In mid-July of this year, over 350 participants from more than 25 countries convened in New York City to explore their common interests in corporate governance at the sixth annual meeting of the International Corporate Governance Network (ICGN) (see www.icgn.org).

The gathering brought together securities regulators, representatives of securities dealer associations, stock exchanges, the OECD and the World Bank, prominent accounting and legal professionals, captains of industry, labour leaders, and, most notably, investors representing US$10 trillion (EUR10.8 trillion) in investment capital. These remarkably diverse participants all share the view that corporate governance is critical to the global economic system (see box “Global developments in corporate governance”).

Demand for investment capital is increasing throughout both the developed and developing world. At the same time, governments and multilateral agencies are cutting back on aid. As barriers to the free flow of capital fall, policy makers have come to recognise that the quality of corporate governance is relevant to capital formation. They also realise that weak corporate governance systems, combined with corruption and cronyism:

- Distort the efficient allocation of resources.
- Undermine opportunities to compete on a level playing field.
- Ultimately hinder investment and economic development.

In a McKinsey survey issued in June 2000, investors from all over the globe indicated that they will pay large premiums for companies with effective corporate governance (see box “The McKinsey survey” and diagrams “Paying for good governance” and “Premiums investors would pay”).

This finding is supported by a recent survey of investors in Europe and the US which found that approximately half of European investors, and 61% of US investors, have decided not to in-
vest in a company, or have reduced their investment, because of poor governance practices (Russell Reynolds Associates, Corporate Governance in the New Economy - 2000 International Survey of Institutional Investors. Copies of the survey can be requested from www.russreyn.com) (see diagrams “Evaluating corporate governance” and “Importance of factors influencing investment decisions”).

In-house counsel, who frequently advise both management and the board of their companies, can play an active part in encouraging companies to adopt effective governance standards. They are often called on to address legal issues related to the governance of the corporation, for example:

- Companies seeking to exchange equity for capital (whether issuing shares to the public or through a private placement) need guidance on governance mechanisms favoured by the investing community (as well as advice on relationships with shareholders). Given differences in national legal systems and stock exchange listing requirements, this need is more acute where cross-border listings (and the expectations of foreign investors) are involved.

- Lawyers advising on mergers and acquisitions and joint ventures need a solid understanding of governance issues (as well as of the relevant laws, regulations, listing rules, norms of best practice and local governance cultures), as the parties contemplate the governance structure of the emerging entity. Again, these issues are more complex in cross-border transactions.

- Even on a national level, counsel need to understand governance responsibilities and best practice recommendations and how they impact on the potential liability of directors and officers. This is the case both in countries where director and officer duties are heavily regulated, and in countries such as the US that rely heavily on private litigation to ensure corporate compliance with the law.

- In-house counsel can provide significant value when they advise compa-
**The McKinsey survey**

In a 1996 McKinsey survey of US investors, two-thirds of those surveyed reported that they would pay more for a “well-governed” company (a company responsive to investors, with an independent board), all other factors being equal (Robert F. Felton et al., “Putting a Value on Board Governance,” 4 McKinsey Quarterly 170, 170-71, 174 (1996)).

In June 2000, McKinsey replicated this survey in Asia, Europe and Latin America, and the same results hold. Over 200 institutional investors in the US, Europe, Asia and Latin America (representing US $3.25 trillion (EUR3.5 trillion) in assets) were involved in the survey (McKinsey Investor Opinion Survey, June 2000).

The size of the premium investors are willing to pay varies by country. It is lowest in the US and the UK, higher in Asia (Indonesia, South Korea and Japan) and highest in Latin America (Venezuela and Colombia) (see diagrams “Paying for good governance” and “Premiums investors would pay”).

This suggests that the quality of corporate governance at the company level is perceived as most valuable in situations where both:

- Mandated disclosure and legal protection for shareholders are weaker.
- Investors believe there is the most room for improvement.

See www.mckinsey.com/features/investor_opinion/index.html

**The driving forces**

Interest in corporate governance has exploded around the globe due to a host of factors:

- The spread of capitalism and privatisation.
- The growth of corporations.
- Deregulation and globalisation.
- Shareholder activism.
- The Asian crisis.

**Capitalism and privatisation.** Market-based economic systems (dominated by voluntary private sector activity) have replaced command and control-based economic systems in the vast majority of nations. This is most apparent in the countries that have emerged from the former Soviet block, but it is also happening (although less dramatically) in China and elsewhere. In a related development, governments all over the world are relinquishing to the private sector their ownership interests in firms.

