benefits. Research analysts could increase the scrutiny of controlling management groups, a situation that will improve firm values. Analysts engage in information discovery and their efforts collectively improve corporate governance. If a firm's demand for external financing is large it may be willing to provide information to analysts whose certification improves the credibility of the released information. The role of financial analysts in contributing to improved corporate governance in Africa is limited the low human capital development of countries in the continent and the ravages of the AIDS pandemic which significantly affects the educated workforce.

In countries where there are strong unions, such as South Africa and Ghana, some state-owned enterprises have been sold to management and employees, in part, because of union pressure to preserve jobs. In general, the concern for preserving jobs, especially where there are strong unions, has made privatization very difficult as it prevents the determination of the true share price of the enterprise. This creates corporate governance problems. Investors are reluctant to acquire SOEs when a government insists that "employment levels will be retained" as did the South African government. However, it has been reported that in Uganda, privatization of SOEs could result in increased both production and employment levels.

3. Best Practices in Corporate Governance

3.1 Ensuring the Basis for an Effective Corporate Governance Framework

The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.

To ensure an effective corporate governance framework, it is necessary that an appropriate and effective legal, regulatory and institutional foundation is established upon which all market participants can rely in establishing their private contractual relations. This corporate governance framework typically comprises elements of legislation, regulation, self-regulatory arrangements, voluntary commitments and business practices that are the result of a country's specific circumstances, history and tradition. The desirable mix between legislation, regulation, self-regulation, voluntary standards, etc. in this area will therefore vary from country to country. As new experiences accrue and business circumstances change, the content and structure of this framework might need to be adjusted.

Countries seeking to implement the principles should monitor their corporate governance framework, including regulatory and listing requirements and business practices, with the objective of maintaining and strengthening its contribution to market integrity and economic performance. As part of this, it is important to take into account the interactions and complementarity between different elements of the corporate governance framework and its overall ability to promote ethical, responsible and transparent corporate governance practices. Such analysis should be viewed as an important tool in the process of developing an effective corporate governance framework. To this end, effective and continuous consultation with the public is an essential element that is widely regarded as good practice. Moreover, in developing a corporate governance framework in each jurisdiction, national legislators and regulators should duly consider the need for, and the results from, effective international dialogue and cooperation. If these conditions are met, the governance system is more likely to avoid over-regulation, support the exercise of entrepreneurship and limit the risks of damaging conflicts of interest in both the private sector and in public institutions.

3.1.1. The corporate governance framework should be developed with a view to its impact on overall economic performance, market integrity and the incentives it creates for market participants and the promotion of transparent and efficient markets.

The corporate form of organisation of economic activity is a powerful force for growth. The regulatory and legal environment within which corporations operate is therefore of key importance to overall economic outcomes. Policy makers have a responsibility to put in place a framework that is flexible enough to meet the needs of corporations operating in widely different circumstances, facilitating their development of new opportunities to create value and to determine the most efficient deployment of resources. To achieve this goal, policy makers should remain focused on ultimate economic outcomes and when considering policy options, they will need to undertake an analysis of the impact on key variables that affect the functioning of markets, such as incentive structures, the efficiency of self-regulatory systems and dealing with systemic conflicts of interest. Transparent and efficient markets serve to discipline market participants and to promote accountability.

3.1.2. The legal and regulatory requirements that affect corporate governance practices in a jurisdiction should be consistent with the rule of law, transparent and enforceable.

If new laws and regulations are needed, such as to deal with clear cases of market imperfections, they should be designed in a way that makes them possible to implement and enforce in an efficient and even handed manner covering all parties. Consultation by government and other regulatory authorities with corporations, their representative organisations and other stakeholders, is an effective way of doing this. Mechanisms should also be established for parties to protect their rights. In order to avoid over-regulation, unenforceable laws, and unintended consequences that may impede or distort business dynamics, policy measures should be designed with a view to their overall costs and benefits. Such assessments should take into account the need for effective enforcement, including the ability of authorities to deter dishonest behaviour and to impose effective sanctions for violations.

Corporate governance objectives are also formulated in voluntary codes and standards that do not have the status of law or regulation. While such codes play an important role in improving corporate governance arrangements, they might leave shareholders and other stakeholders with uncertainty concerning their status and implementation. When codes and

principles are used as a national standard or as an explicit substitute for legal or regulatory provisions, market credibility requires that their status in terms of coverage, implementation, compliance and sanctions is clearly specified.

3.1.3. The division of responsibilities among different authorities in a jurisdiction should be clearly articulated and ensure that the public interest is served.

Corporate governance requirements and practices are typically influenced by an array of legal domains, such as company law, securities regulation, accounting and auditing standards, insolvency law, contract law, labour law and tax law. Under these circumstances, there is a risk that the variety of legal influences may cause unintentional overlaps and even conflicts, which may frustrate the ability to pursue key corporate governance objectives. It is important that policy-makers are aware of this risk and take measures to limit it. Effective enforcement also requires that the allocation of responsibilities for supervision, implementation and enforcement among different authorities is clearly defined so that the competencies of complementary bodies and agencies are respected and used most effectively. Overlapping and perhaps contradictory regulations between national jurisdictions is also an issue that should be monitored so that no regulatory vacuum is allowed to develop (i.e. issues slipping through in which no authority has explicit responsibility) and to minimise the cost of compliance with multiple systems by corporations.

When regulatory responsibilities or oversight are delegated to non-public bodies, it is desirable to explicitly assess why, and under what circumstances, such delegation is desirable. It is also essential that the governance structure of any such delegated institution be transparent and encompass the public interest.

3.1.4. Supervisory, regulatory and enforcement authorities should have the authority,integrity and resources to fulfil their duties in a professional and objective manner. Moreover, their rulings should be timely, transparent and fully explained.

Regulatory responsibilities should be vested with bodies that can pursue their functions without conflicts of interest and that are subject to judicial review. As the number of public companies, corporate events and the volume of disclosures increase, the resources of supervisory, regulatory and enforcement authorities may come under strain. As a result, in order to follow developments, they will have a significant demand for fully qualified staff to provide effective oversight and investigative capacity

which will need to be appropriately funded. The ability to attract staff on competitive terms will enhance the quality and independence of supervision and enforcement.

3.2. The Rights of Shareholders and Key Ownership Functions

The corporate governance framework should protect and facilitate the exercise of shareholders' rights.

Equity investors have certain property rights. For example, an equity share in a publicly traded company can be bought, sold, or transferred. An equity share also entitles the investor to participate in the profits of the corporation, with liability limited to the amount of the investment. In addition, ownership of an equity share provides a right to information about the corporation and a right to influence the corporation, primarily by participation in general shareholder meetings and by voting.

As a practical matter, however, the corporation cannot be managed by shareholder referendum. The shareholding body is made up of individuals and institutions whose interests, goals, investment horizons and capabilities vary. Moreover, the corporation's management must be able to take business decisions rapidly. In light of these realities and the complexity of managing the corporation's affairs in fast moving and ever changing markets, shareholders are not expected to assume responsibility for managing corporate activities. The responsibility for corporate strategy and operations is typically placed in the hands of the board and a management team that is selected, motivated and, when necessary, replaced by the board.

Shareholders' rights to influence the corporation centre on certain fundamental issues, such as the election of board members, or other means of influencing the composition of the board, amendments to the company's organic documents, approval of extraordinary transactions, and other basic issues as specified in company law and internal company statutes. This Section can be seen as a statement of the most basic rights of shareholders, which are recognised by law in virtually all OECD countries. Additional rights such as the approval or election of auditors, direct nomination of board members, the ability to pledge shares, the approval of distributions of profits, etc., can be found in various jurisdictions.

3.2.1 Basic shareholder rights should include the right to:

(1) Secure methods of ownership registration;
(2) Convey or transfer shares;
(3) Obtain relevant and material information on the corporation on a

timely and regular basis;
(4) Participate and vote in general shareholder meetings;
(5) Elect and remove members of the board; and
(6) Share in the profits of the corporation.

3.2.2. Shareholders should have the right to participate in, and to be sufficiently informed on, decisions concerning fundamental corporate changes such as:

(1) Amendments to the statutes, or articles of incorporation or similar governing documents of the company;
(2) The authorisation of additional shares; and
(3) Extraordinary transactions, including the transfer of all or substantially all assets, that in effect result in the sale of the company.

The ability of companies to form partnerships and related companies and to transfer operational assets, cash flow rights and other rights and obligations to them is important for business flexibility and for delegating accountability in complex organisations. It also allows a company to divest itself of operational assets and to become only a holding company. However, without appropriate checks and balances such possibilities may also be abused.

3.2.3. Shareholders should have the opportunity to participate effectively and vote in general shareholder meetings and should be informed of the rules, including voting procedures, that govern general shareholder meetings:

(1) Shareholders should be furnished with sufficient and timely information concerning the date, location and agenda of general meetings, as well as full and timely information regarding the issues to be decided at the meeting.

(2) Shareholders should have the opportunity to ask questions to the board, including questions relating to the annual external audit, to place items on the agenda of general meetings, and to propose resolutions, subject to reasonable limitations.

In order to encourage shareholder participation in general meetings, some companies have improved the ability of shareholders to place items on the agenda by simplifying the process of filing amendments and resolutions.

Improvements have also been made in order to make it easier for shareholders to submit questions in advance of the general meeting

and to obtain replies from management and board members. Shareholders should also be able to ask questions relating to the external audit report. Companies are justified in assuring that abuses of such opportunities do not occur. It is reasonable, for example, to require that in order for shareholder resolutions to be placed on the agenda, they need to be supported by shareholders holding a specified market value or percentage of shares or voting rights.

This threshold should be determined taking into account the degree of ownership concentration, in order to ensure that minority shareholders are not effectively prevented from putting any items on the agenda. Shareholder resolutions that are approved and fall within the competence of the shareholders' meeting should be addressed by the board.

