USER GUIDE

TOOLKIT 2

Developing Corporate Governance Codes of Best Practice

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Global Corporate Governance Forum

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Foreword

Good corporate governance makes good, hard-nosed business sense. Countries with strong corporate governance practices attract capital. Today's domestic and international investors are likely to shy away from countries that do not guarantee investor rights, that do not provide for adequate corporate disclosure, and that do not ensure sound board practices.

Whilst globalization of economies has increased, and international corporate guidelines have been adopted, each country has its own values, societal norms, way of doing business, and special circumstances. Thus, to guide policymakers, market players, and corporations in adopting sound corporate governance practices at the local level, every country should endeavor to develop its own corporate governance code. It was with this knowledge that the Guidelines for Corporate Governance in the Commonwealth were written.

Of course the principles and guidelines of a country code need to follow international governance standards. Yet, while applying their minds to incorporate international principles, concepts, and developments into a country code, crafting committees must also integrate the special circumstances that pertain to that country.

When developing a corporate governance code, it is preferable to have the support of the government as well as the business community. This does not mean that a corporate governance code should be enforced by way of statute, but it does mean that the code crafting committee and the various task teams that draft the code need to be handpicked so that business leaders, regulators such as stock exchanges, professional bodies such as lawyers and accountants, labor unions, and organized business such as chambers of commerce are all represented on the committee.

Many countries have now adopted corporate governance codes of best practices, but the governance of a company is a dynamic matter. A written code of best practice does not become the law of the Medes and Persians that altereth not. In fact, the code must be revisited, improved, and revised as the conduct of business changes in response to changing mores in society.

In short, the establishment of a code of best practice in a country is a continuous labor of love. It takes time and effort, and there have to be willing participants who want to do it in the interests of their country. Having regard to international institutional investment taking place across an electronic, borderless world, however, every country today should endeavor to establish its own code within the parameters of internationaly approved principles and guidelines of corporate governance.

Mervyn King*, Chairman of the King Committee on Corporate Governance, South Africa*

What is the purpose of this toolkit?

Corporate governance codes are essential tools for enhancing corporate governance practices at the national level. Their primary role is to raise standards and to drive reform efforts. Many developed and developing countries have adopted corporate governance codes of best practice to restore and sustain investor confidence in the wake of a financial crisis or corporate scandals. But corporate governance codes also serve as benchmarks for monitoring and implementing corporate practices and policies at the company level.

This corporate governance reform toolkit emphasizes the purpose and benefits of developing corporate governance codes of best practice. The toolkit focuses on the various steps involved in crafting, disseminating, implementing, monitoring, and reviewing corporate governance codes of best practice.

The toolkit aims to provide users with a variety of tools and examples that can help organizations and individuals produce best practice codes to help improve corporate governance practices at the country level. Because corporate governance codes have now been adopted in many countries, this toolkit draws attention to the importance of monitoring, updating, and improving existing codes of best practice.

The Global Corporate Governance Forum recognizes that there are many different ways and valid approaches to developing and implementing a corporate governance code. Codes can be successfully initiated by governments, business groups, or regulators. They can be implemented through market pressure, professional organizations, or listing rules. Whatever the chosen approach, it is essential that the code comply with international standards while addressing a country's specificities and reform needs.

What is in this toolkit?

This toolkit is divided into two volumes containing, respectively, three and five modules. The first volume addresses the rationale for developing a corporate governance code of best practice, whereas the second volume focuses on the practical process involved in developing and implementing a code. Toolkit users will find guidance on the parties involved in developing a corporate governance code, background materials and recommendations on how to draw up the content of a code, and advice on how to monitor and review existing codes.

Who will find this toolkit useful?

Stakeholders involved in developing, monitoring, and updating a corporate governance code

Although the toolkit provides essential guidance to organizations and individuals developing a corporate governance code for the first time, the methodology and guidance can also help standing corporate governance committees monitor, update, and improve existing corporate governance codes.

This toolkit is aimed primarily at:

- Corporate governance committees or task forces in the process of developing a corporate governance code of best practices at the country level;
- Professional organizations, business associations, and regulators taking the leadership in developing or implementing a corporate governance code of best practice;
- Government agencies seeking to improve corporate governance standards and practices at the country level;
- Corporate governance committees and organizations monitoring, reviewing, and updating existing corporate governance codes.

Public and private organizations and institutions fostering corporate governance reform efforts

This toolkit can furthermore be a useful reference for any public or private organization interested or engaged in fostering corporate governance reforms efforts and who might be consulted about or associated with a new corporate governance initiative. These stakeholders may, for example, include policymakers, regulators, professional associations, training organizations, and the media.

Development agencies

This toolkit can provide useful support to multilateral and bilateral development agencies engaged in funding and supporting local corporate governance reform programs and strengthening corporate governance and disclosure practices at the company level.

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Importance of Corporate Governance

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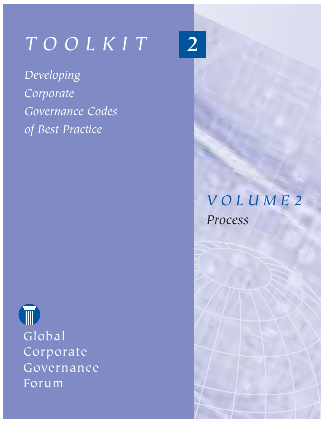

Volume 2 - Process

MODULE 1
Initiating

MODULE 2
Managing

MODULE 3
Consulting

MODULE 4
Researching and Drafting

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Implementing and Monitoring

ANNEXES

Sample Step-by-Step Toolkit Rollout

STEPS	MEETING AGENDA	GO TO*	POST MEETING ACTIVITIES	GO TO*
INITIAL SETUP			The formation of the committee	V2M1
			The appointment of the chairman	V2M1
			The appointment of a project manager	V2M1
			The appointment of a secretary	V2M1
			Initial consultation with key stakeholder	V2M1
			Premeetings and discussions between the chairman and individual members of the committee	V2M1
			Securing funding and support	V2M2
1	Discuss master schedule	V2M2	Finalize detailed master schedule	V2M2
	Agree on the committee's terms of reference	V2M2	Hire consultant	V2M1
	Consider challenges facing the committee	V2M2	Review international best practices	V2M4
	Consider the target and scope of the code	V1M2 V2M2	Review the country's current laws, regulations, and practices	V2M4
	Consider implementation mechanisms and nature of the code's provisions	V1M2 V2M5	Review the country's corporate governance development needs and priorities	V2M4
	Decide on appointment of a consultant	V2M1	Issue a press release explaining the process and describing the committee's terms of reference	V2M3
	Agree on initial press release	V2M3		
2	Agree on finalized master schedule	V2M2	Draft the consultation document	V2M3 V2M4
	Discuss the country's corporate governance needs and priorities	V2M4		
	Review general research findings	V2M4		
	Agree on broad outline of the code	V1M2 V2M4	Consider methods of consultation	V2M3
	Consider formation of subcommittees	V2M4		
	Evaluate the committee's work and progress	V2M2		
3	Discuss the draft of the consultation document	V2M3 V2M4	Finalize consultation document	V2M3 V2M4
	Agree on consultation strategy and methods	V2M3	Set up consultation process	V2M3
	Evaluate the committee's work and progress	V2M2	Start researching specific content of the code	V2M4

STEPS	MEETING AGENDA	GO TO*	POST MEETING ACTIVITIES	GO TO*
4	Agree on consultation document	V2M3 V2M4	Continue research on specific content of the code	V2M4
	Discuss specific research findings and content	V2M4	Start consulting with key stakeholders	V2M3
	Evaluate the committee's work and progress	V2M2	Begin drafting of complete code	V2M4
5	Discuss consultation feedback	V2M4	Continue consulting with key stakeholders	V2M3
	Discuss research findings	V2M4	Finalize first draft of the code	V2M4
	Discuss first full draft of code	V2M4	Develop dissemination and implementation strategy	V2M5
	Evaluate the committee's work and progress	V2M2		
6	Discuss second draft	V2M4	Modify second draft	V2M4
	Discuss consultation feedback	V2M4	Draft foreword and preamble	V2M4
	Approve dissemination and implementation strategy	V2M5		
	Evaluate the committee's work and progress	V2M2		
7	Agree on final code	V2M4	Final proof reading of code	V2M4
	Agree on dates of launching event	V2M5	Arrangement of launch	V2M5
	Approve design and format of code	V2M4	Distribution of code	V2M5
	Agree on press release	V2M5	Liaison with media	V2M3 V2M5
	Evaluate the committee's work and progress	V2M2	Liaison with key stakeholders	V2M3
8	Assess impact of launch	V2M5	Adoption of the code by key stakeholders	V2M1 V2M5
	Agree on time frame and methods to assess the code's impact	V2M5	Integration of recommendations into company charters and policies	V1M3 V2M5
	Agree on time frame to review the code	V2M5	Integration of selected recommendation into listing rules, securities regulations, and other laws and regulations	V2M3 V2M5
	Final evaluation of the committee's work and progress	V2M2 V2M5	Monitoring and measuring the impact of the code	V2M5
			Reviewing and updating the code	V2M5

*V = Volume / M = Module

What tools will you find in this toolkit?

1 Module tabs

Each module is introduced by a color tab that presents the rationale and the key content of the module.

2 Thinking points

Each module features a number of thinking points to help users address key steps in developing, implementing, and reviewing a corporate governance code of best practice.

3 Examples

This toolkit does not advocate a one-size-fits-all model. Rather, it provides a menu of options through examples from around the world, from developing as well as developed countries.

4 Cross-references

Each module includes cross-references to other modules to direct users to related topics and guidelines.

5 Further reading

Volume 1 provides an indicative list of readings that further discuss academic and practical issues related to this toolkit.

6 Quotes

Individual modules include experts' quotes and extracts from existing corporate governance codes of best practice.

7 Annexes

Annexes in each volume provide background information and samples that can help users in their practical, step-by-step approach to developing a corporate governance code.

8 CD ROM

The entire toolkit is contained in the CD ROM included in this user guide.

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Thematic index

contributors

To develop this toolkit and gather lessons learned from developing and developed countries alike, the Global Corporate Governance Forum invited corporate governance reform champions from various regions of the world to share their experiences in developing corporate governance codes of best practice.

The Forum would especially like to thank the following people for their contribution to this toolkit by providing materials, examples, and extensive comments on the milestones and challenges involved in drafting, implementing, and reviewing corporate governance codes of best practice.

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TOOLKIT 2

Developing Corporate Governance Codes of Best Practice

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T O O L K I T

2

Developing Corporate Governance Codes of Best Practice

RATIONALE

VOLUME 1

Global Corporate Governance Forum

V O L U M E 1

Rationale

TOOLKIT 2

Developing Corporate Governance Codes of Best Practice

Global Corporate Governance Forum

VOLUME 1

Rationale

Why Is Corporate Governance Important?

MODULE 1 AT A GLANCE:

Before heading into the task of developing a corporate governance code of best practices, it is important to understand what corporate governance is and how it can affect growth and development.[1] This section reviews definitions and key research findings to help advocates of local reform make the business case for corporate governance to a wider constituency.

This module reviews:

- Definitions of corporate governance
- Why corporate governance is receiving so much attention
- How corporate governance affects growth and development

1. This module of the toolkit relies on material contained in *Corporate Governance and Development*, written by Stijn Claessens, for the Global Corporate Governance Forum, Focus 1, 2003.

THINKING POINT
How would you define corporate governance for your code?

DEFINING CORPORATE GOVERNANCE

Corporate governance codes do not often explicitly define what corporate governance is. Most codes of best practice deal with corporate governance as a concept and explain its importance without defining its meaning. Yet the way corporate governance is defined may affect the scope and content of a code. Perhaps the most famous definition of corporate governance was provided in 1992 by Sir Adrian Cadbury in the Report on Financial Aspects of Corporate Governance in the United Kingdom: "Corporate governance is the system by which companies are directed and controlled." Here corporate governance is defined as a set of mechanisms through which firms operate when ownership is separated from management. One size does not fit all, and other definitions of corporate governance may be used. But whether a broad or a narrow definition of corporate governance is chosen, it is important that the fundamental values of transparency, accountability, fairness, and responsibility be respected in order for firms to build and sustain the confidence of investors, stakeholders, and society as a whole.

QUOTE

CORPORATE GOVERNANCE DEFINED

"The term 'corporate governance' is susceptible both to broad and narrow definitions. In fact, many of the codes do not even attempt to articulate what is encompassed by the term. . . . The important point is that corporate governance is a concept, rather than an individual instrument. It includes debate on the appropriate management and control structures of a company. Further it includes the rules relating to the power relations between owners, the Board of Directors, management and, last but not least, the stakeholders such as employees, suppliers, customers and the public at large."

—N.R. Narayana Murthy, Chairman, Committee on Corporate Governance, Securities and Exchange Board of India, 2003.

In the corporate governance literature, definitions of corporate governance vary widely but tend to fall into two groups. The first category focuses on the actual behavior of corporations—their performance, efficiency, growth, financial structure, and treatment of shareholders and other stakeholders. The second category concerns itself with the normative framework, that is, the rules under which firms operate. Those rules come from such sources as the legal system, the judicial system, financial markets, and labor markets.

The first set of definitions covers corporate governance issues within the firm itself. These issues include such matters as how the board of directors operates, the role of executive compensation in determining firm performance, the relationship between labor policies and firm performance, and the role of multiple shareholders.

The second set of definitions deals with laws and rules governing corporations and their effects on the behavioral patterns of firms, investors, and others. The normative framework can be defined narrowly or more broadly. Under a narrow definition, the focus would be on the rules in capital markets governing equity investments in publicly listed firms. These rules would include listing requirements, arrangements governing insider dealing, disclosure and accounting rules, and protections of minority shareholder rights.

Under a definition more specific to the provision of finance, the focus would be on how outside investors protect themselves against expropriation by the insiders. Issues in this category would include minority right protections and the strength of creditor rights, as reflected in collateral and bankruptcy laws. Other issues might be the composition and the rights of the executive directors and the ability to pursue class-action suits. This definition is close to the one advanced by economists Andrei Shleifer and Robert Vishny in 1997: “Corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment.” This definition can be expanded to define corporate governance as being concerned with the resolution of collective action problems among dispersed investors and the reconciliation of conflicts of interest between various corporate claimholders.

Under a broader definition, corporate governance can encompass both the determination of value-added by firms and the allocation of it among stakeholders that have relationships with the firm. Under this definition, the objective of a good corporate governance framework is to maximize the

QUOTE

CORPORATE GOVERNANCE DEFINED

"In its broadest sense, corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interest of individuals, of corporations and of society. The incentives to corporations and those who own and manage them to adopt internationally accepted governance standards is that these standards will assist them to achieve their aims and to attract investment. The incentive for their adoption by states is that these standards will strengthen their economies and encourage business probity."

—Sir Adrian Cadbury, Foreword to Corporate Governance and Development, Global Corporate Governance Forum, Focus 1, 2003

contribution of the firm to the overall economy. In this case, corporate governance would include the relationship between shareholders, creditors, and corporations; between financial markets, institutions, and corporations; and between employees and corporations. Under this definition, corporate governance could also encompass corporate social responsibility pertaining to such issues as charitable contributions or environmental concerns.

In a diverse international context, the question arises whether the corporate governance framework extends to rules or to institutions. Here, two views have been advanced. One is the view that the framework is determined by rules, and related to that, to markets and outsiders. This is the view prevailing in or applying to Anglo-Saxon countries. In much of the rest of the world, institutions—specifically banks and insiders—are thought to determine the actual corporate governance framework. In reality, both institutions and rules matter, and a sharp distinction between the two, while often used, can be misleading. Institutions do not arise in a vacuum and are affected by the rules in the country, as well as international standards. Similarly, laws and rules are affected by the country's institutional setup. Moreover, both institutions and

DEFINITIONS OF CORPORATE GOVERNANCE IN CODES OF BEST PRACTICE

OECD

"Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set and the means of attaining those objectives and monitoring performance are determined."

Organisation for Economic Co-operation and Development, OECD Principles of Corporate Governance, 2004

TURKEY

"With respect to the country, sound corporate governance means:
- Improvement of a country's image, prevention of outflow of domestic funds,
- Increase in foreign capital investments,
- Increase in the competitive power of the economy and capital markets,
- Overcoming crises with less damage,
- More efficient allocation of resources attainment, and
- Maintenance of a higher level of prosperity."

Turkey's Capital Markets Authority, Corporate Governance Principles, 2003

BELGIUM

"Corporate governance is a set of rules and behaviors according to which companies are managed and controlled. A good corporate governance model will achieve its goal by setting a proper balance between entrepreneurship and control, as well as between performance and conformance."

—Belgian Code on Corporate Governance, 2004

COMMONWEALTH

"Corporate Governance is essentially about leadership:
- leadership for efficiency;
- leadership for probity;
- leadership with responsibility;
- leadership which is transparent and which is accountable."

Commonwealth Association for Corporate Governance, Guidelines—Principles for Corporate Governance in the Commonwealth, 1999

KENYA

"Corporate governance can be defined as 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 with the satisfaction of other stakeholders in the context of its corporate mission."

Private Sector Corporate Governance Trust, Guidelines for Good Corporate Governance in State-Owned Corporations, 2002

INDIA

"Corporate governance is the acceptance by management of the inalienable rights of shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders. It is about commitment to values, about ethical business conduct and about making a distinction between personal and corporate funds in the management of a company."

Report of the Committee on Corporate Governance of the Securities and Exchange Board of India, 2003.

rules evolve over time through the political process that affects the shape of economic and legal institutions.

The scope of institutions and rules that might matter to a code of good governance can be bewildering. An easier way to find the meaning of corporate governance is to take the functional approach. This approach recognizes that financial services come in many forms, but that when the services are unbundled, most, if not all, key elements are similar. This line of analysis of the functions—rather than the specific products provided by financial institutions, and markets—has distinguished six types of functions:

- Pooling resources and subdividing shares
- Transferring resources across time and space
- Managing risk
- Generating and providing information
- Dealing with incentive problems
- Resolving competing claims on the wealth generated by the corporation

Corporate governance can be defined as the range of institutions and policies involved in these functions as they relate to corporations. Both markets and institutions will, for example, affect the way the corporate governance function of generating and providing high-quality and transparent information is performed.

QUOTE

CORPORATE GOVERNANCE DEFINED

"Corporate governance refers to that blend of law, regulation and appropriate voluntary private sector practices which enables the corporation to attract financial and human capital, perform efficiently and thereby perpetuate itself by generating long term economic value for its shareholders, while respecting the interests of stakeholders and society as a whole."
—Ira M. Millstein, 2003

WHY IS CORPORATE GOVERNANCE RECEIVING SO MUCH ATTENTION?

Recent corporate governance scandals in the United States and Europe—some of which have triggered the largest insolvencies in history—have caused a crisis of confidence in the corporate sector. As a result, corporate governance has entered the vocabulary not only of financial economists but also of day traders, pension fund beneficiaries, employees of all ranks, chief executive officers, and prime ministers. During the wave of financial crises of 1997–98 in Asia, Russia, and Latin America, the behavior of the corporate sector affected entire economies. Deficiencies in corporate governance endangered the stability of the global financial system. Improving corporate governance is now recognized in most countries and policy circles to have first-order macroeconomic consequences and has become a mainstream concern. *(For a discussion on the role of corporate governance codes in restoring confidence after scandals and crises, see Volume 1, Module 3.)*

Beyond the scandals and crises, however, are several structural reasons explaining why corporate governance has become more important for economic development and well-being. The private, market-based investment process is now much more important for most economies than it used to be. That process is underpinned by better corporate governance. With the size of firms increasing and the role of financial intermediaries and institutional investors growing, decisions about mobilizing capital are now one step removed from the principal/owner. At the same time, the opening up and liberalization of financial and real markets have broadened investment choices and made decisions about the allocation of capital more complex. Structural reforms, including price deregulation and increased competition, have increased companies' exposure to risk from market forces. These developments have made monitoring the use of capital more complex in certain ways, enhancing the need for good corporate governance.

THINKING POINT

Why is corporate governance receiving attention in your country?

HOW DOES CORPORATE GOVERNANCE AFFECT GROWTH AND DEVELOPMENT?

Corporate governance affects growth and development and well-being more generally through several different channels. Empirical evidence has documented these relationships at the level of the country, the sector, and the individual firm and from the perspective of the investor.

WHY CORPORATE GOVERNANCE MATTERS

1. The private, market-based investment process—underpinned by good corporate governance—is now much more important for most economies than it used to be. Privatization has raised corporate governance issues in sectors that were previously in the hands of the state. Firms have turned to public markets to seek capital, and mutual societies and partnerships have converted themselves into publicly listed corporations.

2. Technological progress, liberalization and opening up of financial markets, trade liberalization, and other structural reforms—notably, price deregulation and the removal of restrictions on products and ownership—have all made the allocation of capital among competing purposes, within and across countries, more complex. So too is monitoring the use of capital. This complexity makes good governance more important—but also more difficult.

3. The mobilization of capital is increasingly one step removed from the principal/owner, given the increasing size of firms and the growing role of financial intermediaries. The role of institutional investors is also growing in many countries. This increased delegation of investment has raised the need for good corporate governance arrangements.

4. Deregulation and reform have reshaped the local and global financial landscape. Long-standing institutional arrangements for corporate governance are being replaced with new institutional arrangements, but in the meantime, inconsistencies and gaps have emerged.

5. International financial integration has increased, and trade and investment flows are increasing. This has led to many cross-border issues in corporate governance, including occasional clashes of differing corporate governance cultures.

Increased access to financing

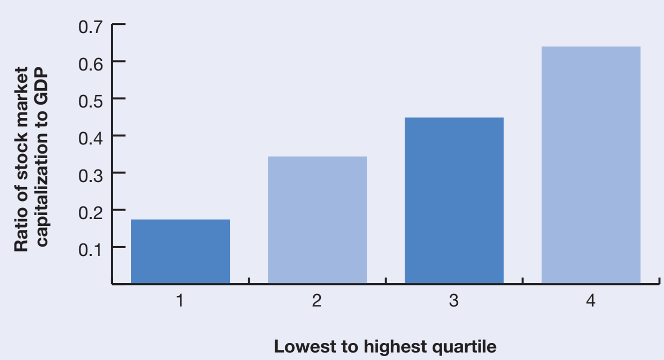
Countries that strongly protect property rights have better-developed financial and capital markets, according to the law and finance literature. In particular, better creditor rights and shareholder rights have been shown to be associated with deeper and more developed banking and capital markets.

CHANNELS OF GROWTH AND DEVELOPMENT

- **Sound corporate governance can increase access to external financing by firms, which can lead to larger investment, higher growth, and creation of more jobs.**
- **Sound governance can lower the cost of capital and raise the value of the firm, making investments more attractive, which in turn can lead to growth and more employment.**
- **Good governance produces better operational performance through better allocation of resources and better management, creating wealth more generally.**
- **Good corporate governance can reduce the risk of financial crises, which can have devastating economic and social costs.**
- **Good corporate governance can lead to better relationships with all stakeholders, and thus improve labor relations as well as the climate for improving social aspects such as environmental protection.**

A similar relationship exists between the quality of shareholder protection and the development of countries' capital markets. Figure 1 depicts the relationship between an index of shareholder rights and the size of the stock markets (as a ratio of gross domestic product). Countries are sorted into four equal groups, or quartiles, depending where they rank on a scale that is the product of their equity rights and the efficiency of the judicial system. The figure shows a strong relationship, with the market capitalization almost quadrupling between the countries with the fewest shareholder rights and countries with the greatest shareholder protections.

Figure 1. The Relationship between Shareholder Rights and the Size of Stock Markets



The better the quality of shareholder protection, the larger the country's stock markets.
Source: La Porta and others (1997).

THINKING POINT
What constitutes sound corporate governance in your country?

Thus, in countries with strong property rights, firms have better access to finance and can be expected to invest more and grow faster. The effects on growth of better property rights through greater access to financing can be large. For example, countries in the third quartile enjoy between 1 and 1.5 extra percentage points of GDP growth a year, compared with countries in the first quartile. There is also evidence that under conditions of poor corporate governance (and underdeveloped financial and legal systems and higher corruption), the growth rate of the smallest firms is the most adversely affected, and fewer new firms start up—particularly small firms.

QUOTE

IMPORTANCE OF GOOD GOVERNANCE

Policymakers around the world acknowledge that corporate governance reform is vital for developing countries seeking to attract investment and thereby strengthen their economies. In March 2002, 75 heads of state from the developed and developing worlds agreed that: "Private international capital flows … are vital complements to national and international development efforts.… To attract and enhance inflows of productive capital, countries need to continue their efforts to achieve a transparent, stable and predictable investment climate.… Special efforts are required in priority areas such as … corporate governance."

—United Nations International Conference on Financing for Development, Monterrey, Mexico, 2002

Higher firm valuation

The quality of the corporate governance framework affects not only the access to and amount of external financing, but also the cost of capital and firm valuation. Outsiders are less willing to provide financing and are more likely to charge higher rates for that financing if they are less assured that they will get an adequate rate of return. Conflicts between small and large controlling shareholders are greater in weaker corporate governance settings, implying that smaller investors are receiving lower rates of return. The empirical evidence for these effects is clear. The cost of capital has been shown to be higher and firm valuation lower in countries with weaker property rights.

QUOTE

IMPORTANCE OF GOOD GOVERNANCE

"If a country does not have a reputation for strong corporate governance practices, capital will flow elsewhere. If investors are not confident with the level of disclosure, capital will flow elsewhere. If a country opts for lax accounting and reporting standards, capital will flow elsewhere. All enterprises in that country—regardless of how steadfast a particular company's practices may be—suffer the consequences. Markets must now honor what they perhaps, too often, have failed to recognize. Markets exist by the grace of investors. And it is today's more empowered investors that will determine which companies and markets will stand the test of time and endure the weight of greater competition. It serves us well to remember that no market has a divine right to investors' capital."

—Arthur Levitt, former chairman of the U.S. Securities and Exchange Commission

STUDIES

FIRM VALUATION

UNITED STATES

An independent academic study of 5,460 publicly traded U.S. companies concluded that companies with superior corporate governance practices tended to have better stock price performance, as well as higher profitability, larger dividend payouts, and lower risk levels than other similar companies in the same sector. The study was conducted by Professor Lawrence Brown and a research team from Georgia State University. The key data source for the study was the ISS Corporate Governance Quotient (CGQ), a compilation of data for more than 60 governance criteria in the following categories: board, charter or bylaws, state of incorporation, executive and director compensation, qualitative factors, stock ownership, and director education.

—Georgia State University and Institutional Shareholder Services (ISS) Research, February 2004

KOREA

Bernard Black, Hasung Jang, and Woocham Kim developed a corporate governance index (CGI) for 525 companies listed on the Korea Stock Exchange in 2001. The study found that well-governed firms in Korea trade at a premium of 160 percent compared with poorly governed firms. The research also found that the share price for firms with a majority of outside directors on the board was 40 percent higher than it was for firms where outside directors were in the minority. The researchers also noted that investors appeared to value the same cash flows more highly for better governed firms, implying that better-governed firms have a lower cost of capital.

—Black, Jang, and Kim, 2003

Investors also seem to lower their valuation of firms and countries with relatively worse corporate governance. Many research projects show that good corporate governance is essential for establishing an attractive investment climate characterized by competitive companies and efficient financial markets. Perhaps the most widely known research in this area is the McKinsey Global Investor Opinion Survey, which was first undertaken in 2000 and was updated in 2002. The findings from these surveys emphasized that companies not only needed to be well governed, but also to be perceived in the market as being well governed. This research implies that managers can potentially add significant shareholder value by developing good governance practices.

More detailed empirical research by Deutsche Bank, based upon companies' published financial reports, has confirmed the results of the McKinsey study. Deutsche Bank found that companies in emerging regions in Latin America, Africa, Eastern Europe, and the Middle East all have high-value premiums on their well-governed companies listed on their stock exchanges.

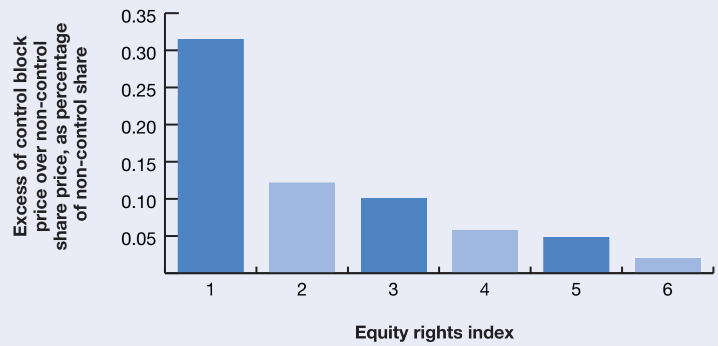
QUOTE

FIRM VALUATION

"Good corporate governance structures encourage companies to create value (through entrepreneurism, innovation, development and exploration) and provide accountability and control systems commensurate with the risks involved."
—Australian Stock Exchange, Principles of Good Governance and Best Practices Recommendations, 2003

Furthermore, in countries with weaker property rights, controlling shareholders also obtain a fraction of the value of the firm that exceeds their direct ownership stake, at the expense of minority shareholders. Figure 2 depicts this phenomenon by using the prices paid for a block of shares that implies transferring control over the firm relative to the price of normal shares in a number of actual transactions, plotted against the equity rights index. The higher cost of capital, and the corresponding lower firm valuation, translates into economic costs for lower corporate governance countries, as less attractive investments are bypassed.

Figure 2. The Relationship between Weak Corporate Governance and the Cost of Capital



Weak corporate governance translates into higher costs of capital.

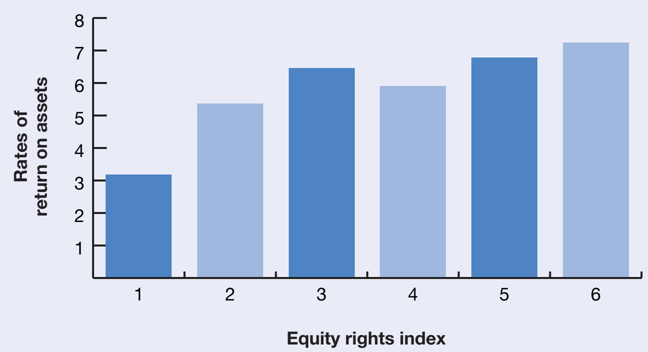
Source: Dyck and Zingales (2004)

Better operational performance

In the end, better corporate governance adds value by improving the performance of firms through more efficient management, better asset allocation, better labor policies, and similar efficiency improvements. Studies in the United States, Korea, and elsewhere strongly suggest that at the firm level, better corporate governance leads not only to improved rates of return on equity and higher valuation, but also to higher profits and sales growth. This evidence is maintained when controlling for the fact that "better" firms may adopt better corporate governance and perform better for other reasons. Although they are not as strong, research results also show that operational performance is higher in countries with better corporate governance than in other countries.

These findings are reflected in figure 3, which shows a weaker relationship between a measure of the quality of the governance framework and firm performance than for the relationship between the quality of the governance framework and access to financing and valuation. Other factors may explain the weaker relationship. For example, firms in developing countries may face better growth opportunities, thus reporting higher profits, although they may have worse corporate governance. There may also be a reporting bias. Firms in worse corporate governance environments may be more likely to overstate their accounting profits, for example.

Figure 3. The Relationship between Governance and Firm Operational Performance



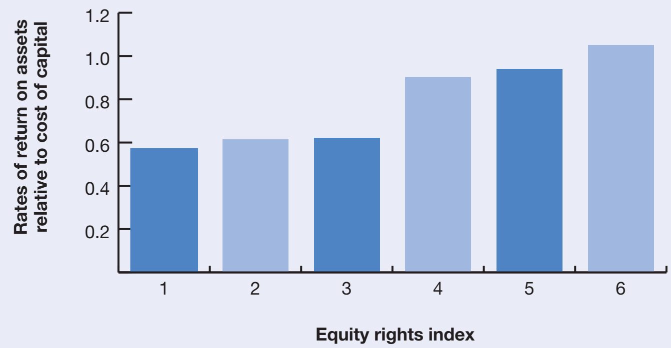
Better corporate governance translates into somewhat higher returns on assets.

Source: Data on returns are from Claessens and others (2000) and cover the 1996–99 period. The index on equity rights is from La Porta and others (1998). The figure excludes Mexico and Venezuela, where rates of return were heavily influenced by inflation and/or currency movements.

The limited relationship between operational performance and corporate governance measures at the country level may also reflect the fact that corporate governance in most countries does not concern a conflict between management and owners; such conflicts tend to lead to inefficient firm operation and low rates on assets. Rather, because most firms are closely held or controlled by insiders, corporate governance deals with conflicts between controlling shareholders and minority shareholders, leading to lower valuation and reduced access to external financing.

This interpretation is supported by a comparison of the rate of return on investment relative to the cost of capital for different strengths of corporate governance framework. Figure 4 depicts firms' rate of return on investment for a sample of some 19,000 publicly listed firms from a variety of countries, plotted against an index showing the strength of equity rights. The figure shows that firms in many countries do not earn the cost of capital required by shareholders; only in the countries with the strongest corporate governance framework does the rate of return on investment exceed the cost of capital. The relationship derives, however, largely from the higher cost of capital—that is, the lower valuation of firms—in countries with weak corporate governance.

Figure 4. The Relationship between Firms' Rate of Return on Investment and the Strength of Equity Rights



Higher equity rights translate into higher returns on investment relative to cost of capital

Source: The data on returns come from Gugler, Mueller, and Yurtoglu (2003), who in turn use data from Worldscope. The figure depicts the marginal rates of return on new investment adjusted for the cost of capital calculated using the Tobin's Q model. The index on equity rights is again from La Porta and others (1998).

Reduced risk of financial crises

The quality of corporate governance can also affect firms' behavior in times of economic shocks and actually contribute to the occurrence of financial distress, with adverse effects throughout the economy. During the East Asian financial crisis, cumulative stock returns of firms in which managers had high levels of control, but little direct ownership, were 10 to 20 percentage points lower than those of other firms.

This shows that corporate governance can play an important role in determining individual firms' behavior, in particular the incentives of insiders to expropriate the assets of minority shareholders during times of distress. Similarly, a study of

QUOTE

IMPORTANCE OF GOOD GOVERNANCE

"In today's integrated markets, failure to deal with the regulatory issues associated with corporate governance will have repercussions on global financial markets and jeopardize financial stability. That is why responsible policymakers at all levels cannot ignore the issue and why the European Union, and the European Commission must not."

—Fritz Bolkestein, Internal Market Commissioner, European Commission, 2004

the stock performance of listed companies from Indonesia, Republic of Korea, Malaysia, the Philippines, and Thailand found that performance is better in firms with better accounting disclosure and higher outside ownership concentration. These firm-level findings are consistent with the view that corporate governance helps explain firm performance during a financial crisis.

Country-level evidence shows that weak legal institutions for corporate governance were key factors in exacerbating the stock market declines during the 1997 East Asian financial crisis. In countries with weaker investor protection, net capital inflows were more sensitive to negative events that adversely affected investors' confidence. In such countries, the risk of expropriation increases during bad times, because the expected return of investment is lower. These countries are therefore more likely to witness collapses in currency and stock prices.

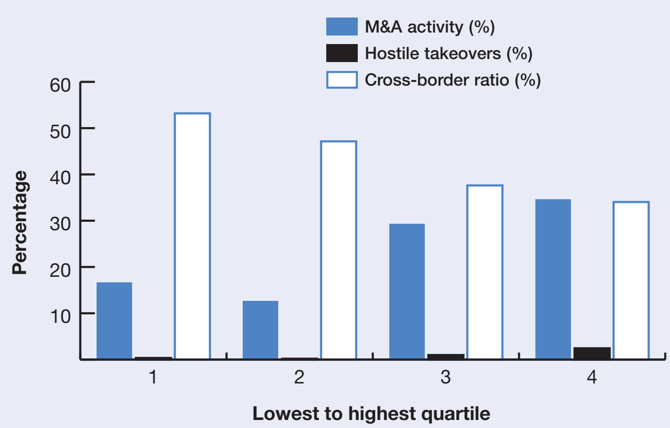
The view that poor corporate governance of individual firms can have economywide effects is not limited to developing countries. Recently, the argument has been made that in developed countries corporate collapses and undue profit boosting (Enron, WorldCom), managerial corporate looting (Tyco), audit fraud (Arthur Andersen), and inflated reports of stock performance (by supposedly independent investment analysts) have led to crises of confidence among investors, leading to the declines in stock market valuation and other economywide effects, including some slowdowns in economic growth. While this evidence is anecdotal, and weaker corporate governance has not triggered financial crises in the United States or other affected countries, corporate governance deficiencies clearly have started to carry a discount, either specific to particular firms or for markets as whole, even in developed countries. As such, poor corporate governance practices can pose a negative externality on the economy as a whole for any country.