**Corporate growth.** Private sector activity organised through the corporate form played an ever-increasing role in national economies throughout the whole of the 20th century. Corporations have proved to be most efficient organisers of economic activity. This efficiency has led to the growth of large multinational companies, some of which are perceived to have a global reach and economic and political power that transcend the reach and power of governments.

**Deregulation and globalisation.** New communication and distribution technologies, and the removal of trade and investment barriers, have created truly global markets with global competition for goods, services and capital, and even corporate control (as shown by the recent boom in cross-border mergers and acquisitions). A whole new level of economic interdependence is emerging, as evidenced by the EU and the North American Free Trade Agreement (NAFTA). Deeper and broader cross-border business relationships between nations signal significant changes to all aspects of society, from culture to labour markets and political focus.

**Shareholder activism.** Equity financing, which has long been important in the US and UK, is becoming a more important source of investment capital in many European and Asian nations. At the same time, capital available for equity investment in corporations has become concentrated in the hands of sophisticated financial intermediaries such as pension funds and mutual funds. This trend was first apparent in the US and the UK, but is spreading with the rise of private investment vehicles around the globe.

Some of the largest and most activist US institutional investors, such as the Teachers Insurance & Annuity Association-College Retirement Equities Fund (TIAA-CREF) and California Public Employees’ Retirement System (CalPERS) regularly support governance initiatives in relation to their international holdings. These investors, who view themselves as corporate “owners”, see a link between sound corporate governance and lowered investment risk. They exercise their rights as investors to some degree on the basis of governance quality. TIAA-CREF, a private pension fund, is the largest pension fund (public or private) in the US, with assets of more than US$300 billion (EUR324 billion) under investment. CalPERS is the largest US public pension fund, with over US$170 billion (EUR183 billion) in assets under investment.
The sheer size of assets in the control of institutional investors exerts pressure on corporations to conform to shareholders’ expectations on governance (see box “The Anglo-American influence”). For example, a group of shareholders in Vodafone Airtouch recently objected to management’s proposal to pay a £10 million (EUR16.24 million; US$15 million) bonus (half in cash and half in shares) to its chief executive, Chris Gent, for achieving the acquisition of Mannesmann, the first successful unsolicited offer for a German company (see www.lawdepartment.net/global “A charm offensive”, EC, 2000, V(5), 35). They were led by the UK National Association of Pension Funds, whose members are reported to have more than £800 billion (EUR1,300 billion; US$1,200 billion) of assets. In an attempt to appease objecting investors, Chris Gent promised to spend half of his bonus on Vodafone’s shares.

The Asian crisis “wake-up”. The financial crisis that began in East Asia, and rapidly spread to Russia, Brazil and other areas of the globe, showed that systematic failure of investor protection mechanisms, combined with weak capital market regulation, in systems that rely heavily on “crony capitalism,” can lead to failures of confidence that spread from individual firms to entire countries. Insufficient financial disclosure and capital market regulation, lack of minority shareholder protection, and failure of board and controlling shareholder accountability all supported lending and investing practices based on relationships rather than on a prudent analysis of risk and reward (see Ira M. Millstein, “The Basics of a Stable Global Economy,” The Journal of Commerce (30th November, 1989)).

In hindsight, the not-surprising result was that companies over-invested in non-productive and often speculative activities. When capital fled these economies in 1997 and 1998, the G7, the World Bank and other multilateral agencies recognised that the efforts to strengthen the global financial architecture needed to include governance reform.

What exactly is corporate governance?
Economic theory holds that when a sole proprietor manages a firm, profits and value will tend to be maximised because they are directly linked to the owner-manager’s self interest (the value of the owner-manager’s investment and income). But when firm ownership is separated from control, the manager’s self interest may lead to the misuse of corporate assets, for example through the pursuit of overly risky or imprudent projects. Corporate financiers (whether they are individuals or pension funds, mutual funds, banks and other financial institutions, or even governments) need assurances that their investments will be protected from misappropriation and used as intended for the agreed corporate objective. These assurances are at the heart of what effective corporate governance is all about (see box “The views of leading voices”).

Narrowly defined, corporate governance concerns the relationships between corporate managers, directors and the providers of equity capital. It can also encompass the relationship of the corporation to stakeholders and society. More broadly defined, corporate governance can encompass the combination of laws, regulations, listing rules and voluntary private sector practices that enable the corporation to:
- Attract capital.
- Perform efficiently.
- Achieve the corporate objective.
- Meet both legal obligations and general societal expectations.