(3) Effective shareholder participation in key corporate governance decisions, such as the nomination and election of board members, should be facilitated. Shareholders should be able to make their views known on the remuneration policy for board members and key executives. The equity component of compensation schemes for board members and employees should be subject to shareholder approval.

To elect the members of the board is a basic shareholder right. For the election process to be effective, shareholders should be able to participate in the nomination of board members and vote on individual nominees or on different lists of them. To this end, shareholders have access in a number of countries to the company's proxy materials which are sent to shareholders, although sometimes subject to conditions to prevent abuse. With respect to nomination of candidates, boards in many companies have established nomination committees to ensure proper compliance with established nomination procedures and to facilitate and coordinate the search for a balanced and qualified board. It is increasingly regarded as good practice in many countries for independent board members to have a key role on this committee. To further improve the selection process, the principles also call for full disclosure of the experience and background of candidates for the board and the nomination process, which will allow an informed assessment of the abilities and suitability of each candidate.

The principles call for the disclosure of remuneration policy by the board. In particular, it is important for shareholders to know the specific link between remuneration and company performance when they assess the capability of the board and the qualities they should seek in

nominees for the board. Although board and executive contracts are not an appropriate subject for approval by the general meeting of shareholders, there should be a means by which they can express their views. Several countries have introduced an advisory vote which conveys the strength and tone of shareholder sentiment to the board without endangering employment contracts. In the case of equity-based schemes, their potential to dilute shareholders' capital and to powerfully determine managerial incentives means that they should be approved by shareholders, either for individuals or for the policy of the scheme as a whole. In an increasing number of jurisdictions, any material changes to existing schemes must also be approved.

(4) Shareholders should be able to vote in person or in absentia, and equal effect should be given to votes whether cast in person or in absentia.

The principles recommend that voting by proxy be generally accepted. Indeed, it is important to the promotion and protection of shareholder rights that investors can place reliance upon directed proxy voting. The corporate governance framework should ensure that proxies are voted in accordance with the direction of the proxy holder and that disclosure is provided in relation to how undirected proxies will be voted. In those jurisdictions where companies are allowed to obtain proxies, it is important to disclose how the Chairperson of the meeting (as the usual recipient of shareholder proxies obtained by the company) will exercise the voting rights attaching to undirected proxies. Where proxies are held by the board or management for company pension funds and for employee stock ownership plans, the directions for voting should be disclosed.

The objective of facilitating shareholder participation suggests that companies consider favourably the enlarged use of information technology in voting, including secure electronic voting in absentia.

3.2.4. Capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership should be disclosed.

Some capital structures allow a shareholder to exercise a degree of control over the corporation disproportionate to the shareholders' equity ownership in the company.
Pyramid structures, cross shareholdings and shares with limited or multiple voting rights can be used to diminish the capability of non-controlling shareholders to influence corporate policy.

In addition to ownership relations, other devices can affect control over the corporation. Shareholder agreements are a common means for groups of shareholders, who individually may hold relatively small shares of total equity, to act in concert so as to constitute an effective majority, or at least the largest single block of shareholders. Shareholder agreements usually give those participating in the agreements preferential rights to purchase shares if other parties to the agreement wish to sell. These agreements can also contain provisions that require those accepting the agreement not to sell their shares for a specified time. Shareholder agreements can cover issues such as how the board or the Chairman will be selected. The agreements can also oblige those in the agreement to vote as a block. Some countries have found it necessary to closely monitor such agreements and to limit their duration.

Voting caps limit the number of votes that a shareholder may cast, regardless of the number of shares the shareholder may actually possess. Voting caps therefore redistribute control and may affect the incentives for shareholder participation in shareholder meetings.
Given the capacity of these mechanisms to redistribute the influence of shareholders on company policy, shareholders can reasonably expect that all such capital structures and arrangements be disclosed.

3.2.5. Markets for corporate control should be allowed to function in an efficient and transparent manner.

(1) The rules and procedures governing the acquisition of corporate control in the capital markets, and extraordinary transactions such as mergers, and sales of substantial portions of corporate assets, should be clearly articulated and disclosed so that investors understand their rights and recourse. Transactions should occur at transparent prices and under fair conditions that protect the rights of all shareholders according to their class.

(2) Anti-take-over devices should not be used to shield management and the board from accountability.
In some countries, companies employ anti-take-over devices. However, both investors and stock exchanges have expressed concern over the possibility that widespread use of anti-take-over devices may be a serious impediment to the functioning of the market for corporate control. In some instances, take-over defences can simply be devices to shield the management or the board from shareholder monitoring. In implementing any anti-takeover devices and in dealing with take-over

proposals, the fiduciary duty of the board to shareholders and the company must remain paramount.

3.2.6. The exercise of ownership rights by all shareholders, including institutional investors, should be facilitated.

As investors may pursue different investment objectives, the principles do not advocate any particular investment strategy and do not seek to prescribe the optimal degree of investor activism. Nevertheless, in considering the costs and benefits of exercising their ownership rights, many investors are likely to conclude that positive financial returns and growth can be obtained by undertaking a reasonable amount of analysis and by using their rights.

(1) Institutional investors acting in a fiduciary capacity should disclose their overall corporate governance and voting policies with respect to their investments, including the procedures that they have in place for deciding on the use of their voting rights.
It is increasingly common for shares to be held by institutional investors. The effectiveness and credibility of the entire corporate governance system and company oversight will, therefore, to a large extent depend on institutional investors that can make informed use of their shareholder rights and effectively exercise their ownership functions in companies in which they invest. While this principle does not require institutional investors to vote their shares, it calls for disclosure of how they exercise their ownership rights with due consideration to cost effectiveness. For institutions acting in a fiduciary capacity, such as pension funds, collective investment schemes and some activities of insurance companies, the right to vote can be considered part of the value of the investment being undertaken on behalf of their clients. Failure to exercise the ownership rights could result in a loss to the investor who should therefore be made aware of the policy to be followed by the institutional investors.

In some countries, the demand for disclosure of corporate governance policies to the market is quite detailed and includes requirements for explicit strategies regarding the circumstances in which the institution will intervene in a company; the approach they will use for such intervention; and how they will assess the effectiveness of the strategy. In several countries institutional investors are either required to disclose their actual voting records or it is regarded as good practice and implemented on an "apply or explain" basis. Disclosure is either to their clients (only with respect to the securities of each client) or, in the case

of investment advisors to registered investment companies, to the market, which is a less costly procedure. A complementary approach to participation in shareholders' meetings is to establish a continuing dialogue with portfolio companies. Such a dialogue between institutional investors and companies should be encouraged, especially by lifting unnecessary regulatory barriers, although it is incumbent on the company to treat all investors equally and not to divulge information to the institutional investors which is not at the same time made available to the market. The additional information provided by a company would normally therefore include general background information about the markets in which the company is operating and further elaboration of information already available to the market.

When fiduciary institutional investors have developed and disclosed a corporate governance policy, effective implementation requires that they also set aside the appropriate human and financial resources to pursue this policy in a way that their beneficiaries and portfolio companies can expect.

(2) Institutional investors acting in a fiduciary capacity should disclose how they manage material conflicts of interest that may affect the exercise of key ownership rights regarding their investments.

The incentives for intermediary owners to vote their shares and exercise key ownership functions may, under certain circumstances, differ from those of direct owners. Such differences may sometimes be commercially sound but may also arise from conflicts of interest which are particularly acute when the fiduciary institution is a subsidiary or an affiliate of another financial institution, and especially an integrated financial group. When such conflicts arise from material business relationships, for example, through an agreement to manage the portfolio company's funds, such conflicts should be identified and disclosed.

At the same time, institutions should disclose what actions they are taking to minimise the potentially negative impact on their ability to exercise key ownership rights. Such actions may include the separation of bonuses for fund management from those related to the acquisition of new business elsewhere in the organisation.

3.2.7. Shareholders, including institutional shareholders, should be allowed to consult with each other on issues concerning their basic shareholder rights as defined in the Principles, subject to exceptions to prevent abuse.

It has long been recognised that in companies with dispersed ownership, individual shareholders might have too small a stake in the company to warrant the cost of taking action or for making an investment in monitoring performance. Moreover, if small shareholders did invest resources in such activities, others would also gain without having contributed (i.e. they are "free riders"). This effect, which serves to lower incentives for monitoring, is probably less of a problem for institutions, particularly financial institutions acting in a fiduciary capacity, in deciding whether to increase their ownership to a significant stake in individual companies, or to rather simply diversify. However, other costs with regard to holding a significant stake might still be high. In many instances institutional investors are prevented from doing this because it is beyond their capacity or would require investing more of their assets in one company than may be prudent. To overcome this asymmetry which favours diversification, they should be allowed, and even encouraged, to co-operate and co-ordinate their actions in nominating and electing board members, placing proposals on the agenda and holding discussions directly with a company in order to improve its corporate governance. More generally, shareholders should be allowed to communicate with each other without having to comply with the formalities of proxy solicitation.

It must be recognised, however, that co-operation among investors could also be used to manipulate markets and to obtain control over a company without being subject to any takeover regulations. Moreover, co-operation might also be for the purposes of circumventing competition law. For this reason, in some countries, the ability of institutional investors to co-operate on their voting strategy is either limited or prohibited. Shareholder agreements may also be closely monitored. However, if co-operation does not involve issues of corporate control, or conflict with concerns about market efficiency and fairness, the benefits of more effective ownership may still be obtained.

Necessary disclosure of co-operation among investors, institutional or otherwise, may have to be accompanied by provisions which prevent trading for a period so as to avoid the possibility of market manipulation.

3.3. The Equitable Treatment of Shareholders

The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders

should have the opportunity to obtain effective redress for violation of their rights.