More generally, poor corporate governance can affect the functioning of a country's financial markets. For one thing, poor corporate governance can increase financial volatility. When information is poorly protected—due to a lack of transparency and insiders having an edge on firms' activities and prospects—investors and analysts may have neither the ability to analyze firms (because it is very costly to collect information) nor the incentive (because insiders benefit regardless).

In such a weak property rights environment, inside investors with private information, including analysts, may, for example, trade on information before it is disclosed to the public. Evidence shows that the lack of transparency associated with weaker corporate governance leads to more synchronous stock price movements, limiting the price discovery role of the stock markets. A study of stock prices within a common trading mechanism and currency (the Hong Kong stock exchange), found that stocks from environments with less investor protection (China-based) trade at higher bid-ask spreads and exhibit thinner depths than more protected stocks (Hong Kong-based).

Another area where corporate governance affects firms and their valuation is mergers and acquisitions (M&A). During the 1990s, the volume of M&A activity and the premiums paid were significantly larger in countries with better investor protection. This finding indicates that an active market for mergers and acquisitions—an important component of a corporate governance regime—arises only in countries with better investor protection (figure 5). The analysis also shows that in cross-border deals, the acquirers are typically from countries with better investor protection than the targets, suggesting that cross-border transactions play a governance role by improving the degree of investor protection within target firms. It further suggests that cross-border transactions aid in the convergence of corporate governance systems.

Figure 5. The Relationship between Merger and Acquisition Activity and the Strength of Corporate Governance



The market for M&A is more active in stronger corporate governance countries, while cross-border M&A are aimed at weaker corporate governance countries.

Source: The chart depicts data on international mergers and acquisitions used in the paper by Rossi and Volpin (2003), sorted by the level of equity right protection of La Porta and others (1998). *M&A activity* is the percentage of traded companies targeted in a completed deal. *Hostile takeovers* is the number of attempted hostile takeovers as a percentage of domestic traded firms. *Cross-border ratio* is the number of cross-border deals as a percentage of all completed deals. Source is SDC Platinum, provided by Thompson Financial Securities Data, and the World Development Indicators.

Better relations with other stakeholders

Besides the principal owner and management, public and private corporations must deal with many other stakeholders, including banks, bondholders, employees, and local and national governments. Each of these monitors, disciplines, motivates, and affects the firm and its management in various ways. They do so in exchange for some control and cash flow rights, which relate to each stakeholder's own comparative advantage, legal forms of influence, and form of contracts. Commercial banks, for example, have a greater amount of inside knowledge, because they typically have a continuing relationship with the firm. Formal influence of commercial banks may derive from the covenants banks impose on the firm with regard, for example, to dividend policies, or requirements for approval of large investments, mergers and acquisitions, and other large undertakings. Bondholders also may have such covenants or even specific collateral. Furthermore, lenders typically have legal rights of a state-contingent nature. They acquire control rights in case of financial distress and even ownership rights in case of bankruptcy, as defined by the country's laws. Debt and debt structure can be an important disciplining factor, as it can limit free cash flow and thereby reduce private benefits. Trade finance can have a special role, because it is a short-maturity claim, with perhaps some specific collateral. Suppliers can have particular insights into the operation of the firm, because they are more aware of the economic and financial prospects of the industry.

QUOTE

IMPORTANCE OF CORPORATE GOVERNANCE

"The importance of corporate governance lies in its contribution both to business prosperity and to accountability. . . . Good governance ensures that constituencies (stakeholders) with a relevant interest in the company's business are fully taken into account."
—Hampel Report, 1998

Employees have a number of rights and claims. As with other input factors, there will be an outside labor market, thus putting pressure on firms to provide not only financially attractive opportunities, but also socially attractive ones. Labor laws define many of the relationships between corporations and employees, and these laws may have some corporate governance aspects.

Rights of employees in firm affairs can be formally defined, as is the case in France, Germany, and the Netherlands where it is mandatory for employees in larger companies to have some seats on the board. Employees of course voice their opinion on firm management more generally. And in countries where poorly performing CEOs and other senior management get fired, a market for senior management exerts some discipline on poor performance.

Stakeholder management

Two forms of behavior can be distinguished in corporate governance issues related to other stakeholders: stakeholder management and social issue participation. For the first category, the firm has no choice but to behave "responsibly" to stakeholders: they are input factors that the firm must have to operate; and these stakeholders have alternative opportunities if the firm does not treat them well (typically, for example, labor can work elsewhere). Acting responsibly toward each of these stakeholders is thus necessary. Acting responsibly is also most likely to benefit the firm, financially and otherwise.

Acting responsibly can in turn benefit the firm's shareholders and other stakeholders. A firm with good employee relationships, for example, is likely to find it easier to attract external financing. Collectively, a high degree of corporate responsibility can ensure good relationships with all the firm's stakeholders and thereby improve the firm's overall financial performance. Of course, the effects depend importantly on information and reputation because knowing which firms are more responsible to stakeholders is not always easy.

QUOTE

IMPORTANCE OF CORPORATE GOVERNANCE

"Corporations create jobs, generate tax income, produce a wide array of goods and services ... and increasingly manage our savings and secure our retirement income. Amidst growing reliance worldwide on the private sector, the issue of corporate governance has similarly risen in prominence."

—Organisation for Economic Co-operation and Development, OECD Principles of Corporate Governance, 1999

Social issue participation

Whether participation in social issues is also related to good firm performance is less clear. Involvement in some social issues carries costs. These can be direct, as when expenditures for charitable donations or environmental protection increase and so lower profits. Costs can also be indirect, as when the firm becomes less flexible and operates at lower efficiency.

The general argument has been that these forms of social corporate responsibility can still pay: that is, they can be good business for all and go hand in hand with good corporate governance. So while the business reasons to respect the environment or donate to social charity, for example, may be less direct, such actions can still create positive externalities in the form of better relationships with other stakeholders.

So far, few studies have attempted to document these effects. Yet the willingness, for example, of many firms to adopt high international standards such as ISO 9000, which go beyond the narrow interest of production and sales, suggest that there is empirical support for positive effects at the firm level.

At the country level, more-developed countries clearly tend to have both better corporate governance and rules requiring more socially responsible behavior of corporations. Some evidence suggests, however, that government-forced forms of stakeholdership may be less advantageous financially. A study found reduced market-to-book values and return on equity in Germany, where the codetermination system allocates some control rights over corporate assets to employees by law.

The problem is in part determining what is the cause and what the effect. At the firm level, does good corporate performance beget better social corporate responsibility, as the firm can afford it? Or does better social corporate responsibility lead to better performance? The firms that adopt high standards, for example, might well be the better-performing firms even if they had not adopted such standards. At the country level, a higher level of development may well allow and create pressures for better social responsibility, while at the same time improving corporate governance.

(For more research results on the importance and impact of good corporate governance practices, go to Volume 1, Annex 1: "Further reading.")

What Are Corporate Governance Codes of Best Practice?

MODULE 2 AT A GLANCE:

Corporate governance codes of best practice are just one element of the legal framework in which businesses operate. They are not to be confused with legal codes, which constitute a body of laws, nor with international standards or company codes. Corporate governance codes of best practice can nevertheless take several forms. They may be generic in scope, they may be drawn up for specific groups of companies, or they may address a specific aspect of corporate governance such as disclosure or board practices. Concerned with raising the standards beyond legal requirements, corporate governance codes of best practice are by nature voluntary, yet various incentive mechanisms may encourage corporate compliance with essential provisions of the code.

This module reviews:

- The various types of corporate governance codes of best practice
- The environment of corporate governance codes of best practice
- The status of corporate governance codes of best practice
- The incentive mechanisms encouraging compliance with corporate governance codes of best practice

TYPES OF BEST PRACTICE CODES

Corporate governance codes of best practice are sets of nonbinding recommendations aimed at improving and guiding the governance practices of corporations within a country's specific legal environment and business context. These codes are typically based on principles and focus on country-specific issues. They can differ in their focus or scope and be more or less detailed. Whether intended to restore investor confidence or to support a better investment climate, codes of best practice have now been adopted in many countries as a way to introduce international standards and adapt them to the local environment. *(For a discussion on the purpose of codes, see Volume 1, Module 3).*

Codes of best practice for generic business activities

Very few governance codes apply to all categories of business activity. Country codes are geared mostly toward listed companies. In countries with a limited number of traded companies, the issue is whether to develop a code targeted at listed companies or to opt for a more comprehensive code. Developing a code for listed companies may be seen as an opportunity to attract capital and increase the number of listed firms. But for the economy as a whole, it might be more relevant to craft a more generic code that could eventually include specific recommendations for listed companies.

EXAMPLE

COMPREHENSIVE NATIONAL CODE: SOUTH AFRICA

Corporate governance reform in South Africa was initiated with the formation of the King Committee on Corporate Governance in 1992, under the auspices of the Institute of Directors of Southern Africa. Under the leadership of Mervyn King, a former judge and businessman, the committee produced the King Report on Corporate Governance in 1994.

The report used the United Kingdom's Cadbury Report as a guide while giving "regard to the special circumstances existing in South Africa, more particularly the entrance into the business community of members of previously disadvantaged communities" at a time of political transition to a full-fledged democracy. The report focused on composition of the board and its roles and processes, as well as on decisionmaking and the provision of information.

Continued next page

EXAMPLE

COMPREHENSIVE NATIONAL CODE: SOUTH AFRICA (CONT.)

With publication of a revised code in 2002 (known as the second King Report), the importance of risk management received special consideration for the first time in South Africa. The revised report recommends that companies audit their risk exposure annually and disclose the audits to their shareholders.

One country with a corporate governance code that attempts a comprehensive coverage of all business activity is South Africa. The two King Reports (1994 and 2002) resulted from the recognition that commercial activities in the South African economy were dominated by companies that were not quoted on the Johannesburg Stock Exchange. Many developing countries are in a similar situation, with large numbers of small and medium-size firms as well as state-owned enterprises that are not listed on their stock exchange. Especially in low-income countries, the number of traded companies on stock exchanges is extremely small, and corporate governance codes pertaining to major nonlisted firms, family ventures, and banks are thus all the more important.

Codes of best practice for listed companies

Countries with a developed, active capital market typically have national corporate governance codes targeted at listed companies. The United Kingdom has one of the most sophisticated codes of this kind. Securities regulators in developing countries with large numbers of traded companies such as China and Russia have also introduced codes to comply with investor and shareholder expectations.

The country with the largest capital market in the world—the United States—has never formally adopted a national corporate governance code of best practice. According to the National Association of Corporate Directors (NACD), the cautious pace and limited scope of governance codes in the United States can be attributed to several factors. These include the country's federal system of government consisting of 50 states and the federal government, which share power under the U.S. Constitution.

EXAMPLES

CODES FOR LISTED COMPANIES

UNITED KINGDOM

The first Combined Code for listed companies in the United Kingdom was adopted in June 1998. It was built on the recommendations from the Cadbury, Greenbury, and Hampel corporate governance committees. With further input from the Higgs Report, the Combined Code was revised and published in July 2003 and took effect for all UK companies listed on the London Stock Exchange for reporting periods beginning on or after November 2003.

The main areas addressed by the Combined Code are the responsibilities given to boards of directors, including their appointment, remuneration, accountability, and relations with shareholders, and the responsibilities of institutional investors. *(The revision and consequent evolution of codes is discussed in Volume 2, Module 5.)*

The Combined Code also has provisions on the design of performance-related remuneration; guidance on the liability of nonexecutive directors in the areas of care, skill, and diligence; and provisions for the disclosure of corporate governance arrangements. *(A full copy of the Combined Code is available at www.fsa.gov.uk.)*

CHINA

The Code for Corporate Governance for Listed Companies in China was issued in January 2002 by the China Securities Regulatory Commission and the State Economic and Trade Commission. The code sets forth, among other things, protections of investors' interests and rights and the basic rules and standards to be followed by directors, supervisors, managers, and other senior management members of listed companies. The code is composed of seven chapters:

- Shareholders and shareholders' meetings
- Listed companies and their controlling shareholders
- Directors and boards of directors
- The supervisors and supervisory board
- Performance assessments and incentive and disciplinary systems
- Stakeholders
- Information disclosure and transparency

(A full copy of China's Code for Corporate Governance for Listed Companies can be found at www.csrc.gov.cn.)

THINKING POINT

What type of corporate governance code of best practice might best meet your needs?

States have traditionally governed the formation and governance of corporations, guided by models such as the Model Business Corporation Act developed by the American Bar Association. *(See http://washburnlaw.edu/centers/transactional/ statutes/mbca2002.pdf.)* The traditional duties of care, loyalty, and good faith owed by corporate fiduciaries (directors) are therefore typically found in state corporation statutes.

Another factor is that in regulating corporations, the United States relies on common law elements, which are nonstatutory and judicially based, rather than on statutes. The NACD gives as an example the "business judgment rule," which says that corporate boards cannot be held liable for a decision that turns out to be incorrect, as long as the directors exercised due care, loyalty, and good faith. This is a judicial principle that emanates from judicial decisions, not from state or federal statute.

The United States also relies on affected groups to govern by developing voluntary corporate governance guidelines. These guidelines are often based on published guidelines developed by groups such as the NACD and the Business Roundtable. Most companies look to these voluntary guidelines to improve their practices. But the accounting frauds and bankruptcies of a few major companies in the early 2000s undermined confidence in the voluntary guidelines and sparked the reforms that led to the adoption of the Sarbanes-Oxley Act and new listing regulations. *(For more details on the Sarbanes-Oxley Act, see Volume 1, Module 3.)*

Codes of best practice for specific types of companies

Sector-specific corporate governance codes focus on specific types of companies such as banks, state-owned enterprises (SOEs), or small and medium-size enterprises. These codes are often more operational and cover issues that are not typically dealt with in existing principle-based codes. Sector-specific codes can prove especially relevant for low-income countries or countries where few companies are listed. The number of codes of this type could well increase in importance in the coming years with the growing relevance of corporate governance beyond capital markets. Many countries, for example, are currently considering developing codes for their state-owned enterprises using the international benchmark recently developed by the Organisation for Economic Co-operation and Development (OECD).

EXAMPLES

SECTOR-SPECIFIC CODES

KENYA: STATE-OWNED ENTERPRISES

Kenya's Private Sector Corporate Governance Trust (CCG) developed its Guidelines for Good Corporate Governance in State-Owned Corporations in 2002 on the assumption that "state-owned corporations will continue to play an important role in the production and creation of wealth necessary for enhancing national development."

The guidelines set out four objectives:

- Assisting individual corporations in formulating detailed codes of best practice that address their specific circumstances.
- Aiding the further evolution of better practices and procedures in state-owned corporations.
- Enabling boards of state-owned corporations in Kenya to focus on both their performance and conformance roles in directing their respective enterprises.
- Providing a governance criterion for evaluating state-owned corporations.

COLOMBIA: SMALL AND MEDIUM-SIZE ENTERPRISES

The objective of this Framework Code of Good Governance is to furnish closely held small and medium-size enterprises with a tool for ensuring the sustainability and integrity of Colombian businesses in today's globalized economy. The code is designed to serve as a frame of reference for businesses attempting to craft internal codes of corporate governance. The standards are intended as general guidelines to be adapted by each firm to its own organizational structure, line of business, and sources of financing.

Codes focusing on specific aspects of corporate governance

Some codes of best practice focus upon specific aspects of corporate governance such as board practices or disclosure. These codes of best practice should not be confused with professional codes of conduct adopted by the members of professional bodies such as accounting federations or institutes of directors. Professional codes are typically developed and implemented by professional, self-regulated organizations to ensure that high-quality service is provided by their members and that high levels of public trust are maintained in particular professions.

QUOTE

GUIDELINES FOR SMALL AND MEDIUM-SIZE BUSINESS

"Corporate Governance is important to the operation and the strategic development of SMEs [small and medium-size enterprises]. Indeed, practicing good corporate governance could help SMEs establish robust business processes and prepare them for future expansion. The guidelines on corporate governance prepared by the Hong Kong Institute of Directors for SMEs offer a roadmap for corporate governance to companies in various stages of development."

—Paul Chow, chief executive,
Hong Kong Exchanges and Clearing, 2005

In contrast, codes of best practice addressing specific aspects of corporate governance are geared toward improving corporate governance by addressing specific issues that are not otherwise dealt with. These codes tend to be more detail oriented and can prove very useful when reviewing and improving more comprehensive codes of best practice.

EXAMPLE

CODES ADDRESSING SPECIFIC GOVERNANCE ISSUES

SRI LANKA: EFFECTIVENESS OF AUDITORS

In 2002, the Securities and Exchange Commission of Sri Lanka appointed a committee to evaluate the role of auditors and finalize a practical and comprehensive set of guidelines to strengthen the effectiveness of auditors and the audit process in listed companies. Published in 2003, the Guidelines for Best Practice on the Role of Auditors primarily focus on issues relating to the independence of external auditors. The guidelines require rotation of audit firms or audit partners once every five years, place restrictions on audit and nonaudit services in certain circumstances, and mandate disclosure of fees relating to audit and nonaudit services.

EXAMPLE

CODES ADDRESSING SPECIFIC GOVERNANCE ISSUES

THAILAND: DIRECTORS OF LISTED COMPANIES

The Stock Exchange of Thailand (SET) issued a code in 1998, which was further revised in 1999, that focuses on the roles, responsibilities, behavior, and remuneration of directors of boards of listed companies. The SET believes that the best practice recommendations laid out in this code should help ensure that practices in the boardroom meet high standards. The code addresses board composition, roles and responsibilities of directors, appointment to the board, holding a director's position, directors' remuneration, board and shareholders' meetings, and reports.

THE ENVIRONMENT OF CODES OF BEST PRACTICE

THINKING POINT
What laws and regulations directly affect corporate governance in your country?

The legal environment in which corporations operate is typically quite complex. Corporate governance practices are typically affected by a myriad of government laws and regulations, industry standards and guidelines, and the individual company's own by-laws and rules. Corporate governance codes must therefore be developed with the knowledge that they will be part of a large body of existing laws, regulations, principles, and best practices.

Following are the kinds of norms that can have a direct impact on corporate governance practices:

- International laws (treaties, agreements, directives)
- National laws (legal codes)
- Subnational legislation (state laws)
- Regulations
- Listing rules
- Standards, guidelines, and codes of best practice
- Organic documents of the corporation (company charter)
- Corporate rules and provisions (company by-laws)

At the national level especially, the volume, variety, and complexity of legislation affecting corporate activity have been expanding considerably over time in most countries. In her work "The Globalization of Corporate Governance," Holly Gregory, of Weil, Gotshal and Manges, lists "a host of laws and regulations," in addition to stock exchange listing rules, that affect corporate governance. These include disclosure requirements and accounting standards; the issue and sale of securities; company formation; shareholder rights and proxy voting; mergers and acquisitions; fiduciary duties of directors, officers, and controlling shareholders; contract enforcement; bankruptcy and creditors' rights; labor relations; financial sector practices; and tax and pension policy. *(For an example of the extensive range of legislation and regulation that can affect a corporate director in the United Kingdom, see Volume 1, Annex 2)*

Gregory also observes that the corporate governance environment is defined by:

- The quality and availability of judicial and regulatory enforcement of these laws and regulations
- A general understanding of corporate citizenship
- Societal expectations about the corporate objectives
- Domestic and international competition in product, service, and capital markets, as well as in the markets for management, labor, and corporate control

International standards and guidelines

Beyond a few exceptions including a directive on transparency, adopted by the European Union in 2004, and a treaty establishing by-laws for companies doing business in both Argentina and Brazil, signed in 1990, few international or supranational laws directly affect corporate governance practices across borders.

EXAMPLE

EUROPEAN UNION GOVERNANCE DIRECTIVE

Following several corporate scandals in Europe, the European Commission stepped in and pushed ahead with the Directive on Minimum Transparency Requirements for Listed Companies, which was adopted in 2004. The objective of the directive is to raise the quality of information available to investors on companies' performance and financial position as well as on changes in major shareholdings. This measure is expected to contribute to better investor protection, enhanced investor confidence, and a better functioning of European capital markets. The directive must be implemented by member states within two years of its publication in the EU's *Official Journal in 2004.*

EXAMPLES

INTERNATIONAL CORPORATE GOVERNANCE STANDARDS AND GUIDELINES

OECD PRINCIPLES

The purpose of the OECD "Principles of Corporate Governance," which were last revised in 2004, is to present the common best practice standards that countries with different cultures could agree upon without being unduly prescriptive. The principles apply regardless of a country's level of ownership concentration, its model of board representation, or whether it has a civil law or a common law tradition.

The principles are primarily concerned with listed companies, but they may also be a useful tool to improve corporate governance in nontraded companies. The principles are organized into six sections:

- Ensuring the basis for an effective corporate governance framework
- The rights of shareholders and key ownership functions
- The equitable treatment of shareholders
- The role of stakeholders in corporate governance
- Disclosure and transparency
- The responsibilities of the board

(For further information on the OECD principles, refer to www.oecd.org.)

CACG GUIDELINES

After extensive consultation with many corporate governance experts in commonwealth countries, the Commonwealth Association of Corporate Governance (CACG) produced a set of guidelines in 1999. These guidelines cover leadership, board appointments, strategy and values, company performance, compliance, and communication. They also cover accountability to shareholders, relationships with stakeholders, balance of powers, internal procedures, assessment of board performance, management appointments and development, technology, risk management, and annual review of future solvency.

(For further information on the guidelines, refer to www.cacg-inc.com.)

ICGN STATEMENT ON INSTITUTIONAL SHAREHOLDER RESPONSIBILITIES

The International Corporate Governance Network (ICGN) statement sets out a framework of best practices pertaining to shareholders' fiduciary responsibilities. The statement was published in December 2003 after extensive consultation among network members. The statement primarily covers general responsibilities to ensure that investments are managed exclusively in the financial interests of their beneficiaries as amplified by contract and law. It also covers voting guidelines, accountability, and conflicts of interest. *(For further details on the statement, refer to www.icgn.org.)*

OECD GOVERNANCE GUIDELINES FOR STATE-OWNED ENTERPRISES

In 2005 the OECD adopted a set of guidelines on corporate governance for state-owned enterprises (SOEs) in the belief that SOEs would likely remain important in many countries, and that their governance would be a critical element in ensuring their positive contribution to the overall economic efficiency and competitiveness of the economies concerned. The guidelines contain chapters on:

- Ensuring an effective legal and regulatory framework for SOEs
- The state acting as owner
- Equitable treatment of shareholders
- Relations with stakeholders
- Transparency and disclosure
- The responsibilities of SOE boards

(For further information on the OECD guidelines, refer to www.oecd.org.)

THINKING POINT
What corporate governance provisions are best dealt with through codes of best practice in your country?

At the international level, most efforts to improve corporate governance practices have for obvious reasons focused on developing nonbinding and principles-based common standards. The development of international corporate governance standards is led primarily by multilateral and regional organizations such as the Organisation for Economic Co-operation and Development and the Commonwealth Association of Corporate Governance. These standards can successfully serve as benchmarks and models for national codes and regulations. Many countries, among them Republic of Korea, Russia, and Zambia, have for example used the OECD Principles of Corporate Governance as the starting point of their national codes.

International standards and guidelines have primarily targeted listed companies, although many of these governance recommendations are expected to benefit a wider range of firms. Building on the need to address the concerns of specific sectors, international standards have also been developed to provide guidelines to institutional investors and, more recently, to state-owned enterprises.

THE STATUS OF CODES OF BEST PRACTICE

A much-debated issue in any country is the appropriate regulatory approach for corporate governance. In other words, which aspects of corporate governance are best dealt with through laws and which aspects should be self-regulated? This question becomes especially relevant in cases of market failure. The temptation may be to adopt strict laws because codes of best practice are typically voluntary, and thus, unlike legal obligations, compliance is not mandatory. Yet whereas laws require compliance with minimum standards, best practice codes focus on raising standards. Because corporate governance codes involve building consensus for reforms, they often elicit more popular support than do laws and regulations that are imposed on companies.

One size does not fit all, and choosing the right approach often depends on the context of reform and other considerations such as a country's legal framework, the content of existing laws, and local corporate practices. Depending on a country's legal traditions as well as on the status of the existing legal framework for corporate governance, codes can either serve as drivers for legal reforms or constitute an alternative, soft-enforcement mechanism.

QUOTES

BEST PRACTICE CODES VERSUS LAWS

UNITED KINGDOM

"We believe that our approach, based on compliance with a voluntary code coupled with disclosure, will prove more effective than a statutory code. It is directed at establishing best practice, at encouraging pressure from shareholders to hasten its widespread adoption, and at allowing some flexibility in implementation. We recognize, however, that if companies do not back our recommendations, it is probable that legislation and external regulation will be sought to deal with some of the underlying problems which the report identifies. Statutory measures would impose a minimum standard and there would be a greater risk of boards complying with the letter, rather than with the spirit, of their requirements."

—Report of the Committee on the Financial Aspects of Corporate Governance (Cadbury Report), 1992

RUSSIAN FEDERATION

"High standards of corporate governance cannot be assured by legislative provisions alone. Legislation alone cannot be expected, and is inherently unable, to regulate all issues related to the management of companies. First, the law establishes and should establish only general mandatory rules. It cannot regulate and should not have as its purpose to regulate in detail all matters of corporate operations. . . . Second, legislation is unable to react rapidly to changes in corporate governance practices, as amending laws is very time consuming."

—Russian Code of Corporate Conduct, 2002

UKRAINE

"The drafting of the Ukrainian Corporate Governance Principles needs to be examined in the context of the overall development of the legal framework in the corporate sector. Ukraine entered the new millennium with a corporate legislation unable to provide a solid legal framework for joint stock companies although the lack of a good set of legal tools for regulating a broad range of corporate relations has been a major flaw since the transition began. After several failed attempts to pass a much needed law on joint stock companies, the adoption of the Ukraine Corporate Governance Principles tends to accomplish a dual mission. First to set down principles based on international best practices of corporate governance. Second to fill the legal gap in regulation of corporations by helping Ukrainian companies introduce best practice provisions into their by-laws."

—International Finance Corporation, Ukraine Corporate Development Project, 2003

GERMANY

"The Justice Minister restricted herself to setting the legal framework and thus gave German business the opportunity in an act of self-organization to propose a code which contains nationally and internationally recognized standards of good responsible corporate governance and presents the German corporate governance system in a form which also makes it transparent to foreign investors."

—Dr. Gerhard Cromme, chairman, German Corporate Governance Code, 2002

Codes and laws compared

Before developing a code of corporate governance, it is therefore important to consider the respective features of laws and codes:

- *Focus*. Codes tend to focus on identifying and articulating "good" or "best" practice. Laws tend to focus on identifying minimum threshold behaviors and practices. In other words, codes set out norms to which companies should aspire, while laws set minimum standards to be met.
- *Development*. The process of developing a code is often easier than developing and passing new legislation.
- *Implementation*. Codes can often be implemented faster than laws, which may require the drafting and approval of implementing rules and regulations.
- *Enforcement*. Compliance with codes tends to be voluntary; compliance with laws is compulsory. Codes tend not to have explicit enforcement mechanisms but rely instead on self-regulation and self-discipline. In some cases, an industry or economic sector monitors its members for compliance. In contrast, laws are enforced through the judicial system and regulatory agencies and entail explicit penalties for noncompliance.
- *Flexibility*. Codes are relatively easier than laws to review and modify and can often respond to crises more quickly.
- *Evolutionary*. Because they are easier to amend, codes are often considered a first step before the enactment of law and regulation. Codes are sometimes adopted specifically to forestall legislation or regulation.
- *Comprehension*. Drafters of codes usually give priority to ease of comprehension and accessibility, whereas laws give priority to legal precision, sometimes at the expense of clarity.

Complying with codes

As noted earlier, codes of best practice are typically voluntary by nature, and so compliance is not mandatory. But codes nevertheless have an important impact on corporate governance practices.

In some cases, companies in the industry or sector covered by the code voluntarily comply to forestall enactment of laws that might be more binding on their operations. In other cases, codes are seen as a first step before legislation is passed, with a country gaining valuable experience from learning what part of the code works and what needs reform.

THINKING POINT

What would encourage companies to comply with your corporate governance code?

QUOTE

COMPLYING WITH CODES

"Some governance codes are linked to listing or legally mandated disclosure requirements. Others are purely voluntary in nature, but may be designed to help forestall further government or listing body regulation. In the developing nations, governance codes are more likely to address basic principles of corporate governance that tend to be more established in developed countries through company law and securities regulation, such as:

- The equitable treatment of shareholders.
- The need for reliable and timely disclosure of information concerning corporate governance and ownership.
- The holding of annual general meetings of shareholders."

—Holly Gregory, "The Globalization of Corporate Governance," *Global Counsel*, September and October 2000

In several countries, the code of best practice itself contains recommendations for laws or regulations that would strengthen compliance with key governance principles.

EXAMPLES

CODES RECOMMENDING LEGAL ACTION

SOUTH AFRICA

The King II Report, published in 2002, included four pages of recommendations requiring amendment to South African laws and regulations.

SRI LANKA

The Sri Lanka Code of Best Practice, developed in 1996 by the Institute of Chartered Accountants, made recommendations on matters relating to financial aspects of corporate governance as a first step preceding introduction of legislation. The code suggested possible amendments in the Securities and Exchange Commissions Act and the Companies Act, among others, as well as amendments to the rules and regulations of the Colombo Stock Exchange.

In some countries stock exchanges, as part of their listing rules, have required companies to comply with certain provisions of codes of best practice in order to be listed. In the case of Pakistan, stock exchanges have even fully integrated the existing code into their listing regulations.

EXAMPLE

INTEGRATED CODE: PAKISTAN

All stock exchanges in Pakistan have adopted the corporate governance code by incorporating it into their listing regulations. As a result, all listed companies in Pakistan are now required to comply with all of the provisions of the code. The introduction of the code was also followed by amendments to the Companies Ordinance, which further strengthened corporate governance in Pakistan.

Following the model of the United Kingdom, several voluntary codes use the "comply or explain" mechanism. Under this approach, listed companies are asked to state that they comply with various provisions of the code or explain why they do not. Supporters of this approach say that it offers great flexibility as well as high degree of compliance.

QUOTE

THE 'COMPLY OR EXPLAIN' APPROACH

UNITED KINGDOM

The Preamble of the United Kingdom Combined Code of Corporate Governance, published in 2003, states:
"The Code contains main and supporting principles and provisions. The existing Listing Rules require listed companies to make a disclosure statement in two parts in relation to the Code. In the first part of the statement, the company has to report on how it applies the principles in the Code. In future this will need to cover both main and supporting principles. The form and content of this part of the statement are not prescribed, the intention being that companies should have a free hand to explain their governance policies in the light of the principles, including any special circumstances applying to them which have led to a particular approach. In the second part of the statement the company has either to confirm that it complies with the Code's provisions or—where it does not—to provide an explanation. This 'comply or explain' approach has been in operation for over ten years and the flexibility it offers has been widely welcomed both by company boards and by investors. It is for shareholders and others to evaluate the company's statement."

QUOTES

THE 'COMPLY OR EXPLAIN' APPROACH

TURKEY

The Corporate Governance Principles, adopted by the Capital Market Board of Turkey in June 2003, state:
"The implementation of the Principles is optional. However, the explanation concerning the implementation status of the Principles, if not detailed reasoning thereof, conflicts arising from inadequate implementation of these Principles, and explanation on whether there is a plan for change in the company's governance practices in the future should all be included in the annual report and disclosed to public. . . . Within the Principles, 'comply or explain' approach is valid. However, the 'R' letters on the sides of some of the Principles indicate that those are recommendations only. With respect to non-conformity with . . . recommendations, no disclosure is required. Additionally, the Principles, marked as recommendations, may be subject to the 'comply or explain' approach in the medium and long term."

GERMANY

The German "Corporate Governance Code," amended on May 21, 2003, states:
"The recommendations of the Code are marked in the text by the use of the word 'shall.' Companies can deviate from them, but are then obliged to disclose this annually. This enables companies to reflect sector and enterprise-specific requirements. Thus, the Code contributes to more flexibility and more self-regulation in the German corporate constitution. Furthermore, the Code contains suggestions which can be deviated from without disclosure; for this the Code uses terms such as 'should' or 'can.' The remaining passages of the Code not marked by these terms contain provisions that enterprises are compelled to observe under applicable law."

BRAZIL

The recommendations by the Comissão de Valores Mobiliários (CVM, the Securities and Exchange Commission of Brazil), as amended in June 2002, state the following:
"This code contains recommendations by Comissão de Valores Mobiliários on good corporate governance practices. The adoption of such practices usually implies higher behavior standards than those required by law, or by CVM itself. This is why non-compliance with this code is not subject to punishment by CVM. Notwithstanding the above, CVM will soon require that public companies include their level of adherence to these practices in their annual filings, in the form 'comply or explain.' If a company does not adopt a recommendation, it should explain its reasons."

[A comparative list of major corporate governance codes from developed and developing countries can be found in Volume 1, Annex 5 at the end of this volume. Most corporate governance codes from around the world can be downloaded from the European Institute for Corporate Governance at www.ecgi.org/codes/.]

Why Are Corporate Governance Codes Useful?

MODULE 3 AT A GLANCE:

Many developed and developing countries have introduced corporate governance codes to restore and sustain investor confidence in the wake of a financial crisis or corporate scandal. Another primary purpose of corporate governance codes is to raise standards and drive corporate governance reforms. Codes of best practice on corporate governance are important tools for enhancing governance systems and practices nationally. They serve as benchmarks for monitoring and implementing corporate practices and policies at the company level.

This module reviews how corporate governance codes have proven useful in:

- Building investor confidence
- Raising standards and driving corporate governance reform
- Providing benchmarks to implement and measure corporate governance at the corporate level

THINKING POINT
What is the primary reason for introducing a code of corporate governance in your country?

BUILDING CONFIDENCE

Ineffective boards, weak internal controls, poor audits, lack of adequate disclosure, and lax enforcement have led to financial crises and major corporate scandals around the world in recent years. In response several countries have adopted corporate governance codes that have become major instruments in restoring public and investor confidence in the market and preventing future financial crises. *(For a discussion on the importance of corporate governance, see Volume 1, Module 1.)*

Preventing financial crisis

The financial crises in Asia, Russia, and elsewhere in the late 1990s widely demonstrated that poor governance can exacerbate other problems and harm national economic performance and global financial stability. Although circumstances differed, all of the crisis countries had distorted governance structures that led to inefficient economic decisionmaking. When imbalances became too large to be ignored, they touched off a rout in financial markets, setting back the economic development efforts of entire countries and regions.

QUOTE

PREVENTING CRISIS

"One of the most important underlying factors behind the cause of both the recent financial crises and recent company scandals that broke out across the world can be attributed to the inadequacy of sound corporate governance principles by both the public and private sectors. As a result, the concept of corporate governance has gained increased attention from all around the world. . . . Therefore the CMB [Capital Markets Board] has defined corporate governance principles, which can be used primarily by listed companies as well as by joint stock companies in both the private and public sector."

—Dr. Dogan Cansizlar, chairman, Capital Markets Board of Turkey, June 2003

QUOTES

BUILDING INVESTOR CONFIDENCE

OECD

"The recent financial crises in Asia and elsewhere . . . have made amply clear to other countries around the world why the issues of transparency and accountability in corporate governance are so important to investor confidence and to overall national economic performance."

—Organisation for Economic Co-operation and Development, 1999

KOREA

"For corporations to procure long-term funds under a blanket of stability, a governance structure acknowledged internationally is a must. In response to these demands of the present era, the Committee enacts this Code to present a direction for better corporate governance that will render our companies more credible, domestically and internationally, and enhance transparency and efficiency of the management."

—Committee on Corporate Governance, 1999

THAILAND

"It is widely criticized that Thai listed companies have weak corporate governance comparing to those in developed countries. It can also be explained that this weak corporate governance was one of the causes that led Thailand into the current crisis. This is because there was not enough transparency and reliable information for investors and even the management to accurately assess the relevant risks and make prudent decisions. In addition, this poor governance also caused nervous investors to withdraw or cancel their investments which made the crisis worse. . . . Therefore, the strengthening of corporate governance of Thai companies is crucial for the country to get out of this crisis."

—Office of the Securities and Exchange Commission, 1999

In the years leading up to the 1997 financial crisis, some Asian countries had already begun to strengthen their corporate governance regimes for publicly listed companies. For example, the Confederation of Indian Industries set up a committee in 1996 to examine corporate governance issues in that country. Convinced that good corporate governance was essential if Indian companies were going to compete for domestic and global capital at competitive rates, the confederation issued a first draft of its code in April 1997, just as the Asian financial crisis was brewing.

