

1

TOOLKIT

*Developing Corporate
Governance Codes of
Best Practice*

RATIONALE

VOLUME 1



Global
Corporate
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Forum

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VOLUME 1
Rationale

TOOLKIT 2
*Developing Corporate
Governance Codes of
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Global
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VOLUME 1

Rationale



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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

THINKING POINT

Why is corporate governance receiving attention in your country?

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.

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

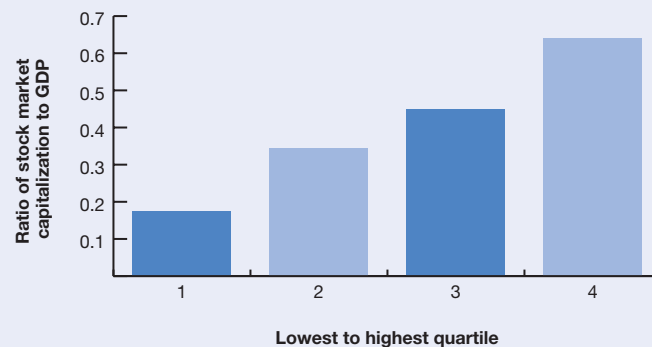
Countries that strongly protect property rights have better-developed financial and capital markets, according to the law and finance literature. In particular, better creditor rights and shareholder rights have been shown to be associated with deeper and more developed banking and capital markets.

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

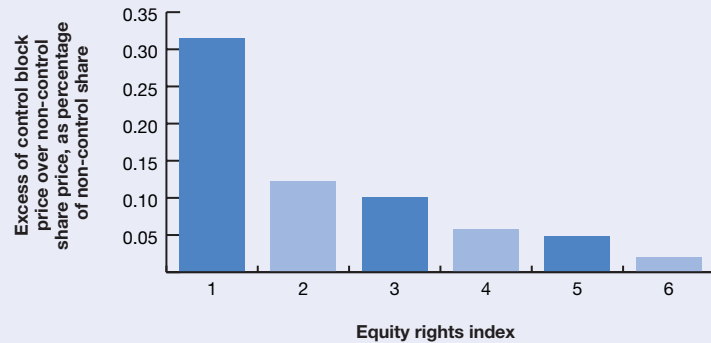
FIRM VALUATION

“Good corporate governance structures encourage companies to create value (through entrepreneurship, 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.

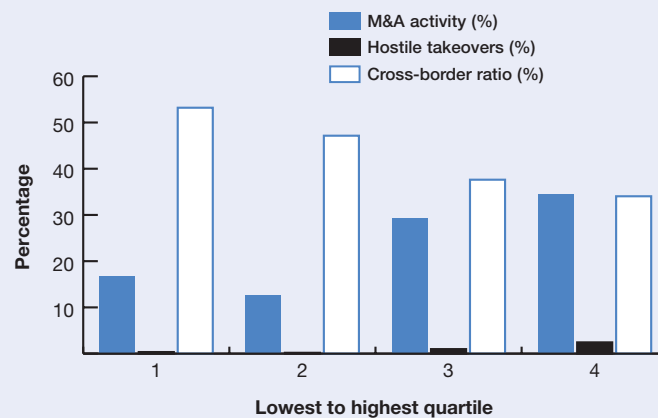
More generally, poor corporate governance can affect the functioning of a country's financial markets. For one thing, poor corporate governance can increase financial volatility. When information is poorly protected—due to a lack of transparency and insiders having an edge on firms' activities and prospects—investors 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 stakeholderism 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

**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.

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).

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.

THINKING POINT

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

THE ENVIRONMENT OF CODES OF BEST PRACTICE

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*.

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.

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

EXAMPLE

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

QUOTE

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.”

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

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 than 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.

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.

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 PRACTICESANDEAN 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

ANNEXES

1. Further reading
2. Example of laws that affect corporate directors
3. The German scorecard approach
4. Summary of General Motors' board guidelines
5. Comparison of selected corporate governance codes of best practice