All these factors underscore the reality that corporate managers, directors and investors (as well as those advising them, such as lawyers and accountants) function within a larger business and legal environment that shapes behaviour (see box “The corporate governance environment”).

National differences exist as to what constitutes the raison d’être of companies (the corporate objective), and the answer to the question “For whom is the corporation governed?” will vary from country to country (see “National differences” below). But whatever view prevails, effective governance ensures that boards and managers are held accountable for pursuing the corporate objective, however that objective is defined (see “The importance of corporate governance” below).

National differences. Different governance systems articulate the corporate objective in different ways, depending on which of two primary concerns is taken as the main focus:
- Societal expectations.
- Ownership rights.

Some nations focus on the need to sat-
isfy societal expectations and, in particular, the interests of employees and other stakeholders (variously defined to include suppliers, creditors, tax authorities and the communities in which corporations operate). This view predominates in continental Europe (particularly Germany, France and The Netherlands) and in certain countries in Asia.

Other countries emphasise the primacy of ownership and property rights, and focus the corporate objective on returning a profit to shareholders over the long term. Under this view, employees, suppliers and other creditors have contractual claims on the company. As owners with property rights, shareholders have a claim to whatever is left after all contractual claimants have been paid. This “residual” right is given weight by companies focusing the corporate objective on shareholder value. Associated with the US, Canada, the UK and Australia, this view of the corporate governance objective is generally justified on the following grounds:

• Accountability to shareholders provides a single measurable objective that avoids the risk of diffusing the accountability of managers and directors. If managers and directors are accountable to a whole range of stakeholders, almost any action can be justified as in the interest of some group of stakeholders, and this gives managers and directors unfettered discretion.

• Focusing on long-term shareholder value encourages investment capital to be put to the most efficient economic use from a market perspective and this should benefit society broadly.

In advising clients on how to reconcile the two approaches, in-house counsel should bear in mind that, although much ideological debate has arisen about which of the two descriptions of the corporate objective should prevail, as a practical matter the two concepts do not present inherent conflicts (except when posed in the extreme). Generally, viewed in the long term, stakeholder and shareholder interests are not mutually exclusive. Corporations do not succeed by consistently neglecting the expectations of employees, customers, suppliers, creditors, and local communities, but neither do corporations attract necessary capital from equity markets if they fail to meet shareholders’ expectations of a competitive return.

In the extreme situations in which the short-term interests of various stakeholders collide, a clear understanding of who legal duties are owed to assists boards and managers to take necessary, timely, but difficult actions.

The importance of corporate governance. No matter what view of the corporate objective is taken, effective governance ensures that boards and managers are accountable for pursuing it. The role of corporate governance in making sure that board and management are accountable is of broad importance to society for a number of reasons. Effective corporate governance:

• Promotes the efficient use of resources both within the company and
the larger economy. Debt and equity capital should flow to those corporations capable of investing it in the most efficient manner for the production of goods and services most in demand, and with the highest rate of return. In this regard, effective governance should help protect and grow scarce resources, therefore helping to ensure that societal needs are met. In addition, effective governance should make it more likely that managers who do not put scarce resources to efficient use, or who are incompetent or (at the extreme) corrupt, are replaced.

- Assists companies (and economies) in attracting lower-cost investment capital by improving both domestic and international investor confidence that assets will be used as agreed (whether that investment is in the form of debt or equity). Although managers need to have latitude for discretionary action if they are to innovate and drive the corporation to compete successfully, rules and procedures are needed to protect capital providers, including:
  - independent monitoring of management;
  - transparency as to corporate performance, ownership and control;
  - participation in certain fundamental decisions by shareholders.

- Assists in making sure that the company is in compliance with the laws, regulations and expectations of society. Effective governance involves the board of directors ensuring legal compliance and making judgments about activities that, while technically lawful in the countries in which the company operates, may raise political, social or public relations concerns.

- Provides managers with oversight of their use of corporate assets. Corporate governance may not guarantee improved corporate performance at the individual company level, as there are too many other factors that impact on performance. But it should make it more likely for the company to respond rapidly to changes in business environment, crisis and the inevitable periods of decline. It should help guard against managerial complacency and keep managers focused on improving firm performance, making sure that they are replaced when they fail to do so.

- Is closely related to efforts to reduce corruption in business dealings. Although it may not prevent corruption, effective governance should make it more difficult for corrupt practices to develop and take root, and more likely that corrupt practices are discovered early and eliminated. Effective governance is a check on the power of the relatively few individuals within the corporation who control large amounts of other people’s money (see www.lawdepartment.net/global “Steering

The corporate governance environment

The corporate governance environment is shaped by stock exchange listing rules and a host of laws and regulations concerning:

- 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.
- Labour relations.
- Financial sector practices.
- Tax and pension policy.