Investors' confidence that the capital they provide will be protected from misuse or misappropriation by corporate managers, board members or controlling shareholders is an important factor in the capital markets. Corporate boards, managers and controlling shareholders may have the opportunity to engage in activities that may advance their own interests at the expense of non-controlling shareholders. In providing protection to investors, a distinction can usefully be made between *ex-ante* and *ex-post* shareholder rights. *Ex-ante* rights are, for example, pre-emptive rights and qualified majorities for certain decisions. *Ex-post* rights allow the seeking of redress once rights have been violated. In jurisdictions where the enforcement of the legal and regulatory framework is weak, some countries have found it desirable to strengthen the *ex-ante* rights of shareholders such as by low share ownership thresholds for placing items on the agenda of the shareholders meeting or by requiring a supermajority of shareholders for certain important decisions. The principles support equal treatment for foreign and domestic shareholders in corporate governance. They do not address government policies to regulate foreign direct investment.

One of the ways in which shareholders can enforce their rights is to be able to initiate legal and administrative proceedings against management and board members. Experience has shown that an important determinant of the degree to which shareholder rights are protected is whether effective methods exist to obtain redress for grievances at a reasonable cost and without excessive delay. The confidence of minority investors is enhanced when the legal system provides mechanisms for minority shareholders to bring lawsuits when they have reasonable grounds to believe that their rights have been violated. The provision of such enforcement mechanisms is a key responsibility of legislators and regulators.

There is some risk that a legal system, which enables any investor to challenge corporate activity in the courts, can become prone to excessive litigation. Thus, many legal systems have introduced provisions to protect management and board members against litigation abuse in the form of tests for the sufficiency of shareholder complaints, so-called safe harbours for management and board member actions (such as the business judgement rule) as well as safe harbours for the disclosure of information. In the end, a balance must be struck between allowing investors to seek remedies for infringement of ownership rights and avoiding excessive litigation. Many countries have found that alternative adjudication procedures, such as administrative hearings or arbitration

procedures organised by the securities regulators or other regulatory bodies, are an efficient method for dispute settlement, at least at the first instance level.

3.3.1. All shareholders of the same series of a class should be treated equally.

(1) Within any series of a class, all shares should carry the same rights. All investors should be able to obtain information about the rights attached to all series and classes of shares before they purchase. Any changes in voting rights should be subject to approval by those classes of shares which are negatively affected.

The optimal capital structure of the firm is best decided by the management and the board, subject to the approval of the shareholders.
Some companies issue preferred (or preference) shares which have a preference in respect of receipt of the profits of the firm but which normally have no voting rights. Companies may also issue participation certificates or shares without voting rights, which would presumably trade at different prices than shares with voting rights. All of these structures may be effective in distributing risk and reward in ways that are thought to be in the best interests of the company and to cost-efficient financing. The principles do not take a position on the concept of "one share one vote". However, many institutional investors and shareholder associations support this concept.

Investors can expect to be informed regarding their voting rights before they invest. Once they have invested, their rights should not be changed unless those holding voting shares have had the opportunity to participate in the decision. Proposals to change the voting rights of different series and classes of shares should be submitted for approval at general shareholders meetings by a specified majority of voting shares in the affected categories.

(2) Minority shareholders should be protected from abusive actions by, or in the interest of, controlling shareholders acting either directly or indirectly, and should have effective means of redress.
Many publicly traded companies have a large controlling shareholder. While the presence of a controlling shareholder can reduce the agency problem by closer monitoring of management, weaknesses in the legal and regulatory framework may lead to the abuse of other shareholders in the company. The potential for abuse is marked where the legal system allows, and the market accepts, controlling shareholders to exercise a level of control which does not correspond to the level of risk

that they assume as owners through exploiting legal devices to separate ownership from control, such as pyramid structures or multiple voting rights. Such abuse may be carried out in various ways, including the extraction of direct private benefits via high pay and bonuses for employed family members and associates, inappropriate related party transactions, systematic bias in business decisions and changes in the capital structure through special issuance of shares favouring the controlling shareholder.

In addition to disclosure, a key to protecting minority shareholders is a clearly articulated duty of loyalty by board members to the company and to all shareholders. Indeed, abuse of minority shareholders is most pronounced in those countries where the legal and regulatory framework is weak in this regard. A particular issue arises in some jurisdictions where groups of companies are prevalent and where the duty of loyalty of a board member might be ambiguous and even interpreted as to the group. In these cases, some countries are now moving to control negative effects by specifying that a transaction in favour of another group company must be offset by receiving a corresponding benefit from other companies of the group.

Other common provisions to protect minority shareholders, which have proven effective, include pre-emptive rights in relation to share issues, qualified majorities for certain shareholder decisions and the possibility to use cumulative voting in electing members of the board. Under certain circumstances, some jurisdictions require or permit controlling shareholders to buy-out the remaining shareholders at a share-price that is established through an independent appraisal. This is particularly important when controlling shareholders decide to de-list an enterprise. Other means of improving minority shareholder rights include derivative and class action law suits. With the common aim of improving market credibility, the choice and ultimate design of different provisions to protect minority shareholders necessarily depends on the overall regulatory framework and the national legal system.

(3) Votes should be cast by custodians or nominees in a manner agreed upon with the beneficial owner of the shares.

In some OECD countries it was customary for financial institutions which held shares in custody for investors to cast the votes of those shares. Custodians such as banks and brokerage firms holding securities as nominees for customers were sometimes required to vote in support of

management unless specifically instructed by the shareholder to do otherwise.

The trend in OECD countries is to remove provisions that automatically enable custodian institutions to cast the votes of shareholders. Rules in some countries have recently been revised to require custodian institutions to provide shareholders with information concerning their options in the use of their voting rights. Shareholders may elect to delegate all voting rights to custodians. Alternatively, shareholders may choose to be informed of all upcoming shareholder votes and may decide to cast some votes while delegating some voting rights to the custodian. It is necessary to draw a reasonable balance between assuring that shareholder votes are not cast by custodians without regard for the wishes of shareholders and not imposing excessive burdens on custodians to secure shareholder approval before casting votes. It is sufficient to disclose to the shareholders that, if no instruction to the contrary is received, the custodian will vote the shares in the way it deems consistent with shareholder interest.

It should be noted that this principle does not apply to the exercise of voting rights by trustees or other persons acting under a special legal mandate (such as, for example, bankruptcy receivers and estate executors).

Holders of depository receipts should be provided with the same ultimate rights and practical opportunities to participate in corporate governance as are accorded to holders of the underlying shares. Where the direct holders of shares may use proxies, the depositary, trust office or equivalent body should therefore issue proxies on a timely basis to depository receipt holders. The depository receipt holders should be able to issue binding voting instructions with respect to the shares, which the depositary or trust office holds on their behalf.

(4) Impediments to cross border voting should be eliminated.

Foreign investors often hold their shares through chains of intermediaries. Shares are typically held in accounts with securities intermediaries, that in turn hold accounts with other intermediaries and central securities depositories in other jurisdictions, while the listed company resides in a third country. Such cross-border chains cause special challenges with respect to determining the entitlement of foreign investors to use their voting rights, and the process of communicating with such investors. In combination with business practices which provide only a very short

notice period, shareholders are often left with only very limited time to react to a convening notice by the company and to make informed decisions concerning items for decision. This makes cross border voting difficult. The legal and regulatory framework should clarify who is entitled to control the voting rights in cross border situations and where necessary to simplify the depository chain. Moreover, notice periods should ensure that foreign investors in effect have similar opportunities to exercise their ownership functions as domestic investors. To further facilitate voting by foreign investors, laws, regulations and corporate practices should allow participation through means which make use of modern technology.

(5) Processes and procedures for general shareholder meetings should allow for equitable treatment of all shareholders. Company procedures should not make it unduly difficult or expensive to cast votes.

The right to participate in general shareholder meetings is a fundamental shareholder right. Management and controlling investors have at times sought to discourage non-controlling or foreign investors from trying to influence the direction of the company. Some companies have charged fees for voting. Other impediments included prohibitions on proxy voting and the requirement of personal attendance at general shareholder meetings to vote. Still other procedures may make it practically impossible to exercise ownership rights. Proxy materials may be sent too close to the time of general shareholder meetings to allow investors adequate time for reflection and consultation. Many companies in OECD countries are seeking to develop better channels of communication and decision-making with shareholders. Efforts by companies to remove artificial barriers to participation in general meetings are encouraged and the corporate governance framework should facilitate the use of electronic voting in absentia.

3.3.2. Insider trading and abusive self-dealing should be prohibited.

Abusive self-dealing occurs when persons having close relationships to the company, including controlling shareholders, exploit those relationships to the detriment of the company and investors. As insider trading entails manipulation of the capital markets, it is prohibited by securities regulations, company law and/or criminal law in most OECD countries. However, not all jurisdictions prohibit such practices, and in some cases enforcement is not vigorous. These practices can be seen as constituting a breach of good corporate governance inasmuch as they violate the principle of equitable treatment of shareholders.

The principles reaffirm that it is reasonable for investors to expect that the abuse of insider power be prohibited. In cases where such abuses are not specifically forbidden by legislation or where enforcement is not effective, it will be important for governments to take measures to remove any such gaps.

3.3.3. Members of the board and key executives should be required to disclose to the board whether they, directly, indirectly or on behalf of third parties, have a material interest in any transaction or matter directly affecting the corporation.

Members of the board and key executives have an obligation to inform the board where they have a business, family or other special relationship outside of the company that could affect their judgement with respect to a particular transaction or matter affecting the company. Such special relationships include situations where executives and board members have a relationship with the company via their association with a shareholder who is in a position to exercise control. Where a material interest has been declared, it is good practice for that person not to be involved in any decision involving the transaction or matter.

3.4 The Role of Stakeholders in Corporate Governance

The corporate governance framework should recognise the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.

A key aspect of corporate governance is concerned with ensuring the flow of external capital to companies both in the form of equity and credit.