Such efforts notwithstanding, serious shortcomings remained in some corporate governance regimes and contributed to the instability in the region's financial markets during the 1997 financial crisis. The countries most affected in the crisis were Indonesia, Republic of Korea, Malaysia, the Philippines, and Thailand. To varying degrees these countries all suffered from overcapacity, poor quality of investments, excessive diversification by large business groups, and overexposure to debt (especially unhedged short-term foreign debt). As the crisis unfolded, the precarious position of some companies and banks became clear. It also became apparent that the risks that many companies carried were both poorly understood and poorly disclosed.

In the wake of the crisis, governments and international organizations studied and implemented various structural reforms to prevent such crises in the future. Key components of the reforms were corporate governance codes that emphasized transparency and accountability as well as sound financial, managerial, and accounting practices.

Curbing corporate scandals

The numerous corporate scandals and large corporate failures over the past years in several countries have also badly shaken investor confidence in systems for managing accountability and transparency. The loss of millions of jobs and billions of dollars as a direct result of failures of governance has created enormous policy pressures to restore and maintain public and investor confidence in corporate activities. The concerns pertaining to accountability are leading to the development or review of corporate governance codes of best practice and in some cases to the enforcement of new laws and regulations. The appropriate regulatory response varies from country to country. *(For a discussion on laws versus best practice codes, refer to Volume 1, Module 2.)*

QUOTE

CURBING CORPORATE SCANDALS

"The numerous high-profile cases of corporate governance failure have focused the minds of governments, regulators, companies, investors and the general public on the weakness in corporate governance systems and the associated threat posed to the integrity of financial markets. In response, OECD ministers called for an assessment of the OECD Principles by 2004."

—Grant Kirkpatrick, *Global Corporate Governance Guide 2004*

One of the first codes introduced in the wake of corporate scandals was drawn up in the United Kingdom, where several large companies went bankrupt in the late 1980s and 1990s, including the Bank of Credit and Commerce International, Pollypeck International, and Maxwell Communication Corp. The collapses were attributed to weak governance systems, lax oversight by the boards of directors, and too much control vested in a single top executive. In response to the public outcry, the Financial Reporting Council, the London Stock Exchange, and the accountancy profession set up the Cadbury Committee (after its chairman, Sir Adrian Cadbury) in May 1991 to study the problem. The resulting Cadbury Code, issued in 1992, called for openness, subject only to commercial confidentiality; honest, balanced, and complete financial reporting; and holding directors accountable for providing quality information.

QUOTE

CURBING CORPORATE SCANDALS

"The Committee has become the focus of far more attention then I ever envisaged when I accepted the invitation to become its chairman. The harsh economic climate is partly responsible, since it has exposed company reports and accounts to unusually close scrutiny. It is, however, the continuing concern about standards of financial reporting and accountability, heightened by BCCI, Maxwell and the controversy over directors' pay, which has kept corporate governance in the public eye."

—Sir Adrian Cadbury, chairman, Committee on the Financial Aspects of Corporate Governance, 1992

In the United States, the collapse of several of the country's most prominent businesses, including Enron Corp, WorldCom, and Tyco International, did not promote the adoption of a new code but did lead to passage in 2002 of legislation significantly tightening financial accounting and reporting for American companies. Known as Sarbanes-Oxley for its chief authors, the legislation helped restore investor confidence in the American markets. The law prescribed new or enhanced governance standards for all U.S. public companies and public accounting firms and set criminal penalties for lack of compliance. The act established:

- New standards for corporate boards and audit committees
- New accountability standards and criminal penalties for corporate management
- New independence standards for external auditors
- A Public Company Accounting Oversight Board under the Securities and Exchange Commission to oversee public accounting firms and issue accounting standards.

Sarbanes-Oxley also requires the Securities and Exchange Commission to issue necessary rules and regulations for implementing and enforcing the new law.

QUOTE

BUILDING INVESTOR CONFIDENCE

"The more national corporate governance codes converge towards best practice, the easier it will be to restore confidence in capital markets in the wake of the scandals that have shaken trust in some European companies, including traditional 'blue chips.' Broad convergence not only strengthens shareholders' rights and the protection of third parties such as creditors and employees, it makes it easier for investors to compare investment opportunities."

—Frits Bolkestein, Internal Market Commissioner, European Commission, 2004

Other countries also experienced corporate governance failures. After companies in Italy, the Netherlands, and elsewhere were found near collapse or in bankruptcy as a result of poor governance, the European Commission decided in 2003 to draw up a Commission Action Plan for modernizing company laws and encouraging the adoption of corporate governance codes.

That plan was followed in 2004 by the launch of a European Corporate Governance Forum. The forum's role is to examine best practices in member states with a view to promoting the convergence of national corporate governance codes and providing advice to the Commission. The forum is composed of fifteen senior experts from various professional backgrounds (such as stock issuers, investors, academics, regulators, and auditors), whose experience and knowledge of corporate governance are widely recognized within Europe. Furthermore, in 2005 the Commission set up an expert advisory group to provide detailed technical advice on preparing corporate governance and company law measures. The technical work of this group will complement the forum's more strategic role in promoting convergence of corporate governance in Europe. *(More information on the European Commission's work in corporate governance is available at http://www.europa.eu.int/comm/internal_market/company/index_en.htm.)*

EXAMPLES

CORPORATE SCANDALS

UNITED STATES: ENRON

The giant energy trader Enron, consistently listed as one the top 10 companies in the country and as a good investment, went bankrupt in December 2001 after it could not pay interest on several loans. It soon became clear that the company had existed for years by inflating its profits and using accounting devices such as "special purpose entities" to conceal its debt. Several top executives at the company pleaded guilty to or were convicted of fraud and other crimes. Enron's collapse was the first in a series of high-profile corporate bankruptcies and wrongdoings in the United States that badly eroded confidence in the honesty and integrity of American businesses.

ITALY: PARMALAT

The Italian food giant Parmalat went bankrupt in December 2003 after a default on a bond payment triggered investigations into the company's finances. Investigators quickly found that the company's managers had been literally inventing assets and falsifying accounts for as long as 15 years. Also injured in the incident were the international accounting firms that had worked with Parmalat but failed to discover the deception.

EXAMPLES

CORPORATE SCANDALS

UNITED KINGDOM: EQUITABLE LIFE

In the United Kingdom, Equitable Life nearly went under after revelations that it had long been promising its policyholders benefits far in excess of the assets it held. One reason for the shortfall was the company's practice of making maximum payments rather than building a reserve to meet its future obligations. A report issued by Lord Penrose in March 2004 said regulatory failure played a role in the company's downfall. It also said the company's nonexecutive directors were so dependent on the chief executive that they were "largely incapable of exercising any influence."

SINGAPORE: CHINA AVIATION OIL

The Singapore unit of China Aviation Oil found itself in trouble late in 2004, after it was revealed that the company had lost $550 million in speculative trading on oil derivatives. The Singapore company supplied one-third of China's aviation fuel. It was the biggest derivatives trading scandal since Barings Bank collapsed in 1995.

In addition, the director of the Singapore unit alleged that the parent company, China Aviation Oil Holding, knew about the losses when it sold 15 percent of the Singapore unit's stock, worth $108 million, to secretly cover failed margin calls. At the time of the stock sale, the company was advising 7,000 private investors that they could still expect profits, even though the firm was effectively bankrupt. International credit rating agencies said the China Aviation Oil case highlighted wider governance problems, including complex corporate structures and unreliable accounting practices that made it extremely difficult to analyze some China-related companies.

CHILE: CHISPAS

Shareholder rights were at the heart of a scandal in 1997–98 in Chile, involving a controversial transaction between Endesa Espana, a Spanish utility holding company, and Enersis, the holding company of Endesa Chile, at the time the largest private electricity company in Latin America. Enersis was controlled by a group of five investment companies (Chispas). The Spanish company negotiated a deal with the president of Enersis that would have paid far more for the class B voting stock, which had little equity, than for class A shares, which held most of the equity but no voting rights. The deal would also have given additional benefits to holders of class B stock. When the details of the proposed transaction became public, the equity shareholders challenged it. The transaction was voided, the president of Enersis was fired, and the Chilean government, with the help of the International Finance Corporation, designed a new regulatory framework for corporate governance and takeovers.

RAISING STANDARDS AND DRIVING REFORM

Beyond financial crises and corporate scandals, the globalization of financial markets and the need to compete for domestic and international capital has led to the adoption of corporate governance codes building on internationally agreed best practices. These codes often drive the corporate governance reform agenda by introducing market-driven best practice recommendations adopted on a voluntary basis.

Building consensus for reform

In many countries corporate governance reform has been led by the introduction of corporate governance codes of best practice.

Because the crafting of codes often requires the contribution of a wide range of public and private stakeholders such as market regulators, business associations, and professional organizations, codes often constitute a first step in building consensus on the reform agenda. The development of a code provides a catalyst for experts in the corporate governance field to meet, discuss controversial issues, and arrive at a consensus. *(For more information on stakeholders involved in the crafting process of codes, see Volume 2, Module 3.)*

Adapting international standards

The development of international corporate governance standards and guidelines often constitutes a major achievement in finding common best practices that countries with different cultures can agree upon. For example, the OECD Principles of Corporate Governance, which have become part of the Financial Stability Forum's 12 key standards for sound financial systems, were issued to assist governments in their efforts to evaluate and improve their frameworks for corporate

QUOTE

DRIVING REFORM

"Turkey needed to improve the competitiveness of its capital markets to attract global finance. To achieve such competitiveness, the quality of the corporate governance framework was considered as one of the most important criteria. In that context, developing a corporate governance code was seen as a key [device] for attracting foreign investments."
—Melsa Ararat, Corporate Governance Forum of Turkey, 2003

EXAMPLES

DRIVING REFORM

UKRAINE

After various attempts to pass a new joint stock company law had failed, the Securities and Stock Market State Commission decided in 2003 to adopt a corporate governance code to provide for the transition from state-owned enterprises to privatization, to attract higher levels of foreign direct investment, and to raise the overall level of investor confidence in shares issued by public companies.

CHINA

The Chinese Securities Regulatory Commission formulated the Code of Corporate Governance for Listed Companies in 2002 to "promote the establishment and improvement of the modern enterprise system by listed companies, to standardize the operation of listed companies and to bring forward the healthy development of the securities market of our country."

POLAND

The need to respond to the lack of confidence in Poland's capital market, the need to deal with the structural problems hampering its development, and the requirement to support the country's efforts on privatization and macroeconomic stabilization were the critical issues driving the drafting of the Corporate Governance Code for Polish Listed Companies. This code addressed several weaknesses in the Polish economy, including the extent and sources of ownership concentration and control, cases of obvious abuses of shareholder rights, ineffective checks and balances in a company's governance structures, and inadequate disclosures to shareholders.

governance. The Principles for Corporate Governance in the Commonwealth, developed by the Commonwealth Association for Corporate Governance in 1999, constitute another important regional cross-border effort to find common guidelines for best corporate governance practices.

International standards provide a set of guidelines against which countries can assess their own corporate governance framework and establish their own set of best practices. Corporate governance codes are the primary vehicle through which these international corporate governance standards can be introduced, translated, and adapted to the local context.

International standards and regional guidelines are deliberately written to apply in countries with either a civil law or common law tradition and with varying levels of ownership concentration and differing board models. Precisely because of this, they remain broad in their scope and must be turned into practical, specific measures and recommendations that are explicitly applicable to a country's corporate sector.

QUOTES

RAISING STANDARDS

BANGLADESH

"The obvious function of a Code of Corporate Governance for Bangladesh is to improve the general quality of corporate governance practices. The Code does this by defining best practices of corporate governance and specific steps that organizations can take to improve corporate governance.… In some areas the Code specifies more stringent practices than is required by the Bengladeshi law, but it should be emphasised that these additional requirements are in keeping with international best practices."

—The Code of Corporate Governance for Bangladesh, March 2004

RUSSIAN FEDERATION

"Improvement of corporate governance in the Russian Federation is vital for increasing investments in all sectors of the Russian economy from both domestic sources and foreign investors. One means to foster such improvement is to introduce standards that are based on an analysis of best practices of corporate governance."

—Coordination Council For Corporate Governance, Russian Code of Corporate Conduct, 2002

EXAMPLE

RAISING STANDARDS: MEXICO

The Mexican National Banking and Securities Commission in 1997 surveyed 49 countries on how they dealt with shareholder rights. The survey found that shareholder rights in Mexico were below the standards of other members of the Organisation for Economic Co-operation and Development as well as other Asian and Latin American countries. To remedy this shortcoming, Mexico developed the Mexican Best Corporate Practices Code.

By adopting their own corporate governance codes, countries translate international standards to fit local needs and circumstances. In many countries, once a code is in place, it also provides local ownership over international standards, which may otherwise be perceived as a foreign imposition.

QUOTE

ADAPTING INTERNATIONAL STANDARDS

"When I was president of the Commonwealth Association for Corporate Governance covering the 56 countries in the Commonwealth, my council recognized that, while we could write principles for the establishment of corporate governance codes in the Commonwealth, each country in the Commonwealth would have to develop its own code. It was with this knowledge that we wrote 'The Principles for Corporate Governance in the Commonwealth.' We pointed out that each country needed to establish its own guidelines having regard to its special circumstances."

—Mervyn King, former president of the Commonwealth Association for Corporate Governance, 2005

MONITORING PROGRESS AND GUIDING IMPLEMENTATION

While building consensus over the reform agenda and introducing international standards, country codes also provide specific benchmarks against which corporate behavior can be monitored and good practices implemented through governance policies at the company level.

QUOTE

MEASURING CORPORATE GOVERNANCE PRACTICES

"The Code is the major measuring standard for evaluating whether a listed company has a good corporate governance structure, and if major problems exist with the corporate governance structure of a listed company."

—Code of Corporate Governance for Listed Companies in China, 2002

Measuring corporate governance practices

Codes of best practice provide benchmarks for measuring corporate governance practices and developing rating tools and scorecards for investors to use in evaluating a company's performance.

For example, the CFA Center for Financial Market Integrity, the policy arm of the CFA Institute, a professional body of financial analysts with members in 119 countries, released "The Corporate Governance of Listed Companies: A Manual for Investors" in May 2005. Among the contents are corporate governance codes from around the world, both existing and proposed. The CFA Institute created the project through a global corporate governance task force of more than 30 varied specialists from 12 countries. The new manual explains how to evaluate factors such as board and management practices and shareowner rights to assess possible risks in corporate governance structure that could affect shareowner value. The CFA Institute intends to update the manual as corporate governance practices change over time.

Corporate governance codes have also served as the basis for developing scorecards that can be helpful in tracking actual progress in improving corporate governance practices. In 2000, for example, the German Society of Investment Analysis and Asset Management introduced a corporate governance scorecard based on the German Corporate Governance Code and other internationally relevant best practice standards. This model served as a basis for developing such scorecards in East Asian countries such as Indonesia and the Philippines. *(For a description of the German scorecard approach, see Volume 1, Annex 3.)*

QUOTE

THE SCORECARD APPROACH

"The main goals of the scorecard approach are to:

- Facilitate the work of analysts and investors through a systematic and easy overview of all relevant issues of good governance.
- Enable companies to easily assess the 'reach' and the quality of their own governance situation.
- Allow [setting of] minimum scores by investors for governance as part of general investment politics.
- Enable comparisons across industries and countries.
- Be readily available to all interested parties via the Internet.
- Ensure high degrees of usage: the completion of the Scorecard via programmed tools (MS Excel) should therefore be possible."

—Christian Strenger, member, German Government Commission on Corporate Governance, and director, DWS Investment GMBH, April 2002

In most countries corporate governance consulting firms and rating agencies are actively developing rating tools benchmarked to existing best practice. Just as investors require credit ratings of corporate entities from independent credit rating firms before making decisions on certain investments and debt instruments, investors also require independent reviews and evaluation of a company's corporate governance practices from rating firms. Although the quality of their services may vary and the methodology they use is not always disclosed, most rating agencies are now offering corporate governance services, based on accepted standards, to:

- Facilitate company analysis for financial analysts and investors
- Help corporations improve their corporate governance structures and practices

Some of the well-known organizations engaged in corporate governance ratings include Standard and Poor's, International Shareholder Services (ISS), Deminor, and Deutsche Bank.

Guidance for company codes

Some large companies adopted their first company corporate governance codes before national best practices or international standards were introduced. The General Motors guidelines, issued in January 1994, represent one of the first attempts by a company to set up a specific corporate governance structure for itself. *(A summary of the GM guidelines, compiled by the Center for Private Enterprise, can be found in Volume 1, Annex 4.)*

These pioneering companies notwithstanding, commercial and corporate sectors are increasingly using existing corporate governance codes as benchmarks to improve their own governance practices and policies so that they can project themselves in the world markets as being qualified for international investments. Company codes and guidelines are extremely useful for effective implementation of corporate governance best practices. Regularly updated company codes provide essential guidance for boards and help build trust in the company for existing and potential investors. This can be especially relevant where the overall legal corporate governance framework is still at an early stage of development and enforcement remains weak.

EXAMPLE

GUIDELINES FOR COMPANY POLICIES AND PRACTICES: THE NETHERLANDS

The Royal Dutch Petroleum Company has taken steps to comply in all material respects with the Recommendations on Corporate Governance in the Netherlands, which were issued in 1997. When the Corporate Governance Committee, chaired by Morris Tabaksblat, issued a new Dutch corporate governance code in December 2003, Royal Dutch Petroleum took immediate steps to amend its practices to reflect much of the revised code in its governance structure.

QUOTES

GUIDELINES FOR COMPANY POLICIES AND PRACTICES

ANDEAN COUNTRIES (BRAZIL, COLOMBIA, ECUADOR, PERU, AND VENEZUELA)

"The main objective of the [Andean Corporate Governance] Code was [for it] to be effectively implemented. That is what explains the absolutely pragmatic and practical approach followed in the Code. The implementation of the Code is to be made through the company documentation (Bylaws, articles of incorporation, board policies, etc.) and, in some special cases, shareholder agreements."

—IAAG, "Outcomes for a Corporate Governance Andean Code," 2005

BANGLADESH

"Individual organizations can comply with the Code by writing the provisions into their articles of association and incorporating the code into company procedures and reporting practices. Management and the board of directors should use the Code of Corporate Governance as a guideline to develop procedures for evaluation and accountability within the organization."

—Code of Corporate Governance for Bangladesh, March 2004

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ANNEX 2. EXAMPLE OF LAWS THAT AFFECT CORPORATE DIRECTORS

Following is a list of laws and regulations that company directors in the United Kingdom must monitor to ensure that their companies remain in compliance with legal requirements.

CORPORATE ISSUES	Criminal Justice Act, 1993 Companies Act, 1985 and 1989 Insolvency Act, 1986 Company Directors Disqualification Act, 1986
STOCK EXCHANGE REQUIREMENTS FOR LISTED COMPANIES	Combined Code Listing rules Mergers and takeovers
SAFETY MATTERS	Health and Safety at Work Act, 1974 Regulations on controlling hazardous substances,1994
EMPLOYMENT ISSUES	Unfair dismissal and statements of reasons for dismissal, 1999 Human Rights Act, 1998 Employment Relations Act, 1998 National Minimum Wage Act, 1998 Employment Rights (Dispute Resolution) Act, 1998 Employment Rights Act, 1996 Disability Discrimination Act, 1995 Pensions Act, 1995 Sunday Trading Act, 1994 Trade Union and Labor Relations (Consolidation) Act, 1992 Wages Act, 1986 Sex Discrimination Acts, 1975 and 1986 Race Relations Act, 1976 Equal Pay Act, 1970 Parental Leave Regulations Transfer of undertakings (protection of employment) regulations Regulations on time off for young people for study and training Regulations on compensation for unfair dismissal Regulations on trade union recognition Regulations on part-time workers

ANNEX 2. EXAMPLE OF LAWS THAT AFFECT CORPORATE DIRECTORS (CONT.)

ENVIRONMENTAL MATTERS	Environmental Act, 1995 Water Act, 1989 Town and Country Planning Act, 1974 Control of Pollution Act, 1974 Fire Precautions Act, 1971
INTELLECTUAL PROPERTY	Patents Act, 1977 Public Interest Disclosure Act, 1998 Data Protection Act, 1998
CONSUMER PROTECTION	Sales of Goods Act, 1979 Supply of Goods and Services Act, 1982 Consumer Protection Act, 1987 Trades Description Act, 1968 Consumer Credit Act, 1974
COMPETITION	Competition Act, 1998
FINANCIAL MATTERS	Financial Services Act, 2000 Late Payment of Commercial Debt Interest Act, 1998 Insolvency Act, 1986 Theft Act, 1968

ANNEX 3. THE GERMAN SCORECARD APPROACH

Christian Strenger, member of the German Government Commission on Corporate Governance and director of DWS Investment GmbH, described the German Scorecard approach as follows.

STRUCTURE AND CONTENT

1) Structure:
To allow an easy understanding and application of the Scorecard by the user, a concise structure has been sought. It contains on five pages a main body dedicated to the individual scoring process followed by a summary page which gives an overview by showing the partial scores achieved for each criterion as well as the total score. The main body of the Scorecard is divided into seven relevant criteria, which comply with the structure of the official 'German Corporate Governance Code.'

Every criterion comprises relevant points not exceeding a number of ten. All points directly relating to the 'German Corporate Governance Code' show the corresponding references in brackets.

As the Scorecard is in the first instance devised for analysts and investors, additional important issues of corporate governance not yet covered by the Code are also included. Thus current deficits from the investor's point of view in the 'German Corporate Governance Code' are being dealt with by the Scorecard (such points are clearly identifiable as they have no reference to the Code).

2) Content:

a) 'Corporate Governance-Commitment': This checks the extent how basic principles of good governance are anchored in the company, that its realization is achieved by a sufficiently neutral corporate governance officer and that there is an ongoing commitment for adjusting to new developments and advances in governance standards.

b) 'Shareholders and the General Meeting': The criterion reviews all relevant issues related to the equal treatment of shareholders, focusing on the existence of full voting rights and pre-emptive rights for shareholders in most circumstances of capital increases.

c) 'Cooperation between Management Board and Supervisory Board': This sets the communication arrangements between Management Board and Supervisory Board.

d) 'Management Board': The emphasis is on details of the compensation elements rewarding shareholder value orientation and excluding, for example, option repricing. The criterion also deals with practical conflicts of interest and own-account share dealing.

e) 'Supervisory Board': Besides introducing a compensation element, depending on longer term profitability, conflicts of interest, qualification standards for Supervisory Board members and expert committees for complex tasks (particularly the audit committee) are the focus here.

f) 'Transparency': Equal and regular information for all shareholders ('fair disclosure'), also via the Internet, as well as detailed analysis of deviations from previous targets, are key points here.

ANNEX 3. THE GERMAN SCORECARD APPROACH (CONT.)

g) 'Reporting and Audit of the Annual Financial Statements': Apart from demanding international accounting and auditing standards and full information on stock options, the criterion focuses particularly on sufficient independence of the auditor and his appropriate compensation, different accounting standards and internal and external information matters like maximum periods for publishing reports.

METHODOLOGY

1) The approach:
The scorecard should enable the user to evaluate corporate governance principles and practices in a quick but systematic fashion with a concise structure of the major criteria with relevant individual points.

2) Calculation and weighting of the scorecard:
The calculation and weighting of the scorecard should follow an easy path that gives standard weightings but also allows the reflection of individual weighting differences. The calculation should be menu-driven and follow proven methods like MS Excel standard software.

The conceptual approach to the evaluation question should reward the fulfillment of a good standard of governance and an active commitment with a possible score of 65% - 75%. The remaining percentage should be achievable if additional important governance items are fulfilled.

Taking the German Scorecard as the example: A company displaying an active 'Corporate Governance Commitment' (first criterion) and fulfilling all 'Recommendations' of the 'German Corporate Governance Code', reaches a score of 75%. If the additional 'Suggestions' of the Code and additional 'best practice standards' are fulfilled, the maximum 'Total Score' of 100% can be achieved.

This 25% gap over the fulfillment of the 'Recommendations' is clearly meant to incentivise companies to pursue more than the 'Recommendations'. In first tests since the publication of the new Scorecard a few weeks ago, German companies with demanding governance standards reached scores between 80% and 95%.

For more information on the German Scorecard, go to www.dvfa.com.

ANNEX 4. SUMMARY OF GENERAL MOTORS' BOARD GUIDELINES

Following is a summary, prepared by the Center for International Private Enterprise, of the guidelines for the board of directors for General Motors. A complete text of the guidelines is available at www.gm.com.

SELECTION AND COMPOSITION OF THE BOARD

Board Membership Criteria

The Committee on Director Affairs is responsible for reviewing with the Board, on an annual basis, the appropriate skills and characteristics required of Board members in the context of the current make-up of the Board. This assessment should include issues of diversity, age, skills such as understanding of manufacturing technologies, international background, etc. – all in a context of an assessment of the perceived needs of the Board at that point in time.

Selection and Orientation of New Directors

The Board itself should be responsible, in fact as well as procedure, for selecting its own members and in recommending them for election by the stockholders. The Board delegates the screening process involved to the Committee on Director Affairs with the direct input from the Chairman of the Board, as well as the Chief Executive Officer. The Board and the Company have a complete orientation process for new Directors that includes background material, meetings with senior management and visits to Company facilities.

Extending the Invitation to a Potential Director to Join the Board

The invitation to join the Board should be extended by the Board itself, by the Chairman of the Committee on Director Affairs (if the Chairman and CEO hold the same position), the Chairman of the Board, and the Chief Executive Officer of the Company.

BOARD LEADERSHIP

Selection of Chairman and CEO

The Board should be free to make this choice any way that seems best for the Company at a given point in time.

Therefore, the Board does not have a policy, one way or the other, on whether or not the role of the Chief Executive and Chairman should be separate and, if it is to be separate, whether the Chairman should be selected from the non-employee Directors or be an employee.

Lead Director Concept

The Board adopted a policy that it will have a Director selected by the outside Directors who will assume the responsibility of chairing the regularly scheduled meetings of outside Directors or other responsibilities which the outside Directors as a whole might designate from time to time.

Currently, this role is filled by the non-executive Chairman of the Board. Should the Company be organized in such a way that the Chairman is an employee of the Company, another director would be selected for this responsibility.

BOARD COMPOSITION AND PERFORMANCE

Size of the Board

The Board presently has 14 members. It is the sense of the Board that a size of 15 is about right. However, the Board would be willing to go to a somewhat larger size in order to accommodate the availability of an outstanding candidate(s).

ANNEX 4. SUMMARY OF GENERAL MOTORS' BOARD GUIDELINES (CONT.)

Mix of Inside and Outside Directors

The Board believes that as a matter of policy there should be a majority of independent Directors on the GM Board (as stipulated in By-law 2.12). The Board is willing to have members of Management, in addition to the Chief Executive Officer, as Directors. But the Board believes that Management should encourage senior managers to understand that Board membership is not necessary or a prerequisite to any higher management position in the Company. Managers other than the Chief Executive Officer currently attend Board meetings on a regular basis even though they are not members of the Board.

On matters of corporate governance, the Board assumes decisions will be made by the outside directors.

Board Definition of What Constitutes Independence for Outside Directors

GM's By-law defining independent directors was approved by the Board in January 1991. The Board believes there is no current relationship between any outside director and GM that would be construed in any way to compromise any Board member being designated independent. Compliance with the By-law is reviewed annually by the Committee on Director Affairs.

Former Chief Executive Officer's Board Membership

The Board believes this is a matter to be decided in an individual instance. It is assumed that when the Chief Executive Officer resigns from that position, he/she should offer his/her resignation from the Board at the same time. Whether the individual continues to serve on the Board is a matter for discussion at that time with the new Chief Executive Officer and the Board.

A former Chief Executive Officer serving on the Board will be considered an inside director for purposes of corporate governance.

Directors Who Change their Present Job Responsibility

It is the sense of the Board that individual directors who change the responsibility they held when they were elected to the Board should submit a letter of resignation to the Board.

It is not the sense of the Board that in every instance the Directors who retire or change from the position they held when they came on the Board should necessarily leave the Board. There should, however, be an opportunity for the Board, via the Committee of Director Affairs, to review the continued appropriateness of Board membership under these circumstances.

Term Limits

The Board does not believe it should establish term limits. While term limits could help insure that there are fresh ideas and viewpoints available to the Board, they hold the disadvantage of losing the contribution of directors who have been able to develop, over a period of time, increasing insight into the Company and its operations and, therefore, provide an increasing contribution to the Board as a whole.

As an alternative to term limits, the Committee on Director Affairs, in consultation with the Chief Executive Officer and the Chairman of the Board, will review each director's continuation on the Board every five years. This will also allow each director the opportunity to conveniently confirm his/her desire to continue as a member of the Board.

Retirement Age
It is the sense of the Board that the current retirement age of 70 is appropriate.

Board Compensation Review
It is appropriate for the staff of the Company to report once a year to the Committee on Director Affairs the status of GM Board compensation in relation to other large US companies. As part of a Director's total compensation and to create a direct linkage with corporate performance, the Board believes that a meaningful portion of a Director's compensation should be provided in common stock units.

Change in Board compensation, if any, should come at the suggestion of the Committee on Director Affairs, but with full discussion and concurrence by the Board.

Executive Sessions of Outside Directors
These outside Directors of the Board will meet in Executive Session three times each year. The format of these meetings will include a discussion with the Chief Executive Officer on each occasion.

Assessing the Board's Performance
The Committee on Director Affairs is responsible to report annually to the Board an assessment of the Board's performance. This will be discussed with the full Board. This should be done following the end of each fiscal year and at the same time as the report on Board membership criteria.

This assessment should be of the Board's contribution as a whole and specifically review areas in which the Board and/or the Management believes a better contribution could be made. Its purpose is to increase the effectiveness of the Board, not to target individual Board members.

Board Interaction with Institutional Investors, the Press, Customers, etc.
The Board believes that the Management speaks for General Motors. Individual Board members may, from time to time at the request of the Management, meet or otherwise communicate with various constituencies that are involved with General Motors. If comments from the Board are appropriate, they should, in most circumstances, come from the Chairman.

BOARD RELATIONSHIP TO SENIOR MANAGEMENT

Regular Attendance of Non-Directors at Board Meetings
The Board is comfortable with the regular attendance at each Board meeting of non-Board members who are members of the President's Council.

Should the Chief Executive Officer want to add additional people as attendees on a regular basis, it is expected that this suggestion would be made to the Board for its concurrence.

Board Access to Senior Management
Board members have complete access to GM's Management.

It is assumed that Board members will use judgment to be sure that this contact is not distracting to the business operation of the Company and that such contact, if in writing, be copied to the Chief Executive and the Chairman.

Furthermore, the Board encourages the Management to, from time to time, bring managers into Board meetings who: (a) can provide additional insight into the items being discussed because of personal involvement in these areas;

ANNEX 4. SUMMARY OF GENERAL MOTORS' BOARD GUIDELINES (CONT.)

and/or (b) represent managers with future potential that the senior management believes should be given exposure to the Board.

MEETING PROCEDURES

Selection of Agenda Items for Board Meetings
The Chairman of the Board and the Chief Executive Officer (if the Chairman is not Chief Executive Officer) will establish the agenda for each Board meeting.

Each Board member is free to suggest the inclusion of item(s) on the agenda.

Board Materials Distributed in Advance
It is the sense of the Board that information and data that are important to the Board's understanding of the business be distributed in writing to the Board before the Board meets. The Management will make every attempt to see that this material is as brief as possible while still providing the desired information.

Board Presentations
As a general rule, presentations on specific subjects should be sent to the Board members in advance so that Board meeting time may be conserved and discussion time focused on questions that the Board has about the material. On those occasions in which the subject matter is too sensitive to put on paper, the presentation will be discussed at the meeting.

COMMITTEE MATTERS

Number, Structure and Independence of Committees
The current Committee structure of the Company seems appropriate. There will, from time to time, be occasions in which the Board may want to form a new Committee or disband a current Committee depending upon the circumstances. The current six Committees are Audit, Capital Stock, Director Affairs, Finance, Incentive and Compensation, and Public Policy. The Committee membership, with the exception of the Finance Committee, will consist only of independent Directors as stipulated in By-law 2.12.

Assignment and Rotation of Committee Members
The Committee on Director Affairs is responsible, after consultation with the Chief Executive Officer and with consideration of the desires of individual Board members, for the assignment of Board members to various Committees.

It is the sense of the Board that consideration should be given to rotating Committee members periodically at about a five-year interval, but the Board does not feel that such a rotation should be mandated as a policy since there may be reasons at a given point in time to maintain an individual Director's Committee membership for a longer period.

Frequency and Length of Committee Meetings
The Committee Chairman, in consultation with Committee members, will determine the frequency and length of the meetings of the Committee.

Committee Agenda
The Chairman of the Committee, in consultation with the appropriate members of management and staff, will develop the Committee's agenda.

Each Committee will issue a schedule of agenda subjects to be discussed for the ensuing year at the beginning of each year (to the degree these can be set). This forward agenda will also be shared with the Board.

LEADERSHIP DEVELOPMENT

Formal Evaluation of the Chief Executive Officer
The full Board (outside Directors) should make this evaluation annually, and it should be communicated to the Chief Executive Officer by the (non-executive) Chairman of the Board or the Lead Director.

The evaluation should be based on objective criteria including performance of the business, accomplishment of long-term strategic objectives, development of Management, etc.

The evaluation will be used by the Executive Compensation Committee in the course of its deliberations when considering the compensation of the Chief Executive Officer.

Succession Planning
There should be an annual report by the Chief Executive Officer to the Board on succession planning. There should also be available, on a continuing basis, the Chief Executive Officer's recommendation as to his successor should he/she be unexpectedly disabled.

Management Development
There should be an annual report to the Board by the Chief Executive Officer on the Company's program for Management development.

This report should be given to the Board at the same time as the succession planning report, noted previously.

ANNEX 5. COMPARISON OF SELECTED CORPORATE GOVERNANCE CODES OF BEST PRACTICE

This comparison of selected corporate governance codes of best practice in the Americas, Europe, Asia, Africa, and Australia, is based on a framework developed by Holly Gregory of Weil, Gotshal and Manges in 2003. The selected codes as well as other major corporate governance codes not listed here can be downloaded from the European Corporate Governance Institute's electronic library at http://www.ecgi.org/codes.