The corporate governance environment is also 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 objective.
- Competition in product, service and capital markets, as well as in the markets for management, labour and corporate control.

The Anglo-American influence

The financial power of US and UK institutional investors, and their growing interest in foreign equity, is apparent from a recent study by the Conference Board (a not-for-profit business research organisation) (Institutional Investment Report: International Patterns of Institutional Investment (2000)) (www.conference-board.org)

According to the study:

- Institutional investors hold US$24 trillion (EUR26 trillion) in financial assets in the world’s top five markets.
- Well over two-thirds (76%) of these assets are held by US and UK investors.
- The 25 largest US pension funds (who tend to be the more activist investors in the US market) account for two-thirds of all foreign equity investment by US investors.
- The percentage of foreign equity held in the individual portfolios of these top 25 US pension funds is rising (from an average of 8% of the portfolio in 1993 to a current average of 18% of the individual portfolio).
Global developments in corporate governance

The following are examples of recent corporate governance developments across the globe.

**Brazil**

The eighth largest economy in the world is facing reforms of the legal and regulatory framework designed to help Brazilian companies tap into global capital. In particular, legislation to reform the Corporation Law would strengthen protection for minority shareholders and reduce reliance on non-voting preferred shares. It is expected to be passed in some form by early autumn 2000.

Internal private sector pressure for reform is expected to increase with the creation of three investment funds focused on corporate governance activism under the management of established fund managers (Dynamo, Fa tor/Sinergia and Bradesco-Templeton).

**EU**

The adoption of a common European currency, the freer flow of capital, goods, services and people across EU borders, and increased merger activity among large European companies (and Europe’s largest stock exchanges) have all created tremendous interest among European issuers and investors, member states and the Commission in:

- The shared aims, as well as the differences, in corporate governance practice across Europe (reflected in corporate governance codes).
- Any related barriers to the development of a single EU financial market.

Numerous corporate governance codes have been adopted by different groups in many of the 15 member states, and other entities (such as the OECD, EASD and ICGN) have also adopted codes that may relate to practice in member states. Prominent codes include the following:

- Belgium (Cardon Report).
- France (Vienot I and II; Lévy-Lang Report).
- Germany (German Panel Report).
- Ireland (IAIM Guidelines).
- Italy (Draghi Report).
- The Netherlands (Peters Code).
- Portugal (CMVM Recommendations).
- Spain (Report of the Special Committee).

**France**

A new report issued in 1999 by the French business association, Medef (the second Vienot Report), recommends that boards of public companies that have a single-tier board structure should be allowed to separate the post of président du conseil d’administration into separate chairman and CEO positions (the report is available at www.medef.fr). It also calls for expanded disclosure to shareholders as to:

- Executive remuneration policy.
- Stock option schemes.
- The total amount of directors’ remuneration.
- Individual directors’ remuneration for attendance at board meetings.

Another French business association (Afep) also has recommended that listed companies voluntarily disclose the compensation of directors.

A legislative initiative currently under way would expand these recommendations and take them forward. On 15th March, 2000, the Council of Ministers adopted draft legislation that would enable both listed and unlisted companies to separate the roles of chairman and CEO. The draft would also require listed companies to publish the remuneration of the 10 most highly paid corporate officers. This legislative initiative faces significant opposition from the business community.

**Germany**

A package of tax reform measures pushed through parliament on 14th July, 2000 by Chancellor Gerhard Schröder will eliminate by 2002 the current 50% capital gains tax imposed on corporate sales of shares in other companies (see www.lawdepartment.net/global “Business tax reform 2001”, EC, 2000, V(4), 58). This will:

- Encourage the unwinding of cross-shareholdings among German companies.
- Open German companies to a wider shareholder base, which could lead to an increase in merger and acquisition activity as well as an increase in shareholder activism.

In December 1999, Deutsche Bank’s mutual fund:

- Supported the ranking of German companies on the quality of disclosure, board governance and shareholder rights.
- Released a study that finds a positive correlation between the size of foreign ownership and the quality of governance.

In January 2000, a panel of governance scholars, shareholder activists and corporate executives issued a set of corporate governance guidelines referring to the OECD Principles and encouraging companies to be more transparent on governance and compensation.