Corporate governance is also concerned with finding ways to encourage the various stakeholders in the firm to undertake economically optimal levels of investment in firm-specific human and physical capital. The competitiveness and ultimate success of a corporation is the result of teamwork that embodies contributions from a range of different resource providers including investors, employees, creditors, and suppliers. Corporations should recognise that the contributions of stakeholders constitute a valuable resource for building competitive and profitable companies. It is, therefore, in the long-term interest of corporations to foster wealth-creating cooperation among stakeholders. The governance framework should recognize 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.

3.4.1. The rights of stakeholders that are established by law or through mutual Agreements are to be respected.

In all OECD countries, the rights of stakeholders are established by law (e.g. labour, business, commercial and insolvency laws) or by contractual relations.

Even in areas where stakeholder interests are not legislated, many firms make additional commitments to stakeholders, and concern over corporate reputation and corporate performance often requires the recognition of broader interests.

3.4.2. Where stakeholder interests are protected by law, stakeholders should have the opportunity to obtain effective redress for violation of their rights.

The legal framework and process should be transparent and not impede the ability of stakeholders to communicate and to obtain redress for the violation of rights.

3.4.3. Performance-enhancing mechanisms for employee participation should be permitted to develop.

The degree to which employees participate in corporate governance depends on national laws and practices, and may vary from company to company as well. In the context of corporate governance, performance enhancing mechanisms for participation may benefit companies directly as well as indirectly through the readiness by employees to invest in firm specific skills.

Examples of mechanisms for employee participation include: employee representation on boards; and governance processes such as works councils that consider employee viewpoints in certain key decisions. With respect to performance enhancing mechanisms, employee stock ownership plans or other profit sharing mechanisms are to be found in many countries. Pension commitments are also often an element of the relationship between the company and its past and present employees. Where such commitments involve establishing an independent fund, its trustees should be independent of the company's management and manage the fund for all beneficiaries.

3.4.4. Where stakeholders participate in the corporate governance process, they should have access to relevant, sufficient and reliable information on a timely and regular basis.

Where laws and practice of corporate governance systems provide for participation by stakeholders, it is important that stakeholders have access to information necessary to fulfil their responsibilities.

3.4.5. Stakeholders, including individual employees and their representative bodies, should be able to freely communicate their concerns about illegal or unethical practices to the board and their rights should not be compromised for doing this.

Unethical and illegal practices by corporate officers may not only violate the rights of stakeholders but also be to the detriment of the company and its shareholders in terms of reputation effects and an increasing risk of future financial liabilities. It is therefore to the advantage of the company and its shareholders to establish procedures and safe-harbours for complaints by employees, either personally or through their representative bodies, and others outside the company, concerning illegal and unethical behaviour. In many countries the board is being encouraged by laws and or principles to protect these individuals and representative bodies and to give them confidential direct access to someone independent on the board, often a member of an audit or an ethics committee. Some companies have established an ombudsman to deal with complaints. Several regulators have also established confidential phone and e-mail facilities to receive allegations. While in certain countries representative employee bodies undertake the tasks of conveying concerns to the company, individual employees should not be precluded from, or be less protected, when acting alone. When there is an inadequate response to a complaint regarding contravention of the law, the *OECD Guidelines for Multinational Enterprises* encourage them to report their *bona fide* complaint to the competent public authorities. The company should refrain from discriminatory or disciplinary actions against such employees or bodies.

3.4.6. The corporate governance framework should be complemented by an effective, efficient insolvency framework and by effective enforcement of creditor rights.

Especially in emerging markets, creditors are a key stakeholder and the terms, volume and type of credit extended to firms will depend

importantly on their rights and on their enforceability. Companies with a good corporate governance record are often able to borrow larger sums and on more favourable terms than those with poor records or which operate in nontransparent markets. The framework for corporate insolvency varies widely across countries. In some countries, when companies are nearing insolvency, the legislative framework imposes a duty on directors to act in the interests of creditors, who might therefore play a prominent role in the governance of the company. Other countries have mechanisms which encourage the debtor to reveal timely information about the company's difficulties so that a consensual solution can be found between the debtor and its creditors.

Creditor rights vary, ranging from secured bond holders to unsecured creditors. Insolvency procedures usually require efficient mechanisms for reconciling the interests of different classes of creditors. In many jurisdictions provision is made for special rights such as through "debtor in possession" financing which provides incentives/protection for new funds made available to the enterprise in bankruptcy.

3.5. Disclosure and Transparency

The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.

In most OECD countries a large amount of information, both mandatory and voluntary, is compiled on publicly traded and large unlisted enterprises, and subsequently disseminated to a broad range of users. Public disclosure is typically required, at a minimum, on an annual basis though some countries require periodic disclosure on a semi-annual or quarterly basis, or even more frequently in the case of material developments affecting the company. Companies often make voluntary disclosure that goes beyond minimum disclosure requirements in response to market demand.
A strong disclosure regime that promotes real transparency is a pivotal feature of market-based monitoring of companies and is central to shareholders' ability to exercise their ownership rights on an informed basis.

Experience in countries with large and active equity markets shows that disclosure can also be a powerful tool for influencing the behaviour of companies and for protecting investors. A strong disclosure regime can help to attract capital and maintain confidence in the capital markets. By contrast, weak disclosure and non-transparent practices can contribute to unethical

behaviour and to a loss of market integrity at great cost, not just to the company and its shareholders but also to the economy as a whole.

Shareholders and potential investors require access to regular, reliable and comparable information in sufficient detail for them to assess the stewardship of management, and make informed decisions about the valuation, ownership and voting of shares. Insufficient or unclear information may hamper the ability of the markets to function, increase the cost of capital and result in a poor allocation of resources.

Disclosure also helps improve public understanding of the structure and activities of enterprises, corporate policies and performance with respect to environmental and ethical standards, and companies' relationships with the communities in which they operate. The *OECD Guidelines for Multinational Enterprises* are relevant in this context.

Disclosure requirements are not expected to place unreasonable administrative or cost burdens on enterprises. Nor are companies expected to disclose information that may endanger their competitive position unless] disclosure is necessary to fully inform the investment decision and to avoid misleading the investor. In order to determine what information should be disclosed at a minimum, many countries apply the concept of materiality.

Material information can be defined as information whose omission or misstatement could influence the economic decisions taken by users of information.

The principles support timely disclosure of all material developments that arise between regular reports. They also support simultaneous reporting of information to all shareholders in order to ensure their equitable treatment. In maintaining close relations with investors and market participants, companies must be careful not to violate this fundamental principle of equitable treatment.

3.5.1. Disclosure should include, but not be limited to, material information on:

(1) The financial and operating results of the company.

Audited financial statements showing the financial performance and the financial situation of the company (most typically including the balance sheet, the profit and loss statement, the cash flow statement and notes to the financial statements) are the most widely used source of information on companies. In their current form, the two principal goals of financial statements are to enable appropriate monitoring to take place and to provide the basis to value securities. Management's discussion and analysis of operations is typically included in annual

reports. This discussion is most useful when read in conjunction with the accompanying financial statements. Investors are particularly interested in information that may shed light on the future performance of the enterprise.

Arguably, failures of governance can often be linked to the failure to disclose the "whole picture", particularly where off-balance sheet items are used to provide guarantees or similar commitments between related companies. It is therefore important that transactions relating to an entire group of companies be disclosed in line with high quality internationally recognised standards and include information about contingent liabilities and off-balance sheet transactions, as well as special purpose entities.

(2) Company objectives.
In addition to their commercial objectives, companies are encouraged to disclose policies relating to business ethics, the environment and other public policy commitments. Such information may be important for investors and other users of information to better evaluate the relationship between companies and the communities in which they operate and the steps that companies have taken to implement their objectives.

(3) Major share ownership and voting rights.
One of the basic rights of investors is to be informed about the ownership structure of the enterprise and their rights vis-à-vis the rights of other owners. The right to such information should also extend to information about the structure of a group of companies and intra-group relations.

Such disclosures should make transparent the objectives, nature and structure of the group. Countries often require disclosure of ownership data once certain thresholds of ownership are passed. Such disclosure might include data on major shareholders and others that, directly or indirectly, control or may control the company through special voting rights, shareholder agreements, the ownership of controlling or large blocks of shares, significant cross shareholding relationships and cross guarantees.

Particularly for enforcement purposes, and to identify potential conflicts of interest, related party transactions and insider trading, information about record ownership may have to be complemented with information about beneficial ownership. In cases where major

shareholdings are held through intermediary structures or arrangements, information about the beneficial owners should therefore be obtainable at least by regulatory and enforcement agencies and/or through the judicial process. The OECD template *Options for Obtaining Beneficial Ownership and Control Information* can serve as a useful self-assessment tool for countries that wish to ensure necessary access to information about beneficial ownership.

(4) Remuneration policy for members of the board and key executives, and information about board members, including their qualifications, the selection process, other company directorships and whether they are regarded as independent by the board.

Investors require information on individual board members and key executives in order to evaluate their experience and qualifications and assess any potential conflicts of interest that might affect their judgement.

For board members, the information should include their qualifications, share ownership in the company, membership of other boards and whether they are considered by the board to be an independent member. It is important to disclose membership of other boards not only because it is an indication of experience and possible time pressures facing a member of the board, but also because it may reveal potential conflicts of interest and makes transparent the degree to which there are inter-locking boards.

A number of national principles, and in some cases laws, lay down specific duties for board members who can be regarded as independent and in some instances recommend that a majority of the board should be independent. In many countries, it is incumbent on the board to set out the reasons why a member of the board can be considered independent. It is then up to the shareholders, and ultimately the market, to determine if those reasons are justified. Several countries have concluded that companies should disclose the selection process and especially whether it was open to a broad field of candidates. Such information should be provided in advance of any decision by the general shareholder's meeting or on a continuing basis if the situation has changed materially.