ANNEX I. FURTHER READING

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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	<ul style="list-style-type: none"> Criminal Justice Act, 1993 Companies Act, 1985 and 1989 Insolvency Act, 1986 Company Directors Disqualification Act, 1986
STOCK EXCHANGE REQUIREMENTS FOR LISTED COMPANIES	<ul style="list-style-type: none"> Combined Code Listing rules Mergers and takeovers
SAFETY MATTERS	<ul style="list-style-type: none"> Health and Safety at Work Act, 1974 Regulations on controlling hazardous substances, 1994
EMPLOYMENT ISSUES	<ul style="list-style-type: none"> 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	<ul style="list-style-type: none"> • Improve company's performance, competitiveness, and access to capital • Improve quality of governance-related information available to equity markets
SCOPE	Listed companies
CONTENT	<ul style="list-style-type: none"> • 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	<ul style="list-style-type: none"> • 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	<ul style="list-style-type: none"> • 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	<ul style="list-style-type: none"> • Support long-term value creation and sustainable growth • Improve quality of governance-related information available to capital markets
SCOPE	Listed companies
CONTENT	<ul style="list-style-type: none"> • 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	<ul style="list-style-type: none"> • Improve company performance, competitiveness, and access to capital • Improve quality of governance-related information available to equity markets
SCOPE	Listed companies
CONTENT	<ul style="list-style-type: none"> • 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	<ul style="list-style-type: none">• Improve company performance, competitiveness, and access to capital• Improve quality of governance-related information available to equity markets
SCOPE	Companies
CONTENT	<ul style="list-style-type: none">• 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	<ul style="list-style-type: none"> • Improve quality of governance-related information available to equity markets
SCOPE	Listed companies
CONTENT	<ul style="list-style-type: none"> • 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.ccg.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	<ul style="list-style-type: none"> • Improve company's performance, competitiveness, and access to capital • Improve quality of governance-related information available to equity markets
SCOPE	Listed companies
CONTENT	<ul style="list-style-type: none"> • 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	<ul style="list-style-type: none"> • 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	<ul style="list-style-type: none"> • Improve company performance, competitiveness, and access to capital • Improve quality of governance-related information available to equity markets
SCOPE	Listed companies
CONTENT	<ul style="list-style-type: none"> • 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	<ul style="list-style-type: none"> • 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 Entreprises Privees (AFEP) and Association des Grandes Entreprises Franciases (AGREF)
COMPLIANCE	Voluntary (disclosure encouraged)
OBJECTIVES	<ul style="list-style-type: none"> • Improve quality of board (supervisory) governance • Improve quality of governance-related information available to equity markets
SCOPE	Listed companies
CONTENT	<ul style="list-style-type: none"> • 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 blserve@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 Entreprises Privees (AFEP) and Association des Grandes Entreprises Franciases (AGREF)
COMPLIANCE	Voluntary (disclosure encouraged)
OBJECTIVE	Improve quality of board (supervisory) governance
SCOPE	Listed companies
CONTENT	<ul style="list-style-type: none"> • 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 (CNPFF) and Association des Grandes Entreprises Franciases (AGREF)
COMPLIANCE	Voluntary
OBJECTIVE	Improve quality of board (supervisory) governance
SCOPE	Listed companies
CONTENT	<ul style="list-style-type: none"> • 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	<ul style="list-style-type: none"> • 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	<ul style="list-style-type: none">• 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	<ul style="list-style-type: none"> • Shareholders • Board of commissioners (<i>Komisaris</i>) • Board of managing directors (<i>Direksi</i>) • 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	<ul style="list-style-type: none"> • Improve company performance, competitiveness, and access to capital • Improve quality of governance-related information available to equity markets.
SCOPE	Listed companies
CONTENT	<ul style="list-style-type: none"> • 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	<ul style="list-style-type: none">• Improve quality of board (supervisory) governance• Improve company performance, competitiveness, and access to capital
SCOPE	Listed companies
CONTENT	<ul style="list-style-type: none">• 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	<ul style="list-style-type: none"> • Improve quality of board (supervisory) governance • Improve company performance, competitiveness, and access to capital
SCOPE	Listed companies
CONTENT	<ul style="list-style-type: none"> • 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	<ul style="list-style-type: none"> • Improve quality of board governance • Improve company performance, competitiveness, and access to capital
SCOPE	Companies
CONTENT	<ul style="list-style-type: none"> • 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	<ul style="list-style-type: none"> • Improve quality of board (supervisory) governance • Set standards for review of Korean law
SCOPE	Listed companies, all companies encouraged to comply as relevant
CONTENT	<ul style="list-style-type: none"> • 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	<ul style="list-style-type: none"> • Improve company performance, competitiveness, and access to capital • Improve quality of board governance
SCOPE	Listed companies
CONTENT	<ul style="list-style-type: none"> • 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	<ul style="list-style-type: none"> • Improve quality of board (supervisory) governance • Improve company performance, competitiveness, and access to capital
SCOPE	Listed companies
CONTENT	<ul style="list-style-type: none"> • 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	<ul style="list-style-type: none">• Improve quality of board (supervisory) governance• Improve company performance, competitiveness, and access to capital
SCOPE	Listed companies
CONTENT	<ul style="list-style-type: none">• 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	<ul style="list-style-type: none"> • 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	<ul style="list-style-type: none"> • 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	<ul style="list-style-type: none"> • 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 jurisdictions
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	<ul style="list-style-type: none"> • Improve quality of board governance • Improve quality of governance-related information available to equity markets
SCOPE	Listed companies
CONTENT	<ul style="list-style-type: none"> • 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	<ul style="list-style-type: none"> • 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	<ul style="list-style-type: none"> • Improve quality of board governance • Improve quality of governance-related information available to equity markets
SCOPE	Listed companies
CONTENT	<ul style="list-style-type: none"> • 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	<ul style="list-style-type: none"> • 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	<ul style="list-style-type: none"> • 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	<ul style="list-style-type: none"> • 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	<ul style="list-style-type: none"> • 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	<ul style="list-style-type: none"> • 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	<ul style="list-style-type: none"> • 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	<ul style="list-style-type: none"> • 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	<ul style="list-style-type: none"> • 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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