**Italy**

In the past decade, Italy has undertaken significant reforms to securities laws and market regulations. In addition, a number of state-owned enterprises (including the Italian Stock Exchange (Borsa Italiana SpA)) were privatised to reduce budget deficits and meet European Monetary Union requirements.

In 1998, the legislature approved a Decree based on the work of the Draghi
Commission, with provisions designed to:

- Discourage cross-ownership among companies listed on the exchange.
- Permit shareholder agreements.
- Simplify rules for tender offers.
- Strengthen shareholder rights by enabling minority shareholders to call a shareholders’ meeting.
- Enable shareholders to bring claims on behalf of the company.
- Enable shareholders to appoint a member of the board of statutory auditors.

In July 1999, the Borsa Italiana SpA issued a set of non-mandatory governance guidelines for listed companies.

**Japan**

Over the past two years, corporate governance changes have become visible in Japan:

- In July 1999, 37 companies joined with Sumitomo Bank and Nissan when they sought shareholder approval to reduce the size of their boards from 20-40 directors to about 10. These companies were following the example set by Sony in 1997, when it became the first Japanese company to reduce the size of its board.
- In January 2000, Japan saw its first home-grown hostile takeover bid for a public company. Ultimately, Yoshiaki Murakami failed in his bid to gain control of Shoei, an under-performing property developer, with nearly 66 billion yen (US$609,249,515; EUR673,708,114) in reserve.
- In April 2000, the Japanese government began a two-year programme to revamp and modernise corporate governance statutes. The main targets of reform are laws affecting disclosure, the structure and duties of boards, and shareholder rights.
- More companies are nominating outsiders to their boards. Within the past year, Softbank and Orix have nominated non-executive outsiders.
- In June 2000, at their AGM, Sumitomo Bank revealed the compensation packages of their executives. This candour came in response to a dissident resolution filed by a group of individual investors, and marks the first time that a financial institution in Japan has revealed information of this nature.

**Korea**

Korea’s Commercial Code has been amended three times in the past five years (in 1995, 1998, and 1999). Reforms include the following:

- A heightened fiduciary duty has been imposed on directors. In addition, directors must report any information that may damage the company to the company’s statutory auditor.
- The minimum holding requirements for shareholders have been lowered with respect to any of the following:
  - gaining injunctive relief against directors who have acted in contravention of the articles of incorporation;
  - bringing a shareholder derivative action on behalf of the company;
  - convening a special shareholders meeting;
  - compelling the production of financial records.
- If provided for in the articles of incorporation, shareholders may vote in writing without having to attend a shareholders meeting.
- Shareholders may request cumulative voting for the purpose of electing directors, and companies must respect this unless the articles of incorporation explicitly forbid it.

In spring 2000, a shareholder-activist group, PSPD, pressed for and achieved board changes at Dacom, a large telecoms concern. The reforms included measures to ensure that the chairman of the board is a non-executive and at least half of the board is independent. A fully independent audit committee will monitor related party transactions to ensure they are done at arm’s length.

**The Netherlands**

For a European jurisdiction often chosen by multinational companies as a location in which to establish their holding companies, there have been remarkably few developments in the sphere of corporate governance.

In 1997 the Peters Committee on Corporate Governance, established by the Association of Securities Issuing Companies and the Amsterdam Stock Exchange Association, issued a code of best practice recommendations for effective corporate governance. Compliance with the Peters Code is wholly voluntary (it is not mandated by statute or encouraged through mandatory disclosure).

After a survey of companies concluded that many of the Peters Code recommendations were not being followed, the ministers of economic affairs, social affairs and labour and justice announced in May 1999 a regulatory initiative aimed at reforming certain governance practices relating to transparency and accountability. The reform effort, however, appears to have stalled.

**Russia**

Russia has had to mould a free market system from the ground up, and much of the efforts to date have focused on putting into place a basic framework of laws and regulatory capacity. Unfortunately, the broad perception is that protection of minority shareholder rights continue to lag, although, in 1999, a Federal Law on the Protection of Rights and Legitimate Interests of Investors in the Securities Market was enacted. Foreign investors have attempted to press their rights, with little success to date, although there have been rumours that Putin has intervened on foreign investors’ behalf several times.

In late June 2000, the Putin government set out its economic programme, with
some governance-related initiatives. The “Gref plan” includes proposals to:

- Improve the protection of property rights.
- Clamp down on interested party transactions.
- Improve disclosure.

In an attempt to improve the credibility of Russian companies and their securities, State Street Bank and George Soros have helped to launch the Vasiliev Institute for Corporate Governance. The Institute intends to increase the information available to foreign investors by rating Russian listed companies based on the effectiveness of their corporate governance. In addition, the Institute will lobby for more stringent investor protection.