Information about board and executive remuneration is also of concern to shareholders. Of particular interest is the link between remuneration and company performance. Companies are generally expected to

disclose information on the remuneration of board members and key executives so that investors can assess the costs and benefits of remuneration plans and the contribution of incentive schemes, such as stock option schemes, to company performance. Disclosure on an individual basis (including termination and retirement provisions) is increasingly regarded as good practice and is now mandated in several countries. In these cases, some jurisdictions call for remuneration of a certain number of the highest paid executives to be disclosed, while in others it is confined to specified positions.

(5) Related party transactions.
It is important for the market to know whether the company is being run with due regard to the interests of all its investors. To this end, it is essential for the company to fully disclose material related party transactions to the market, either individually, or on a grouped basis, including whether they have been executed at arms-length and on normal market terms. In a number of jurisdictions this is indeed already a legal requirement. Related parties can include entities that control or are under common control with the company, significant shareholders including members of their families and key management personnel.

Transactions involving the major shareholders (or their close family, relations etc.), either directly or indirectly, are potentially the most difficult type of transactions. In some jurisdictions, shareholders above a limit as low as 5 per cent shareholding are obliged to report transactions. Disclosure requirements include the nature of the relationship where control exists and the nature and amount of transactions with related parties, grouped as appropriate. Given the inherent opaqueness of many transactions, the obligation may need to be placed on the beneficiary to inform the board about the transaction, which in turn should make a disclosure to the market. This should not absolve the firm from maintaining its own monitoring, which is an important task for the board.

(6) Foreseeable risk factors.
Users of financial information and market participants need information on reasonably foreseeable material risks that may include: risks that are specific to the industry or the geographical areas in which the company operates; dependence on commodities; financial market risks including interest rate or currency risk; risk related to derivatives and off-balance sheet transactions; and risks related to environmental liabilities. The principles do not envision the disclosure of information in greater detail

than is necessary to fully inform investors of the material and foreseeable risks of the enterprise. Disclosure of risk is most effective when it is tailored to the particular industry in question. Disclosure about the system for monitoring and managing risk is increasingly regarded as good practice.

(7) Issues regarding employees and other stakeholders.
Companies are encouraged, and in some countries even obliged, to provide information on key issues relevant to employees and other stakeholders that may materially affect the performance of the company. Disclosure may include management/employee relations, and relations with other stakeholders such as creditors, suppliers, and local communities.

Some countries require extensive disclosure of information on human resources. Human resource policies, such as programmes for human resource development and training, retention rates of employees and employee share ownership plans, can communicate important information on the competitive strengths of companies to market participants.

(8) Governance structures and policies, in particular, the content of any corporate governance code or policy and the process by which it is implemented.

Companies should report their corporate governance practices, and in a number of countries such disclosure is now mandated as part of the regular reporting. In several countries, companies must implement corporate governance principles set, or endorsed, by the listing authority with mandatory reporting on a "comply or explain" basis. Disclosure of the governance structures and policies of the company, in particular the division of authority between shareholders, management and board members is important for the assessment of a company's governance.

As a matter of transparency, procedures for shareholders meetings should ensure that votes are properly counted and recorded, and that a timely announcement of the outcome is made.

3.5.2. Information should be prepared and disclosed in accordance with high quality standards of accounting and financial and non-financial disclosure.

The application of high quality standards is expected to significantly improve the ability of investors to monitor the company by providing increased reliability and comparability of reporting, and improved insight into company performance. The quality of information substantially depends on the standards under which it is compiled and disclosed. The Principles support the development of high quality internationally recognised standards, which can serve to improve transparency and the comparability of financial statements and other financial reporting between countries. Such standards should be developed through open, independent, and public processes involving the private sector and other interested parties such as professional associations and independent experts. High quality domestic standards can be achieved by making them consistent with one of the internationally recognised accounting standards. In many countries, listed companies are required to use these standards.

3.5.3. An annual audit should be conducted by an independent, competent and qualified, auditor in order to provide an external and objective assurance to the board and shareholders that the financial statements fairly represent the financial position and performance of the company in all material respects.

In addition to certifying that the financial statements represent fairly the financial position of a company, the audit statement should also include an opinion on the way in which financial statements have been prepared and presented. This should contribute to an improved control environment in the company.

Many countries have introduced measures to improve the independence of auditors and to tighten their accountability to shareholders. A number of countries are tightening audit oversight through an independent entity. Indeed, the *Principles of Auditor Oversight* issued by IOSCO in 2002 states that effective auditor oversight generally includes, *inter alia,* mechanisms: "…to provide that a body, acting in the public interest, provides oversight over the quality and implementation, and ethical standards used in the jurisdiction, as well as audit quality control environments"; and "...to require auditors to be subject to the discipline of an auditor oversight body that is independent of the audit profession, or, if a professional body acts as the oversight body, is overseen by an independent body". It is desirable for such an auditor oversight body to operate in the public interest, and have an appropriate membership, an adequate charter of

responsibilities and powers, and adequate funding that is not under the control of the auditing profession, to carry out those responsibilities.

It is increasingly common for external auditors to be recommended by an independent audit committee of the board or an equivalent body and to be appointed either by that committee/body or by shareholders directly. Moreover, the IOSCO *Principles of Auditor Independence and the Role of Corporate Governance in Monitoring an Auditor's Independence* states that, "standards of auditor independence should establish a framework of principles, supported by a combination of prohibitions, restrictions, other policies and procedures and disclosures, that addresses at least the following threats to independence: self-interest, self-review, advocacy, familiarity and intimidation".

The audit committee or an equivalent body is often specified as providing oversight of the internal audit activities and should also be charged with overseeing the overall relationship with the external auditor including the nature of non-audit services provided by the auditor to the company. Provision of non-audit services by the external auditor to a company can significantly impair their independence and might involve them auditing their own work. To deal with the skewed incentives which may arise, a number of countries now call for disclosure of payments to external auditors for non-audit services.

Examples of other provisions to underpin auditor independence include, a total ban or severe limitation on the nature of non-audit work which can be undertaken by an auditor for their audit client, mandatory rotation of auditors (either partners or in some cases the audit partnership), a temporary ban on the employment of an ex-auditor by the audited company and prohibiting auditors or their dependents from having a financial stake or management role in the companies they audit. Some countries take a more direct regulatory approach and limit the percentage of non-audit income that the auditor can receive from a particular client or limit the total percentage of auditor income that can come from one client. An issue which has arisen in some jurisdictions concerns the pressing need to ensure the competence of the audit profession. In many cases there is a registration process for individuals to confirm their qualifications. This needs, however, to be supported by ongoing training and monitoring of work experience to ensure an appropriate level of professional competence.

3.5.4 External auditors should be accountable to the shareholders and owe a duty to the company to exercise due professional care in the conduct of

the audit.

The practice that external auditors are recommended by an independent audit committee of the board or an equivalent body and that external auditors are appointed either by that committee/body or by the shareholders' meeting directly can be regarded as good practice since it clarifies that the external auditor should be accountable to the shareholders. It also underlines that the external auditor owes a duty of due professional care to the company rather than any individual or group of corporate managers that they may interact with for the purpose of their work.

3.5.5. Channels for disseminating information should provide for equal, timely And cost-efficient access to relevant information by users.

Channels for the dissemination of information can be as important as the content of the information itself. While the disclosure of information is often provided for by legislation, filing and access to information can be cumbersome and costly. Filing of statutory reports has been greatly enhanced in some countries by electronic filing and data retrieval systems. Some countries are now moving to the next stage by integrating different sources of company information, including shareholder filings. The Internet and other information technologies also provide the opportunity for improving information dissemination.

A number of countries have introduced provisions for ongoing disclosure (often prescribed by law or by listing rules) which includes periodic disclosure and continuous or current disclosure which must be provided on an *ad hoc* basis. With respect to continuous/current disclosure, good practice is to call for "immediate" disclosure of material developments, whether this means "as soon as possible" or is defined as a prescribed maximum number of specified days. The IOSCO *Principles for Ongoing Disclosure and Material Development Reporting by Listed Entities* set forth common principles of ongoing disclosure and material development reporting for listed companies.

3.5.6. The corporate governance framework should be complemented by an Effective approach that addresses and promotes the provision of analysis or advice by analysts, brokers, rating agencies and others, that is relevant to decisions by investors, free from material conflicts of interest that might compromise the integrity of their analysis or advice.

In addition to demanding independent and competent auditors, and to facilitate timely dissemination of information, a number of countries have taken steps to ensure the integrity of those professions and activities that serve as conduits of analysis and advice to the market. These intermediaries, if they are operating free from conflicts and with integrity, can play an important role in providing incentives for company boards to follow good corporate governance practices.

Concerns have arisen, however, in response to evidence that conflicts of interest often arise and may affect judgement. This could be the case when the provider of advice is also seeking to provide other services to the company in question, or where the provider has a direct material interest in the company or its competitors. The concern identifies a highly relevant dimension of the disclosure and transparency process that targets the professional standards of stock market research analysts, rating agencies, investment banks, etc.

Experience in other areas indicates that the preferred solution is to demand full disclosure of conflicts of interest and how the entity is choosing to manage them. Particularly important will be disclosure about how the entity is structuring the incentives of its employees in order to eliminate the potential conflict of interest. Such disclosure allows investors to judge the risks involved and the likely bias in the advice and information. IOSCO has developed statements of principles relating to analysts and rating agencies (*IOSCO Statement of Principles for Addressing Sell-side Securities Analyst Conflicts of Interest; IOSCO Statement of Principles Regarding the Activities of Credit Rating Agencies*).

3.6 The Responsibilities of the Board

The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.

Board structures and procedures vary both within and among OECD countries. Some countries have two-tier boards that separate the supervisory function and the management function into different bodies. Such systems typically have a "supervisory board" composed of non-executive board members and a "management board" composed entirely of executives. Other countries have "unitary" boards, which bring together executive and nonexecutive board members. In some countries there is also an additional statutory body for audit purposes. The Principles are intended to be sufficiently general to apply to

whatever board structure is charged with the functions of governing the enterprise and monitoring management.