AUSTRALIA

NAME	Principles of Good Corporate Governance and Best Practice Recommendations
DATE	March 2003
ISSUING BODY	Australian Stock Exchange (ASX) Corporate Governance Council
COMPLIANCE	Disclosure (comply or explain)
OBJECTIVES	• Improve company's performance, competitiveness, and access to capital • Improve quality of governance-related information available to equity markets
SCOPE	Listed companies
CONTENT	• Laying solid foundations for management and oversight • Structuring the board to add value • Promoting ethical and responsible decisionmaking • Safeguarding integrity in financial reporting • Making timely and balanced disclosure • Respecting the rights of shareholders • Recognizing and managing risk • Encouraging enhanced performance • Remunerating fairly and responsibly • Recognizing the legitimate interests of stakeholders
INTERNET ADDRESS	http://www.asx.com.au/about/pdf/asxrecommendations.pdf

BANGLADESH

NAME	The Code of Corporate Governance for Bangladesh
DATE	March 2004
ISSUING BODY	Bangladesh Enterprise Institute Taskforce on Corporate Governance, composed of members from the private sector, the government, nongovernmental organizations (NGOs), and other bodies.
COMPLIANCE	Voluntary (disclosure encouraged)
OBJECTIVES	• Improve performance, competitiveness, and access to capital • Improve quality of governance related information available to capital markets
SCOPE	The private sector, financial institutions, state-owned enterprises, and NGOs
CONTENT	• Board issues • Role of shareholders • Financial reporting, auditing, and nonfinancial disclosures • Sector specific provisions for financial institutions and state-owned enterprises • Exhortations to other entities • NGO governance principles
INTERNET ADDRESS	http://www.gcgf.org/library/codes/bangladesh/Bangladesh_codes_corp_gov_mar2004.pdf

BELGIUM

NAME	Belgian Corporate Governance Code
DATE	December 2004
ISSUING BODY	Corporate Governance Committee (Lippens Committee)
COMPLIANCE	Disclosure (comply or explain)
OBJECTIVES	• Support long-term value creation and sustainable growth • Improve quality of governance-related information available to capital markets
SCOPE	Listed companies
CONTENT	• Board of directors • Senior management • Shareholders • Disclosure
INTERNET ADDRESS	http://www.eccg.org/codes/country_documents/belgium/draft_code_dec2004_en.pdf

BRAZIL (1)

NAME	Recommendations on Corporate Governance
DATE	June 2002
ISSUING BODY	Securities and Exchange Commission of Brazil (CVM)
COMPLIANCE	Voluntary
OBJECTIVES	• Improve company performance, competitiveness, and access to capital • Improve quality of governance-related information available to equity markets
SCOPE	Listed companies
CONTENT	• Transparency of ownership and control; shareholders meetings • Structure and responsibilities of the board of directors • Minority shareholder protection • Accounting and auditing
INTERNET ADDRESS	http://www.cvm.gov.br/ingl/mapa/redir.asp?submenu=/ingl/public/submenu.asp&submain=/ingl/public/publ/governanca/recomen.doc

BRAZIL 2

NAME	Code of Best Practice for Corporate Governance
DATE	May 1999, revised March 2004
ISSUING BODY	Brazilian Institute for Corporate Governance (IBCG), a private-sector corporate governance association
COMPLIANCE	Voluntary
OBJECTIVES	• Improve company performance, competitiveness, and access to capital • Improve quality of governance-related information available to equity markets
SCOPE	Companies
CONTENT	• Ownership • Boards of directors • Management • Independent auditing • The fiscal council • Conduct and conflicts of interest
INTERNET ADDRESS	http://www.ibgc.org.br/imagens/stconteudoarquivos/ibgc%20code%203rd%20edition.pdf

CANADA (1)

NAME	Corporate Governance Guidelines for Building High-Performance Boards
DATE	January 2004
ISSUING BODY	Canadian Coalition for Good Governance, an institutional investors association
COMPLIANCE	Voluntary
OBJECTIVE	• Improve quality of governance-related information available to equity markets
SCOPE	Listed companies
CONTENT	• Individual directors, including quality motivation of board members, director ownership of shares, and appointing a majority of independent directors • Board structure, including separating board chair and CEO, establishing independence and mandates of board committees, and following audit committee requirements • Board processes, including evaluating performance of boards and committees, reviewing performance of individual board members, assessing CEO and succession planning, providing management oversight and strategic planning, overseeing management evaluation and compensation, and reporting governance policies and initiatives to shareholders
INTERNET ADDRESS	http://www.ccgg.ca

CANADA (2)

NAME	Beyond Compliance: Building a Governance Culture (Saucier Report)
DATE	November 2001
ISSUING BODY	The Joint Committee on Corporate Governance, a committee related to the Toronto Stock Exchange
COMPLIANCE	Disclosure (comply or explain)
OBJECTIVES	• Improve company's performance, competitiveness, and access to capital • Improve quality of governance-related information available to equity markets
SCOPE	Listed companies
CONTENT	• Improving board effectiveness • The importance of board independence • Controlling shareholders and publicly traded subsidiaries • A board mandate and disclosure • Audit committees and the Blue Ribbon Committee Report • Ongoing attention to governance
INTERNET ADDRESS	http://www.cica.ca/multimedia/download_library /research_guidance/risk_management_governance/governance_eng_nov26.pdf

CANADA (3)

NAME	Where Were the Directors? Guidelines for Improved Governance in Canada (Dey Report)
DATE	December 1994
ISSUING BODY	Toronto Stock Exchange Committee on Corporate Governance
COMPLIANCE	Disclosure (comply or explain)
OBJECTIVE	Improve company performance, competitiveness, and access to capital
SCOPE	Listed companies
CONTENT	• Board of directors • Committees of the board
INTERNET ADDRESS	http://www.ecgi.org/codes/country_documents/canada/dey.pdf

CHINA

NAME	Code of Corporate Governance for Listed Companies in China
DATE	January 2002
ISSUING BODY	The China Securities Regulatory Commission and the State Economic and Trade Commission, commissions organized by the Government
COMPLIANCE	Disclosure (comply or explain)
OBJECTIVE	• Improve company performance, competitiveness, and access to capital • Improve quality of governance-related information available to equity markets
SCOPE	Listed companies
CONTENT	• Shareholders and shareholder meetings • Listed companies and controlling shareholders • Directors and the board of directors • Supervisors and the supervisory board • Performance assessments and incentive and disciplinary systems • Stakeholders • Information disclosure and transparency
INTERNET ADDRESS	http://www.csrc.gov.cn

DENMARK

NAME	Recommendations for Good Corporate Governance in Denmark
DATE	December 2001
ISSUING BODY	The Norby Commission, a committee organized by government
COMPLIANCE	Voluntary (disclosure encouraged)
OBJECTIVE	Improve company performance, competitiveness, and access to capital
SCOPE	Listed companies, but all companies encouraged to comply as relevant
CONTENT	• The role of shareholders and their interaction with the management of the company • The role of the stakeholders and their importance to the company • Openness and transparency • The tasks and responsibility of the board • The composition of the board • Remuneration to the directors and managers • Risk management
INTERNET ADDRESS	www.corporategovernance.dk

FRANCE (1)

NAME	Promoting Better Corporate Governance in Listed Companies (Bouton Report)
DATE	September 2002
ISSUING BODIES	Association Francaise des Enterprises Privees (AFEP) and Association des Grandes Enterprises Franciases (AGREF)
COMPLIANCE	Voluntary (disclosure encouraged)
OBJECTIVES	• Improve quality of board (supervisory) governance • Improve quality of governance-related information available to equity markets
SCOPE	Listed companies
CONTENT	• The role and operation of the board of directors • Composition of the board • Evaluation of the board • The audit committee • The nominating committee • The compensation committee • Strengthening the independence of statutory auditors • Financial information on accounting standards and practices
INTERNET ADDRESS	Available upon request at bllserve@abanet.org

FRANCE (2)

NAME	Report of the Committee on Corporate Governance (Vienot II Report)
DATE	July 1999
RELATED DOCUMENTS	The Board of Directors in Listed Companies (Vienot I), July 1995
ISSUING BODIES	Association Francaise des Enterprises Privees (AFEP) and Association des Grandes Enterprises Franciases (AGREF)
COMPLIANCE	Voluntary (disclosure encouraged)
OBJECTIVE	Improve quality of board (supervisory) governance
SCOPE	Listed companies
CONTENT	• Separation of the offices of chairman and CEO • Disclosure of the compensation granted to corporate officers of listed companies • Disclosure of stock option or stock purchase plans in listed corporations
INTERNET ADDRESS	http://www.eycom.ch/corporate-governance/reference/pdfs/11/en.pdf

FRANCE (3)

NAME	The Board of Directors in Listed Companies (The Vienot I Report)
DATE	July 1995
ISSUING BODY	Conseil National du Patronat Francais (CNPF) and Association des Grandes Enterprises Franciases (AGREF)
COMPLIANCE	Voluntary
OBJECTIVE	Improve quality of board (supervisory) governance
SCOPE	Listed companies
CONTENT	• The function of the board of directors • Duties and powers of the board of directors • Board membership • Operation of the board of directors
INTERNET ADDRESS	http://www.ecgi.org/codes/country_documents/france/vienot1_en.pdf

GERMANY

NAME	German Corporate Governance Code (Cromme Commission Code)
DATE	February 2002 (revised in May 2003)
ISSUING BODY	Government Commission for the German Corporate Governance Code
COMPLIANCE	Disclosure (comply or explain)
OBJECTIVE	Improve company performance, competitiveness, and access to capital
SCOPE	Listed companies, but all companies encouraged to comply as relevant
CONTENT	• Shareholders and the general meeting • Cooperation between the management board and the supervisory board • The management board • The supervisory board • Transparency • Reporting and the audit of annual financial statements
INTERNET ADDRESS	http://www.gurn.info/topic/corpgov/kdd03.pdf

INDIA

NAME	Report of the Committee on Corporate Governance
DATE	February 2000
ISSUING BODY	Securities and Exchange Board of India (SEBI)
COMPLIANCE	Specified recommendations are mandatory
OBJECTIVE	Improve company performance, competitiveness, and access to capital
SCOPE	Listed companies
CONTENT	• Board of directors • Nominee directors • Chairman of the board • Audit committee • Remuneration committee • Accounting standards and financial reporting • Management • Shareholders
INTERNET ADDRESS	http://www.sebi.gov.in/commreport/corpgov.html

INDONESIA

NAME	Code for Good Corporate Governance
DATE	March 2001
ISSUING BODY	National Committee for Corporate Governance
COMPLIANCE	Disclosure (comply or explain)
OBJECTIVE	Improve quality of board (supervisory) governance
SCOPE	Listed companies, state-owned enterprises, and companies utilizing public funds; all companies encouraged to comply as relevant
CONTENT	• Shareholders • Board of commissioners (*Komisaris*) • Board of managing directors (*Direksi*) • Audit systems • Corporate secretary • Stakeholders • Disclosure • Confidentiality • Insider information • Business ethics and corruption • Donations • Compliance with health, safety, and environmental protection regulations • Equal employment opportunity
INTERNET ADDRESS	The code is available from the Jakarta Stock Exchange at http://www.jsx.co.id

ITALY

NAME	Report and Code of Conduct (Preda Report)
DATE	October 1999, revised July 2002, further revised May 2003
ISSUING BODY	Committee for the Corporate Governance of Listed Companies, a committee related to the stock exchange
COMPLIANCE	Disclosure (comply or explain)
OBJECTIVE	• Improve company performance, competitiveness, and access to capital • Improve quality of governance-related information available to equity markets.
SCOPE	Listed companies
CONTENT	• The role of the board of directors • Composition of the board of directors • Independent directors • The chairman of the board of directors • Information to be provided to the board of directors • Confidential information • Appointment of directors • Remuneration of directors • Internal control • Internal control committee • Transactions with related parties • Relations with institutional investors and other shareholders • Shareholders meetings • Members of the board of auditors
INTERNET ADDRESS	http://www.borsaitalia.it/opsmedia/pdf/8077.pdf

JAPAN (1)

NAME	Principles of Corporate Governance for Listed Companies
DATE	May 2004
ISSUING BODY	Tokyo Stock Exchange
COMPLIANCE	Voluntary (comply or explain)
OBJECTIVES	• Improve quality of board (supervisory) governance • Improve company performance, competitiveness, and access to capital
SCOPE	Listed companies
CONTENT	• Rights of shareholders • Equitable treatment of shareholders • Relationship with stakeholders in corporate governance • Disclosure and transparency • Responsibilities of board of directors, auditors or board of corporate auditors, and other relevant groups
INTERNET ADDRESS	http://www.tse.or.jp/english/listing/cg/principles.pdf

JAPAN (2)

NAME	Revised Corporate Governance Principles
DATE	May 1998, revised October 2001
ISSUING BODY	Japan Corporate Governance Committee, Corporate Governance Forum of Japan, a business and academic association
COMPLIANCE	Voluntary
OBJECTIVES	• Improve quality of board (supervisory) governance • Improve company performance, competitiveness, and access to capital
SCOPE	Listed companies
CONTENT	• Mission and role of the board of directors • Mission and role of the committees established within the board of directors • Leadership responsibility of the CEO • Addressing shareholder derivative litigation • Securing fairness and transparency for executive management • Reporting to the shareholders and communicating with investors
INTERNET ADDRESS	http://www.jcgf.org/en/

KENYA

NAME	Principles for Corporate Governance in Kenya and a sample Code of Best Practice for Corporate Governance
DATE	November 1999, revised July 2000
ISSUING BODY	Private Sector Initiative for Corporate Governance, a private-sector, nongovernmental body
COMPLIANCE	Voluntary
OBJECTIVES	• Improve quality of board governance • Improve company performance, competitiveness, and access to capital
SCOPE	Companies
CONTENT	• Authority and duties of board members or shareholders • Leadership • Appointments to the board • Strategy and values • Structure and organization • Corporate performance, viability, and financial sustainability • Corporate compliance • Corporate communication • Accountability to members • Balance of powers • Internal control procedures • Assessment of performance of the board of directors • Induction and development of executive management • Adoption of technology and skills • Management of corporate risk • Corporate culture • Social and environmental responsibility • Recognition of utilization of professional skills and competencies • Recognition and protection of members' rights and obligations • Attention of the board
INTERNET ADDRESS	http://www.cipe.org/regional/africa/code.pdf

KOREA (REPUBLIC OF)

NAME	Code of Best Practice for Corporate Governance
DATE	September 1999
ISSUING BODY	Korean Committee on Corporate Governance, a nongovernmental body
COMPLIANCE	Disclosure (comply or explain)
OBJECTIVES	• Improve quality of board (supervisory) governance • Set standards for review of Korean law
SCOPE	Listed companies, all companies encouraged to comply as relevant
CONTENT	• Shareholders • Board of directors • Audit systems • Stakeholders • Management monitoring by the market
INTERNET ADDRESS	http://www.ecgi.org/codes/country_documents/korea/code_korea.pdf

MALAYSIA

NAME	Malaysian Code of Corporate Governance
DATE	March 2000
ISSUING BODY	The Securities Commission
COMPLIANCE	Disclosure (comply or explain)
OBJECTIVE	• Improve company performance, competitiveness, and access to capital • Improve quality of board governance
SCOPE	Listed companies
CONTENT	• Directors • Directors' remuneration • Shareholders • Accountability and audit
INTERNET ADDRESS	http://www.acga-asia.org/loadfile.cfm?site_file_id=78

MEXICO

NAME	Corporate Governance Code for Mexico
DATE	June 1999
ISSUING BODY	El Consejo Coordinador Empresarial (CCE), a committee related to the Stock Exchange
COMPLIANCE	Disclosure (comply or explain)
OBJECTIVES	• Improve quality of board (supervisory) governance • Improve company performance, competitiveness, and access to capital
SCOPE	Listed companies
CONTENT	• Board of directors, including recommendations on the functions, structure, operation, and duties of the board • Evaluating and compensating directors • Auditing • Finances and planning • Stockholder information
INTERNET ADDRESS	http://www.ecgi.org

NETHERLANDS (1)

NAME	The Dutch Corporate Governance Code (Tabaksblat Code)
DATE	December 2003
ISSUING BODY	Corporate Governance Committee
COMPLIANCE	Voluntary (disclosure encouraged)
OBJECTIVES	• Improve quality of board (supervisory) governance • Improve company performance, competitiveness, and access to capital
SCOPE	Listed companies
CONTENT	• Compliance and enforcement of the code • The management board • The supervisory board • Shareholders and general meetings of shareholders • The audit of the financial reporting and the position of the internal audit function and the external auditor
INTERNET ADDRESS	http://www.ecgi.org

NETHERLANDS (2)

NAME	Peters Code (Forty recommendations on corporate governance in the Netherlands)
DATE	June 1997
ISSUING BODY	Secretariat Committee on Corporate Governance, a committee related to the stock exchange and a business, industry and academic association
COMPLIANCE	Voluntary (disclosure encouraged)
OBJECTIVE	Improve quality of board (supervisory) governance
SCOPE	Listed companies
CONTENT	• The supervisory board, including duties, profile, composition, appointment, and remuneration • Supervisory board procedures • The board of directors • Functioning of the general meeting of shareholders and the role of investors • Compliance with recommendations, auditors, and rating • Monitoring • Buyback of shares
INTERNET ADDRESS	http://www.ecgi.org

RUSSIAN FEDERATION

NAME	Russian Code of Corporate Conduct
DATE	April 2002
ISSUING BODY	The Coordination Council for Corporate Governance
COMPLIANCE	Voluntary (disclosure encouraged)
OBJECTIVE	Improve company performance, competitiveness, and access to capital
SCOPE	Joint stock companies, but all companies encouraged to comply as relevant
CONTENT	• General shareholder meetings • Board of directors • Executive bodies of the company • Corporate secretary • Major corporate actions • Disclosure of information • Supervision of financial and business operations of the company • Dividends • Resolution of corporate conflicts
INTERNET ADDRESS	http://rid.ru

SOUTH AFRICA

NAME	King Report on Corporate Governance for South Africa (II)
RELATED DOCUMENTS	King Report on Corporate Governance for South Africa (I)
ISSUING BODY	The King Committee on Corporate Governance under the auspices of the Institute of Directors in South Africa
DATE	March 2002
COMPLIANCE	Disclosure (comply or explain)
OBJECTIVE	Improve quality of board (supervisory) governance
SCOPE	Listed companies, banks, financial and insurance entities, and public sector enterprises and agencies; all other companies expected to consider applying the principles of this code as appropriate in their particular circumstances
CONTENT	• Boards and directors • Risk management • Internal audit • Integrated sustainability reporting • Accounting and auditing • Compliance and enforcement • Role of the media • Encouraging shareholder activism • The role of the organized business • Enforcement in other jursidictions
INTERNET ADDRESS	Available from www.iodsa.co.za

SPAIN (1)

NAME	Report to Foster Transparency and Security in the Markets and in Listed Companies (Aldama Report)
DATE	January 2003
ISSUING BODY	Special commission established by the government
COMPLIANCE	Disclosure (comply or explain)
OBJECTIVES	• Improve quality of board governance • Improve quality of governance-related information available to equity markets
SCOPE	Listed companies
CONTENT	• The principle of transparency and the duty of disclosure • The principle of security and the duty of loyalty • Directors' responsibilities • Shareholders' meetings • Board of directors • Composition of the board of directors • The chairperson of the board of directors • Board of directors commissions • Remuneration of the board and senior management • Drafting of the annual accounts and half-yearly and quarterly reports • Professional service providers
INTERNET ADDRESS	http://www.ecgi.org

SPAIN (2)

NAME	The Governance of Spanish Companies (Olivencia Report)
DATE	February 1998
ISSUING BODY	Special committee for the study of a code of corporate governance for boards of directors of listed companies, a committee organized by the government
COMPLIANCE	Voluntary
OBJECTIVE	Improve company performance, competitiveness, and access to capital
SCOPE	Listed companies and other privatized companies
CONTENT	• The board of directors' mission • Composition of the board of directors • Structure of the board of directors • The working of the board of directors • Appointment and removal of directors • Directors' powers regarding information • Director remuneration • The director's duty of loyalty • The board of directors and the shareholders • Relations between boards and markets • Relations between the board and the auditors • Adoption and publication of the rules of governance
INTERNET ADDRESS	http://www.cnmv.es/delfos/tendencias/espa%f1a3.htm

SWEDEN

NAME	Swedish Code of Corporate Governance
DATE	December 2004
ISSUING BODY	The Code Group (the Asbrink Committee) a committee appointed by the government
COMPLIANCE	Disclosure (comply or explain)
OBJECTIVES	• Improve quality of board governance • Improve quality of governance-related information available to equity markets
SCOPE	Listed companies
CONTENT	• The shareholders' meeting • Appointing the board and the auditor • The board of directors • Senior management • Auditors
INTERNET ADDRESS	http://www.sweden.gov.se/sb/d4089/a/26296

SWITZERLAND

NAME	Swiss Code of Best Practice (Bockli Report)
DATE	June 2002
ISSUING BODY	Swiss Business Federation (Economiesuisse)
COMPLIANCE	Voluntary
OBJECTIVE	Improve quality of board (supervisory) governance
SCOPE	Listed companies, but all companies encouraged to comply as relevant
CONTENT	• Shareholders • Board of directors and executive management • Auditing • Disclosure
INTERNET ADDRESS	http://www.economiesuisse.ch

UNITED KINGDOM (1)

NAME	The Combined Code
DATE	July 1998, revised July 2003
RELATED DOCUMENTS	• Report of the Committee on the Financial Aspects of Corporate Governance (Cadbury Code) • Greenbury Report • Hampel Report
ISSUING BODY	The Financial Reporting Council (FRC)
COMPLIANCE	Disclosure (comply or explain)
OBJECTIVE	• Improve quality of board governance • Improve quality of governance-related information available to equity markets • Improve investor confidence by raising standards of corporate governance
SCOPE	Listed companies
CONTENT	• Companies, including directors, remuneration, accountability and audit, and relations with shareholders • Institutional shareholders
INTERNET ADDRESS	http://www.asb.org.uk/documents/pdf/combinedcodefinal.pdf

UNITED KINGDOM (2)

NAME	Report of the Committee on the Financial Aspects of Corporate Governance (Cadbury Code)
DATE	December 1992
ISSUING BODY	The Committee on the Financial Aspects of Corporate Governance established by the Stock Exchange
COMPLIANCE	Disclosure (comply or explain)
OBJECTIVES	• Improve quality of board governance • Improve quality of governance-related information available to equity markets
SCOPE	Listed companies, but other companies encouraged to comply as relevant
CONTENT	• The board • Auditing • Shareholders
INTERNET ADDRESS	http://www.ecgi.org/codes/country_documents/uk/cadbury.pdf

UNITED STATES

NAME	Principles of Corporate Governance
DATE	May 2002, revised April 2003
ISSUING BODY	Business Roundtable
COMPLIANCE	Voluntary
OBJECTIVES	• Improve quality of board (supervisory) governance • Improve quality of governance-related information available to equity markets
SCOPE	Listed companies, but all companies encouraged to comply as relevant
CONTENT	• Key corporate actors • Roles of the board of directors and management • How the board performs its oversight function • Relationships with stockholders and other constituencies
INTERNET ADDRESS	http://www.brt.org/pdf/704.pdf

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Co-founded by the World Bank Group and the Organisation for Economic Co-operation and Development, the Global Corporate Governance Forum is an advocate, a supporter, and a disseminator of high standards and practices of corporate governance in developing countries and transition economies. The Forum's donors include the International Finance Corporation and the governments of France, India, Luxembourg, Norway, Sweden, Switzerland, and the United States.

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2

TOOLKIT 2

Developing Corporate Governance Codes of Best Practice

PROCESS

VOLUME 2

Process

Global Corporate Governance Forum

VOLUME 2

T O O L K I T   2

Developing Corporate Governance Codes of Best Practice

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Process

Initiating the Process

MODULE 1 AT A GLANCE:

The process of developing a corporate governance code of best practices can be initiated successfully either from the top down or the bottom up, depending on the setting and the circumstances. The parties and individuals involved in the initial stages of developing the corporate governance code also are likely to have a substantial impact on the nature, scope, content, and ultimate success of the code.

This module reviews:

- The parties involved in the initial stages of developing a corporate governance code
- The formation of the crafting committee
- The appointment and functions of the key individual members

INITIATING AND LEADING THE PROCESS

Corporate governance codes of best practice have been initiated by both the private sector and public institutions. Government commissions, capital market authorities, stock exchanges, institutional investors, business groups, director associations, and professional organizations have all developed and issued corporate governance codes.

QUOTE

INITIATING CODES OF BEST PRACTICE

"Numerous private sector and government-related organizations, institutional investors, and stock markets have, in the past decade, become active in driving corporate governance reform. One of their most influential efforts has been to issue guidelines (also called principles, recommendations or codes of best practice). Adapted to their respective cultures and business structures, these guidelines and codes generally promote practices designed to enhance accountability to shareholders, improve board independence, and foster corporate responsibility."

—Holly Gregory, *The Globalization of Corporate Governance*, 2002

The initiator is the person or organization that is the first to identify the need to improve corporate governance practices within a country. The lead organization is the one that coordinates the code crafting process, whereas the implementing organization is the one that formally adopts the code at the end of the process. The initiating, leading, and implementing organizations may be one and the same. In some cases there is more than one implementing organization. The initiator may well become the leader of the crafting process, but that process can also be handed over to a different organization. In some cases, as in Turkey, a private sector initiative may result in the development of a first draft for a code that then serves as a basis for a more institutionalized process. In these cases the organization taking on the initiative typically also becomes the institution to formally adopt the code. Even if codes do not always bear their names, initiating organizations play an essential role because they are the groups that not only recognize the need for improved corporate governance practices but also create the momentum for developing a code. (*Volume 1, Annex 5 provides a comparative list of codes, including the organizations that have developed or adopted existing codes of corporate governance.*)

No single type of organization is best suited to initiating or developing a corporate governance code. Virtually every possible combination has resulted in the adoption of quality codes. What is essential is that all interested parties be involved in the process and represented on the crafting committee. It is important that the lead organization consults with various institutions and organizations and considers their possible contribution to the code crafting process. The careful selection of participating parties not only ensures that all important issues are taken into account in the content of the code but also helps secure support from these parties when it comes to implementing the code. (*For a discussion on consulting with stakeholders, see Volume 2, Module 3. The code implementation process is discussed in Volume 2, Module 5.*)

The role of capital market institutions

Securities and exchange commissions and stock exchanges provide important membership on the corporate governance code crafting committee or task force. Especially when recommendations are targeted on listed companies, the active participation of these institutions is critical to ensure that the finalized code is officially adopted and implemented. Codes of best practice are not always initiated by market regulators, but many have been developed under the leadership of capital market authorities and stock exchanges, including those in Australia, China, Indonesia, Pakistan, and Slovak Republic, to name just a few.

EXAMPLE

INITIATION BY MARKET REGULATORS

AUSTRALIA

The Australian Stock Exchange set up a Corporate Governance Council, which brought all of the major stakeholders together to develop and agree on a set of best practice corporate governance standards for listed companies in Australia. The council identified several topical issues requiring the development of standards, which were subsequently addressed in the Principles of Good Corporate Government and Best Practice Recommendations, published by the exchange in 2003.

THINKING POINT

What role should the government play in initiating the code crafting process?

The role of the government

As the importance of corporate governance becomes better understood, governments increasingly wish to encourage the development of good practices, on the grounds that these are associated with developing an attractive investment climate, contributing to economic growth, and improving national competitiveness. (*For a discussion of the importance of corporate governance for the broader economy, go to Volume 1, Module 1*.)

In many cases the government has initiated the process of developing a corporate governance code by appointing an organization or a task force to draft a report on recommendations for improving corporate governance practices in the country. Yet, only in a few cases has the government actually played a leading role in developing a corporate governance code, preferring to keep a low profile in favor of the private sector.

Regardless of its level of involvement, the government is often perceived to be an essential source of support. In some cases, the government has been a significant provider of financing and personnel. In the United Kingdom, for example, staff from various government departments including the Department of Trade and Industry and the Treasury, were assigned to assist Derek Higgs in preparing the Report on the Effectiveness of Non-Executive Directors, issued in 2003.

EXAMPLE

ROLE OF THE GOVERNMENT

CHINA

China is an example of a government taking the lead in developing a code of best practice. The Code of Corporate Governance for Listed Companies in China was developed by the State Economic and Trade Commission (now known as the State Asset Management Commission) and the China Securities Regulatory Commission.

EXAMPLES

ROLE OF THE GOVERNMENT

GERMANY

Various corporate reform efforts in Germany have been led by the government. In September 2001 the chancellor appointed the Baum Commission to review the management and control of companies and the modernization of the stock corporation law. The commission's report recommended the development of a German code of best practice, which was adopted in February 2002 and amended in May 2003.

DENMARK

Denmark's Ministry of Economic and Business Affairs formed the Nørby Committee in March 2001 to assess corporate governance practices and recommend improvements that would help prepare Danish companies to compete in global markets.

REPUBLIC OF KOREA

At the request of the Korean Ministry of Finance and Economy, a committee on corporate governance was established as a nongovernmental body in March 1999 to develop a code of best practices. The committee was composed of 14 members from the fields of business, finance, accounting, law, and academia, along with an advisory group of 13 law, securities, and financial specialists.

NEW ZEALAND

In June 2003 New Zealand's minister of commerce asked the Securities Commission to develop corporate governance principles for the country. After an extensive public consultation process, a corporate governance code was issued in February 2004 setting out best practice for various corporate governance matters including the composition and operation of board committees, director remuneration, and codes of ethics.

The role of private organizations and professional associations

Frequently the leading professional associations play a major role in developing corporate governance codes, often forming a majority of the membership within the code development committee. Representation from the following professions should be considered:

- *Legal profession*. Lawyers frequently play a major role in developing corporate governance codes. In particular, their knowledge of the existing legal parameters within which companies operate may be very useful, so that the code does not contradict or repeat any existing laws. Lawyers who are skilled in drafting legislation may also prove very useful to the code crafting committee.

- *Accounting profession*. Accountants have specialized knowledge concerning financial reporting and disclosure that can be extremely important in constructing a corporate governance code.

- *Auditing profession*. Auditors also have specialized and valuable knowledge concerning financial reporting and disclosure, the role of the audit committee, internal controls, and risk management.

- *Directors institutes*. These institutes can help ensure that the crafting committee covers the interests of corporate directors, particularly in the areas of fiduciary duties, business judgment, risk, and internal control.

- *Corporate/company secretary associations*. Members of these associations have valuable information on the interests of company secretaries, particularly in the areas of company registration, filing responsibilities, and compliance issues.

- *Shareholder associations*. These associations can offer expertise in shareholder interests, particularly in the areas of disclosure policy, the conduct of general (shareholder) meetings, and voting regimes.

- *Trade unions*. In some countries, such as Germany, where employee representatives sit on boards of directors, it may also be useful to include a trade union representative on the crafting committee.

EXAMPLES

ROLE OF PRIVATE, PROFESSIONAL GROUPS

BANGLADESH

The Bangladesh Enterprise Institute, a private, nonprofit institution, was the first organization in the country to recognize the need for and promote the drafting of a corporate governance code.

BRAZIL

Brazil's first code of corporate governance was initiated in 1995 by the Instituto Brasileiro de Governanca Corporativa (IBGC), a private, self-financed, independent institution.

SRI LANKA

Sri Lanka's corporate governance code was an initiative of the Institute of Chartered Accountants of Sri Lanka. The institute played a leading role throughout the process of developing and crafting the code. Although several other stakeholders had expressed interest at different times in developing a code as a part of a more general reform process, no work had actually been done before the institute began actively promoting its initiative.

UNITED KINGDOM

The Turnbull Report on Internal Control was an initiative developed by the Institute of Chartered Accountants of England and Wales (ICAEW) at the request of the London Stock Exchange. The ICAEW took the lead again in 2005, when it led a review of the Turnbull report.

The role of the business community and financial sector

In many countries, the corporate and financial sectors have been the first to recognize that improvements in corporate governance can lead to increases in the competitiveness of companies and improvements in the efficiency of financial markets. Business associations and leading financial institutions or institutional investors may play a major role in developing a corporate governance code. Some of these initiatives suggest that corporate governance codes need not necessarily be developed by national bodies only and that directly interested parties may also take the initiative of introducing corporate governance best practices. One example is the set of guidelines developed in 1998 by the California Public Employees Retirement System (CalPERS) laying a foundation for ensuring accountability of a corporation's management to its owners.

EXAMPLES

ROLE OF THE BUSINESS AND FINANCE COMMUNITIES

CANADA

In January 2004, the Canadian Coalition of Good Governance, whose members manage approximately $500 billion in assets on behalf of pension fund contributors, mutual fund unit holders, and other individual investors, developed Corporate Governance Guidelines for Building High Performance Boards. (*For further information on these guidelines, refer to www.ccgc.ca*.)

SLOVAK REPUBLIC

The National Bank of Slovakia was one of the main supporters of the country's code of corporate governance.

TURKEY

The Turkish Industrialists' and Businessmen's Association (TUSIAD) initiated and led the development of the first corporate governance best practices code developed in Turkey. This organization is composed of senior executives of the major industrial and service companies in Turkey, including several that are among global Fortune 500 companies.

EXAMPLE

ROLE OF THE BUSINESS AND FINANCE COMMUNITIES

ROMANIA

The lead body for the Bucharest Stock Exchange code was the Strategic Alliance of Business Associations. Leadership from this organization provided important status and recognition for the corporate governance initiative.

FORMING THE CRAFTING COMMITTEE

The lead organization plays a key role in setting up the crafting committee and getting the process on track. Several steps typically take place before the first meeting of the committee. These tasks include:

- Consulting main stakeholders.
- Appointing a chairman.
- Appointing a project manager. Often the project manager is an employee from the lead organization, who is given a leave of absence to work on the initiative.
- Appointing the project team. The lead organization may consider providing project members (often on a part-time basis).
- Appointing a secretary and organizing secretariat services and meeting facilities. The lead organization may have secretariat services and meeting facilities that it can provide to the committee at subsidized rates, cost, or (in some cases) at no charge.
- Securing funding.
- Organizing premeeting discussions between the chairman and individual members of the committee.

Selecting a chairman

The chairman is pivotal in creating the conditions for the overall effectiveness of the code crafting process, and so his or her selection should be undertaken with care and deliberation. The chairman is typically the first committee member to be appointed, especially when government initiates the code development process. In some cases committee members representing various institutions can also appoint a chairman from among themselves. In most other cases the chairman is selected from within the ranks of the lead organization. A wise lead organization consults with other parties before appointing the chairman to facilitate future relations with these organizations.

The table below provides examples of chairmen who led the code crafting process and indicates their professional background at the time of their chairmanship.

CHAIRMEN AND THEIR PROFESSIONAL POSITIONS

COUNTRY	CHAIRMAN	CODE/REPORT	POSITION
Belgium	Daniel Cardon de Lichtbuer	Belgian Cardon Report	Chairman, Banque Bruxelles Lambert (BBL)
Belgium	Baron Maurice Lippens	Belgian Lippens Report	Chairman, Fortis
Canada	Peter Dey	Dey Report	Partner, Osler, Hoskin, and Harcourt LLP
France	Marc Vienot	Vienot Reports I & II	Chairman, Societe Generale
France	Daniel Bouton	Bouton Report	President, Societe Generale
Germany	Gerard Cromme	Cromme Report	Chairman of the Supervisory Board, Thyssen Krupp
Italy	Stefano Preda	Preda Report	CEO, Italian Stock Exchange (Borsa Italia)
Netherlands	Morris Tabaksblat	Tabaksblat Report	Chairman, Reed Elsevier
South Africa	Mervyn King	King Report I & II	Former high court judge
Spain	Enrique de Aldama	Aldama Report	President, Confederation of Employers Organizations, and Chairman, Obralia
Switzerland	Peter Bockli	Bockli Report	Director, Nestle SA and Union de Banques Suisses (UBS)
United Kingdom	Adrian Cadbury	Cadbury Report	Former Chairman, the Cadbury Group, and Director, Bank of England

THINKING POINT
How would you define the respective roles of the chairman and project manager?

Once selected, the chairman should be given the necessary support to guide the committee through the difficult and challenging process ahead. Chairmanship is a highly personalized activity and is not governed by any set of fixed rules. Every successful chairman does it his or her own way, and these ways can and do differ widely. It is therefore only possible to generalize about how the chairman's role should be performed. (*The management of the code crafting process is discussed in Volume 2, Module 2*.)

The chairman is responsible for leading the committee in setting the values and standards of the project and for maintaining a relationship of trust among the project manager, the secretariat, and the committee members. The chairman should also evaluate the performance of individuals and of the committee as a whole on a regular basis. (*For a discussion on evaluating committee performance, see Volume 2, Module 2*.)

The chairman should be informed, experienced, trusted, and supportive of the project manager. At certain times, however, a degree of detachment from the project manager can be valuable in ensuring objective debate on controversial matters.

Appointing a project manager

Once the chairman has been selected, the code crafting committee usually needs to identify a suitable person to manage the committee's work. A strong relationship between the chairman and the project manager lies at the heart of an effective committee. The respective roles of the chairman and the project manager vary from one committee to another and depend on the chairman's involvement. The relationship often works best where the chairman and the project manager have a complementary mix of skills and experiences.

EXAMPLE

THE ROLE OF THE PROJECT MANAGER

SOUTH AFRICA

Phil Armstrong was appointed as the principal convenor (project manager) of the code crafting committee chaired by Mervyn King. One of the main tasks of the convener was to coordinate the activities of five task teams established to deliver expert research and advice on each of the topics assigned to them by the committee.

In general the chairman should not seek executive responsibility and should let the project manager take credit for his or her achievements.

The role of the project manager is typically to:

- Develop the operating plan and master schedule, which reflect the objectives and priorities established in the terms of reference
- Maintain a dialogue with the chairman for putting the operating plan into action
- Ensure that the objectives and standards of performance are understood by all parties
- Put in place adequate operational planning and financial controls for the project
- Closely monitor the project activities to ensure the plans are being followed
- Closely monitor the project spending against the budget
- Maintain operational performance, which is likely to involve overseeing any research activities and supervising the crafting of the code
- Take remedial action when unexpected problems occur and inform the committee as needed

DESIRABLE ATTRIBUTES IN A PROJECT MANAGER

STRATEGIC PERCEPTION

- Foresight
- Creativity
- Organizational awareness
- Long-term perspective
- Strategic awareness
- Ability to make decisions
- Critical faculty
- Decisiveness
- Judgment

INTERACTION WITH OTHERS

- Confidence
- Coordination
- Flexibility
- Presence
- Integrity
- Learning ability
- Motivation
- Persuasiveness
- Sensitivity

COMMUNICATION

- Listening skills
- Openness
- Verbal fluency
- Presentation skills
- Written communication skills
- Responsiveness

ANALYSIS AND USE OF INFORMATION

- Detail-oriented
- Open-minded
- Numeracy
- Ability to identify issues

ACHIEVEMENT OF RESULTS

- Business acumen
- Delegation skills
- Exemplar
- Drive
- Resilience
- Risk acceptance
- Tenacity

The desirable personal attributes of a project manager are listed in the table on page 11. This list may be useful when constructing a job specification for a project manager.