UK

The broad review of company law initiated by the Department of Trade and Industry has resulted in a consultative paper (published in March 2000 by the Company Law Review Steering Group) proposing key governance reforms. Although there has been much debate on whether or not a more stakeholder-focused model would be beneficial, the steering group has recommended that a “shareholder-oriented, but inclusively framed, duty of loyalty” is most likely to lead to “optimal conditions for companies to contribute to the overall health and competitiveness of the economy.”

The steering group considered and rejected the adoption of the two-tier board structure common in many EU countries, but recommends:

- Implementing direct legislation or rules to create clear monitoring obligations for non-executive directors.
- Requiring an increase in the proportion of non-executive directors on boards.
- Changing the non-executive directors’ appointment method to minimise the role which executive directors play in appointing non-executive directors.
- Tightening the definition of director independence.
- Strengthening the independence of the chairman.

In June 2000 the National Association of Pension Funds (NAPF) (see main text “Shareholder activism”) published an extensive set of corporate governance standards to serve as proxy voting guides for member funds. The NAPF’s standards follow the Combined Code, but push for stronger requirements in some areas, by recommending:

- Separation of the positions of chairman of the board and CEO.
- A ten-part test to determine board member independence.
- Avoiding re-pricing share options in situations of under-performance.
- An annual shareholder vote on the report of each company’s remuneration committee.

US

In 1998, SEC concerns about corporate financial reporting led the New York Stock Exchange and National Association of Securities Dealers to convene a private sector Blue Ribbon Committee to recommend ways to improve audit committee oversight of financial reporting. The Committee’s Report, issued in February 1999, focused on:

- Strengthening the independence and qualifications of audit committee members.
- Improving audit committee effectiveness.
- Improving the mechanisms for discussion and accountability among the audit committee, the outside directors and management.

After a period of public comment, the

clear of bribery”, EC, 2000, V(4), 37.

The multi-jurisdictional dimension

Corporate governance practices vary across nations and individual companies. This variety reflects not only distinct societal values, but also different ownership structures, business circumstances and competitive conditions. It also reflects differences in the strength and enforceability of contracts, the political standing of shareholders and debt-holders, and the development, and enforcement capacity, of legal systems.

In developed countries, the discussion on how to improve corporate governance tends to assume that the following are in place:

- Well-developed and well-regulated securities markets.
- Laws that recognise shareholders as the legitimate owners of the corporation and require the equitable treatment of minority and foreign shareholders.
- Enforcement mechanisms through which these shareholder rights can be protected.
- Securities, corporate and bankruptcy laws that enable corporations to transform (to merge, acquire, divest and downsize) and even to fail.
- Anti-corruption laws to prevent bribery and protection against fraud on investors.
- Sophisticated courts and regulators.
- An experienced accounting and auditing sector.
- Significant corporate disclosure requirements.

In addition, developed countries are also more likely to have well-developed private sector institutions, such as:

- Organisations of institutional investors.
- Professional associations of directors, corporate secretaries and managers.
- Rating agencies, security analysts and a sophisticated financial press.

Conversely, many developing and emerging market nations have not yet fully developed the legal and regulatory systems, enforcement capacities and private sector institutions required to support effective corporate governance. Therefore, corporate governance reform efforts in these countries tend to focus on the fundamental framework. Reform needs vary, but often include:
In the past two years, institutional investors have focused their activism on the “dead hand” poison pill, an anti-takeover mechanism that is illegal in Delaware but still used by companies incorporated in other jurisdictions. Dead hand poison pills provide that only directors who are in office for a specified period of time before a proxy fight may redeem or amend shareholder rights plans. Investors argue that dead hand pills serve only to entrench management. In the most recent proxy season, TIAA-CREF, the world’s largest pension system, submitted resolutions to 17 companies asking them to remove the dead hand provision from the poison pills they use. Of these 17 companies, 15 complied with TIAA-CREF’s request, which led the pension system to withdraw its resolutions.

Institutional investors are also targeting stock option schemes, out of concern for potential dilutive effect. Investors are particularly concerned about option repricing in situations where the company’s stock price has decreased. Stock options are generally intended to be a form of incentive-based pay. Lowering strike prices when stock performance declines appears to reward executives for doing a poor job. This issue has received considerable attention with respect to high tech and e-commerce companies. For example, Microsoft has asserted that its stock option schemes, out of concern for potential dilutive effect. Investors are particularly concerned about option repricing in situations where the company’s stock price has decreased. Stock options are generally intended to be a form of incentive-based pay. Lowering strike prices when stock performance declines appears to reward executives for doing a poor job. This issue has received considerable attention with respect to high tech and e-commerce companies. For example, Microsoft has asserted that it must reprice options to keep its top employees from seeking more lucrative opportunities elsewhere.