Together with guiding corporate strategy, the board is chiefly responsible for monitoring managerial performance and achieving an adequate return for shareholders, while preventing conflicts of interest and balancing competing demands on the corporation. In order for boards to effectively fulfil their responsibilities they must be able to exercise objective and independent judgement. Another important board responsibility is to oversee systems designed to ensure that the corporation obeys applicable laws, including tax, competition, labour, environmental, equal opportunity, health and safety laws. In some countries, companies have found it useful to explicitly articulate the responsibilities that the board assumes and those for which management is accountable.

The board is not only accountable to the company and its shareholders but also has a duty to act in their best interests. In addition, boards are expected to take due regard of, and deal fairly with, other stakeholder interests including those of employees, creditors, customers, suppliers and local communities. Observance of environmental and social standards is relevant in this context.

3.6.1 Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders.

In some countries, the board is legally required to act in the interest of the company, taking into account the interests of shareholders, employees, and the public good. Acting in the best interest of the company should not permit management to become entrenched.

This principle states the two key elements of the fiduciary duty of board members: the duty of care and the duty of loyalty. The duty of care requires board members to act on a fully informed basis, in good faith, with due diligence and care. In some jurisdictions there is a standard of reference which is the behaviour that a reasonably prudent person would exercise in similar circumstances. In nearly all jurisdictions, the duty of care does not extend to errors of business judgement so long as board members are not grossly negligent and a decision is made with due diligence etc. The principle calls for board members to act on a fully informed basis. Good practice takes this to mean that they should be satisfied that key corporate information and compliance systems are fundamentally sound and underpin the key monitoring role of the board advocated by the principles. In many jurisdictions this meaning is already

considered an element of the duty of care, while in others it is required by securities regulation, accounting standards etc.

The duty of loyalty is of central importance, since it underpins effective implementation of other principles in this document relating to, for example, the equitable treatment of shareholders, monitoring of related party transactions and the establishment of remuneration policy for key executives and board members. It is also a key principle for board members who are working within the structure of a group of companies: even though a company might be controlled by another enterprise, the duty of loyalty for a board member relates to the company and all its shareholders and not to the controlling company of the group.

3.6.2. Where board decisions may affect different shareholder groups differently, the board should treat all shareholders fairly.

In carrying out its duties, the board should not be viewed, or act, as an assembly of individual representatives for various constituencies. While specific board members may indeed be nominated or elected by certain shareholders (and sometimes contested by others) it is an important feature of the board's work that board members when they assume their responsibilities carry out their duties in an even-handed manner with respect to all shareholders. This principle is particularly important to establish in the presence of controlling shareholders that *de facto* may be able to select all board members.

3.6.3. The board should apply high ethical standards. It should take into account the interests of stakeholders.

The board has a key role in setting the ethical tone of a company, not only by its own actions, but also in appointing and overseeing key executives and consequently the management in general. High ethical standards are in the long term interests of the company as a means to make it credible and trustworthy, not only in day-to-day operations but also with respect to longer term commitments. To make the objectives of the board clear and operational, many companies have found it useful to develop company codes of conduct based on, *inter alia*, professional standards and sometimes broader codes of behaviour. The latter might include a voluntary commitment by the company (including its subsidiaries) to comply with the *OECD Guidelines for Multinational Enterprises* which reflect all four principles contained in the *ILO Declaration on Fundamental Labour Rights*. Company-wide codes serve as a standard for conduct by both the board and key executives, setting

the framework for the exercise of judgement in dealing with varying and often conflicting constituencies. At a minimum, the ethical code should set clear limits on the pursuit of private interests, including dealings in the shares of the company. An overall framework for ethical conduct goes beyond compliance with the law, which should always be a fundamental requirement.

3.6.4. The board should fulfil certain key functions, including:

(1) Reviewing and guiding corporate strategy, major plans of action, risk policy, annual budgets and business plans; setting performance objectives; monitoring implementation and corporate performance; and overseeing major capital expenditures, acquisitions and divestitures.

An area of increasing importance for boards and which is closely related to corporate strategy is risk policy. Such policy will involve specifying the types and degree of risk that a company is willing to accept in pursuit of its goals. It is thus a crucial guideline for management that must manage risks to meet the company's desired risk profile.

(2) Monitoring the effectiveness of the company's governance practices and making changes as needed**.**

Monitoring of governance by the board also includes continuous review of the internal structure of the company to ensure that there are clear lines of accountability for management throughout the organisation. In addition to requiring the monitoring and disclosure of corporate governance practices on a regular basis, a number of countries have moved to recommend or indeed mandate self-assessment by boards of their performance as well as performance reviews of individual board members and the CEO/Chairman.

(3) Selecting, compensating, monitoring and, when necessary, replacing key executives and overseeing succession planning.

In two tier board systems the supervisory board is also responsible for appointing the management board which will normally comprise most of the key executives.

(4) Aligning key executive and board remuneration with the longer term interests of the company and its shareholders.

In an increasing number of countries it is regarded as good practice for boards to develop and disclose a remuneration policy statement covering board members and key executives. Such policy statements specify the relationship between remuneration and performance, and include measurable standards that emphasise the longer run interests of the company over short term considerations. Policy statements generally tend to set conditions for payments to board members for extra-board activities, such as consulting. They also often specify terms to be observed by board members and key executives about holding and trading the stock of the company, and the procedures to be followed in granting and re-pricing of options. In some countries, policy also covers the payments to be made when terminating the contract of an executive.

It is considered good practice in an increasing number of countries that remuneration policy and employment contracts for board members and key executives be handled by a special committee of the board comprising either wholly or a majority of independent directors. There are also calls for a remuneration committee that excludes executives that serve on each others' remuneration committees, which could lead to conflicts of interest.

(5) Ensuring a formal and transparent board nomination and election process.
These principles promote an active role for shareholders in the nomination and election of board members. The board has an essential role to play in ensuring that this and other aspects of the nominations and election process are respected. First, while actual procedures for nomination may differ among countries, the board or a nomination committee has a special responsibility to make sure that established procedures are transparent and respected. Second, the board has a key role in identifying potential members for the board with the appropriate knowledge, competencies and expertise to complement the existing skills of the board and thereby improve its value-adding potential for the company. In several countries there are calls for an open search process extending to a broad range of people.

(6) Monitoring and managing potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related party transactions.

It is an important function of the board to oversee the internal control systems covering financial reporting and the use of corporate assets and to guard against abusive related party transactions. These functions are sometimes assigned to the internal auditor which should maintain direct access to the board. Where other corporate officers are responsible such as the general counsel, it is important that they maintain similar reporting responsibilities as the internal auditor. In fulfilling its control oversight responsibilities it is important for the board to encourage the reporting of unethical/unlawful behaviour without fear of retribution. The existence of a company code of ethics should aid this process which should be underpinned by legal protection for the individuals concerned. In a number of companies either the audit committee or an ethics committee is specified as the contact point for employees who wish to report concerns about unethical or illegal behaviour that might also compromise the integrity of financial statements.

(7) Ensuring the integrity of the corporation's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for risk management, financial and operational control, and compliance with the law and relevant standards.

Ensuring the integrity of the essential reporting and monitoring systems will require the board to set and enforce clear lines of responsibility and accountability throughout the organisation. The board will also need to ensure that there is appropriate oversight by senior management. One way of doing this is through an internal audit system directly reporting to the board. In some jurisdictions it is considered good practice for the internal auditors to report to an independent audit committee of the board or an equivalent body which is also responsible for managing the relationship with the external auditor, thereby allowing a coordinated response by the board. It should also be regarded as good practice for this committee, or equivalent body, to review and report to the board the most critical accounting policies which are the basis for financial reports. However, the board should retain final responsibility for ensuring the integrity of the reporting systems. Some countries have provided for the chair of the board to report on the internal control process.

Companies are also well advised to set up internal programmes and procedures to promote compliance with applicable laws, regulations and standards, including statutes to criminalise bribery of foreign officials

that are required to be enacted by the *OECD Anti-bribery Convention* and measures designed to control other forms of bribery and corruption.

Moreover, compliance must also relate to other laws and regulations such as those covering securities, competition and work and safety conditions. Such compliance programmes will also underpin the company's ethical code. To be effective, the incentive structure of the business needs to be aligned with its ethical and professional standards so that adherence to these values is rewarded and breaches of law are met with dissuasive consequences or penalties. Compliance programmes should also extend where possible to subsidiaries.

(8) Overseeing the process of disclosure and communications.
The functions and responsibilities of the board and management with respect to disclosure and communication need to be clearly established by the board. In some companies there is now an investment relations officer who reports directly to the board.

3.6.5. The board should be able to exercise objective independent judgement on corporate affairs.

In order to exercise its duties of monitoring managerial performance, preventing conflicts of interest and balancing competing demands on the corporation, it is essential that the board is able to exercise objective judgement. In the first instance this will mean independence and objectivity with respect to management with important implications for the composition and structure of the board. Board independence in these circumstances usually requires that a sufficient number of board members will need to be independent of management. In a number of countries with single tier board systems, the objectivity of the board and its independence from management may be strengthened by the separation of the role of chief executive and chairman, or, if these roles are combined, by designating a lead non-executive director to convene or chair sessions of the outside directors. Separation of the two posts may be regarded as good practice, as it can help to achieve an appropriate balance of power, increase accountability and improve the board's capacity for decision making independent of management. The designation of a lead director is also regarded as a good practice alternative in some jurisdictions. Such mechanisms can also help to ensure high quality governance of the enterprise and the effective functioning of the board. The Chairman or lead director may, in some countries, be supported by a company secretary. In the case of two tier board systems, consideration should be given to whether corporate governance

concerns might arise if there is a tradition for the head of the lower board becoming the Chairman of the Supervisory Board on retirement.