Appointing the committee's secretary

The development of a code can generate an extensive volume of documentation. To ensure that all of the processes are methodically recorded, the documentation should be organized to provide a complete record of all meetings, consultations, correspondence, and discussions. A cross-referenced documentation system should be developed and managed by an experienced individual. In countries with an Anglo-Saxon legal tradition, this role is often undertaken by a chartered secretary.

The objective of the documentation system is to provide:

- Adequate support to the discussion and decisionmaking processes
- A chronological account of the events that have taken place
- Written summaries of discussions and decisions reached
- A synopsis of all comments and recommendations made to the committee
- Easy access to research results and background documentation

A clear record of all meetings is important. There have been instances where the recommendations contained in a code of best practices have been challenged, and committee members have had to defend their decisions. In such an event, discussion notes and meeting minutes can be useful evidence concerning the thought process that led the committee to reach its particular recommendation.

In addition, some suggestions do not reach the stage of becoming "recommendations" in the code for a variety of reasons. Documenting these reasons may be useful, and even necessary, if a query is raised about how the committee reached a decision on a particular topic.

Selecting the members of the committee

Although a number of stakeholders are likely to publicly endorse the code crafting process, only a few key persons within a small number of institutions are likely to carry out the onerous tasks associated with developing a code. It is therefore advisable that these key people and institutions be identified and the necessary support elicited from them as early as possible.

The members of the code crafting committee should be knowledgeable about corporate governance best practices both nationally and internationally. Factors in their selection should also include their ability to:

- Provide valuable input to effective decisionmaking and constructive debate. Committee members should be able to question intelligently, challenge rigorously, and decide dispassionately.
- Uphold the highest standards of integrity and probity and promote highest standards of corporate governance.
- Develop effective relationships and open communications both inside and outside the committee.
- Establish a close relationship of trust with the chairman, project manager, secretariat, and other committee members.
- Understand and represent the perspectives of important sectors, interests, and stakeholders.

THINKING POINT

What organizations should be represented on the crafting committee?

Some chairmen have found it useful to establish some contact and rapport with each of the committee members before the initial committee meeting so that good interpersonal relationships can be created before the crafting process formally begins. The interaction within a diverse group of persons, possibly having conflicting or competing interests, can at times be a difficult situation to handle, and the early bonding between members of the committee and the chairman, perhaps on an informal basis, can often help smooth the process from the outset.

During the crafting process, certain vested interests may need to be challenged, and the members must have the ability to persuade their organizations of the benefits of the proposed changes. It is important to obtain widespread support across the business community when developing a corporate governance initiative. If the key stakeholders support the initiative in the first place and are consulted and involved during the development phase, they are far more likely to be important champions and endorsers of the initiative when it is launched and implemented. However, many code committees have discovered significant advantages associated with selecting some members of the committee who are independent in judgment and have no potential conflicts of interest or vested interests that need to be protected.

It is important to consider carefully which institutions should be fully on board at the start of the code development process and which consulted only at a later stage. Such decisions, of course, depend on the objectives of the code and the business environment of each country. Because the crafting committee needs to reach consensus on each recommendation, having too many players early on can have the perverse effect of paralyzing the process. (*For a detailed description of the consultation process, go to Volume 2, Module 3.*)

EXAMPLES

ORGANIZATIONS REPRESENTED ON THE CODE CRAFTING COMMITTEE

SRI LANKA

The code crafting committee in Sri Lanka consisted of representatives from the Securities and Exchange Commission, the Colombo Stock Exchange, the Registrar of Companies, the Sri Lanka Accounting and Auditing Standards Monitoring Board, the Institute of Chartered Accountants of Sri Lanka, the Chambers of Commerce, and the Bar Association, as well as several representatives from the Central Bank and leading banks.

PERU

The lead organization in developing the Principles of Good Governance for Peruvian Companies was the National Supervisory Commission of Companies and Securities. Other members of the committee included representatives from the:

- Ministry of Economy and Finance
- Superintendency of Banking and Insurance
- Lima Stock Exchange
- Association of Banks
- National Confederation of Private Business Institutions
- Association of Capital Market Promoting Companies
- Center of Studies on Capital and Financial Markets

EXAMPLES

ORGANIZATIONS REPRESENTED ON THE CODE CRAFTING COMMITTEE

UKRAINE

The drafting of the code was undertaken by a Task Force on Corporate Governance and Shareholder Rights, a body organized under the patronage of the Securities and Stock Market State Commission. The task force included representatives from various government departments and agencies, representatives of nongovernmental organizations, and representatives of international organizations such as the International Finance Corporation.

GERMANY

The code crafting committee comprised representatives from the German Stock Exchange and from the professional organizations (particularly the accountancy bodies). It also had members from shareholders associations, institutional investors, leading banks, and trade unions.

Hiring consultants and experts

Many committees decide to engage the services of an experienced local or international consultant to assist in researching and drafting the content of the code or monitoring the development of the code. Before deciding on hiring a consultant, it is important for the committee to assess its needs and draw up the specific tasks expected from the consultant. The consultant's task can be exclusively focused on researching and drafting the code. Alternatively, the consultant's role can be much broader and include management support activities or marketing advice. (*For a description of the key tasks included in the terms of reference established to hire a consultant in Sri Lanka to help develop the corporate governance code, see Volume 2, Annex 1. For a sample letter engaging a consultant, see Volume 2, Annex 2.*)

EXAMPLE

HIRING A CONSULTANT

BANGLADESH

A consultant from an international development agency provided advice concerning the composition and formation of the task force crafting a code of best practices in Bangladesh. In addition the consultant provided advice on preparing code drafts.

International agencies may be able to guide the code crafting committee on identifying suitable consultants as well as financing some of the costs. Care should be taken to ensure that the consultant selected is sensitive to the national and cultural values of the host country. Moreover, when involving international organizations or hiring well-known international experts, it is important for a local organization to maintain leadership of the initiative in order to create effective local ownership and to ensure effective implementation of the code.

Managing the Process

MODULE 2 AT A GLANCE:

Pioneering corporate governance initiatives, including the development of codes of best practice, may have a tendency to drift unless some discipline is imposed to help manage the project. The code crafting committee should establish milestones, setting determinable results to be delivered at specified intervals, so that the project manager, the chairman, and the committee members can monitor progress. This module provides guidance on managing and monitoring the code crafting process and discusses the importance of maintaining a master schedule to keep the project on track.

This module reviews:
- Developing a master schedule
- Setting the terms of reference for the committee's work
- Dealing with internal and external challenges

THINKING POINT

How should the committee organize the various aspects of its work?

GETTING STARTED

The members of the code crafting committee are typically busy and influential leaders or experts who have limited time to devote to the affairs and functions of the committee. Prospective committee members should be given an estimate of the amount of their time the project will require before they are asked to give their commitment to the committee's work.

Practical organizational procedures, as well as the framework for developing the content of the code, should be discussed at the committee's first meeting. The dates and agendas of subsequent meetings, a working plan, and the objectives and terms of reference of the committee are typically the focus of the committee's first meeting. It is thus important that all committee members attend the first meeting.

Developing a master schedule

Developing a corporate governance code is often more complicated than one might expect and involves many tasks in addition to drafting, such as conducting research, consulting stakeholders, and raising awareness. As with most high-profile projects, adopting a working plan, or master schedule, is therefore essential to help the committee manage a range of activities that often need to take place simultaneously. Together with effective "buy-in" from all parties, the master schedule can aid the committee in meeting tight deadlines, anticipating potential conflicts and difficulties, and avoiding slippages that could knock the project off course.

It is highly recommended that individual members of the committee be given responsibility for ensuring that specific activities are completed by the deadline agreed upon in the master schedule. That approach not only ensures that deadlines are met but helps the project manager monitor the progress of different parts of the project. The table on the next page provides an example of a master schedule.

The timing and content suggested in this sample master schedule may vary depending on the setting and the particular issues that a committee faces. The committee might need to meet more or less often, for example, to review successive drafts of the code, discuss research and consultation feedback, and deal with unexpected issues. Sufficient time should be allocated in between meetings for all parts of the consultation process—especially if support for the development of a code is weak or the importance of corporate governance is not well understood.

SAMPLE MASTER SCHEDULE

MEETING	MONTH	MEETING AGENDA	SUBSEQUENT ACTIVITIES
First meeting	Month 1	• Discuss master schedule • Agree on the committee's terms of reference • Consider challenges facing the committee • Consider the target and scope of the code • Consider implementation mechanisms and nature of the code's provisions • Decide on appointment of a consultant • Agree on initial press release	• Finalize detailed master schedule • Hire consultant • Review international best practices • Review the country's current governance laws, regulations, and practices • Review the country's corporate governance development needs and priorities • Issue a press release explaining the process and describing the committee's terms of reference
Second meeting	Month 2	• Agree on finalized master schedule • Discuss the country's corporate governance needs and priorities • Review general research findings • Agree on broad outline of the code • Consider need to establish subcommittees • Evaluate the committee's work and progress	• Consider methods of consultation • Draft the consultation document
Third meeting	Month 3	• Discuss the draft of the consultation document • Agree on consultation strategy and methods • Evaluate the committee's work and progress	• Finalize consultation document • Set up consultation process • Start researching specific content of the code
Fourth meeting	Month 4	• Agree on consultation document • Discuss specific research findings and content • Evaluate the committee's work and progress	• Continue research on specific content of the code • Start consulting with key stakeholders • Begin drafting code

SAMPLE MASTER SCHEDULE

MEETING	MONTH	MEETING AGENDA	SUBSEQUENT ACTIVITIES
Fifth meeting	Month 5	• Discuss consultation feedback • Discuss research findings • Discuss first draft of code • Evaluate the committee's work and progress	• Continue consulting with key stakeholders • Finalize first draft of the code • Develop dissemination and implementation strategy
Sixth meeting	Month 6	• Discuss second draft • Discuss consultation feedback • Approve dissemination and implementation strategy • Evaluate the committee's work and progress	• Modify second draft • Draft foreword and preamble
Seventh meeting	Month 7	• Agree on final code • Agree on dates of launching events • Approve design and format of code • Agree on press release • Evaluate the committee's work and progress	• Final proofreading of code • Arrangement of launch • Issue press release • Distribution of code • Liaison with media • Liaison with key stakeholders
Eighth meeting	Month 8	• Assess impact of launch • Agree on time frame and methods to assess code impact • Agree on time frame to review the code • Final evaluation of the committee's work	

Time frames for developing corporate codes of best practice can vary widely. In most cases the process takes about six months, although some have been finalized within three months and others have taken a year and a half to complete. For example, the Korean Committee on Corporate Governance was established in March 1999 and met eight times over a period of six months. The German corporate governance code was also developed over a six-month period, between September 2001 and February 2002. (*For guidance to each step of the crafting and implementation process discussed in this toolkit, please refer to the User Guide*)

Developing terms of reference

One of the first tasks for the code crafting committee is discussing and setting the project's terms of reference. Agreeing on the terms of reference can help avoid later misunderstandings or potential conflicts on the goals and scope of the code. The terms of reference may include the following:

- The overarching objectives of the code
- The specific goals or purpose of the code
- A description of the circumstances that led to the development of the code
- The scope of the code or the type of companies to which the code is targeted
- The primary areas that the code's recommendations are to cover
- A description of the compliance mechanisms recommended for the code

THINKING POINT
What are the specific goals of the code?

Terms of reference vary depending on the country's corporate governance framework, the reasons why a code is being developed, and who has taken the initiative for developing a code. Initiatives led by the private sector tend to focus more on specific goals of the code and the impact of corporate governance on corporate performance. Government-led initiatives tend to emphasize the overarching objectives of the code and the importance of improving corporate governance practices for the country as a whole. Both aspects are important. (*For a discussion on initiating and leading the development of a corporate governance code of best practices, refer to Volume 2, Module 1*.)

The project's terms of reference are usually found in the code's introduction or preamble. They can be very detailed or quite broad. In most cases they not only provide the committee with a framework for establishing best practice recommendations but also provide users and stakeholders with the background leading to the drafting of the code and a rationale for its adoption and enforcement (*For a discussion on why corporate governance matters, refer to Volume 1, Module 1*.)

While reviewing the terms of reference, the crafting committee should also engage in preliminary discussions on whether the code should be a broadly based statement of principles or a more narrowly drawn document focused on details. The committee may also decide it wants to make recommendations for improving laws and regulations based on its research findings. Certain provisions of the code, for example, could be flagged for incorporation in the country's legal framework or adoption as listing requirements. This approach can be especially useful in countries where the legal corporate governance framework is still weak.

EXAMPLES

SAMPLE TERMS OF REFERENCE

INDIA

The Shri Kumar Mangalam Birla Committee, whose recommendations were adopted by the Securities and Exchange Board of India (SEBI), set out the following goals in its detailed terms of reference:

- To recommend suitable amendments to the listing agreement executed by the stock exchanges with listed companies and any other appropriate measures to improve the practice of corporate governance in the listed companies. Areas of governance to be considered included provision of information, both financial and nonfinancial; the manner and frequency of such disclosures; and the responsibilities of independent and nonexecutive directors.
- To draft a code of corporate best practices.
- To suggest safeguards for companies to adopt that govern the use of inside information and insider trading.

SOUTH AFRICA

In 2001, the second King committee on corporate governance adopted the following guiding principles as its terms of reference:

- To review the first King Report and to assess the need for revisions in light of local and international developments since the report was adopted in 1994.
- To review and clarify the recommendation in the first King Report for an “inclusive approach” to embrace the interests of a wide range of stakeholders for the sustainable success of companies (without subverting the primary interests of shareholders as stated in South African corporate law).
- To recognize the increasing importance placed on nonfinancial issues worldwide and to consider and recommend reporting issues associated with social and ethical accounting, auditing, and reporting, and safety, health, and environment issues.
- To recommend how company compliance with a new code of corporate governance for South Africa can be measured and compared through a “balanced scorecard” approach.

EXAMPLE

SAMPLE TERMS OF REFERENCE

BELGIUM

A committee chaired by Maurice Lippens was established to draft a single code of best practice on corporate governance for all listed companies. The committee's objective was to draft a code aligned with international practice and European Union recommendations.

The committee should also consider compliance issues. Should compliance with the code be fully voluntary, or should the committee make recommendations to encourage and enforce compliance? One popular approach is the "comply or explain" mechanism, introduced by the Cadbury Committee in the United Kingdom. Under this approach, companies are asked to comply with the code (or certain of its provisions) or explain why they have not. (*For a more detailed discussion on the scope of codes and their compliance mechanisms, refer to Volume 1, Module 2*.)

These questions will most likely arise again as the drafting of the code progresses, but an up-front discussion on these issues may be of great help in establishing the master schedule as well as researching the content of the code. (*For a discussion on researching the code's content, refer to Volume 2, Module 4*.)

EXAMPLE

LEVELS OF COMPLIANCE

AUSTRIA

The Austrian Code of Corporate Governance has the following three categories of provisions:

- ***Legal requirements*. These are provisions that companies listed on Austria's stock exchange must comply with or face legal penalties.**
- ***Comply or explain*. These are provisions of the code that companies must either comply with or give their reasons for failing to comply.**
- ***Recommendations*. These provisions are entirely voluntary. Noncompliance requires neither disclosure nor explanation.**

DEALING WITH DIFFICULTIES

During the crafting process, chairmen and project managers are likely to have to deal with issues and challenges that they had not anticipated. Problems can arise either with stakeholders from outside the committee or from within the committee itself. It is therefore advisable to anticipate possible problems and adopt management and monitoring techniques that can help deal with any issues that may stall the code crafting process. As a general rule, a certain amount of "slack" time should always be built into all phases of the project to permit problem solution and conflict resolution.

Dealing with outside resistance

Any new initiative may meet with a certain amount of resistance and skepticism as well as practical obstacles. Most code crafting committees experience at least one of the following problems.

Lack of understanding and skepticism

The importance of corporate governance and the purposes of a code of best practice are not always well understood. Successful committees develop a strong rationale for the code development process and build sufficient time into the schedule for consultation with important stakeholders.

QUOTE

DEALING WITH GENERAL SKEPTICISM: POLAND

"In developing the Corporate Governance Code for Polish Listed Companies…in 2002, the major challenge was to acquire active involvement from market participants. Lack of knowledge and familiarity with the issue was part of the problem. The macroeconomic slowdown and bearish market also played a role: many believed that the problem was the lack of investment opportunities rather than bad corporate governance, which many believed could or should be improved on an individual basis. There was also some skepticism whether the implementation of corporate governance standards would bring the expected economic results or how much could be achieved through corporate governance codes—and voluntary guidelines…. Furthermore, there were doubts whether the problems and solutions applicable to the Anglo-Saxon model could be suitable for Poland whose company law is based on the German model. There was a common opinion that the main bottleneck for the development of the Polish corporate governance system was weak enforcement and the court system, which cannot be addressed by a corporate governance code."

—Maciej Dzierzanowski, Gdansk Institute for Market Economics,
and Piotr Tamowicz, Polish Forum for Corporate Governance

Lack of support

It is common for committees to find little enthusiastic support from business leaders and investors. In particular, these groups may associate corporate governance changes with bureaucratic "red tape" and "box ticking." It is imperative that the committee is able to persuade key stakeholders of the merits and benefits associated with reform of corporate governance and the adoption of a code of best practices. (*For a discussion on raising awareness and consulting with stakeholders, refer to Volume 2, Module 3*.)

QUOTE

LACK OF SUPPORT: SRI LANKA

"There was initially a rather lukewarm reaction to the code drafting process and hence it was necessary to generate interest amongst the business community. This was achieved through regular press and media briefings undertaken by the committee which helped to kindle an interest in the need and benefits of such a code."

—Ajith Nivard Cabraal, chairman of the Corporate Governance Committee

Lack of existing legal framework

Many transition and developing countries have an inadequate legal framework. The code crafting committees in these countries typically need to focus on developing recommendations that may serve as a first step to reforming the corporate governance legal environment while considering possible compliance and enforcement procedures. Some committees, as in Ukraine, have dealt with the problem by recommending that the code eventually be turned into a law. In these cases it is important for the committee to distinguish best practices, which should remain voluntary, and minimum standards, which must be legally adopted.

Lack of funds

Developing a corporate governance code does not require a large outlay of funds, but the process can turn out to be more expensive than expected. Securing funding well in advance can be very helpful in planning consultation events with stakeholders, promoting the code, and hiring consultants. At the start of the project, the project manager should be aware of the amount and sources of available funding. Funding can be sought from international organizations, professional associations, private firms, and banks as well as from stock exchanges. Organizations that provide financial support to the code crafting committee are typically acknowledged in the foreword or introduction to the code. For some organizations, being publicly associated with a corporate governance reform initiative and the development of a code of best practices may constitute an important incentive for providing funds or in-kind support.

EXAMPLES

FUNDING

BANGLADESH

Several international development agencies such as the United Kingdom's Department for International Development, the Commonwealth Secretariat, and the Global Corporate Governance Forum provided financial support for the development of the Code of Corporate Governance for Bangladesh. The initiative was also supported by the Bangladesh Bank.

HUNGARY

The Corporate Governance Recommendations developed by the Budapest Stock Exchange were funded with substantial support from the British Government's Know How Fund.

QUOTE

FUNDING: REPUBLIC OF KOREA

"Financial backing of the Committee has been provided by the Korea Stock Exchange, Korea Securities Dealers Association, Korea Listed Companies Association and Korea Investment Trust Companies Association. Their support is sincerely appreciated."
—Jae-Chul Kim, Code of Best Practice for Corporate Governance, 1999

To help identify potential problems and deal with them at an early stage of the initiative, some project managers find it useful to generate a "Strengths/Weaknesses/Opportunities/Threats" (SWOT) analysis. Once such a SWOT analysis is conducted, a clear plan can be developed to overcome the identified difficulties and minimize negative reactions. A SWOT chart is shown in the table below.

EXAMPLE OF A SWOT ANALYSIS

STRENGTHS	WEAKNESSES
• Enthusiastic and well-respected chairman • Strength of committee membership • Buy-in from key stakeholders • Government support • Support from development agencies and international organizations, such as the World Bank Group or the Asian Development Bank	• Low interest or apathy from key stakeholder groups • Lack of existing legal framework • Low funding • Low media interest • Competing initiatives
OPPORTUNITIES	**THREATS**
• A financial crisis or corporate scandal, generating calls for corrective action • New government and momentum for reform • Publication of World Bank corporate governance Report on the Observance of Standards and Codes (ROSC)	• Political uncertainty, such as a pending general election • Conflicts within the crafting committee

Dealing with internal challenges

Problems do not always come from the outside. Difficulties may also arise within the crafting committee that slow down the development of the code. Members may disagree on the process as well as over the content of the code.

QUOTES

DEALING WITH CHALLENGES

GERMANY

"The major challenges encountered during the drafting process were to overcome different opinions by members of the commission due to their role as representatives of specific interest groups, e.g. investors, corporations, unions, academics. One solution was the introduction of two types of criteria: mandatory recommendations ('shall do') and voluntary suggestions ('should do'). Some of the critical issues that could not be agreed were thus classified as should-do suggestions."

—Christian Strenger, Government Commission on German Corporate Governance and DWS Investment, March 2003

BANGLADESH

In developing the corporate governance code for Bangladesh, the task force met the following challenges:

- Lack of understanding about the nature of codes versus laws and regulations: "We tried to say that the code could emphasize certain aspects of the law, and would in many cases ask companies to go beyond the law (i.e. 'raise the bar'). Only slowly did the task force and some government officials understand that concept."
- Lack of consensus on terms of reference: "Task force members often focused on reforms necessary in policy, infrastructure, and law and order, rather than focusing on best practices for companies and organizations."
- Lack of stability: "The speed with which civil servants and government officials change positions makes it difficult for them to gain exposure and understanding of corporate governance and the role of the government. In addition, it is difficult to develop relationships within government departments."
- Lack of consensus about the nature of the recommendations: "A practical difficulty in drafting the code was deciding between general principles or more detail-oriented guidelines. Given the lack of understanding regarding what corporate governance is, specific recommendations seemed both helpful and more likely to lead to compliance. . . . However, more general guidelines or a principle-based document would have maybe been easier to gain consensus on. The question was whether such a consensus would have made much sense?"

—Wendy Werner, Bangladesh Enterprise Institute

THINKING POINT

What are the main challenges your code crafting committee faces?

To prevent a build-up of conflicts within the committee, the chairman and the project manager should ensure that:

- The committee agenda takes full account of the issues and concerns of all committee members.
- The committee agenda is forward looking and concentrates on discussing important issues rather than merely ratifying proposals from the project leader.
- Sufficient time is allowed for discussion of complex or contentious issues.
- Informal meetings are arranged beforehand if necessary to enable the efficient use of time for the committee discussions. It is particularly important that committee members perceive that they have sufficient time to consider critical issues and are not faced with unrealistic deadlines for decisionmaking.
- Active engagement by all the members of the committee is encouraged.
- The chairman promotes effective relationships and open communications among the project manager, the secretariat, and the committee members.
- The project leaders provide committee members with accurate, timely, and clear information.

To head off possible conflicts and identify potential problems, as well as to monitor the committee's work progress, chairmen may consider evaluating the work of the committee and the performance of individual members. It may be useful to allow a few minutes at the end of each meeting for this evaluation to take place. Typically the chairman may start by summarizing the work session and achievements to date before discussing specific issues. The evaluation process is most effective when it builds on feedback from all committee members. The evaluation typically considers two sets of questions:

- Is the committee operating well? Are the members competent and balanced in their approach to drafting the code? Does the committee meet regularly? Do the agendas advance the work of the committee? Are the minutes accurate?

- Does the committee possess any features associated with a poorly run committee meeting? Is it so big as to be unwieldy or so small as to be unrepresentative? Do the members offer too small a range of expertise? Do the members see their role as one of protecting their own vested interests? Is the information provided by committee members inadequate?

The way decisions are made can also indicate how well a committee is operating. A committee is poorly run if decisions are made without serious debate or challenge, if they are made by cabals within the committee or outside the committee meeting, or if they can be overturned by a dominant individual. An inability to make difficult and unpleasant, but necessary, decisions is also a sign of trouble. Other indicators are failure to monitor the committee finances and failure to stay on schedule (which often happens when deadlines and responsibilities have not been clearly established at the beginning of the process or if the scope of the project has been underestimated).

(*For a guide on evaluating committee performance, see Volume 2, Annex 3*.)

Consulting Stakeholders

MODULE 3 AT A GLANCE:

Consulting with stakeholders is crucial to developing a successful corporate governance code of best practices. Getting feedback from all the constituencies involved in setting, implementing, and enforcing the corporate governance framework is essential for:

- Assessing the country's corporate governance reform needs
- Validating the committee's terms of reference
- Developing and testing the content of the code
- Ensuring support for the code, better implementation, and ultimately a higher level of compliance with the code's provisions

There are many ways of consulting with stakeholders, and it is important for the committee to establish a consultation strategy early in the code crafting process and select methods of engaging key stakeholders.

This module reviews:

- Key stakeholders and their level of involvement
- Methods of consultation

STAKEHOLDERS AND THEIR LEVEL OF INVOLVEMENT

Widespread support from policymakers, regulators, and the business community is essential to the successful development and introduction of a corporate governance code of best practice. If the key stakeholders support the initiative in the first place and are consulted and involved during the development phase, they are far more likely to be important champions for the initiative when it is launched and implemented.

Engaging stakeholders

The development of a corporate governance code requires an inclusive approach. The perceptions and interests of all the interested parties should be considered; no stakeholder group should be excluded from the process. At times the views of some of the key stakeholders are likely to conflict with others. In such instances, the challenge for the code crafting committee and its chairman is to obtain a workable compromise and to integrate stakeholders' comments while hewing to the objectives of the code and the country's corporate governance reform needs. *(On integrating consultation feedback, see Volume 2, Module 4.)*

The value to the committee of maintaining good relationships with stakeholders cannot be overemphasized. If for some reason key stakeholders are not made a part of the process or their views are not sought, they may grow increasingly critical of, and even hostile to, the code crafting process. In such circumstances, their actions could delay or stall the process.

Project managers may find it useful to develop a checklist that identifies who the major players are. The key stakeholders and supporters of a corporate governance code crafting process may vary depending on the scope and target of the code, but they typically include:

- The stock market and securities regulator
- The stock exchanges
- The department of commerce or registrar of companies
- The central bank
- Professional associations, including associations of accountants, auditors, corporate lawyers, bankers, and company secretaries
- Investor and shareholder associations
- Institutes of directors
- Chambers of commerce, trade associations, and business associations

(*For a discussion on the various stakeholders that may be involved in developing a corporate governance code, refer to Volume 2, Module 1*.)

EXAMPLE

STAKEHOLDER CONSULTATION: BRAZIL

During the consultation process, Brazil's code crafting committee consulted many entities, including :

- **The Brazilian securities and exchange commission (Comissão de Valores Mobiliáros)**
- **The São Paulo Stock Exchange**
- **The national development bank (BNDES)**
- **The association of listed companies (Abrasca)**
- **The association of minority investors (Animec).**

In addition, personal visits, emails, and the Internet were used to consult other stakeholders.

Stakeholders need to be involved at every stage of the code crafting process. Yet the committee may decide to engage individual stakeholders differently and seek various levels of feedback. There are typically three levels of stakeholder engagement:

- *Notify and inform*. The committee may want to notify and inform parties on the progress of the initiative to raise broad awareness, provide opportunities for feedback, and ensure that no organizations and individuals can claim that they were unaware of the initiative.
- *Consult*. The committee may want to actively seek the advice and expertise of certain parties at specific stages in the crafting process to improve the content of the code, validate and measure the impact of certain recommendations, and ensure that important parties cannot claim that they were not consulted in the process of developing the corporate governance code.
- *Involve*. The committee may want to actively involve some constituencies to ensure their support and their willingness to adopt the code once it is published.

Code crafting committees may find it useful to set up a consultation management table to keep track of plans for engaging with specific stakeholders at various stages of the code development process. The table on page 33 provides an example of what such a table might look like.

SAMPLE STAKEHOLDER CONSULTATION MANAGEMENT TABLE

STAKEHOLDER	NEWS OF NEW CORPORATE GOVERNANCE INITIATIVE	COMPOSITION OF CODE CRAFTING COMMITTEE	CHAIRMANSHIP OF THE COMMITTEE	CONSULTATION DOCUMENT/ DRAFT CODE	PUBLICATION AND ADOPTION OF CODE
Companies, business organizations	Inform	Involve	Consult	Involve	Inform and involve
Financial institutions	Inform	Involve	Consult	Involve	Inform and involve
Institutional investors	Inform	Involve	Consult	Consult and involve as necessary	Inform and involve
Legislature	Inform	Consult	Consult	Inform and consult as necessary	Inform and involve
Executive branch	Inform	Consult	Consult	Inform and consult as necessary	Inform and involve
Regulatory bodies	Inform	Consult	Consult	Inform and consult as necessary	Inform and involve
Stock exchanges	Inform	Involve	Consult	Inform and consult as necessary	Inform and involve
Professional bodies	Inform	Involve	Consult	Involve	Inform and involve
Universities	Inform	Involve	-	Involve	Inform
Media	Inform	Inform	-	-	Inform and involve as appropriate
Lawyers	Inform	Involve	-	Involve	Inform
Trade unions	Inform	Inform	-	-	Inform
Shareholder associations	Inform	Inform	-	Involve	Inform
International organizations	Inform	Inform, consult, or involve as necessary	-	-	Inform

Prioritizing stakeholders

It may be difficult at times to decide how much a specific group should be involved in the code crafting process. A power/interest matrix can be a useful mechanism for considering the necessary level of the committee's involvement with different stakeholder groups. Such a matrix classifies stakeholders in relation to the power they hold and the extent to which they are likely to show interest in the corporate governance initiative. The committee can then make decisions about the relationship it wishes to adopt toward each specific stakeholder.

STAKEHOLDER POWER / INTEREST MATRIX

	LOW INTEREST	HIGH INTEREST
HIGH POWER	Keep satisfied (consult)	Keep engaged (involve)
LOW POWER	Minimal effort (notify)	Keep informed (inform)

In this context, power is associated with the mechanisms by which the activities of stakeholders are able to influence the process of developing the corporate governance code (that is, the extent to which individuals and groups of people are able to persuade, induce, or coerce the developers of the code to follow certain courses of action). Clearly, those stakeholders who are considered to have both high power and high interest need to be regarded as key players whose involvement in the process is crucial. Completion of the matrix usually leads to further consideration of strategies and plans for:

- Communications and consultation with different stakeholders
- Mechanisms for involving stakeholders in decisions and plans
- Influencing specific stakeholders, particularly if it is necessary to increase their support

Several issues are important to consider when placing stakeholders on the power/interest matrix. These include:

- The support needed, wanted, or expected from any stakeholder group
- The level of influence held by stakeholders and the implications of their possible withdrawal or lack of cooperation
- The politics of balancing a variety of stakeholder interests
- The need to nurture and control some of the key players

The table below shows how specific stakeholders groups might be positioned on the power/interest matrix in a specific scenario.

SAMPLE STAKEHOLDER POWER/INTEREST MATRIX SCENARIO

	LOW INTEREST	HIGH INTEREST
HIGH POWER	Media	Business community Stock exchanges Securities regulator
LOW POWER	-	Ministry of foreign trade Shareholder association

This table presents a scenario where the media have been identified as having a low level of interest in the corporate governance initiative. If the committee regards journalists as key opinion makers, however, it may wish to take a proactive approach to educate them about corporate governance. Such an approach can help ensure that the media will give corporate governance issues a higher priority and greater visibility.

The table also shows that the ministry of foreign trade has a high level of interest in the corporate governance initiative. The government, however, may wish to have no involvement in the code crafting committee's deliberations.

THINKING POINT
Which stakeholders are likely to be influential in your code drafting process?

Another analytic tool that is commonly used is the power/unpredictability matrix *(see table at top of page 36)*. This matrix identifies the stakeholders that require specific attention and a high level of communication. As in the previous case, power means the extent to which individuals and groups of people are able to persuade, induce, or coerce the developers of the code to follow certain courses of action. Unpredictability refers to the extent to which stakeholders are expected to behave in a predictable manner during the process of developing and implementing the code. The existence of powerful and unpredictable stakeholders should be avoided as far as possible. Unpredictability can often be lessened by improving communication with these key stakeholders.

The second table on page 36 shows how a power/unpredictability matrix can be used. In this scenario both the media and companies have been identified as being very important for the successful implementation of the draft code, but

STAKEHOLDER POWER/ UNPREDICTABILITY MATRIX

	PREDICTABLE	UNPREDICTABLE
HIGH POWER	Committee has a moderate need to communicate	Committee has a high need to communicate
LOW POWER	Committee has a low need to communicate	Committee has a moderate need to communicate

their reaction to the initiative is highly unpredictable. In this situation the committee should focus its efforts on moving these two stakeholders into the predictable column of the matrix, along with financial institutions and the government. The preferred strategy is likely to be improved communication with the two stakeholders. That would increase the committee's understanding of the stakeholders' perspectives and make it more likely that the committee's actions would satisfy the interests of the media and companies.

SAMPLE STAKEHOLDER POWER/UNPREDICTABILITY MATRIX

	PREDICTABLE	UNPREDICTABLE
HIGH POWER	Government, financial institutions (moderate need to communicate)	Media, companies (high need to communicate)
LOW POWER	Shareholder association (low need to communicate)	Trade unions (moderate need to communicate)

Time and resources

The committee should give careful consideration to how much time and resources need to be allocated to each stakeholder. Consideration also should be given to identifying the person within the committee who will be responsible for maintaining the relationship with specified key stakeholders. The following table provides an example of a tool that can be used for allocating resources to communicate with key stakeholder groups

THINKING POINT

What are the resources available to your committee for consulting with stakeholders?

SAMPLE CONSULTATION TIME MANAGEMENT TABLE

	CONSIDERABLE TIME/RESOURCES	MODERATE AMOUNT OF TIME/RESOURCES	SMALL AMOUNT OF TIME/RESOURCES	RESPONSIBILITY (COMMITTEE MEMBER NAME)
Companies	X			Mr. Jones
Financial institutions		X		Mr. Jones
Institutional investors		X		Mr. Jones
Legislature				Mr. Smith
Executive branch			X	Mr. Smith
Regulatory bodies	X			Mr. Bond
Stock exchanges	X			Mr. Bond
Professional bodies		X		Ms. Jackson
Universities			X	Dr. Roberts
Media	X			Mr. Jones
Lawyers		X		Ms. Jackson
Trade unions			X	Mr. Smith
Shareholder associations		X		Ms. Jackson
International organizations			X	Mr. Jones

METHODS OF CONSULTATION

Various types of consultation methods can be used, alone or in combination, throughout the code crafting process. A successful committee determines well in advance which methods will be most successful at what point in the process. In designing its consultation plan, the committee should consider:

- The country's cultural context and various stakeholders' preferred communication style

- The committee's available resources (staff and budget)
- The type of feedback needed and expected
- Communication technologies available to stakeholders and committee members

The table below displays the methods of consultation used most often, along with their respective advantages and disadvantages.

ADVANTAGES AND DISADVANTAGES OF DIFFERENT FORMS OF CONSULTATION

TYPE OF CONSULTATION	ADVANTAGES	DISADVANTAGES
Consultative document	• Evokes interest • Allows respondents to make a considered response	• Low response rate • Responses can be coordinated by pressure groups • Responses may not be representative
Postal questionnaires	• Evokes interest • Convenient • Allows respondents to make a considered response • Inexpensive	• May not evoke sufficient number of responses • May not generate a representative sample • May not evoke response from key stakeholders • May suffer from questionnaire overload
Email questionnaires and website surveys	• Evokes interest • Fast • Convenient • Allows respondents to make a considered response • Inexpensive	• May not evoke sufficient number of responses • Responses may not be representative • May not evoke response from key stakeholders
Telephone questionnaires	• Evokes interest • Convenient • Inexpensive	• Time consuming for respondent and interviewer • Responses may not be representative • Problems with coding and recording oral responses
One-on-one interviews	• Evokes interest • Can deal with controversial issues in a detailed and individual manner	• Can be time consuming • Views expressed are often personal rather than representative • Problems with coding and recording responses if semistructured or unstructured interviews are employed.
Events (such as workshops, focus groups, and conferences).	• Evokes interest • Can focus on controversial issues	• Can be time consuming • Responses may not be representative • May not generate a representative sample • Can involve significant administrative support to organize
Media debate	• Evokes interest • Can focus on controversial issues • Popular views expressed • Can provide useful critical feedback	• Issues can be distorted and sensationalized • Responses may not be representative • Excessive focus on easily understood themes; complex themes ignored • Excessive focus on controversial themes

Consultation tools

Various documents and tools related to the consultation process may be used to seek feedback and support while developing a code of best practice. Typically these documents include press releases, exposure drafts, questionnaires, and surveys.