### World Bank/OECD

Recognising that governance reform requires a combination of regulation and private sector initiative for implementation, the World Bank and OECD have joined together to sponsor a Private Sector Advisory Group on Corporate Governance and a Global Corporate Governance Forum, in addition to their separate activities related to governance reform. A Charter and World Programme for the Forum was formally approved by both the World Bank and OECD in June 2000.

The goal is to:

- Create a public-private partnership to raise awareness of the value of corporate governance improvement.
- Involve the private sector in the implementation of corporate governance reform in emerging market nations.

The Private Sector Advisory Group, comprised of prominent business leaders from around the world, has established an Audit/Accounting Task Force and an Investor Responsibility Task Force, and has been involved in a series of events in Brazil to raise the awareness of the local private sector of the need for reforms. A similar effort is planned for Russia this autumn.

- Stock exchange development.
- The creation of systems for registering share ownership.
- The enactment of laws for basic minority shareholder protection from potential self-dealing by corporate insiders and controlling shareholders.
- The education and empowerment of a financial press.
- The improvement of audit and accounting standards.
- A change in culture and laws against bribery and corruption as accepted ways of doing business.

In addition to differences in the development of legal and regulatory systems and private institutional capacity, nations differ widely in the cultural values that mould the development of their financial infrastructure and corporate governance. In practice, international agreement on a single model of corporate governance or a single set of detailed governance rules is both unlikely and unnecessary. Even among fairly similar systems, like the US and the UK, fundamental distinctions remain that are unlikely to be resolved. One of the most obvious distinctions, for example, is how business managers are kept in check. In the US (like other European nations), regulation plays an important part in the process. In the US (uniquely), regulation focuses primarily on disclosure obligations and significant reliance is placed on shareholder derivative litigation (claims brought on behalf of the company) and class actions as enforcement mechanisms.

However, the reality of the demands of global capital markets has led to some international consensus on the basics of effective corporate governance.

### The OECD Principles


The Millstein Report focused on “what is necessary by way of governance to attract capital.” According to the Millstein Report, government intervention in the area of corporate governance is likely to be most effec-
effective in attracting capital if it focuses on four core standards:

- Fairness, achieved by ensuring both:
  - the protection of shareholder rights (including the rights of minority and foreign shareholders);
  - the enforceability of contracts with resource providers.
- Transparency, accomplished by requiring timely disclosure of adequate, clear and comparable information concerning corporate financial performance, corporate governance and corporate ownership.
- Accountability, involving the clarification of governance roles and responsibilities, and supporting voluntary efforts to make sure that manage-

### Importance of factors influencing investment decisions

(Ranked according to aggregate response)

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<td>Stock performance</td>
<td>Quality of board of directors</td>
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<td>4</td>
<td>Quality of board of directors</td>
<td>Disclosure practices</td>
<td>Adoption of accounting standards/principles</td>
</tr>
<tr>
<td>5</td>
<td>Quality of corporate governance</td>
<td>Board independence</td>
<td>Quality of corporate governance</td>
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<tr>
<td>6</td>
<td>Board independence</td>
<td>Quality of corporate governance</td>
<td>Board independence</td>
</tr>
<tr>
<td>7</td>
<td>Adoption of accounting standards/principles</td>
<td>Adoption of accounting standards/principles</td>
<td>Quality of board of directors</td>
</tr>
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The report summarises a survey of institutional investors in seven countries broken out into three regions: Continental Europe (Belgium, Germany, France, Italy and The Netherlands), the UK and the US.)
The OECD Principles

The OECD Principles:

- Reflect the broad consensus reached by the 29 OECD member nations with regard to fundamental issues of corporate governance.
- Represent the first inter-governmental accord on the common elements of effective corporate governance.
- Provide significant room to take into account national differences, including differing legal and market frameworks, traditions and cultures.

The OECD Principles build on the four core standards set out in the Millstein Report (see main text “The OECD Principles”): fairness, transparency, accountability and responsibility.