The manner in which board objectivity might be underpinned also depends on the ownership structure of the company. A dominant shareholder has considerable powers to appoint the board and the management. However, in this case, the board still has a fiduciary responsibility to the company and to all shareholders including minority shareholders.

The variety of board structures, ownership patterns and practices in different countries will thus require different approaches to the issue of board objectivity. In many instances objectivity requires that a sufficient number of board members not be employed by the company or its affiliates and not be closely related to the company or its management through significant economic, family or other ties. This does not prevent shareholders from being board members. In others, independence from controlling shareholders or another controlling body will need to be emphasised, in particular if the exante rights of minority shareholders are weak and opportunities to obtain redress are limited. This has led to both codes and the law in some jurisdictions to call for some board members to be independent of dominant shareholders, independence extending to not being their representative or having close business ties with them. In other cases, parties such as particular creditors can also exercise significant influence. Where there is a party in a special position to influence the company, there should be stringent tests to ensure the objective judgement of the board.

In defining independent members of the board, some national principles of corporate governance have specified quite detailed presumptions for non-independence which are frequently reflected in listing requirements. While establishing necessary conditions, such 'negative' criteria defining when an individual is not regarded as independent can usefully be complemented by 'positive' examples of qualities that will increase the probability of effective independence.

Independent board members can contribute significantly to the decision-making of the board. They can bring an objective view to the evaluation of the performance of the board and management. In addition, they can play an important role in areas where the interests of management, the company and its shareholders may diverge such as executive remuneration, succession planning, changes of corporate control, take-over defences, large acquisitions and the audit function. In order for them

to play this key role, it is desirable that boards declare who they consider to be independent and the criterion for this judgement.

(1) Boards should consider assigning a sufficient number of non-executive board members capable of exercising independent judgement to tasks where there is a potential for conflict of interest. Examples of such key responsibilities are ensuring the integrity of financial and non-financial reporting, the review of related party transactions, nomination of board members and key executives, and board remuneration.

While the responsibility for financial reporting, remuneration and nomination are frequently those of the board as a whole, independent non-executive board members can provide additional assurance to market participants that their interests are defended. The board may also consider establishing specific committees to consider questions where there is a potential for conflict of interest. These committees may require a minimum number or be composed entirely of non-executive members. In some countries, shareholders have direct responsibility for nominating and electing non-executive directors to specialised functions.

(2) When committees of the board are established, their mandate, composition
and working procedures should be well defined and disclosed by the board.

While the use of committees may improve the work of the board they may also raise questions about the collective responsibility of the board and of individual board members. In order to evaluate the merits of board committees it is therefore important that the market receives a full and clear picture of their purpose, duties and composition. Such information is particularly important in the increasing number of jurisdictions where boards are establishing independent audit committees with powers to oversee the relationship with the external auditor and to act in many cases independently. Other such committees include those dealing with nomination and compensation. The accountability of the rest of the board and the board as a whole should be clear. Disclosure should not extend to committees set up to deal with, for example, confidential commercial transactions.

(3) Board members should be able to commit themselves effectively to their responsibilities.

Service on too many boards can interfere with the performance of board members. Companies may wish to consider whether multiple board memberships by the same person are compatible with effective board performance and disclose the information to shareholders. Some countries have limited the number of board positions that can be held. Specific limitations may be less important than ensuring that members of the board enjoy legitimacy and confidence in the eyes of shareholders. Achieving legitimacy would also be facilitated by the publication of attendance records for individual board members (e.g. whether they have missed a significant number of meetings) and any other work undertaken on behalf of the board and the associated remuneration.

In order to improve board practices and the performance of its members, an increasing number of jurisdictions are now encouraging companies to engage in board training and voluntary self-evaluation that meets the needs of the individual company. This might include that board members acquire appropriate skills upon appointment, and thereafter remain abreast of relevant new laws, regulations, and changing commercial risks through in-house training and external courses.

3.6.6. In order to fulfil their responsibilities, board members should have access To accurate, relevant and timely information.

Board members require relevant information on a timely basis in order to support their decision-making. Non-executive board members do not typically have the same access to information as key managers within the company.

The contributions of non-executive board members to the company can be enhanced by providing access to certain key managers within the company such as, for example, the company secretary and the internal auditor, and recourse to independent external advice at the expense of the company. In order to fulfil their responsibilities, board members should ensure that they obtain accurate, relevant and timely information.

4 Changes that lead to improved Corporate Governance after privatization (Case Studies)

Corporate governance plays an important role in transforming business and state relations. As financial crises in Asia and Russia have shown, a murky relationship between government officials and private sector companies can undermine the economy and lead to economic collapse. The lack of transparency in business-state interactions often leads to preferential legal and regulatory treatment, asset stripping, wasting resources, and corruption that undermines the competitiveness of national economies while benefiting a few insiders. Corporate governance helps to address these problems and is an effective solution to corporatism, cronyism, and favoritism.

Privatization is a good example of the corporate governance solution. Within SOEs scheduled for privatization introducing good corporate governance can play an important role in preparing companies for the new challenges brought about by private ownership.

When examining the legacy of privatization in transition economies during the 1990s, much of the corruption, shareholder abuse, and self-dealing that resulted can be directly tied to the failure of the state to establish and require effective governance mechanisms within privatizing firms. Corporate governance, therefore, has a crucial role to play not only in preparing firms for privatization, but also in preventing the potential market mayhem that can occur when firms privatize without effective internal controls, reporting mechanisms, and shareholder protections.

Instituting sound internal corporate governance measures into state-owned firms prior to privatization is crucial to ensuring a smooth transition to private ownership both prior to and after the privatization process. Good internal accounting and controls contribute to effective evaluation and can enhance value by reducing investor costs associated with transitioning accounting practices and building internal control systems. Establishing a model of board governance and management accountability prior to privatization also facilitates a smooth transition to private ownership/governance models.

In cases of voucher or IPO forms of privatization, good corporate governance is important in balancing shareholder expectations and rights with the needs of

majority owners seeking to restructure and reorganize firms. Additionally, improved transparency and good board/stakeholder relations help negotiate conflicts that may occur as a result of these efforts.

The values of fairness, accountability, responsibility, and trust that are hallmarks of good corporate governance are central to developing privatization models that ensure value, ease the privatization transaction, protect stakeholder and shareholder interests, and allow for more efficient post-privatization restructuring.

Case Study 1: Privatization of Kenya Airways

The privatization of Kenya Airways (KQ) was the first-ever privatization of an African airline. The sale of a major state-owned asset is usually a highly charged political event, and the two-year process by which 77% of the shares of Kenya Airways were sold to a broad array of private investors was no exception. From the outset the press and public of Kenya speculated as to how and when the process would fail, and which interests would profit from that failure. Yet the privatization was carried out successfully.

Attracting a strategic investor was a key part of the Kenya Airways privatization. KLM became a strategic investor in Kenya Airways. It purchased 26% of the shares of Kenya Airways and agreed that it would not sell its stake for at least five years. This shareholding gave KLM a significant stake in the profitability of Kenya Airways. KLM's control rights included the voting rights for these shares as well as some specific rights:

- The right to appoint two Directors to the Board of Directors of Kenya Airways
- Under a Cooperation Agreement, the right to veto major strategic decisions, including new aircraft acquisitions or material changes in Kenya Airways route network.
- The right to nominate future candidates for the positions of Managing Director and Finance Director to the Board for approval.

Legal protection for investors is also an important part of effective corporate governance. Without rules against managerial self-dealing and affirmative requirements of managerial responsibility to owners, managers have a stronger incentive to pursue their own interests rather than investors' interests. Under such conditions a company will have difficulty raising capital from rational investors.

Moreover, effective corporate governance also requires protection for minority investors. Without such rules, a major shareholder has a greater incentive to take action to appropriate the value of minority investors' investment. Potential minority investors facing such a hazard are less likely to invest.

Case Study 1: Privatization of Kenya Airways…Cont.

Effective legal protection for investors benefits from a clear understanding of responsibilities and objectives. State owned enterprises typically impose a wide variety of objectives on managers and bureaucrats with control rights. These objectives could include regional development, employment generation, industrial policy, and political patronage, among others. Since these objectives often conflict and change, and often are never explicitly described, managers and bureaucrats of state enterprises have considerable discretion in the objectives that they pursue. In contrast, the fiduciary responsibility of the manager of a private company is clearer: maximize the return to shareholders through actions consistent with the law and widely accepted social norms and values. Thus it tends to be easier to establish effective legal standards of responsibility for managers of private companies than for public sector managers.

While legal protection for investors relates to the institutional structure of financial markets in general, the characteristics of a privatization can affect the ability of managers to protect themselves from malfeasance by managers or other investors. Privatizations that give large stakes to insiders -- current managers and employees -- may lead to less effective corporate governance. When insiders have large shareholdings, outside investors are likely to receive less accurate information about the company's performance, particularly if such information might imply the need for a change in management or a restructuring of employment. Such a hazard makes outsider investors less willing to invest.

Three aspects of the Kenya Airways privatization have implications for legal protection of investors. First, employees and managers of Kenya Airways held after the initial offering about 3% of the shares of the company. This size of insider shareholding is not likely to have significant implications for corporate governance. Second, Kenya Airways has significant minority investors. Over 100,000 individual Kenyans are investors in Kenya Airways. Kenyan and international financial institutions also hold minority stakes. Third, Kenya Airways is a significant part of the Kenya stock market. At its offer price, Kenya Airways had a market capitalization of KShs 5.2 billion, which was about 5% of the market capitalization on the Nairobi Stock Exchange at the time of the offer. Thus the minority shareholder protection rules that govern Kenya Airways shareholders and the fiduciary responsibilities that govern Kenya Airways management play an important role in shaping the Kenyan capital market.