The committee should oversee all primary consultation documents that are to be used. Copies of all proposed documents should be circulated to all committee members in ample time to allow members to read and give careful consideration to the drafts before they are discussed at the committee's meetings. When important issues of principle are to be discussed, chairmen may suggest that members submit their comments in writing to the committee's secretary.

The consultative document, or exposure draft

The primary consultation tool when developing a code of best practice is the consultative document, also known as an exposure draft. The purpose of this document is to canvas opinions on a draft of the code before it is finalized. The consultative document should briefly describe the committee's terms of reference and explain the purpose and the scope of the initiative. The document can be more or less sophisticated, depending on the stage of the process at which it is circulated and how much background research the committee has already conducted. The early draft of the code should nevertheless at least include the tentative structure and broad guidelines of the code. (*For more information on the background research needed before a code is drafted, refer to Volume 2, Module 4*.)

The primary advantage of having a consultative document ready at the early stages of the crafting process is to engage stakeholders on the broad goals of the code. However, circulating an early draft runs the risk of fostering too much debate and slowing down the process. Circulating a more sophisticated exposure draft later in the process can help elicit more specific and technical feedback, but some stakeholders may feel left out if they are not asked to participate in the initial discussions on the broad orientation of the code and the issues at hand. To resolve those problems, committees may consider issuing a simple consultative document at an early stage of the work and then issuing a second, more detailed draft before finalizing and agreeing on the code.

As a rule the consultative document should be as short as possible and use simple language to encourage a high response rate. Responses are nevertheless often low in both quality and quantity. Complementary forms of consultation may therefore be needed to increase the response rate and help get more specific feedback.

EXAMPLE

CONSULTING STAKEHOLDERS: TURKEY

A major challenge for Turkey's code crafting committee was involving all market participants in the consultation process, but the initial response rate to the consultative document was significantly lower than anticipated. Additional methods of consultation were developed to elicit a greater response. Notably, the committee organized frequent meetings with key stakeholders and met for two days with business representatives, securities experts, and academics to finalize the code and consolidate the recommendations.

Surveys and questionnaires

Surveys and questionnaires are useful and complementary tools that can guide stakeholders in their responses and provide the committee with more targeted and precise feedback.

When developing a large-scale survey, the committee should seek advice from market research and statistical experts on obtaining representative responses. Such advice is particularly important where there are significant interest groups with predicted differences in perspectives. Different segments of the business community in particular may have varying characteristics that affect their perspectives. For example, a committee seeking feedback from a broad range of companies would want to consider the following characteristics:

- *Sophistication of company*. Companies listed on a number of stock exchanges in different countries often have a more sophisticated perspective than unlisted companies. Listed companies are likely to have more sophisticated internal control systems to comply with accounting standards and disclosure requirements.
- *Size of company*. It is common to find significant differences in responses between large and smaller listed companies. Larger companies, for example,

are often much more in favor of separating the positions of chairman and chief executive officer than are small companies.

- *Sector*. Significant differences are normally found in the perspectives of the public and the private sectors. For example, state-owned enterprises may be more concerned about public safety standards than the private sector.
- *Role of respondent*. In certain consultations, the chairman of a company may respond differently from the CEO, for example; the views of controlling shareholders are likely to differ from the views of minority shareholders. It is therefore advisable for committees to solicit responses from a variety of office holders or shareholders.
- *Geographical*. Regional differences may also need to be considered. For example, the rural response may differ from the urban response.

Postal questionnaires

Many committees develop a questionnaire that covers the key points and issues associated with the proposed code. These questionnaires should not be too lengthy and burdensome for the people asked to complete it. In some countries, key organizations—particularly financial institutions—have been complaining about "survey overload," and in these situations the response rates often have been much lower than anticipated.

Many committees have found it useful to test the questionnaire with some of the key stakeholders on a "one-on-one" basis. This testing may provide early warning signs to the committees that the questions are not eliciting helpful responses or that respondents may be uncomfortable with specific aspects of the proposed code.

THINKING POINT
What methods of consultation would best engage your stakeholders?

Responses to questionnaires need to be processed methodically, and care should be given on how best to analyze the results. Statistical analysis of questionnaire responses is skilled work and should be handled by a person who is competent and knowledgeable in this area. In some cases committees have employed university professors to lead the research. (*For a discussion on the reliability of questionnaire and survey results, refer to Volume 2, Module 4*.)

Internet consultation

The Internet has become an important vehicle for collecting feedback during the code crafting process. The consultation document as well as successive drafts, email questionnaires, and website surveys can be circulated through the Internet. Using the Internet can prove both cost and time effective and help reach a greater number of people. The Internet also has the advantage of allowing respondents to reply at a convenient time for them.

There are two ways to use the Internet. Sending emails constitutes a targeted, proactive way of reaching and engaging specific stakeholders or individuals. For a broader consultation, the lead organization as well as other organizations represented on the crafting committee may consider collecting feedback by posting consultation documents, drafts of the code, or questionnaires and surveys on their respective websites. Most countries have come to use the Internet to circulate their draft codes and solicit feedback. The Republic of Korea, Poland, and Turkey, for example, collected the views of many stakeholders through this channel. Some disadvantages are associated with this method, however, including not obtaining a sufficient number of responses, receiving irrelevant responses, and receiving few if any responses from the most prominent stakeholders.

EXAMPLE

SENDING EMAILS: SOUTH AFRICA

To maximize consultation, an email was sent to a wide range of individuals and institutions who were familiar with or concerned about corporate governance issues. Among those consulted were academics, business owners, business associations, and corporate institutions.

Telephone questionnaires

Telephone questionnaires can also evoke significant interest in the corporate governance initiative. Using the telephone can be a very convenient, inexpensive, and popular method of acquiring information. It is, however, time consuming for both the interviewer and the respondent. Moreover, unless the interviewers are experienced and well trained, proper coding and recording of responses can be problematic. (*A sample telephone interview cover letter can be found in Volume 2, Annex 4*.)

In addition, good research practice dictates that care should be taken to ensure that a representative sample of the target populations is interviewed. Quotas are one way to determine a statistically representative sample. An example of a quota system in operation is described in the example box.

EXAMPLE

TELEPHONE INTERVIEWS: UNITED KINGDOM

During the drafting of the Higgs Report (2002), 605 telephone interviews were completed during a five-week period with directors of listed companies in the United Kingdom. The profile of the sample had to be consistent with the population of directors overall. To make the sample representative, quotas were set that required interviews with:

- 72 chairmen (12 percent of the sample),
- 257 executive directors (42 percent), and
- 276 nonexecutive directors (46 percent).

The sample was structured to ensure that no more than one chairman, one executive director, and one nonexecutive director from the same company were interviewed. (If respondents held more than one directorship, they were asked to comment on the one that took up the greatest proportion of their working time.)

Quotas were also set for the number of interviews with directors from:

- 62 FTSE 100 companies (10 percent of sample)
- 131 FTSE 250 companies (22 percent)
- 412 other listed companies (68 percent).

The demographic profile of the interviewees was also set to be in line with the population of directors overall:

- 35 respondents had to be women (6 percent of sample)
- 7 respondents had to be a member of a minority ethnic group (1 percent)

One-on-one interviews

One-on-one interviews can be very useful to obtain detailed feedback from selected prominent individuals on technical or controversial aspects of the code. Interviews may be semistructured, with the interviewer and respondent engaging in an almost free-form discourse. This type of interview helps clarify any questions a respondent might have about the content of the code and gives the interviewer an opportunity to provide further explanations on specific proposed guidelines and provisions. The more structured the interview, however, the more specific the responses and the easier the recording of responses becomes. One-on-one interviews can be very time consuming and should be reserved to solicit feedback from experts and highly influential stakeholders. The respondent views expressed in these types of interviews are often personal rather than representative.

Consultation events

Consultation events can take various forms. Some events can be organized at the early stages of the consultation process; examples are workshops and public meetings to build stakeholder support or raise general awareness. Other types of events, such as stakeholder forums and focus groups, can be organized later in the code crafting process to obtain specific feedback on proposed provisions of the code.

The structure of the consultation events should be carefully planned:

- Participants should receive sufficient notice of the event. (The amount of notice may vary according to country but should be at least three weeks)
- The notice should clearly specify that the event is being organized to obtain views of the participants in relation to the consultation process. The consultative document is normally attached to any notice of a meeting.
- The event should be scheduled for a convenient time, and the overall time allocated typically should not exceed two hours.
- At the beginning of the event, the chairman or another member of the committee should provide an overview of the consultative process. Views, comments, and suggestions should be invited from the attendees. A wide-ranging discussion should be allowed to take place without any restrictions being placed on the speakers. It is also desirable to have a rapporteur present at the event, who could take notes and prepare a summary of the submissions made for committee members to use in their discussions of the code.
- Toward the end of the event, the chairman should thank the participants and assure them that the committee will take their views into account.
- A few days after the event, a letter of appreciation should be sent to all participants, again thanking them for their involvement. (*A specimen letter of appreciation is given in Volume 2, Annex 5*.)
- The committee should be provided with a full report on all consultation events.

Preliminary meetings and workshops

Preliminary meetings and workshops typically occur when the idea of crafting a best practice code is first being discussed and tested among major stakeholders. These meetings usually involve key market players and reform leaders and focus on the country's basic corporate governance issues and the general improvements needed in the country.

EXAMPLES

PRELIMINARY CONSULTATION MEETINGS

KENYA

In November 1998 a workshop was sponsored and supported by leading organizations in Kenya with an interest in corporate governance, including :

- The Nairobi Stock Exchange
- Capital Markets Authority
- Institute of Certified Public Accountants
- The Kenya Chapter of the Association of Chartered Certified Accountants
- Participants from many leading corporate organizations.

It was agreed that a second forum would be held in March 1999 to discuss major topics and principles of good corporate governance. It was at this seminar that a decision was made to formulate a code of best practice for corporate governance in Kenya. A committee was subsequently set up and authorized to determine the feasibility of a permanent body to oversee the implementation of a code.

BANGLADESH

In 2003 the Bangladesh Enterprise Institute established a task force to develop a corporate governance code in 2003. One of the task force's first acts was to conduct a seminar titled "Strengthening Corporate Governance in Bangladesh," which was attended by the minister of law and justice and the governor of the Bangladesh Bank (the country's central bank). This seminar highlighted the poor governance structures prevailing in banks and other corporate entities that were contributing to the instability of the country's financial and corporate sectors. The seminar also took note of the resulting irregularities that led to a higher cost of capital and acute difficulties in doing business, which in turn resulted in poor competitiveness. High-level participants at the seminar unanimously agreed that a code of best practice on corporate governance was urgently needed to help correct these problems.

Stakeholder forums

Stakeholder forums can be used to invite interested stakeholders to meet with members of the committee to discuss specific topics to be addressed by the code. The topics discussed are typically controversial issues where consensus has not yet been obtained. Many countries have found stakeholder forums to be a useful method of building consensus and obtaining feedback from key stakeholder groups.

EXAMPLES

STAKEHOLDER FORUMS

POLAND

The code crafting committee organized three meetings targeted at different groups of market participants—investors, public companies, and board members.

SRI LANKA

The code crafting committee had separate meetings with each of the identified stakeholders to obtain their candid comments about the content of the code. These meetings provided a forum to exchange views freely and served as an important venue for understanding and appreciating the concerns, needs, and objectives of each of the groups.

Focus groups

Focus groups typically take place once the main principles or guidelines of the code have been developed in a draft format and the committee feels further refinement is needed. Focus groups normally are composed of specific experts and representatives of key stakeholder groups the committee invites to a meeting to discuss specific and technical issues.

Public meetings

Public meetings can provide a wide range of constituencies with the opportunity to ask questions, express their concerns, and learn more about the objectives and purpose of the code. These meetings can occur both at an early stage of the consultation process, to explain the goals of the initiative, and once the code has been finalized, to promote its implementation and explain its content.

EXAMPLES

PUBLIC MEETINGS

MACEDONIA

Macedonia's code drafting committee used an open, inclusive process in its consultation process. It organized more than 27 public debates, 3 of which attracted audiences of more than 500.

UKRAINE

As a first step, a series of seminars and workshops were organized in five major cities across Ukraine to educate the private sector about the role of country corporate governance codes and to solicit feedback and recommendations on what the private sector thought would be useful for a code in Ukraine.

Raising awareness through the media

The media can be a very effective vehicle for raising public awareness about the code crafting process. It can also be helpful in supporting the implementation of the code itself and better corporate governance practices in general. Maintaining good relations with the media and providing journalists with the appropriate information is thus an important task for the committee.

An initial news release explaining the purpose and the mechanisms of the code crafting initiative is often one of the first documents a code crafting committee produces. The news release should build on the committee's terms of reference and include the following information:

- The objectives of the committee
- Details of the membership of the committee (representatives of the key stakeholder groups should be mentioned)
- Quotations from the chairman and other influential persons concerning the need for and the benefits to be obtained from improving corporate governance within the country.
- Contact details for the committee secretariat for journalists requiring further information.

(*For a discussion of terms of reference, see Volume 2, Module 1*.)

Many project managers have sought advice from the communications director of government departments or large organizations in putting together a press list. (*A sample news release can be found in Volume 2, Annex 6*.)

Committees may also consider engaging the media through press events and media debates. Chairmen and committee members should nevertheless not become distracted by the seductive appeal of the media during the crafting process. The main focus of the committee should be on developing the content of the code. In some cases media reports may heighten controversy over specific issues and generate a public debate over the code crafting initiative itself. Broad issues may be distorted and sensationalized, while complex themes are ignored. When controversial issues are debated through the media, committees often feel they are placed in a reactive and defensive position rather than keeping a proactive role.

Once agreement on a final code has been reached, the committee can focus its full attention on publicizing the final document. Now is the time when media coverage can help in implementing the code and building momentum spurring compliance with the recommended reforms. (*For a discussion on implementing the code, refer to Volume 2, Module 5. For additional information on consultation, see the extracts from the Code of Practice on Consultation, developed by the United Kingdom Regulatory Impact Unit, in Volume 2, Annex 7*.)

Researching and Drafting the Code

MODULE 4 AT A GLANCE:

Researching and drafting the content of a new corporate governance code of best practice is the ultimate goal of any committee and underlines all of its activities. Once the code crafting committee has established its terms of reference and decided on the goals and objectives of the code, it must research the content of the code and begin the drafting process. Verbiage for corporate governance codes of best practice does not come prepackaged, and thorough background research is the key to a successful code. In addressing the country's corporate governance reform needs, the final code should follow international best practice but without contradicting existing laws and regulations. This module discusses the various steps involved in researching the content of the code, integrating feedback from stakeholders, adopting the right style and format, and agreeing on the final code.

This module reviews:

- Researching existing international best practice and models
- Assessing the country's legal framework and reform needs
- Integrating consultation feedback
- Adopting the right style and format
- Agreeing on the final code

REASERCHING THE CONTENT OF THE CODE

To produce an effective code, the committee must conduct thorough background research based on its terms of reference and the agreed scope and objectives of the code. (*For a discussion on the committee's terms of reference and the objectives of the code, refer to Volume 1, Modules 2 and 3 and Volume 2, Module 2*.)

The gathering of background information involves:

- Reviewing international best practices
- Understanding current laws, regulations, and practices within the country
- Reviewing the country's corporate governance reform needs

Setting up subcommittees or working groups

Committee members can easily become overwhelmed by the massive amount of information that needs to be reviewed and collected internationally and at the local level in order to adequately translate international standards into country best practice. Some code crafting committees have therefore found it useful to create working groups or subcommittees to increase the efficiency and quality of the research process.

THINKING POINT
Should your committee set up specific subcommittees?

The decision to set up subcommittees needs to be considered in the early stages of the code crafting initiative to avoid any confusion at later stages. It is important that working groups are well-coordinated and that they submit reports with key findings to the full committee to ensure that all members are familiar with the big-picture results. To ensure that the research process does not stall the crafting process, the chairman should be prepared to prevent detailed debates during committee meetings over quirky results that can sometimes arise from the work of subcommittees. The committee's attention should stay focused on the content of the code being produced.

To help with researching the code's background and content, committees may also hire consultants or international experts and seek help from academics. In all cases it is important that the research be carried out in a systematic manner, by individuals who are familiar with general and specific corporate governance issues. (*For further details on hiring consultants, refer to Volume 2, Module 1*.)

EXAMPLE

ESTABLISHING SUBCOMMITTEES

SOUTH AFRICA

The King II committee review was structured into five task teams that focused on:

- *Boards and directors*. This task team looked at a wide range of issues in the area of board governance and director conduct with particular reference to international developments and institutional investor requirements. It specifically looked into issues regarding board practice; the status and responsibilities associated with executive, nonexecutive, and independent directors; and executive and nonexecutive director remuneration. It also revisited the "business judgment rule," which holds corporate boards harmless for business judgments made with diligence and good faith.
- *Accounting and auditing*. This task team considered developments surrounding auditing and nonaudit advisory services, accounting standards in relation to international developments, auditor skills associated with nonfinancial reporting, and the King Committee's previous recommendations regarding legal support for accounting standards in South Africa.
- *Internal audit, control, and risk management*. This task team reviewed and updated guidelines dealing with board and company practices related to risk management and reporting.
- *Integrated sustainability reporting*. This task team investigated recommendations for integrating corporate-related nonfinancial matters into the overall governance and reporting framework of companies in South Africa. The areas covered included health, safety, environment, and public interest and community issues, and their economic impact or relevance.
- *Compliance and enforcement*. This task team considered the supervision and enforcement of existing rules and regulations governing companies in South Africa and recommendations to improve compliance with governance guidelines.

About 50 people served on the task teams. They were carefully selected to embrace a wide range of interests from the private and public sectors, institutional investors and shareholders, civil society, government, and regulators. This broad representation was intended to ensure a wide reference for investigation and consideration of the recommendations arising from the review.

EXAMPLE

SEEKING EXPERT ADVICE: UNITED KINGDOM

Most of the research that underpinned the Higgs Report on the Effectiveness of Non-Executive Directors, issued in 2004, was undertaken by three carefully selected experts: Dr. Terry McNulty, of the Leeds University Business School, and Dr. John Roberts and Dr. Philip Stiles, of the Judge Institute of Management, University of Cambridge.

Reviewing international best practices

Unlike in 1992 when the pioneering Cadbury code was issued, many countries have now developed their own corporate governance code, international standards have been adopted, and a tremendous amount of work has been done in the field of corporate governance. Consulting existing international best practice is extremely important for any committee working on developing or reviewing a corporate governance code and should be undertaken at the outset of the process. A complete review of international best practices is necessary for several reasons:

- First of all, the committee needs to familiarize itself with existing international best practice in order to satisfy one of the main purposes of issuing a corporate governance code, which is to raise corporate governance standards at the country level.
- On a more practical level, consulting international best practice will also help the committee in selecting an existing model on which it can base the structure of its own code.
- Finally, by examining detailed provisions from various codes, the committee can gain precious time by identifying important recommendations and borrowing specific language that can be included in or serve as a basis for the new code.

Considering the number of existing codes and best practice recommendations available today, the biggest challenge for the committee may well be in deciding which of the existing codes, recommendations, and provisions are most relevant to the country. Reviewing international corporate governance principles or standards provides a good starting point

THINKING POINT
Can existing codes serve as benchmarks or models for your code?

for the committee's background research work and can help the committee develop an overall framework or benchmarks against which it can structure its own corporate governance code.

For example, the committee may begin by considering whether the OECD Principles of Corporate Governance can serve as a basis for the national code. Adopted in 1999 and revised in 2004, these principles constitute common best practice standards that countries with different cultures, corporate structures, and legal environments could agree upon without being unduly prescriptive. Issued to assist governments in their efforts to evaluate and improve their frameworks for corporate governance, the OECD principles constitute the most frequently used model for developing country codes. Other regional models, such as the guidelines developed by the Commonwealth Association for Corporate Governance or the Corporate Governance Andean Code, should also be consulted, especially when developing a code in anglophone African countries or South American countries. (*For a discussion on international standards and guidelines, refer to Volume 1, Module 2*.)

The committee may also find it useful to consult the policy objectives Ira Millstein developed in 1997 in a report to the OECD entitled "Perspectives for Public Policy Improvement." These objectives were developed to assist policymakers and regulators in shaping the corporate governance environment and benchmarking their corporate governance practices. They are still as pertinent and challenging as when they were first written and provide excellent guidance for developing a code. (*These policy objectives are set out in Volume 2, Annex 8*.)

As a second step, the committee should research existing country codes. Considering the number of existing codes, it may be useful to structure the research by comparing the table of contents and the scope and objectives of various codes before analyzing specific provisions. Such a procedure can help the committee exclude irrelevant models and avoid the hasty import of inadequate "foreign" codes or clauses. A wise committee selects model codes that build on values, issues, concerns, and practices that are similar to those of the committee's country. It is also recommended that the committee pay closest attention to the most recent codes, to avoid including any "outdated" clauses in the new code. (*For a comparative list of major country codes, refer to Volume 1, Annex 5*.)

EXAMPLES

USING INTERNATIONAL BEST PRACTICE MODELS

UKRAINE

The draft code was based on the OECD Principles of Corporate Governance, which the drafting committee then tailored to respond to the unique features of corporate legislation and corporate activity in Ukraine.

MACEDONIA

In Macedonia's code of best practices, there was some "transplantation" of corporate governance issues from international sources (particularly from the Anglo-Saxon models). These transplants included:

- The decision to recommend a one-tier board of directors
- The recommendation that courts stay out of commercial and business decisionmaking as far as possible (this is the so-called business judgment rule)
- The decision to encourage self-regulation within the capital market

The committee reviewed the following documents before drafting its code:

- 1996 and 2002 drafts of Macedonian company laws
- EU directives and regulations on transparency
- The UK Winter Report
- The EU action plan for modernizing company laws and encouraging the adoption of corporate governance codes
- Recommendations from the European Corporate Governance Forum
- The OECD Principles of Corporate Governance
- The OECD South East Europe Corporate Governance White Paper
- Country studies on legal systems
- The U.S. Sarbanes-Oxley Act regulating accounting and auditing practices

BANGLADESH

A number of codes and guidelines were used as resources in the process of drafting the corporate governance code for Bangladesh. The models were selected based on their applicability to the current situation in Bangladesh and the scope of the code, which covered state-owned enterprises as well as financial institutions. Where a lack of sophistication was perceived in the Bangladesh practices, foreign codes were used to provide guidance. For example, specific provisions on the fiduciary duties of directors as well as on reporting and disclosure requirements were "borrowed" from or based on language used in other country codes.

EXAMPLES

USING INTERNATIONAL BEST PRACTICE MODELS

BRAZIL

Brazil's first code was based upon the International Comparison of Board Best Practices prepared by Gregory and Forminard, the Cadbury code, and the codes of General Motors and NACD (National Association of Corporate Directors) best practices. The second code was based upon the OECD principles. The reason why these specific models were selected was because the code committee considered such codes as benchmarks.

GERMANY

The most recent code was influenced by the UK Combined Code and the first German Code of Best Practice, adopted in 2000. The latest code was also based on German law and took into account all national regulations and practices, including corporate governance issues arising from the two-tier board system.

REPUBLIC OF KOREA

The original Korean code issued in 1999 was based upon the OECD principles. The code reflected specific conditions in Korea regarding large business groups. A second, revised code was influenced to a great extent by the U.S. Sarbanes-Oxley Act.

POLAND

Before it drafted the Polish code of best practices, the committee analyzed foreign and international sets of corporate governance standards, including OECD and NASDAQ principles and the British corporate governance codes. The OECD Principles of Corporate Governance were particularly useful as a checklist to ensure that all critical areas were addressed. In general, foreign codes were used to help:

- Identify the problem areas that could arise
- Identify the issues of importance to the investor community

The specific provisions of the Polish code were subsequently adopted to suit the local circumstances and regulatory environment.

SWITZERLAND

The Code of Best Practice for Corporate Governance was based on:

- The United Kingdom's Cadbury Report
- The UK Hampel Report
- The UK Combined Code
- The French Vienot Report
- The German Baum Commission Report

EXAMPLES

USING INTERNATIONAL BEST PRACTICE MODELS

TURKEY

The code was prepared after a detailed analysis of the OECD Principles of Corporate Governance and existing country codes. The drafters of the code "borrowed" some principles outright and revised others to adapt them to local conditions.

Turkey's code was based on the four principles of corporate governance: transparency, accountability, responsibility, and fairness. Using these principles, the committee decided to focus on the composition and functioning of the board of directors, which was considered a key component in the implementation of corporate governance principles in the context of the Turkish business environment.

ZAMBIA

The draft Code of Corporate Best Practice for Listed Companies in Zambia was influenced by the OECD Principles of Corporate Governance, South Africa's King II Report, and the Commonwealth Association of Corporate Governance Guidelines.

The committee should bear in mind that while research into existing codes and best practice is helpful, existing models still need to be adapted to fit the country's specific needs and circumstances.

Assessing the country's corporate governance framework

THINKING POINT

Does the code comply with existing laws?

Significant differences in the corporate ownership structures and legal frameworks exist between countries. While building on existing international best practice, the committee needs to be aware of these differences and avoid incorporating inappropriate governance recommendations into the new code. It is especially important that the committee review existing laws affecting corporate governance practices so that the code does not contradict existing laws. An effective code will complement the legal and regulatory environment that prevails in the country. Should the committee determine that existing laws are inappropriate or need to be changed to improve the country's corporate governance framework, it can include recommendations to amend the legal framework in a separate section or appendix to the code. (*For a discussion on the legal operating environment of codes, refer to Volume 1, Module 2; for a discussion on the role of codes in fostering legal reform, refer to Volume 1, Module 3.*)

EXAMPLES

TAILORING CODES TO THE LOCAL FRAMEWORK

THE LEGAL CONTEXT: BELGIUM

The Belgium Corporate Governance Code is seen as complementing existing Belgian legislation; no provision of the code may be interpreted as derogating from Belgian law. The crafting committee based its code of best practices on the existing Belgian corporate law, in particular the provisions of the Belgian Code on Companies, and on financial law applicable to listed companies. In developing the code, the committee also paid great attention to the European Commission's recent initiatives in the field of corporate governance, specifically those implementing the Commission's plan, adopted in 2003, for modernizing company law and enhancing corporate governance in the European Union.

CORPORATE OWNERSHIP STRUCTURES: MEXICO

The Corporate Governance Code of Mexico builds on corporate governance codes developed in Canada, England, France, the Netherlands, South Africa, and Spain. Yet in developing the Mexican code, the Bolsa de Valores, or stock exchange, was mindful that the capital structure of Mexican corporations was very different from that of the United Kingdom or the United States. In these countries corporate capital is typically fragmented and held by major institutional investors, whereas in publicly traded Mexican companies, most of the capital is held by a few controlling shareholders.

THE CULTURAL CONTEXT: SOUTH AFRICA

The two King reports recognized the cultural, religious, and ethnic diversity that exists in South Africa and explicitly took into account the "African worldview and culture in the context of governance of companies in South Africa," including values such as spiritual collectiveness, consensus, humility, nondiscrimination, trust, and optimism.

Assessing the country's corporate governance reform needs

THINKING POINT
What key issues should the code address?

In addition to researching international corporate governance best practices and reviewing the existing local legal framework, the committee must also assess its own country's specific reforms needs. The code crafting committee may already have a general idea of the country's primary corporate governance practices and reform needs—these most likely led to the original initiative to develop or review a corporate governance code of best practices. It is nevertheless essential for the committee to review possible areas for improvement in greater detail and to consult all major stakeholders to help the committee formulate the best possible recommendations. (*For a detailed discussion on stakeholder consultation, refer to Volume 2, Module 3.*)

To help draw up an initial list of needed reforms, code crafting committees in developing countries should consult any existing assessments and awareness-raising reports conducted locally or with the support of international organizations. World Bank corporate governance country assessments and the OECD regional corporate governance white papers are good places to start.

The World Bank Corporate Governance Reports on the Observance of Standards and Codes

Perhaps the leading tools for assessing a country's private sector reform needs are the "Reports on the Observance of Standards and Codes" (ROSC), launched by the International Monetary Fund and the World Bank in the wake of the financial crises of the late 1990s. The ROSC exercise aims to identify vulnerabilities and guide policy reforms in the areas of private and financial sector development. The corporate governance assessment under the ROSC program is intended to strengthen property rights, reduce transaction costs and the cost of capital, and promote equity investment and growth. The assessment is structured around the OECD corporate governance principles, using a diagnostic tool developed by the World Bank. The assessment focuses on the legal and regulatory framework and corporate governance practices. It evaluates strengths and weaknesses in different markets and provides a basis for policy dialogue on the scope and prioritization of reforms. The Corporate Governance ROSC is conducted by the World Bank in cooperation with a country's relevant ministries, agencies, and professional bodies.

Countries participate in this assessment process voluntarily. After receiving an invitation, the World Bank commissions a local consultant to complete a questionnaire, or template, mapping the country's legal and regulatory framework guiding corporate governance and collecting information on corporate governance practices. World Bank experts then typically visit a country to meet with government officials, market participants, investors, and issuers; they then draft an assessment report.

The assessment is divided into four parts: an executive summary; an overview of the country's capital market and its institutional framework; a review of corporate governance principle by principle, including policy recommendations; and a summary of recommendations highlighting areas for legislative reform, institutional strengthening, and voluntary and private initiatives. The assessments attempt to show how actual practices of market participants differ from benchmarks for compliance with the legal and regulatory framework. Thus a country's compliance with each OECD corporate governance principle is evaluated both quantitatively and qualitatively. Most countries agree to posting the results of the assessment on the World Bank website (www.worldbank.org/ifa/rosc_cg.html).

Corporate Governance Reports on the Observance of Standards and Codes have been published for the following countries or economies: Bulgaria, Chile, Colombia, Croatia, Czech Republic, Arab Republic of Egypt, Georgia, Hong Kong (China), Hungary, India, Indonesia, Jordan, Republic of Korea, Latvia, Lithuania, Malaysia, Mauritius, Mexico, Moldova, Morocco, Philippines, Panama, Peru, Poland, Slovak Republic, Slovenia, South Africa, Turkey, and Zimbabwe. (*The summary of a Corporate Governance ROSC conducted in India can be found in Annex 9*.)

The OECD Corporate Governance White Papers

In partnership with the World Bank and the International Finance Corporation and with support from various organizations including the Global Corporate Governance Forum, OECD has organized and led regional corporate governance roundtables in five regions: Asia, the Russian Federation, Latin America, Eurasia, and South East Europe. Over the last five years more than 25 meetings have taken place in 18 countries to assess corporate governance practices and build consensus on the reform agenda. Each regional roundtable has issued a white paper that can serve as a background reference for developing a country code. The regional corporate governance white papers can be downloaded from the OECD website at www.oecd.org.

The roundtables have revealed a wide range of corporate governance challenges across the five regions pertaining to enforcement, ownership and control, shareholder rights and equitable treatment, board effectiveness, the role of banks and other stakeholders, transparency, and disclosure. (*For a summary of key cross-regional findings, refer to Volume 2, Annex 10*.)

DRAFTING AND FINALIZING THE CODE

Once the basic research has been completed and any initial consultations conducted, it is time for the committee to start drafting the code.

Selecting the main drafter

Although the committee as a whole agrees on the final draft, usually a single individual drafts—or at the least coordinates the drafting—of successive versions of the code, integrating consultation feedback and comments or amendments agreed by the committee. This task is time consuming and requires a high level of commitment. The decision about who will be drafting the code has to be made at the first couple of meetings. The chairman and individual committee members may also address this question in individual meetings. In most cases the main drafter will be a committee member. Codes have been drafted by chairmen, project managers, and committee secretaries. The committee can also consider hiring an external consultant for this task. In this case the consultant must have a clear understanding of the committee's terms of reference and be given clear guidelines on the desired structure of the code and its scope and objectives. To avoid any miscommunication, the consultant should be asked to attend the committee's meetings.

Whether the primary drafter is a consultant or a member of the committee, it is important that the person be able to devote sufficient time to the task. The drafter should also have:

- A good understanding of international corporate governance issues
- A good understanding of the country's corporate governance framework and needs
- Excellent language skills and experience with drafting reports or regulations
- The ability to work under pressure and to deal with conflicting or changing requirements

Codes typically undergo at least three drafts. The first general draft of the code is most likely to be the exposure draft, or consultation document, that is circulated among stakeholders to solicit their comment. (*For further details on the exposure draft, refer to Volume 2, Module 3*.) A second draft incorporates comments gleaned from stakeholders as well as committee members. The third draft may be the final draft, although committees often refine both the content and the language at least once more before a final code is voted on.

Members of the committee should receive copies of all drafts well ahead of meetings so that they have time to read and consider the content. Often the chairman will suggest that committee meetings be reserved for discussion of important issues of principle and that detailed comments on the draft code be submitted in writing to the committee's secretary.

Style and Format

When reviewing the successive drafts of the code, the committee needs to make basic decisions regarding the format, style, and length of the code; the level of detail of best practice recommendations and provisions; and how to deal with annotations or implementation guidelines. It is always better to separate background information relative to the country's corporate governance environment from the code itself, but annotations and guidelines relative to the implementation of the code's provisions can either be integrated after each provision, as in the Belgian corporate governance code, or be compiled in a separate section entitled "annotations to the code," as is the case with the OECD Principles of Corporate Governance. When choosing to integrate notes, comments, and implementation guidelines after basic recommendations or principles, it is important to differentiate these from the rest of the text in order not to confuse users as to what should be strictly enforced and what are suggestions for implementing the code.

A corporate governance code of best practices can be structured in various ways. Typically a code contains the following elements:

- A table of contents
- A foreword, usually drafted by the chairman of the committee, outlining the conditions that led to the development of the code and acknowledging specific contributions
- An introduction setting out the terms of reference of the committee, the scope and objectives of the code and recommended implementation mechanisms, and the codes and other documents that were consulted during the drafting process

QUOTES

SEPARATING THE MAIN RECOMMENDATIONS FROM IMPLEMENTATION GUIDELINES

BELGIUM

"Principle 1. The Company shall adopt a clear governance structure
1.1. Every company should be headed by a collegial board. The company should define and disclose the board's terms of reference in its Corporate Governance Charter (hereinafter "CG Charter")

Guideline The board's role should be to pursue the long-term success of the company by providing entrepreneurial leadership and enabling risks to be assessed and managed.

Guideline The board's responsibilities should be defined in the articles of association of the company and in the terms of reference of the board. It is the board's duty to define its terms of reference detailing its responsibilities, duties, composition and operation, within the limits defined by the articles of association of the company."

—The Belgium Code on Corporate Governance, December 2004

BANGLADESH

"Financial Reporting, Auditing and Non-Financial Disclosures
IV. Internal Audit
Principles:

A. All listed companies must have an internal audit function within the organization. Private companies should consider establishing a system of internal controls if they do not have an internal audit department.
B. The internal audit department should have a broad scope of work to investigate all levels of the organization and be independent from management, with direct access to the Board of Directors and the Audit Committee.
C. Directors must take adequate action to protect the company and shareholders based on internal audit reports.

Guidelines:

D. The internal audit department should have a letter from the board or chairman of the audit committee giving it the authority to access any records in any location at any time.
E. The internal audit function should have the authority to propose initiatives and changes directly to the board."

—Code of Corporate Governance for Bangladesh, March 2004

- A summary of recommendations, so that the main thrust of the code's content can be easily understood
- The code's recommendations or provisions divided by chapters
- Annotations to the code
- Possible recommendations to improve the legal framework for corporate governance
- Appendixes listing members of the committee, background information, survey results, and the like

To ensure that the code is readily understood by its users and the public, the committee should take care that:

- The code does not become too long. If included, background information or survey results should be put in appendixes or separate sections of the code.
- Precise and simple language is always employed and that terms are defined clearly. For example the role of an independent director has been defined in many different ways. The reader must be left with no ambiguity as to how the term is being defined within the code.
- The code is not overly legalistic in style, but sets out clearly expected behavior and practices.

Once finalized the code needs to be presented in an attractive, reader-friendly format. Many committees find it useful to engage the services of a designer or publishing firm.

Integrating consultation feedback

In the code crafting process, one of the most important and challenging aspects is revising the initial draft to reflect the consultation feedback. As a result of the consultation process and resulting discussions by the committee, it is likely that many refinements will need to be made to the draft code. Some responses and suggestions will have greater validity and importance than others. In any event, all suggestions and comments must be accorded careful and serious consideration. All comments and their disposition by the committee should be carefully recorded. As much as possible the committee should acknowledge the revisions incorporated into the draft as a result of the comments made by specific stakeholders.

Balancing stakeholder feedback

Although the major objective of the consultation process is to help develop and enhance the content of the code, it is also an important political process that will help ensure buy-in from all parties and support the effective implementation of the code. Amending the draft code to reflect a certain level of compromise is thus unavoidable. Yet there are bound to be times when the views of some key stakeholders conflict with those of others. Some draft provisions may need to be modified or altered to suit the concern of certain groups, and seemingly useful recommended amendments may need to be dropped or ignored because of pressures from other groups. In such instances, the committee is usually put in a difficult position and may be seen as favoring some groups at the expense of others. To balance these conflicting positions in a fair and reasonable manner, it is important for the committee to stand by its own terms of reference. The clearer the initial objectives of the code are, the easier it will be to use them as criteria to accept or reject particular views. (*For a detailed discussion on assessing the importance and influence of stakeholders, refer to Volume 2, Module 3*.)

EXAMPLES

INTEGRATING FEEDBACK INTO THE CODE

REPUBLIC OF KOREA

Korea's code crafting committee circulated its exposure draft through the Internet and the media, and opinions were collected at a public hearing. Relevant comments were then integrated into the final draft, which was completed at a general meeting of the code crafting committee and its advisory group.

RUSSIAN FEDERATION

The consultation process in Russia resulted in several major changes to the draft code. The changes called for independent directors on boards, revised the role of the audit and other committees, improved shareholders' rights, and provided for the position of corporate secretary.

SOUTH AFRICA

More than 400 submissions were received in response to the first draft of the second King Report, including a large number from overseas. All observations were carefully reviewed and fully annotated by the applicable task teams and then submitted with recommendations to the King II code committee for final review. As a result of the responses, several significant changes were made to certain sections of the code.

EXAMPLES

RESOLVING DISAGREEMENTS: MACEDONIA

The Macedonian code crafting committee experienced significant difficulties obtaining consensus on issues associated with cumulative voting. This issue proved to be far more complex than the committee had anticipated. Important questions were asked, such as:

- Can shareholders in Macedonia be mobilized?
- Do the existing shareholders within the country understand the current system?
- Do shareholders in Macedonia want large boards?
- How effective can a single director representing minority shareholders be?

Discussing these issues with various stakeholders—especially shareholder groups—and understanding their concerns helped the committee formulate a workable consensus

THINKING POINT
Has the potential impact of each recommendation been assessed?

Another common challenge faced by code crafting committees is the strength of the code. Some stakeholders may claim that the proposed best practices are too stringent, while others may think that the code does not go far enough. A new set of conflicting pressures may therefore be placed on the committee to amend the draft code. Again, it is important for the committee to balance conflicting views in a fair and judicious manner, seeking the most appropriate compromise that is in keeping with the committee's agreed terms of reference. (*For a discussion on the committee's terms of reference, refer to Volume 2, Module 2*.)

Reliability of results

Committees may also come to question the reliability of interviews and survey results, especially if significant interest groups with predicted differences in perspectives are participating in the process. A certain amount of caution should therefore always be applied when integrating specific consultation feedback into the draft code. It is not always easy to determine whether a specific comment reflects the views of a single individual or the general opinion of the stakeholder group to which the individual belongs. This is especially true in the case of one-on-one interviews with a small number of selected individuals. Even in broader consultation exercises, committees must take care to ensure that the selected sample is representative of the surveyed group as a whole. If possible and especially if the committee wishes to make survey results public, expert advice should be sought from market researchers and statisticians to obtain representative responses. These responses can be used to support the recommendations included in the code.

EXAMPLES

RELIABILITY OF CONSULTATION RESULTS: UNITED KINGDOM

During preparation of the Higgs Report, a total of 605 telephone interviews were completed with directors of British listed companies over a five-week period in 2002. The profile of the sample was consistent with the population of directors overall. Yet, the researchers wanted to be sure that their results were statistically reliable. Reliability depends on sampling tolerances, which vary with the size of the sample and the percentage size of the results. For example, on a question where half of the 605 respondents gave the same answer, the researchers determined that the chances were 95 in 100 that this result would not vary more than 4 percentage points, plus or minus, from a complete survey of the entire population using the same procedures. The smaller the sample, the less reliable the results.

Reviewing and approving the code

Once the modifications and amendments to the code have been integrated, the code needs to be reviewed in its totality. Too often drafting committees pay insufficient attention to the way modifications affect the construction and flow of the thought processes, paragraph layout, paragraph headings, spelling of words, and the accuracy of the grammar. Mistakes creep in, which can embarrass the authors and the publishers, as well as dilute the seriousness and the professional nature of the entire document. A skilled person should be entrusted with the important task of editing the final draft for logical flow of thought as well as grammar and presentation.

Modifications can have other unintended consequences. In exceptional situations, an amended clause may effectively nullify the effect of a clause elsewhere. Hence, the entire code should be carefully reviewed to make sure that it is internally consistent and contains no contradictions. The committee should take steps to ensure:

- That every provision or best practice recommendation is valid, useful, acceptable, and desirable, based on previous discussions with any agencies that are likely to be affected by any of the governance changes being proposed.
- That the code content covers the major issues and reform needs of the country while complying with international best practice standards and investor expectations.
- That the code does not contradict existing laws and that any potential changes to the legal framework as a consequence of the code have been given consideration.
- That there are no ambiguities, contradictions, or duplications within the code and that legitimate annotations have not been treated as formal recommendations.
- That each individual recommendation is needed and contributes to enhancing the code.
- That the sense flows logically throughout the code and that all necessary cross-references have been made.

THINKING POINT

Do all committee members agree with the final version of the code?

Once the final review process is completed, the committee typically meets to formally adopt the code. Every committee member should agree to the entire content of the code. It is most likely that once the code has been launched there will be many instances—especially at events involving the media—where critical comments and questions may be raised concerning the code. In such instances, the committee will have to defend its choices and recommendations, and public disagreement among committee members about the code could have a very negative impact on the code's implementation.

Implementing and Monitoring

MODULE 5 AT A GLANCE:

The major risk a corporate governance code faces is becoming a mere window dressing for corporate governance reform. Once the code has been issued, it must be widely disseminated and adopted by the main stakeholders to increase its chances of having a real and lasting effect on corporate practices. Moreover, to be of continuing use to policymakers and corporations, corporate governance codes of best practice need to be regularly updated to reflect current international best practice and local reform needs. Before disbanding, code crafting committees should consider mechanisms for measuring the impact of the code, keeping abreast of local and international corporate governance changes and reforms, and updating the code as needed.

This module reviews:
- Launching and disseminating the code
- Adopting and implementing the code
- Measuring the impact of the code
- Updating the code

LAUNCHING AND IMPLEMENTING THE CODE

Taking steps to see that the newly drafted code of best practice is widely disseminated, adopted by its target audience, and put into practice is the last major task of the code crafting committee. Thus, after the final version of the code has been agreed on but before the code is released to the public, the committee typically makes arrangements to:

- Unveil the final draft at a public launching event
- Disseminate the code
- Ensure that the major stakeholders are ready to adopt and help implement the code

Arranging the launch and disseminating the code

The release of the code creates important momentum for corporate governance reform and provides a unique opportunity to reach out to target users. It is important that the key stakeholders formally endorse the code—and that those endorsements are well publicized. Such endorsements normally pave the way for other major stakeholders to jump on the bandwagon and affirm their commitment to following the code's recommendations. To gain maximum attention for the new code, the committee will want to arrange a public launching, where the code is formally presented and endorsed by a representative gathering of key stakeholders. These stakeholders should include government leaders, regulators, business leaders, academics, and any other organizations that may want to endorse the code publicly.

Among the logistical arrangements the committee must attend to are:

- The organization of the launch event
- The number of copies of the code to be printed
- The distribution channels to be used
- The solicitation of key stakeholders to endorse the code
- The follow-up actions to be taken to promote and popularize the code

The launch event should be carefully planned to gain maximum visibility and support for the new code. It should be held at a convenient time for attendees in a location that is easy to reach. It may be useful to organize the event at the premises of one of the key stakeholders involved in the crafting process and or essential to the code's implementation, such as a stock exchange. Sufficient notice of the launch event should be provided. Key stakeholders should be invited well in advance and given complimentary copies of the code before the event. The overall time allocated to presentations should not exceed two hours. Enough time should be allowed for the committee to present an overview of the key features of the code as well as to formally announce the endorsement by key stakeholders. The committee may want to introduce these stakeholders and invite them to say a few words about why the code is important and how it could be implemented.

To advertise the code to the broadest constituency, the committee should invite the media to the launch event, give journalists copies of the code, and provide them with an explanation of its content. The support of the media and its positive feedback on the code can prove very helpful in raising further awareness and ultimately implementing the code. (*For a discussion on relations with the media, refer to Volume 2, Module 3*.)

EXAMPLES

LAUNCHING THE CODE

SOUTH AFRICA

Widespread notification of the publication of the King II Code was circulated both locally and in the international media. The code was publicly launched in Johannesburg at a conference where the various elements of the King II Code and its implications were discussed. More than 700 people attended this conference. The King II Code was subsequently endorsed and adopted by a wide range of organizations and institutions, including the Johannesburg Stock Exchange, the government sector, and all relevant public institutions.

BRAZIL

The code developed by the Brazilian Institute of Corporate Governance (IBGC) was launched at the São Paulo Stock Exchange, where it was well received. Several companies and institutions had already agreed to adopt the code. Furthermore, the first and second editions of the code were extensively used in setting up the Novo Mercado, a special segment of the stock exchange designed for companies that voluntarily undertake corporate governance commitments that are in addition to those established in current legislation.

RUSSIAN FEDERATION

The Russian Institute of Directors, the Association of Independent Directors, and the Investor Protection Association played a significant role in supporting the code at the launch event. The code was subsequently endorsed by the Russian securities commission.

The publication of the code can be a costly operation, and paper copies need to be widely but wisely disseminated. The committee and the lead organization must decide whether printed as well as electronic copies of the code are to be distributed free of charge and arrange such distribution channels in advance.

Typically codes of best practice are considered public information that should be made freely available to all target users. In some cases, however, such as in South Africa, the code crafters consider that the code contains valuable intellectual property and that a charge should be made for it. In any case the committee needs to have planned for printing expenditures in its budget and arranged for the up-front financing well in advance.

EXAMPLES

DISSEMINATING THE CODE

POLAND

The Corporate Governance Code for Polish Listed Companies (PFCG) was released in both print and electronic versions. Copies of the printed code were distributed at the launching conference and were also mailed to relevant institutions and market participants free of charge. A weekly economic magazine published a series of articles presenting the code's principles and recommendations. The code was also included as an attachment in a white paper on corporate governance in Poland and distributed to many institutions and individuals.

RUSSIAN FEDERATION

The code was distributed to its target users through the Russian securities commission and its regional affiliates and posted on various websites.

BRAZIL

The Brazilian Institute of Corporate Governance published 6,000 copies of the first edition of its code and 10,000 copies of the second expanded edition. Another 3,000 copies of the code were printed in English. Copies of the code were sent to all directors of Brazilian listed companies and distributed during training programs, seminars, and monthly events. The code is also available on various websites.

Because the new code may also be consulted by potential international investors and could help create incentives for new investments, the committee should also consider having its code translated into English. Furthermore, an English version of the code can become a useful consulting tool for any other foreign committee engaging in developing a code.

Implementing the code

Once a code has been publicly launched, the committee's attention necessarily shifts from developing the content of the code to implementing and enforcing its main recommendations.

The effective implementation of corporate governance best practice recommendations typically depends on how fully the following factors come into play:

- *Substance*. Is the code supported by all major stakeholders? In other words, is it generally recognized that the code presents commonly accepted best standards?
- *Common sense*. Do companies recognize that these best practice recommendations will improve their access to capital and enhance their performance?
- *Market pressure*. Are shareholders, institutional investors, banks, and other providers of capital encouraging companies to follow the code's best practice recommendations?
- *Legal backing*. Are recommendations of the code being incorporated in regulations or listing requirements?
- *Enforcement*. Are recommendations of the code being monitored or enforced by market regulators?

The important question of implementing the code and how some of its provisions or recommendations should be enforced should be discussed during the crafting process. As in the case of the Corporate Governance Code for Bangladesh, the code itself can provide useful indications as to how the code could be implemented. The code can also more explicitly suggest, as in the case of the German corporate governance code, which provisions could be made mandatory and which ones should remain best practice recommendations that not all companies may be expected to follow right away.

QUOTE

RECOMMENDATIONS FOR IMPLEMENTATION

"Individual organizations can comply with the code by writing the provisions into their Articles of Association and incorporating the code into company procedures and reporting practices. . . . The most effective regulatory step to implement the Code of Corporate Governance could be its adoption by the Securities and Exchange Commission. Such a step could begin with a "comply or explain" phase, which requires an organization to comply with the code's provisions, but if there are aspects in which the organization does not comply, the reason for such noncompliance must be explained. As has been the case in many other countries, the code could also be incorporated into the listing requirements of the Dhaka and the Chittagong Stock Exchanges. A complementary requirement would be compulsory director training for the board of directors of all listed companies. . . . However, the first step can and should be the initiative of corporations and organizations themselves, through the implementation of this code. . . ."

—Code of Corporate Governance for Bangladesh

Since most codes are targeted mainly at listed companies, securities commissions and stock exchanges have taken the lead in implementing corporate governance codes and reports in most countries. Implementation has taken two basic forms: Either provisions of the code are made mandatory through regulations and listing rules, or companies are given the option of complying with the code or explaining and disclosing why they did not. (*For a discussion on the comply-or-explain mechanism refer to Volume 1, Module 2*.)

When making certain provisions of the code mandatory through regulations and listing rules, care should be given that these provisions can be enforced by the regulating agency and that target companies are able to follow the new rules without the cost of compliance being too high. In many cases, it is not always clear how compliance is monitored and enforced. Enforcement can include the option of delisting, which is often implied but rarely made explicit.

Securities commissions and stock exchanges are not the only organizations to play a key role in monitoring and implementing corporate governance best practices. Other organizations such as central banks, professional organizations, and specific agencies, such as the United Kingdom Financial Reporting Council, can also take the lead in helping raise corporate governance standards and improve practices.

EXAMPLES

IMPLEMENTING THE CODE

INDIA

Corporate Governance changes in India have been driven by the Securities and Exchange Board of India (SEBI). The recommendations made by the Kumar Mangalam Birla Committee were accepted by the SEBI, which made all of the key recommendations mandatory. The recommendations now apply to all listed companies and are enforced by the stock exchanges through listing agreements.

SOUTH AFRICA

In principle, the King II Code operates on a comply-or-explain disclosure regime, and all companies are required to disclose the extent of their compliance. However, certain clauses of the code are now in the process of being selectively adopted within regulatory supervision measures or legislation. Legislation and accompanying regulations relating to banks, insurance companies, and other financial institutions have already incorporated some clauses from the King II Code.

Since March 2003 all companies listed on the Johannesburg Stock Exchange (JSE) have been required to provide a detailed explanation of their compliance with the recommendations of the King II Code and to provide reasons where they do not comply (or an indication of any aspects with which they intend to comply in due course and the timing). The JSE is currently revising its listing rules, however, and is expected to make some of the recommendations set out in the King II Code mandatory.

A detailed Protocol on Corporate Governance in the Public Sector has also been approved by the cabinet but has not yet been fully implemented. Its application and enforcement is expected to be under the supervision of the country's auditor-general, with explanatory guidelines to be issued by the Treasury.

THINKING POINT
Who will be monitoring implementation of the code and its impact?

When several bodies are involved in monitoring and implementing corporate governance best practices, it is important to ensure clarity and coherence of roles of the various agencies involved. In particular the responsibility boundaries between different institutions are likely to need delineation. In the field of disclosure for example, various aspects regarding auditing practices can be regulated by the both the profession and the stock exchange. Care must be taken that the monitoring activities of the two groups do not overlap or conflict with each other.

Because of the number and complexity of corporate governance codes and reports issued in the United Kingdom, a framework and infrastructure for developing, monitoring, and reviewing the corporate governance system has been developed. This framework could also be considered by other countries. (*For a description of this framework, refer to Volume 2, Annex 11*.)

REVIEWING AND UPDATING THE CODE

If they are to fully serve their purpose over the long run, corporate governance codes of best practice need to be reviewed and updated on a regular basis to reflect:

- Evolving standards of best practice
- Changes in the country's corporate governance framework and practices
- Improvements in the quality and the impact of the code

Keeping the code current

Codes can become obsolete in a comparatively short period of time. Since the early 1990s international financial markets have grown stronger as well as more competitive, and financial instruments have become more complex and sophisticated. These important trends have heightened awareness among policymakers of the need to continually monitor and update corporate governance structures and the requirements for improved transparency and disclosure. The recent review of and modifications to the OECD Principles of Corporate Governance are a perfect example of how international standards can evolve over a relatively limited time. (*For a summary of the most significant modifications made to the original OECD principles, refer to Volume 2, Annex 12*.)

EXAMPLE

REVIEW OF THE REVISED COMBINED CODE

UNITED KINGDOM

The Financial Reporting Council (FRC) has announced that the Revised Combined Code (2003) will be reviewed regularly to make sure that it is working effectively and to identify whether any amendment is necessary. The FRC has said it also recognizes the value of stability, and there is no presumption that each review will lead to changes. In 2004 it was announced that the first review would take place in the second half of 2005. If any changes are proposed, the FRC has made a commitment to conduct a public consultation.

Most crafting committees have therefore taken care to set out in the introduction to the code the need to revise its content on a regular basis. Some codes specify a time frame, whereas others consider that circumstances should trigger the necessary update. The advantages of setting a time frame for the review are twofold: it saves time on discussing whether or not the code needs to be reviewed, and it helps committees ensure that a follow-up and monitoring structure is put in place. Reviewing the code does not mean that the code will necessarily be revised, but it does ensure that the code will not become outdated and that its implementation is properly monitored.

QUOTE

PROVIDING FOR THE UPDATE OF CODES

BRAZIL

"It should be noted that CVM [Comissão de Valores Mobiliários] views corporate governance as a dynamic process rather than a fixed set of measures. This code will be updated annually in line with changes in regulation and in the Brazilian and international markets."

—CVM Recommendations on Corporate Governance, June 2002

QUOTES

PROVIDING FOR THE UPDATE OF CODES

REPUBLIC OF KOREA

"The Committee. . .admits that this code may have shortcomings stemming largely from the short preparatory period allotted of six months. Also, the Code of Best Practice is evolutionary in nature and should be reviewed in light of changes in circumstances."

—Jae-Chul Kim, Code of Best Practice for Corporate Governance, September 1999

BELGIUM

"The Committee believes that the Code should lend itself to revisions in the future in order to take account of the experience gained and the changes in legal and business practices. Therefore, the Committee will endeavor to have proper follow-up in place."

—Maurice Lippens, The Belgium Code on Corporate Governance, December 2004

GERMANY

"As a rule the Code will be reviewed annually against the background of national and international developments and be adjusted, if necessary."

—German Corporate Governance Code, May 2003

Permanent corporate governance committees

It is important to identify, designate, or set up an entity responsible for keeping abreast of corporate governance international and local changes, assessing the code's impact, and keeping it up to date. In some countries, code crafting committees have transformed themselves into standing commissions. In other cases the task of evaluating the impact of the code and monitoring corporate governance practices has been taken over by the main implementing agency such as the stock exchange. Examples are given on pages 76 and 77.

EXAMPLES

SETTING UP PERMANENT MONITORING STRUCTURES

CANADA

In 1994 the Toronto Stock Exchange issued guidelines for improved corporate governance known as the Dey Report. In the report the exchange recommended that "a successor committee. . . monitor developments in corporate governance and evaluate the continued relevance of our recommendations."

DENMARK

It seemed natural for the Copenhagen Stock Exchange to continue the Nørby Committee's work. The Copenhagen Stock Exchange Committee on Corporate Governance was formed to ensure the continued development of a management culture and management structures in listed companies. The composition of the committee was essential—not least because the stock exchange recognized the wisdom of adapting the recommendations to changing situations. The Copenhagen Stock Exchange's supervisory board charged the committee with the following terms of reference:

- To monitor the development of corporate governance in the interaction between company managements, shareholders, and other stakeholders
- To monitor the development of the requirements generally governing corporate governance
- To collect the companies' views and experience on implementing the Nørby Committee's recommendations
- To assess the need for revising the Nørby Committee's recommendations for corporate governance

GERMANY

The government commission that drafted the code of corporate best practices has acted as a permanent standing commission since the publication of the code in February 2002. The commission reviews the code regularly (at least annually), taking assessments of its impact into consideration.

REPUBLIC OF KOREA

After the original code was completed, the Korean Stock Exchange set up a Korea Corporate Governance Center in 2001. The center oversees issues related to the code so that it can be revised when necessary.

POLAND

The Polish Forum for Corporate Governance has been developing a publicly available rating system as a tool for monitoring the implementation of its corporate governance code. Such monitoring should also allow for the periodic review of the code provisions.

EXAMPLES

SETTING UP PERMANENT MONITORING STRUCTURES

TURKEY

The committee that developed the code was also entrusted with the task of assessing its impact and revising the code as needed.

SRI LANKA

The Committee on Corporate Governance of the Institute of Chartered Accountants in Sri Lanka (ICASL) retained a standing committee of the ICASL for several years after the first code was issued in 1997. In 2002 a Code of Best Practice on Audit Committees was issued, and a revised Code of Corporate Governance was issued in 2003.

Measuring the impact of the code

Before undertaking any revisions to a code of best practices, it is essential to measure the impact of the current code and analyze its shortcomings. Measuring the direct impact of a corporate governance code of best practices is not always easy. Nor is it easy to determine which improvements in corporate governance are attributable to the existing code and which to other reform efforts. The following criteria have been used to assess the overall impact of codes.

Numbers of references to the code in the media

THINKING POINT
What criteria would you use to measure the impact of your code?

Some countries have adapted methods of evaluating advertising effectiveness and used criteria such as the number of media references and the number of articles devoted to the code. The data and information acquired may not be comprehensive since it is unlikely that all media comment will be identified. Also the financial reports, TV business news, business stories, stock exchange publications, and other similar literature may not all be positive, and so the monitoring body may need to distinguish between positive and negative comment.

Number of official endorsements of the code

One of the main objectives of corporate governance codes of best practice is to create consensus on a reform agenda and to persuade all major stakeholders to

EXAMPLE

MEASURING THE NUMBER OF OFFICIAL ENDORSEMENTS: SWITZERLAND

The Code of Best Practice on Corporate Governance was endorsed by the:

- Swiss Association of Pension Funds (ASIP)
- Association of Private Limited Companies
- Confederation of Swiss Employees
- Swiss Investment Foundation for Sustainable Development (ETHOS)
- Federation of Swiss Industrial Holding Companies
- Swiss Society of Chemical Industries
- Umbrella organization for small and medium enterprises (SGV)
- Swiss Banking Association
- Swiss Institute of Certified Accountants and Tax Consultants
- Swiss Insurance Association
- Swiss Retail Federation
- Swiss Society of Financial Analysts and Portfolio Managers (SSFP)

agree on a set of best practices. Some committees have therefore measured the success of the code by counting the number of target stakeholders that have publicly endorsed it.

Impact on overall corporate practices.

Surveys and country corporate governance assessments can measure changes in corporate practices resulting from the new code. An indirect measure might be the changes made to company by-laws. A more direct measure would count improvements related to board structures and practices, the disclosures of information, shareholder voting policies, and the like.

Impact on the corporate governance legal and regulatory framework

Some countries have used codes as a way to foster corporate governance reforms and to test the ground for developing new laws and regulations. The success of the code can therefore be assessed by measuring how quickly and to what extent new legislation is introduced and the overall corporate governance framework improved.

EXAMPLE

MEASURING THE IMPACT ON THE CORPORATE GOVERNANCE FRAMEWORK: SOUTH AFRICA

Philippe Armstrong, the main convener of the King II committee has identified several effects the committee's report has had on corporate governance activity in South Africa.

- **The Johannesburg Stock Exchange revised its listing rules and increased the mandatory provisions.**
- **The Banks Act and regulations were revised.**
- **Insider trading and other financial markets statutes were introduced.**
- **A Register of Delinquent Directors was established.**
- **Legal backing for the accounting standards was provided.**
- **A review of corporate law was proposed.**
- **Protocols for state-owned enterprises and national Treasury regulations were introduced.**

More recently, the government introduced the Municipal Finance Management Act placing extensive governance obligations on officials and executives associated with municipal financial administration. This proposal has provided a clear signal from policymakers that corporate governance is identified as a matter of national significance.

Impact of specific chapters of the code

Some committees or monitoring entities may also want to get a better understanding of which aspects of the code have had a greater impact. This may help focus attention on areas where improvements are more difficult to implement.

Level of compliance of listed companies.

Stock exchanges can be asked to provide information or assess the general compliance of companies with new listing rules based on the code. If a comply-or-explain mechanism has been introduced with the code, the stock exchange should also assess whether companies actually do disclose if they are in compliance with the code's recommendations and effectively explain their reasons for not complying.

EXAMPLES

MEASURING THE LEVEL OF CORPORATE COMPLIANCE

GERMANY

Gerhard Cromme, the chairman of the German Code Commission, reported that out of 72 recommendations, about 95 percent are followed by all DAX enterprises. Twenty-two of the DAX-30 enterprises report full compliance, with only one disclosed exception. Among the blue-chip DAX-30 companies, only 16 exceptions were disclosed.

For M-DAX enterprises, compliance is only half as good as for the DAX-30 enterprises. One sticking point was a modification to the code made in 2004: companies broadly resisted individualized disclosure of board member remuneration.

CANADA

A study was commissioned to evaluate the impact of the Dey Report five years after its publication. The objective of the research was to assess the extent to which corporate governance of public companies reflects the Toronto Stock Exchange (TSE) guidelines and to identify opportunities for the TSE and the Institute of Corporate Directors (ICD) to support sound practices. Chief executive officers from 1,250 TSE listed companies were invited to participate, and 635 replied. That response rate of approximately 51 percent was two or three times the national response rate for participation in business surveys.

The survey found that progress had been made toward implementing all TSE guidelines. Fully 95 percent of the CEOs said that the size of their board was suitable for individual accountability. However, only 18 percent had written up descriptions of the directors' position or installed a process for assessing board effectiveness. The CEOs' attitudes to the TSE guidelines ranged from enthusiasm to skepticism. Most respondents believed that:

- There was too much emphasis on and formalization of corporate governance
- The temptation for more regulation of governance should be avoided
- The TSE should use moral suasion to improve corporate governance
- The guidelines did not always make sense for smaller companies

Respondents felt that the compensation structure for directors was satisfactory, but few saw the need to have a formal process for evaluating the effectiveness of directors.

Areas where CEOs thought additional guidelines might be helpful included diversification of boards with respect to gender and race, preparing boards to deal with the internationalization of markets, and preventing long-standing boards from perpetuating their own entrenched weaknesses in the absence of any catalyst for change.

EXAMPLE

MEASURING THE IMPACT OF SPECIFIC RECOMMENDATIONS: SOUTH AFRICA

To measure the actual impact of specific aspects of the King 2 report, CLSA Emerging Markets developed a framework based on the key seven characteristics of good corporate governance established in the report: discipline, transparency, independence, accountability, responsibility, fairness, and social responsibility.

The impact of a code can be evaluated using these characteristics in the following manner:

	HIGH IMPACT	MEDIUM IMPACT	LOW IMPACT	NO IMPACT
Discipline				
Transparency				
Independence				
Accountability				
Responsibility				
Fairness				
Social responsibility				

Dealing with unsatisfactory results

The initial results of survey and studies measuring the impact of codes can sometimes be misleading. In some cases key findings can even be negative. When critics arise, they often fall into two opposite categories. In the first case the code is described as being too weak and not having sufficient impact on corporate practices and the reform agenda. In the second case codes are considered to be too prescriptive. Whether it is because of market pressure or regulatory requirements, companies complain that compliance is too burdensome and costly.

EXAMPLES

UNSATISFACTORY RESULTS

MISSTATEMENTS OF COMPLIANCE: SRI LANKA

In Sri Lanka many companies state in their annual reports that they are complying with a wide variety of corporate governance practices. It is common knowledge, however, that many companies do not follow the corporate governance practices even though they say they do. An empirical study conducted by a firm of consultants in September 2002 confirmed the common knowledge. The study found that many claims that companies were following the corporate governance guidelines were grossly exaggerated or largely unsubstantiated.

BOX TICKING EXERCISE: UNITED KINGDOM

In October 2004 the Association of Chartered Certified Accountants (ACCA) published a survey it conducted on the impact of corporate governance rules and recommendations in the United Kingdom. Many board chairmen and company finance directors believed that the rules were having a negative impact upon competitiveness. Almost three-fourths of the top directors believed that compliance was taking up time that could more usefully be spent on improving the company. The ACCA concluded that "the new code appears to be a box ticking exercise instead of making a real difference." Directors placed "satisfying the needs of the regulator" ahead of monitoring internal controls, managing risk, and improving the strategy and operations of the business.

INSUFFICIENT COMPLIANCE: THE NETHERLANDS

A study entitled "Corporate Governance in the Netherlands 2002: The Present Position" revealed that fewer than half of the listed companies complied with the comply-or-explain principle. The present corporate governance committee therefore recommended to the legislature that the comply-or-explain mechanism for listed companies should be given a statutory basis in the Civil Code.

To learn from and build on dissatisfaction with features of the existing code, monitoring committees need to review both the relevance of the content of the code and how the crafting process was conducted. Reviewing the notes, evaluations, and reports produced by the initial code crafting committee can lead to a better understanding of what might have gone wrong or been overlooked. In many cases the crafting committee may not have devoted enough time to the consultation process, and some essential stakeholders may have been neglected. In other cases, the committee may have made so many compromises in order to secure the support of a wide range of stakeholders that the content of the code may have been diluted. Alternatively, the code may be too ambitious and require companies to take on more than they are willing to do or are able to afford. Or the code may have recommended inappropriate implementation and enforcement mechanisms, even though the same mechanisms may have worked perfectly well in another country or context.

THINKING POINT

Has a time frame been set to review and update the code?

A code of best practice may not have its intended effect for any number of reasons. A committee that is assessing the impact of a code and looking for ways to improve it may find the following questions helpful:

- Were the committee's terms of reference clearly defined?
- Did the committee function well and were the right stakeholders represented?
- Did the code raise undue expectations?
- Was the right expertise sought?
- Were the country's current practices and reform needs well assessed?
- Were the models for the code well selected?
- Were any major issues left out of the code?
- Was sufficient time devoted to the consultation process?
- Were the perceptions and concerns of major stakeholders well understood?
- Was the impact of the code's provisions well assessed?
- Did the final code complement and enhance the existing corporate governance framework?
- Was the code set out in a clear, unambiguous, and reader-friendly format?
- Was the code properly disseminated and promoted?
- Did the code receive the required support?

When assessing the code's impact and shortcomings, it is also important to remember that codes of best practice are part of a more general corporate governance framework. As important a role as they play in fostering reforms and improving corporate governance practice, codes of best practice can only fulfill the purpose for which they are intended. They cannot reform an entire country's business practices overnight.

ANNEXES

ANNEX 1. SAMPLE TASKS FOR A CONSULTANT CONTRACT

Following is a description of the key tasks included in the terms of reference for a consultant providing technical support to a code crafting committee in Sri Lanka:

Key Tasks

The advice and inputs expected from the Consultant engaged to provide technical support to develop a Code would be as follows:

- Advise the Code Crafting Committee on the present state-of-the-art internationally accepted Corporate Governance Principles and make recommendations as to which principles should be included in the host country's proposed Code.
- Assist in the preparation of the budget for the Code crafting process and assist the Committee to identify and access financing and/or funding sources, if necessary.
- Advise the Committee as to whether a suitable Code presently applicable in another part of the world or an internationally recognized set of principles such as the OECD Principles, could be used by the Committee as a basic guideline, and if so, decide upon the parameters for the "borrowing" and adapting of the principles.
- Advise the Committee as to how the proposed Code covers the major issues confronting the host country while responding to major international issues as well.
- Advise the Committee on planning the consultation process and hold discussions with the key stakeholders prior to the preparation of the Consultative document.
- Advise the Committee on how to draft and circulate a questionnaire to obtain the views of business, professional, and other stakeholders so that the survey results can become the foundation on which the proposed Code will be constructed.
- Advise the Committee on how to organize and co-ordinate a sufficient number of workshops to obtain responses, views, and comments.
- Advise the Committee on developing and maintaining an effective system of documentation
- Once responses from the consultation have been received, assist the Committee in considering the views, responses, and suggestions made by different stakeholder groups and advise the Committee on the relevance and validity of such submissions. Thereafter, provide professional inputs to enable the Committee to consider whether any modifications are required and if so, assist the Committee in making amendments.
- Advise the Committee on any legal recommendations, Stock Exchange or [regulatory] implications, and any other type of institutional or investor support, etc.
- Advise the Committee on suitable mechanisms to ensure that target companies disclose their compliance with the proposed Code as well as explain the methods by which they have implemented the provisions of the proposed Code.
- At the final draft stage of the proposed Code, critically assess every clause of the proposed Code to ascertain…whether each recommendation contained in the Code would contribute towards improving the corporate governance practices in the country and provide the Committee with brief comments on the effectiveness of each clause.
- Advise the Committee as to how the proposed Code could be enforced among different stakeholders.
- Assist the Committee to convene the "public" events to release the Code and to explain the provisions of the Code to stakeholders.
- Undertake any other matters that the Committee may entrust to the Consultant, and to advise the Committee as and when the Committee seeks the views and/or advice from the Consultant.

ANNEX 2. SAMPLE ENGAGEMENT LETTER FOR A CONSULTANT

Following is a sample letter, from Sri Lanka , for engaging a consultant to support the work of the code crafting committee:

…………………………………………………………
(*give name and address of consultant*)
………………………………………………………..

Dear…………….(give name of consultant)

Consultancy assignment re: developing a Code of Best Practice on Corporate Governance

On [date], upon the recommendation of ………………….., you have been appointed as ....[title]. I am writing to set out the terms of your appointment.

It is agreed that this is a contract for services and is not a contract of employment.

You will be responsible to the Corporate Governance Code Crafting Committee set up under the auspices of [state the name of the group/organization initiating the Code Development Process] and you will be expected to function and discharge your services in accordance with the agreed time table to be developed in consultation with the Chairman and the Committee.

Appointment
Your appointment will be for a term of ……… months commencing on [date], unless otherwise terminated earlier by and at the discretion of either party upon [one month's] written notice.

Time commitment
We require you to attend all meetings of the Committee which will be on a monthly basis, and we expect you to provide advice to the Committee expeditiously in order to ensure that the Code Crafting exercise is completed within a period not exceeding X months from the date of commencement of this assignment. The completion of the Code crafting exercise will be marked by the release of the Code.

Fees
You will be paid a total fee of ……………., which would be settled in stages, as follows:

At the time of:		
Commencement of assignment (10%)	…………………	
The Consultative document being ready for issue to Stakeholders (50%)	…………………	
The Code being published (40%)	…………………	
Total		========

Outside interests
In the event that you become aware of any potential conflicts of interest, these should be disclosed to the chairman and secretary as soon as apparent.

Confidentiality
All information acquired during your appointment is confidential and should not be released, either during your appointment or following termination (by whatever means), to third parties without prior clearance from the chairman.

We look forward to your close co-operation towards the crafting of our country's Code of Best Practice on Corporate Governance.

Thanking you,
Yours sincerely,

Chairman
Corporate Governance Code Crafting Committee

ANNEX 3. EVALUATING THE COMMITTEE'S PERFORMANCE

Following are some of the questions that have been used in the United Kingdom by chairmen to help them in evaluating the performance of their committee:

- How well has the committee been performing against the performance objectives that have been set?
- Is the composition of the committee appropriate, with the right mix of knowledge and skills to maximize performance?
- Are relationships inside and outside the committee working effectively?
- Has the committee responded to any problems or crises that have emerged, and could or should these have been foreseen?
- Are the terms of reference for the committee the right ones?
- How well does the committee communicate with the secretariat and the project manager?
- Is the committee up to date with the latest developments in corporate governance?
- Are relationships and communications with key stakeholders managed effectively?
- Are the processes for setting the agenda effective? Do they enable committee members to raise issues and concerns?
- Is the project manager being used appropriately and to maximum value?
- How well prepared and informed are the committee members?
- Do committee members demonstrate a willingness to devote time and effort to understand the issues and a readiness to participate in events outside the meetings, such as forums, conferences, and workshops?
- What has been the value and quality of contribution of the various committee members at meetings?
- How effective and successful are their relationships with fellow committee members, the project manager, and the secretariat?
- Does the performance and behavior of each committee member engender mutual trust and respect within the committee?
- How well do the committee members communicate with key stakeholders?
- Are the committee members able to present their views convincingly yet diplomatically, and do they listen and take on board the views of others?
- Is appropriate, timely information of the right length and quality provided to the committee?
- Is the secretariat responsive to requests for clarification and amplification?
- Does the committee provide useful feedback to the project manager on its requirements?

ANNEX 4. SAMPLE LETTER FOR TELEPHONE INTERVIEW

Following is an example of a letter sent to individuals to be interviewed by telephone. The letter was used by the Higgs Committee in the United Kingdom for a survey it conducted in 2002.