Case Study 2: Private Management of Water Supply in Côte d'Ivoire

Private management of Côte d'Ivoire's water supply has improved efficiency. In the 1960s, the third largest French water utility (SAUR) created an Ivorien subsidiary, the Côte d'Ivoire Water Distribution Company (SODECI). In 1960, SODECI won its first competitive bid to operate and maintain Abidjan's water supply system. Under a mix of *affermage* (lease) and management and concession contracts, it gradually added to its portfolio the management of sewerage and drainage systems and small urban and rural water supply systems throughout the country. In 1978, the company's shares began trading on the Ivorien stock market. Thanks to the technical and managerial expertise of its foreign partner and the strong contractual incentives to cut costs, SODECI achieved remarkable results in urban areas. By the late 1980s water losses had been cut to 12 percent and the collection rate had been raised to 98 percent for private consumers. At 130 water connections per employee, labour productivity was twice that of the next best West African water utility. Moreover, the number of expatriate staff declined from forty to twelve.

Despite SODECI's good record, overall performance in the water sector fared poorly because of the government's investment and pricing policies. For example, the government discriminated against urban industrial consumers, curbing their production and thus reducing job opportunities. Overinvestment led to underutilized capacity – 50 percent in Abidjan and 28 percent in other urban areas – and a breakdown in sector finances. In the mid 1980s, the government attempted to sell to SODECI the water supply infrastructure that it managed (and the associated debts), but the company lacked sufficient capital to purchase the assets. In 1987, the government granted SODECI a further concession for urban water supply. SODECI is now a private company responsible for the public water service throughout Côte d'Ivoire in the framework of a concession contract with exclusive drinking water production and distribution rights in urban areas, excluding rural areas. The company comes under the authority of the Côte d'Ivoire Ministry of Economic Infrastructures and its share distribution is as follows: SAUR International : 46.06%, Private Côte d'Ivoire shareholders : 37.20%, SODECI staff : 5.39%, SIDIP : 4.19%, The State of Côte d'Ivoire : 3.25% and Others : 3.91%.

SODECI is responsible for the fixed assets it is given charge of; responsible for the use and maintenance of all the installations placed under its responsibility according to the concession contract; responsible for the quality and the continuity of the products and services provided; and co-manages, with the State, the National Water Fund, intended to finance the sector's infrastructure investments. To date, the results in quantitative terms are as over 400 localities served today, compared with only one in 1960; over 380,000 clients today (i.e. 6.5 million inhabitants served), compared with under 4,000 clients in 1960; over 1,300 staff today, compared with under 400 in 1960; approximately 8,000 km of network today, compared with under 200 in 1960; over 30,000 new connections per year today, compared with under 3,000 in 1960.

Case Study 3: Privatization of Tema Steel Company Limited, Ghana

Tema Steel Company Limited (TSCL) manufactures steel products for the priority construction industry as well as the engineering industries in Ghana. It plays an active part in turning its facilities in a recycling industry conserving the natural resources and clearing the various scrap metals from the environment.

TSCL took over the assets of the erstwhile GIHOC Steel Works Limited which was liquidated due to its mismanagement and loss making position under the Divestiture Implementation Programme of Ghana. Initially a joint venture agreement company, TSCL us now wholly owned by private investor, Kitjat Holdings Inc. Apart from it name and the existing infrastructure, which its new management maintains, TSCL has assumed a new role and is now a major provider of steel products. Since its repositioning Tema Steel Company Limited is now a joint venture between the Government of Ghana and private investors.

While the company's broad base objectives are to actively participate in the economic development of Ghana and also do mutually rewarding business, its philosophy is of continued development and diversification. One significant achievement of its operation is increase of production levels and the conversion efficiency of rolled products from the billets from the melting shop has been increased to 88 percent. The company has achieved rolling production level of 21,500 tons per annum as compared to an average production level of 4,500TPA during the 27-year period of GIHOC's operation of the company. Additionally sizes of reinforcing bars have been developed. They are 8mm, 10mm, 16mm, and 32mm.

As a result of good organisational structure and improved corporate governance, the management of Tema Steel Company limited recorded a turnover of about $10 million in 1997, a trend which is unlikely to improve as a result of problems besetting the steel sector. The employment figure was 130 in 1991 before divestiture. After the divestiture, the employment in Tema Steel shot up to 500 while minimum take home pay increased twentyfold as compared to 1991.

By making iron rods readily available to the construction sector at competitive prices the company has contributed significantly in reducing reliance on wood for building and has thus helped and continues to support substantially the slowing down of degradation of the ecology. The company has also contributed to society by saving valuable foreign exchange through reduction of steel imports as well as by earning foreign exchange through exports. Businessmen who, through their private initiative and enterprise, export locally manufacture steel products. Conservatively estimated therefore, for every one person directly employed by the steel industry, 10 people are indirectly employed as a result of economic activities generated by the sector.

Case Study 4: Creation of a Corporate Governance code in the Privatization process of Ecopetrol, Colombia

Ecopetrol, formerly known as Empresa Colombiana de Petróleos, is the largest and primary petroleum company in Colombia. Because of its size, Ecopetrol belongs to a group of the 35 largest petroleum companies in the world and it is one of the four principal petroleum companies in Latin America.

In 2005, good corporate governance practices were instituted by Ecopetrol before it entered the process of issuing shares to private investors. In order to create a better business environment for investment, Ecopetrol worked with Confecámaras and CIPE (Center for International Private Enterprise)on a project to create a corporate governance code in order to consolidate and improve their corporate practices. The modifications made to the Corporate Governance Code were intended to making it coherent with the company bylaws, the strategic framework, and the company's new policies and regulations. The Ethics Code was written up with the workers using the company's intranet portal, and, once it was ready, workshops were used to distribute the code to more than 350 employees in administration, production fields, refineries, and transportation stations. Privatization was preceded by the implementation of corporate governance practices in order to create trust within the investor community.

Ecopetrol now uses the national transparency index (ITN for the initials in Spanish). The instrument creates incentives for avoiding corruption and measures the company's improvement in that area and its implementation of measures to lessen the risk of corruption. In December 2006, the Corporación Transparencia por Colombia (Transparency for Colombia Corporation), a non-profit entity that is the Colombian representative for Transparency International, presented the results of its annual nation-wide measurement.

Ecopetrol was ranked in the first place among 23 state-owned and mixed-economy industrial and commercial companies for its good performance and administration during 2005. Its score was 93.32 points out of 100. The report by Corporación Transparencia por Colombia placed Ecopetrol in the group of the 10 best companies in terms of sustained results in the years, 2005 and 2006. Two years after implementing the corporate governance code developed under the project, Ecopetrol decided to go public.

In November 2007, Ecopetrol held an initial public offering on the Colombian Stock Exchange, which raised $5.7 trillion Colombian Pesos (US$2.8 billion) from the sale of a 10.1% stake. On September 18, 2008 Ecopetrol announced the listing of its American Depositary Shares (ADSs) on the New York Stock Exchange (NYSE). Each ADS represents 20 ordinary shares of Ecopetrol common stock. The ADSs began trading that day on the NYSE under the ticker symbol "EC". JPMorgan Chase Bank, N.A. is acting as depositary for the ADS program and LaBranche & Co Inc. serves as the specialist for trading the ADSs. After privatization, Ecopetrol's total revenue and net income have increased from $15.5 m and $3.2m in 2005 to over $25m and $5 m respectively in 2009.

5 Conclusion

The broader view of corporate governance, as a set of mechanisms that deals with institutional reform and not just company-level changes, suggests that it is one of the integral components of successful development strategies. Corporate governance is fundamentally central to building competitive economies, reducing corruption, promoting property rights, and creating jobs and wealth – all of which are components of successful poverty alleviation efforts. The development community must take a closer look at how corporate governance can be used as a tool to improve public governance and promote democratic and market-oriented reforms.

Ultimately, however, efforts to promote corporate governance must take into account the drivers of reforms – both positive and negative. On the negative side, drivers of corporate governance are most frequently associated with financial failures and corporate scandals.
This set of drivers suggests a reactive approach to corporate governance reform. A more proactive approach is associated with positive drivers, which include search of investment, increased competitiveness, and efforts to combat corruption. Seen in this light, corporate governance can be used as a tool to spur broad-based reforms in the areas of investment and company laws, property rights protection, enforcement mechanisms, accounting and tax laws, judicial reform, and others.

As developing markets reform their systems of corporate governance, they must take into account several factors complicating the process. One nuance is the dichotomy of corporate governance and political governance, exemplified by state-owned enterprises. These publicly-owned businesses are run with certain characteristics of the private sector model, but political influence is expected, and often unconstructive. State-owned enterprises are usually structured to deliver a product or service to society, a commitment that is illustrated by board conduct. During privatization there is an intermediate step of corporatization that can weaken a state-owned enterprise. The best way to prepare for the privatization process is by implementing sound corporate governance practices before the process begins.

Effective corporate governance establishes a system that guides the relationship between owners, managers, and various stakeholders, clarifying

what directors and managers are expected to do and how to do it. Its processes inject transparency into the decision-making process, which is precious to shareholders, potential investors, regulators, customers, suppliers, and any other stakeholders who may be affected by a company's actions.

While the international community has many different corporate governance tools ready for implementation, reformers must avoid the temptation of copying successful initiatives from elsewhere. Successful institutional reforms require building local capacity and commitment to reform efforts, not transferring policies from one set of books to another. Seeking access to capital and entry into global markets, the private sector in many emerging markets can become a true leader in corporate governance reform, allowing the benefits of transparency, responsibility, fairness, and accountability to spread across society and help millions to alleviate poverty.

To implement corporate governance practices in SOEs, governments should start with a public-private understanding that recognizes corporate governance as a competitiveness policy. Every economy has to address different corporate governance problems. For this reason, it is imperative to diagnose and understand local issues rather than simply importing "best practices" from other markets. After getting a grasp on local conditions, reformers should develop strategies to resolve specific problems. Some of the drivers of corporate governance – privatization, capital markets, anti-corruption, building capacity, internationalization – represent different ways to achieve implementation, and might also provide useful starting points.

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