Salutation

You may know that the Chancellor, Gordon Brown, and Secretary of State for Trade and Industry, Patricia Hewitt, have asked me to conduct an independent review of the role and effectiveness of non executive directors.

I attach great importance to building a detailed understanding of the role of the director through primary research. I have therefore asked MORI to conduct, on my behalf, a survey to collect views from a representative cross section of non executive directors active in corporate governance today. I regard this research as crucial to the Review. I therefore very much hope that you will be able to contribute and find time to speak with MORI.

The research will be in the form of a telephone interview, which should take no longer than 10 to 15 minutes to complete, conducted at a time convenient to you. One of the MORI team will be in touch with you shortly regarding your participation. As with all MORI studies, this survey will be conducted in accordance with the Market Research Society Code of Conduct. **This ensures that all answers and comments are confidential and non attributable.**

Thank you in anticipation for your contribution to this works. If you have any queries please contact [give name] from the MORI team on [telephone number].

Yours sincerely

Derek Higgs, Non Executive Directors Review
Robert M Worcester, MORI Chairman

ANNEX 5. SPECIMEN LETTER OF APPRECIATION

Following is an example, from Sri Lanka, of a letter of appreciation to be sent by the chairman of the code crafting committee to participants at consultation events.

Dear [*give name*],

CONSULTATIVE FORUM ON CORPORATE GOVERNANCE

We write to express our sincere appreciation of your active participation at the above forum held on (*give date*). Your participation was a source of great encouragement and assistance to us in our effort to formulate the Code of Best Practice on Corporate Governance and we value your contribution very much.

Our Committee will be taking serious note of all representations made and views expressed at these seminars/workshops as well as of other submissions made directly to us. Our endeavor to craft the Code of Best Practice on Corporate Governance over the next few weeks will benefit immensely by such inputs and the fruits of our combined efforts will certainly be of significance to the capital market development initiative in our country.

We look forward to your continued co-operation and support in the future, and assure you of our highest consideration at all times.

Thanking you,
Yours sincerely,

Chairman
Corporate Governance Committee

ANNEX 6. SAMPLE PRESS RELEASE

Following is an example of a press release on the work of the Copenhagen Stock Exchange Committee on Corporate Governance.

KØBENHAVNS FONDSBØRS
COPENHAGEN STOCK EXCHANGE

PRESS RELEASE

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10 June 2004

Copenhagen Stock Exchange Committee on Corporate Governance to continue its work

The supervisory board has asked the Committee to complete a set of recommendations suitable for the 'comply or explain' principle.

The Copenhagen Stock Exchange Committee on Corporate Governance has received a large number of comments in response to its report published in January 2004. The Committee has evaluated the comments and will complete the consultation process by publishing its conclusion.

However, corporate governance is developing rapidly. Hence, the European Commission is likely to present two recommendations next autumn which, among other innovations, are set to introduce the 'comply or explain' principle.

Against this background, the supervisory board of the Copenhagen Stock Exchange has requested the Committee to continue its work to complete a proposal for revised recommendations that, in the eyes of the Committee, will be suitable for application according to the 'comply or explain' principle. The proposal for revised recommendations will be submitted for consultation beforehand.

The Committee has undertaken to assume this work and expects to complete it in late 2004.

The comments received in response to the report of January 2004 and their conclusion are available at www.cse.dk and www.corporategovernance.dk.

The Copenhagen Stock Exchange has decided that the conclusion of the consultation process in the spring of 2004 shall not form part of its disclosure requirements for issuers of shares. This being the case, only the

NOREX

CVR no. 19 04 26 77
Giro no. 4 02 70 00

ANNEX 6. SAMPLE PRESS RELEASE (CONT.)

KØBENHAVNS FONDSBØRS
COPENHAGEN STOCK EXCHANGE

recommendations following from the Nørby Committee's report from 2001 are covered by the Copenhagen Stock Exchange's recommendation.

President and CEO Hans-Ole Jochumsen says: *"For many years, the Copenhagen Stock Exchange has strived to ensure best practice in the Danish equity market to attract more investors to the market. It is therefore vital that Denmark sends a message signalling that we consider the debate on corporate governance a top priority. The 'comply or explain' principle is already widespread in the EU Member States, making it an obvious road for us to take. The 'comply or explain' principle is preferable to the introduction of corporate governance structures in legislation since the 'comply or explain' principle allows the companies to do as they please as long as they explain the background to their actions."*

Chairman of the Committee Lars Nørby Johansen adds: *"The Committees is of the opinion that the process implemented by the Committee with the report of January 2004 and the subsequent consultation process have been crucial to the Danish debate on corporate governance. The report and the consultation process have enabled us to follow up the viewpoints that have emerged since the first report from the end of 2001. In light of the Copenhagen Stock Exchange's preparation to introduce the 'comply or explain' principle, we will now consider the recommendations, meaning that we will be able to make our proposal for a set of recommendations, which, in our opinion, will work under this principle."*

The Committee's members include:

Lars Nørby Johansen, Chairman (President & CEO of Group 4 Falck A/S), Mads Øvlisen (Chairman of the Board of Directors of e.g. Novo Nordisk A/S), Sten Scheibye (CEO of Coloplast A/S), Peter Ravn (Managing Director of SimCorp A/S), Henrik Stenbjerre (attorney-at-law and partner of Kromann Reumert), Finn L. Meyer (state-authorised public accountant and senior partner of KPMG) and Lars Rohde (CEO of the Danish Labour Market Supplementary Pension Fund).

For further information please contact:
Hans-Ole Jochumsen, President and CEO, tel. +45 33 93 33 66 or
Lars Nørby Johansen, Chairman of the Committee, tel. +45 33 15 83 20

NOREX

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ANNEX 7. U.K. CODE OF PRACTICE ON CONSULTATION

Following are extracts from the United Kingdom's Code of Practice on Consultation (Crown copyright 2004). Although the six consultation criteria in this code apply to public consultations for developing policy by officials in the British government, they provide a useful framework for consideration by committees when developing a corporate governance code of best practice.

CRITERION 1

1. Consult widely throughout the process, allowing a minimum of 12 weeks for written consultation at least once during the development [of the corporate governance code]

1.1 Consultation is a continuous process that needs to be started early in the [code] development process.

1.2 It is important to identify proactively relevant interested parties and those whom the [corporate governance code] will be likely to affect. These groups should be contacted and engaged in discussions as early as possible in the [code] development process.

1.3 Informal consultation with these stakeholders should be conducted prior to the written consultation period. Not only does this lead to a more informed consultation exercise but it also ensures that stakeholders are engaged early and have a better understanding of the [corporate governance code].

1.4 The formal consultation period should always include a written consultation exercise. This written consultation period should be a minimum of 12 weeks. [Crafting committees] should consider the specific circumstances of their stakeholders and consider longer consultation periods at certain times, for example during the summer holiday period.…

1.6 Where a consultation takes place over a holiday period or lasts less then 12 weeks, extra effort should be made to ensure that the consultation is still effective, by supplementing the written exercise with other methods of consultation.…

1.8 … It is important to engage proactively with individuals [and] organizations … Written consultation is not the only or even always the most effective means of consultation. Other forms of consultation may help this process. These might include:

- Stakeholder meetings;
- Public meetings;
- Web forum;
- Public surveys;
- Focus groups;
- Regional events; and
- Targeted leaflet campaigns.

ANNEX 7. U.K. CODE OF PRACTICE ON CONSULTATION (CONT.)

CRITERION 2

2. Be clear about what your proposals are, who may be affected [target companies], what questions are being asked and the timescale for responses.

2.1 Ask focused questions, and be clear about the areas of [corporate governance] on which you are seeking views. Responses that do not refer to the specific questions asked should still be accepted. Encourage respondents to provide evidence, where appropriate, to support their responses.

2.2 Explicitly state any assumptions made abou those who are likely to be affected by the proposed [code]. Encourage respondents to challenge these assumptions.

2.3 As far as possible, consultation should be completely open, with no options ruled out. However, if there are things that cannot be changed because, for example, they are part of [the country's legal requirements] , then make this clear. …

2.4 If there are particular areas where respondents' input would be especially valuable, make this clear as well. Responses are likely to be more useful and focused if respondents know where to concentrate their efforts.

2.5 Representative groups should be asked when responding to give a summary of the people and organizations they represent.

2.6 Provide a list of consultees as an annex to your consultation document and ask for suggestions of other interested parties who should be consulted. It may also be helpful to refer to any earlier or informal consultation.

2.7 Clearly state the deadline for responses and any alternative ways of contributing to the process in the consultation document.

2.8 Explicitly state both who to respond to and who to direct queries to, giving a name, address, telephone number and e-mail address. This may be the same person.

CRITERION 3

3. Ensure that your consultation is clear, concise and widely accessible.

3.1 Clear
Use plain language: avoid jargon and only use technical terms where absolutely necessary. A consultation should be as accessible as possible. Explain complicated concepts as clearly as possible and, where there are technical terms, use a glossary.

3.2 Concise
Provide an executive summary to the written consultation document that covers the main points of the document, preferably no longer than two pages. Even if the document is technical, ensure that the executive summary is accessible to all. …

3.3 Accessible
Ensure that the consultation documents are available in paper format and with the fullest use of electronic means. They should be available and easily found on the internet from the day that the consultation is launched.

3.4 Efforts should be made to bring the consultation to the attention of all interested parties. As well as using the internet you should consider publicizing the consultation in ways most appropriate for the groups you wish to reach.

3.5 Respondents should be able to respond electronically if they chose. Produce documents in electronic formats appropriate to achieving wide accessibility. Consider the range of electronic response methods to ensure that providing a response is simple, engages a broad range of people and encourages deliberation. Costs to users should never be such that they are an obstacle to effective consultation.

…

3.8 … Certain issues may demand particular approaches to consultation: for example, discussion groups or meetings may be appropriate, especially where representative groups' capacity to respond to formal consultation is limited.…

…

ANNEX 7. U.K. CODE OF PRACTICE ON CONSULTATION (CONT.)

CRITERION 4

4. Give feedback regarding the responses received and how the consultation process influenced the [corporate governance code].

4.1 Responses should be carefully and open-mindedly analyzed.… Particular attention may need to be given to representatives bodies, such as business associations, trade unions, … and other organizations representing groups especially affected. In order to ensure that responses are analyzed correctly, it is important to understand whom different bodies represent, and the methodology used to gain members' input into the response.

4.2 Particular attention should be paid to:

- Possible new approaches to the question consulted on;
- Further evidence of the impact of the proposals; and
- Strength of feeling among the particular groups.

4.3 The consultation document should state the date when, and the web address where, the summary of responses will be published. As far as possible this should be within three months of the closing date of the consultation. Those without web access should be able to request a paper copy of this summary.…

4.4 The summary should give an analysis of the responses to questions asked: for each question there should be a summary of responses to that question and then an explanation of how it is proposed to change the [draft code] in light of the responses received. There should also be information provided on themes that came out of the consultation which were not covered by the questions.

4.5 Wherever possible the summary of responses should also include a summary of the next steps for the [corporate governance code], including reasons for decisions taken.

4.6 Explain who will use the responses and for what purpose, and make it clear that responses, including the name and addresses of respondents, may be made public unless confidentiality is specifically requested. …

…

CRITERION 5

5. Monitor your [committee's] effectiveness, including through the use of a designated consultation co-ordinator.

5.1 Each [committee] should have a nominated consultation co-ordinator … . They should act as an adviser to those conducting consultation exercises.

5.2 Consultation should be evaluated for effectiveness, looking at numbers and types of responses, whether some methods of consultation were more successful than others, and how the consultation responses clarified the … options and affected the final [version of the corporate governance code].

…

ANNEX 7. U.K. CODE OF PRACTICE ON CONSULTATION (CONT.)

CRITERION 6

Ensure your consultation follows…best practice….

6.1 When consulting on a review of a [corporate governance code], ensure consideration is given to opportunities for reducing bureaucracy and regulatory burdens …

…

6.4 Consider any unintended consequences of the [draft code] and ask respondents to highlight these in their responses.

6.5 When consulting, ensure that you ask about the practical enforcement and implication issues of your [corporate governance code], including asking respondents for alternative approaches to implementation….

…

ANNEX 8. THE MILLSTEIN REPORT (1997)

In 1997 Ira Millstein wrote a report for the Organisation for Economic Co-operation and Development that provides a set of 25 "policy objectives." These include 20 "Perspectives for Public Policy Improvement" designed to assist policymakers and regulators in shaping the corporate governance environment. The perspectives listed in the Millstein Report provide a framework for policymakers to benchmark their corporate governance practices in their own country. Although these policy objectives were formulated in 1997, they are as pertinent and challenging as when they were first written and provide excellent guidance for developing a code.

THE MILLSTEIN PERSPECTIVES FOR PUBLIC POLICY IMPROVEMENT

1. Flexibility

Policy makers and regulators should be sensitive to corporations' need for flexibility in responding to the changing competitive environment and the related need for flexible adaptive governance structures. Regulation should support a range of ownership and governance forms so that a market for governance arrangements develops.

2. Regulatory impact

Policy makers and regulators should consider the impact of any proposed regulatory initiative on the ability of the corporate sector to respond to competitive market environments. They should avoid those regulations that threaten to unduly interfere with market mechanisms.

3. Regulatory focus

Regulatory intervention in the area of corporate governance is likely to be most effective if limited to:

- **Fairness** – ensuring the protection of shareholder rights and the enforceability of contracts with resource providers
- **Transparency** – requiring timely disclosure of adequate information concerning financial performance
- **Accountability** – clarifying governance roles and responsibilities and supporting voluntary efforts to ensure the alignment of managerial and shareholder interests as monitored by boards of directors—or in certain nations boards of auditors—having some independent members.
- **Responsibility** – ensuring corporate compliance with the other laws and regulations that reflect the respective society's values

4. Clarity, consistency, enforceability

Policy makers and regulators should provide clear, consistent, and enforceable securities and capital market regulations designed to protect shareholder rights and create legal systems capable of enforcing such regulations. Such regulations should seek to treat all equity investors including minority shareholders fairly and should include protections against fraud, dilution, self dealing, and insider dealing.

ANNEX 8. THE MILLSTEIN REPORT (1997) (CONT.)

5. Litigation abuse
Regulations aimed at protecting shareholder rights should be designed to protect against litigation abuse.

6. Basic contract, commercial and consumer law
Policy makers and regulators should ensure that an adequate system of contract, commercial, and basic consumer protection law is in place so that contractual relationships are enforceable.

7. Regulatory impact on active investors
Policy makers and regulators should review whether their securities, tax, and other regulations unduly hinder active investors and whether their regulations concerning institutional investors inappropriately inhibit them from participating as active investors.

8. Corruption and bribery
Policy makers and regulators should ensure that corporations function in an environment that is free from bribery and corruption.

9. Accurate and timely disclosure
Regulators should require that corporations disclose accurate and timely information concerning corporate financial performance. Adequate enforcement mechanisms should be provided.

10. Consistent, comparable disclosure
Regulators should cooperate internationally in developing clear, consistent, and comparable standards for disclosure of corporate financial performance including accounting standards

11. Ownership disclosure
Regulators should extend such disclosure requirements to the corporate ownership structure including disclosure of any special voting rights and of the beneficial ownership of controlling or major blocks of shares

12. Disclosure improvement
Regulators should encourage ongoing improvements in both disclosure techniques and formats.

13. Corporate governance legal standards
Policy makers and regulators should articulate clearly the legal standards that govern shareholder, director, and management authority and accountability including fiduciary roles and legal liabilities. However because corporate governance and expectations concerning roles and liabilities continue to evolve, legal standards should be flexible and permissive of evolution.

14. Shareholder protection
Policy makers and regulators should protect and enforce shareholder rights to vote and participate in annual shareholder meetings.

15. Independent boards
Policy makers and regulators should encourage some degree of independence in the composition of corporate boards.

16. Sound audit practices
Policy makers and regulators should encourage sound audit practices, which include board selection of and reliance on an independent auditor.

17. Investor competition
Governments should avoid regulations that unduly inhibit the ability of institutional investors to compete with one another.

18. Law-abiding corporations
Policy makers and regulators should ensure that corporations abide by laws that uphold the respective society's values such as criminal, tax, antitrust, labor, environmental protection, equal opportunity, and health and safety laws.

19. Individual welfare
Policy makers and regulators should support and encourage education and training efforts, the provision of unemployment benefits, and other similar efforts aimed at promoting the welfare of individuals.

20. Income and opportunity divergence
Policy makers and regulators may wish to consider the implications of significant divergence in income and opportunity paths.

ANNEX 9. SUMMARY OF A CORPORATE GOVERNANCE COUNTRY ASSESSMENT

Following are the key findings of a corporate governance Report on the Observance of Standards and Codes (ROSC) conducted by the World Bank in India. The report was issued and published in 2004.

The 2004 ROSC assessed the observance of OECD Corporate Governance Principles in India using the criteria:

- Observed (O)
- Largely observed (LO)
- Partially observed (PO)
- Materially not observed (MO)
- Not observed (NO)

I. THE RIGHTS OF SHAREHOLDERS			
IA	Basic shareholder rights	O	• Shares traded through a stock exchange are held in dematerialized form in the two depositories: National Securities Depository and Central Depository Services. • Registration in a depository is proof of ownership. • Companies must maintain a register of shareholders or outsource this function to a share transfer agent. • Shares traded through stock exchanges are transferred through book entry at the depositories. • Cash settlement occurs at designated clearing banks of stock exchange clearing houses. Clearance/settlement occurs in DVP2 on T+2. • Novation exists at National Stock Exchange (NSE), but not Stock Exchange, Mumbai (BSE). • Guarantee funds have largely eliminated settlement risk. Central Bank plans to introduce real time gross settlement in 2004. • Annual and half yearly accounts are mailed to shareholders; quarterly accounts are published in newspapers and posted on web pages of issuers and stock exchanges. • Companies must file memorandum, articles of association and periodic financial information with a Registrar of Companies (ROC). Investors can access this information for nominal fee (about USD 1). • Usually, directors are proposed by board and elected by shareholders. Shareholders can propose candidates up to fourteen days before AGM [annual general meeting], but shareholders seldom use this right. • Board proposes dividend, and AGM approves it.

I. THE RIGHTS OF SHAREHOLDERS (CONT.)

IB	Rights to participate in fundamental decisions.	O	• Certain fundamental corporate decisions are the exclusive power of AGM and require 75 percent majority: • changing registered office; • authorizing capital increases; • waiving pre-emptive rights; buying back shares; • amending articles of association; • delisting; • acquisitions, disposals, mergers and takeovers; • changes to company business or objectives; • making loans and investments beyond limits prescribed under CA Section 372A, • authorizing board to: (i) sell or lease major assets; (ii) borrow money in excess of paid-up capital and free reserves, and (iii) appoint sole selling agents and apply to the court for the winding up of company.
IC	Shareholders' AGM rights	O	• AGM mandatory, according to Companies Act (CA). • 21 day AGM notice (meeting place, time, agenda) sent to all shareholders. • In case of special business, agenda must set out material facts, including nature of concern or interest of any director or manager. • Some companies reportedly hold AGMs in remote locations. • Quorum is five shareholders. If quorum is not met after half an hour, meeting is dissolved if called by shareholders, or postponed for one week if called by board. • Shareholders may vote in person or proxy. • CA allows postal voting for fundamental situations. • Any shareholder may apply to Company Law Board (CLB) to call AGM. • Shareholders with 10 percent of paid-up voting capital can call EGM [exceptional general meeting]. • Shareholders can vote by show of hands or demand poll, if they own at least 10 percent of voting rights.

I. THE RIGHTS OF SHAREHOLDERS (CONT.)

ID	Disproportionate control disclosure	LO	No nominee accounts. Shareholder agreements need not be disclosed to company/shareholders. Prevalence of complex cross-holdings across family or business groups still fails to provide a fully transparent picture for shareholders.
IE	Markets for corporate control should be allowed to function	O	SEBI [Securities and Exchange Board of India] Takeover Code has been successfully tested in 25 + hostile bids. Takeover Code requires anyone whose holdings cross 15 percent threshold to make offer for at least 20 percent more of shares.
IF	Cost/benefit to voting	MO	Pension funds seldom exercise voting rights, instead exert influence through nominee directors on the board of their portfolio companies.

II. EQUITABLE TREATMENT OF SHAREHOLDERS

IIA	All shareholders should be treated equally	PO	Shareholders can apply [to] the CLB, SEBI or the company "Grievance Committee" for redress. Derivative and class action suits exist. Doubts persist about the effectiveness of legal remedies in practice.
IIB	Prohibit insider trading	PO	Insider trading is a criminal offense, but enforcement is problematic. Senior management must disclose to board potential conflicts of interest. Directors must disclose share dealings beyond certain threshold.
IIC	Board/Mgrs. disclose interests	PO	Reportedly, misuse of corporate assets and abuse in related party transactions remain problems.

III. ROLE OF STAKEHOLDERS IN CORPORATE GOVERNANCE

IIIA	Stakeholder rights respected	O	Board is required to discuss material issues regarding stakeholders.
IIIB	Redress for violation of rights	PO	Redress can be sought through civil and high courts; however, there are long delays and backlogs.
IIIC	Performance enhancement	O	SEBI has issued detailed guidelines on the issue of stock options.
IIID	Access to information	O	Relevant information is posted on company and stock exchange websites, but quality of info varies among companies.

IV. DISCLOSURE AND TRANSPARENCY

IVA	Disclosure standards	LO	Companies must send annual report to shareholders, stock exchanges, DCA [Department of company Affairs] and ROC; content regulated by statute. Disclosure does not extend to level of ultimate beneficiary and structure of business groups. Quality of financial reporting improving, but stock exchanges lack sufficient resources to ensure compliance and rely heavily on auditors.
IVB	Standards of accounting & audit	LO	Quality of financial disclosure determined by DCA, SEBI and ICAI [Institute of Chartered Accountants of India]. ICAI says India conforms with ISA [International Standards of Auditing]. Judicial delays diminish deterrence factor of some penalties.
IVC	Independent audit annually	PO	Auditors can provide consulting services to the company they audit up to the level of the audit fee, and fees disclosed in the annual report. Disciplinary proceedings can be lengthy.
IVD	Fair & timely dissemination	O	Dissemination channels include direct mailing, company websites, the stock exchange, and press announcements. Printing/distribution of annual report to all shareholders and necessity of publishing accounts of all subsidiaries add greatly to issuer costs.

V. RESPONSIBILITIES OF THE BOARD

VA	Acts with due diligence, care	LO	Unitary board structure. Basic fiduciary duties are not spelled out in legislation, but embedded in sparse existing jurisprudence.
VB	Treat all shareholders fairly	LO	Board members have a fiduciary obligation to treat shareholders fairly. Shareholders can appeal to SEBI or the courts At least 2/3 of board rotational.
VC	Ensure compliance w/ law	O	The company secretary ensures the board complies with its statutory duties and obligations.
VD	The board should fulfill certain key functions	LO	There is no rule vesting the responsibility of overseeing the process of disclosure and communication with the board. Small companies practice “box-ticking.”
VE	The board should be able to exercise objective judgment	PO	Audit and remuneration committees are common. Audit committee has three members, all non-executive and a majority of them independent. Director may have membership on 15 boards and ten committees and may chair five committees.
VF	Access to information	O	Clause 49 mandates information to be placed before the board; it is sufficient to inform directors about firm’s financial/non-financial situation.

A Summary of Policy Recommendations for India (ROSC, 2004)

I. THE RIGHTS OF SHAREHOLDERS		
IA	Basic shareholder rights	NA
IB	Rights to participate in fundamental decisions.	The provision dealing with the selling or leasing of major assets should be further refined to avoid any abuse.
IC	Shareholders AGM rights	• NA
ID	Disproportionate control disclosure	• Shareholder agreements should be disclosed.
IE	Control arrangements should be allowed to function.	• NA
IF	Cost/benefit to voting	Regulators should consider introducing an obligation that institutional investors acting in a fiduciary capacity adopt and disclose their corporate governance and voting policy. Regulators should also disclose to the public how they manage material conflicts of interest that may affect the exercise of their corporate governance rights. Shareholder activism among retail investors should be encouraged.
II. EQUITABLE TREATMENT OF SHAREHOLDERS		
IIA	All shareholders should be treated equally	Depository receipt contracts should provide owners with same rights to vote as are accorded to holders of underlying shares. Consider strengthening regulators' enforcement power to offset backlog and delays of court procedures.
IIB	Prohibit insider trading	Implement SEBI's initiative of a unique client code for each investor. There should be greater cooperation between NSE and BSE on surveillance. Publish share trading by directors and senior management in the newspaper. Successfully prosecute one insider trading case to enhance perception of market integrity.
IIC	Board/Mgrs. disclose interests	While audit committees should pre-vet related party transactions, ultimate responsibility of judging whether a related party transaction is in the best interest of the company should remain with the board.

III. ROLE OF STAKEHOLDERS IN CORPORATE GOVERNANCE

IIIA	Stakeholder rights respected	• NA
IIIB	Redress for violation of rights	Refer to Insolvency and Creditor Rights ROSC.
IIIC	Performance enhancement	Closely follow the international debate on good practices regarding the treatment of stock options.
IIID	Access to information	NA

IV. DISCLOSURE AND TRANSPARENCY

IVA	Disclosure standards	SEBI and stock exchanges need to cooperate more closely to effectively monitor and enforce compliance with listing agreement. Steps must be taken to clarify division of responsibilities among stock exchanges, SEBI and DCA to avoid unintentional regulatory overlap and potential conflicts.
IVB	Standards of accounting & audit	See Accounting and Auditing ROSC. Significantly enhance fines to act as credible deterrents.
IVC	Independent audit annually	Recommendations of Naresh Chandra Committee on Corporate Audit and Governance are included in pending legislation, which should go forward. Consider different options to subject auditors to an auditor oversight body that operates in the public interest and that is not under the control of the auditing profession.
IVD	Fair & timely dissemination	Give shareholders option to decline full annual report in lieu of summary, whose content would be regulated by SEBI.

V. RESPONSIBILITIES OF THE BOARD		
VA	Acts with due diligence, care	The fiduciary obligations should be clearly spelled out in the legal or regulatory framework. Have same standards of care for executive and independent directors, with few exceptions. Provide directors with access to training.
VB	Treat all shareholders fairly	Have DFIs [development finance institutions] nominate expert independent directors on their behalf. Maximum term of independent directors should be capped.
VC	Ensure compliance w/ law	NA
VD	The board should fulfill certain key functions	Consider consulting shareholders with regard to general compensation policy for senior management, rather than individual packages. The department in charge of corporate communication should have a direct reporting line to the board. Clearly-defined board procedures are needed to allow board to effectively exercise its oversight function on risk management.
VE	The board should be able to exercise objective judgment	Given that multiple board memberships by one person can interfere with performance of directors, companies and shareholders should consider desirability of such a situation. Consider special training and certification program for audit committee members. Adequate across-the-board compensation for independent directors will help increase supply of high quality candidates and ensure sufficient time is devoted to their responsibilities. Compliance with the audit committee requirement should be monitored closely by regulators.

ANNEX 10. CORPORATE GOVERNANCE CHALLENGES IDENTIFIED BY THE REGIONAL CORPORATE GOVERNANCE ROUNDTABLES (2004)

Following is a summary of the key findings from a series of regional corporate governance roundtables conducted by the Organisation of Economic co-operation and Development in partnership with the World Bank and the International Finance Corporation with the support of various other organizations including the Global Corporate Governance Forum. Each regional roundtable has issued a white paper that can serve as background reference for developing a country code. The white papers can be downloaded from the OECD website at www.oecd.org

The roundtables have revealed a wide range of corporate governance challenges across the five regions including:

Enforcement

Perhaps the most widespread sentiment expressed in the roundtables was the importance of improving the enforcement of existing law and regulations. While legal traditions vary across countries, there is a broad recognition that the structure, vigilance, and capacity of the regulatory and judicial framework form an integral part of the corporate governance environment. All roundtables have emphasized the need to "close the gap" between formal provisions and actual implementation.

Ownership and control

In many parts of the world, ownership and control is highly concentrated in individual companies or groups of companies. Concentrated ownership is often seen as a solution to the fundamental principal-agent problem of corporate governance. In the absence of a credible legal and regulatory framework, however, the expected benefits may not be realized. (This is especially true when control is also kept through control pyramids and cross-holdings, which lead to a separation of ownership and control). The situation is often further aggravated by insufficient information about ultimate ownership and the use of opaque control structures.

The potential problems that arise from this combination of concentrated ownership, weak shareholder protection and insufficient disclosure has been highlighted in all the regional roundtables. The white papers recommend that policymakers should focus on improving transparency and disclosure and making boards more effective as well as developing and protecting the rights and equitable treatment of shareholders.

Shareholder rights and equitable treatment

Perhaps the most important problem that follows directly from the combination of concentrated ownership, opaque control structures, weak minority protection, and insufficient disclosure is the frequent abuse of related-party transactions. Curbing such transactions should be one of the top priorities for corporate governance reform and a prerequisite for attracting minority investors on a long-term basis.

Improving Board Effectiveness

Roundtable participants described most company boards as either:

- passive rubber stamps or
- active participants in furthering the interest of the controlling shareholder.

While most countries have established the legal duties of board members to exercise care and act in the interest of the company and all shareholders, these legal requirements often have limited influence on actual board practices. This issue reflects the limitations of the judicial system. It has been noted that in many countries participating in the roundtables minority shareholders have never filed a successful suit against a board member.

The role of banks

In many of the roundtable countries, banks have ownership structures that may create conflicts of interest and undermine their own governance as well as their role as monitor.

The role of stakeholders

The regional roundtables revealed that the mechanisms for stakeholder involvement in the governance of companies did not always work as hoped and that stakeholders sometimes faced abusive actions by corporate insiders that impeded their ability to take action illegal operations or seek effective redress for violations of their rights.

Transparency and disclosure

International accounting standards now influence disclosure requirements in all regions covered by the roundtables. These require all companies to take the steps needed to implement these standards.

As a direct consequence of the efforts to curb abusive related-party transactions, the roundtables have called for improvements in the disclosure of ownership to encompass beneficial owners.

ANNEX 11. MONITORING AND ENFORCING CORPORATE GOVERNANCE BEST PRACTICES IN THE UNITED KINGDOM

Following is a summary of the roles and responsibilities of the United Kingdom's Financial Reporting Council, the agency that monitors the country's corporate governance system.

The United Kingdom established the Financial Reporting Council (FRC) in 1990 to promote good financial reporting through its subsidiaries, the Accounting Standards Board and the Financial Reporting Review Panel. In 2003 the government announced reforms of the council designed to create independent regulation of the accountancy and audit profession and to raise corporate governance standards. In 2004 the "new" FRC became operational.

The aim of the FRC is to promote public and investor confidence in corporate reporting and governance. It has the following roles and responsibilities:

- Sets, monitors, and enforces accounting and auditing standards
- Oversees the regulatory activities of the professional accountancy bodies and regulating audit
- Promotes high standards of corporate governance.

The FRC :

- Maintains and monitors the effectiveness of the Combined Code.
- Ensures that the guidance on internal control (the Turnbull Guidance) is up to date
- Influences EU and global developments in corporate governance.

The Financial Reporting Council's functions cover the entire length of the corporate reporting and governance chain. Its remit is much wider than that of any previous regime in the United Kingdom or any equivalent regime in countries with major financial markets. This wide remit allows the council to look at issues affecting corporate reporting in a more coherent way than was possible in the past. The council intends to target its resources on the links in the chain that present the greatest risk to confidence in corporate reporting and governance.

In addition, the Financial Reporting Council oversees:

- **The Accounting Standards Board (ASB)**

The ASB:

- Provides a framework within which others can exercise judgment in resolving accounting issues
- Issues or amends accounting standards and
- Works in collaboration with the International Accounting Standards Board, national standard setters, and EU institutions to develop international standards.
- **Auditing Practices Board (APB)**

This board develops standards and guidance to underpin good auditing practices.

- **Professional Oversight Board for Accountancy (POBA)**

This board is responsible for the independent oversight of the regulation of the accountancy profession and for the regulation of audits, including the monitoring of audit quality.

- **The Financial Reporting Review Panel (FRRP)**

This panel reviews the financial information provided by public and large private companies to determine compliance with relevant accounting requirements.

- **The Accountancy Investigation and Discipline Board (AIDB)**

This board operates an independent and transparent investigation and disciplinary scheme to handle public interest cases.

In carrying out its regulatory functions, the FRC states that

- It has a preference for market-based solutions
- Where it chooses to intervene in the operation of the market, it will do so with as light as touch as possible.
- It intends its interventions to send strong signals to the market

This philosophy conforms with the Better Regulation Task Force Principles of:

- Proportionality
- Accountability
- Consistency
- Transparency

The council considers three questions when advising on new proposals for corporate governance or company law.

- Will change promote enterprise, investment, and the free flow of capital in support of growth and innovation?
- Will change maintain the right balance between oversight by shareholders and the directors' ability to drive the business?
- Will the market be enabled to reward strong performers and punish those who do not serve investors' interests, or will the regulatory authorities become, de facto, the judges of performance?

The FRC's goal is to ensure that enterprise continues to flourish, that the capital markets remain effective, and that people have trust and confidence in business. The council sees the role of the state not as judging corporate performance but as enabling the market—most particularly shareholders—to do so. The council's approach is to give shareholders the opportunity, and the means, to make their own judgements and hold management to account.

ANNEX 12. THE REVIEW OF THE OECD PRINCIPLES OF CORPORATE GOVERNANCE

Following is a summary of the amendments made by the Organisation of Economic Co-operation and Development to its Principles of Corporate Governance in 2004 after a careful review.

The review process was carried out by the Steering Group on Corporate Governance and involved:
- Consultations with a wide group of interested parties, with non-OECD countries, and with several high-level roundtables chaired by the Secretary General.
- A survey of corporate governance developments since 1999
- Draft revised principles were placed on the website for comment in January 2004 and resulted in 100 replies, which were posted on the website.

The major changes in the Principles involved:
- A new chapter on implementation and enforcement
- Stronger shareholder rights
- Improved disclosure
- Whistleblower protection
- Tightened responsibilities of boards

The revisions tackled major issues that included:
- **Controlling executive and director remuneration**
  - boards to align key executive and board remuneration with the long-term interests of company and shareholders and establish a remuneration policy (chapter VI)
  - statement that special remuneration committee with independent directors regarded as best practice in more countries (chapter VI)
  - the remuneration policy to be disclosed (chapter V)
  - shareholders to have ability to make their views known on the policy and to approve equity components of the scheme. (chapter II)
- **Abuse in company groups**
  - clear statement on fiduciary duties of board members to the company and not to the company group (chapter VI)
  - explicit statement that boards to review related-party transactions using independent directors (chapter VI)
  - make general statement of board independence to cover those in a position to influence the company and not just management (chapter VI)
  - stronger annotations to disclosure of related-party transactions (chapter V)
  - stronger principle on board and executive disclosure of material interests (chapter III)
  - stronger call for protection of minority shareholders. (chapter III)
- **Self-dealing and abuse by insiders**
  - strengthened principle calling for boards to establish ethical guidelines and effective compliance procedures (chapter VI)

– boards to oversee internal controls and provide confidential access to whistleblowers (chapter VI)
– tightened disclosure standards to the board and to the market (chapter V)
– strengthened criteria for board independence and greater possibilities for shareholders to question boards and to participate (chapters VI and II)

- **Improved financial market integrity**
  – better disclosure by the company, including related-party transactions
  – boards to focus on overseeing internal controls and major accounting assumptions through independent audit committee (chapter V)
  – more emphasis on auditor independence and reference to IOSCO standards (chapter VI)
  – accountability of external auditors to shareholders and duty of professional care to the company (chapter V)
  – those providing analysis and advice to be free of conflicts of interest (chapter V)
  – improved enforcement (chapter I)
- **Improved enforcement**
  – greater role for shareholders and improved transparency
  – tightening of fiduciary responsibilities of boards
  – improved financial integrity
  – clear objectives for policy in establishing a system leading to transparent and efficient markets
  – legal and regulatory instruments to be transparent and enforceable
  – clear division of responsibilities between domestic authorities
  – supervisory, regulatory, and enforcement authorities should have authority, integrity, and resources to fulfill duties
- **Better exercise of ownership**
  – call for effective shareholder participation in key decisions such as the nomination and election of board members proposing resolutions and making views known on compensation policy (chapter II)
  – call for institutional investors acting in a fiduciary capacity to declare voting policies and how they handle conflict of interests (chapter II)
  – improved possibilities for shareholders to consult with each other on key governance issues (chapter II)
  – eliminating impediments to cross-border voting (chapter III)
  – more detailed annotations covering use of proxy voting and conduct of shareholder meetings (chapter II)

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