Fairness. The OECD Principles expand on the concept of fairness with two separate principles:

- The Corporate governance framework should protect shareholders’ rights (OECD Principle I).
- The Corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights (OECD Principle II)

This Principle recognises that shareholders are property owners, and as owners of a legally recognised and divisible share of a company, they have the right to hold or convey their interest in the company. Effective corporate governance depends on laws, procedures and common practices that protect this property right and ensure secure methods of ownership, registration and free transferability of shares. The Principle also recognises that shareholders have certain participatory rights on key corporate decisions, such as the election of directors and the approval of major mergers or acquisitions. Governance issues relevant to these participatory rights concern voting procedures in the selection of directors, use of proxies for voting, and shareholders’ ability to make proposals at shareholders meetings and to call extraordinary shareholders meetings.

According to Principle II, the legal framework should include laws that protect the rights of minority shareholders against misappropriation of assets or self-dealing by controlling shareholders, managers or directors. Examples include:

- Rules that regulate transactions by corporate insiders and impose fiduciary obligations on directors, managers and controlling shareholders.
- Mechanisms to enforce those rules (for example, the ability of shareholders to bring a claim on behalf of the company in certain circumstances).

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

This Principle recognises that investors and shareholders need information about the performance of the company (its financial and operating results), as well as information about corporate objectives and material foreseeable risk factors to monitor their investment. Financial information prepared in accordance with high-quality standards of accounting and auditing should be subject to an annual audit by an independent auditor. This provides an important check on the quality of accounting and reporting.

In practice, accounting standards continue to vary widely around the world. Internationally prescribed accounting standards that promote uniform disclosure would enable comparability, and assist investors and analysts in comparing corporate performance and making decisions based on the relative merits.

Information about the company’s governance, such as share ownership and voting rights, the identity of board members and key executives, and executive compensation, is also important to potential investors and shareholders and a critical component of transparency.

Accountability. The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board’s accountability to the company and the shareholders (OECD Principle V).

This Principle implies a legal duty on the part of directors to the company and its shareholders. As elected representatives of the shareholders, directors are generally held to be in a fiduciary relationship to shareholders and to the company, and have duties of loyalty and care which require that they avoid self-interest in their decisions and act diligently and on a fully-informed basis. Generally, each director is a fiduciary for the entire body of shareholders and does not report to a particular constituency. As the board is charged with monitoring the professional managers to whom the discretionary operational role has been delegated, it must be sufficiently distinct from management to be capable of objectively evaluating them.

Responsibility. The corporate governance framework should recognise the rights of stakeholders as established by law and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises (OECD Principle III).

This Principle recognises that corporations must abide by the laws and regulations of the countries in which they operate, but that every country must decide for itself the values it wishes to express in law and the corporate citizenship requirements it wishes to impose. As with good citizenship generally, however, law and regulation impose only minimal expectations as to conduct. Outside of the law and regulations, corporations should be encouraged to act responsibly and ethically, with special consideration of the interests of stakeholders and, in particular, employees.

The principles are available in full text at www.oecd.org/daf/governance/principles.htm
The views of leading voices

On the importance of corporate governance:

“The governance of the corporation is now as important in the world economy as the government of countries.”


On the role of government in corporate governance:

“Like a powerful river, the market economy is widening and breaking down barriers. Governments’ role is to accommodate - not block the flow - and yet keep it sufficiently under control so that it doesn’t overflow its banks and drown us with undesirable side effects.”

Ira M. Millstein, Honorary Chairman’s Opening Remarks, ICGN Annual Meeting (13th July, 2000).

On the economic theory of governance:

“[B]eing managers of other people’s money than their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which the partners in a private co-partner frequently watch over their own… Negligence and profusion, therefore, must always prevail more or less in the management of the affairs of [a joint stock] company”.


Evaluating corporate governance

(Percent saying yes)

<table>
<thead>
<tr>
<th>Continent</th>
<th>Has poor governance caused you to reduce or divest your holding in a company?</th>
</tr>
</thead>
<tbody>
<tr>
<td>US</td>
<td>61%</td>
</tr>
<tr>
<td>UK</td>
<td>48%</td>
</tr>
<tr>
<td>Continental Europe</td>
<td>53%</td>
</tr>
</tbody>
</table>

The Russell Reynolds survey points out that despite the importance investors place on corporate governance practices in their investment decision making (and the positive reception they give to companies whose boards adopt corporate governance guidelines), few say their organisations use formal guidelines to help them evaluate the corporate governance practices of the companies in which they invest.

<table>
<thead>
<tr>
<th>Continent</th>
<th>Do you or your corporation have formal guidelines or metrics for evaluating governance practices?</th>
</tr>
</thead>
<tbody>
<tr>
<td>US</td>
<td>16%</td>
</tr>
<tr>
<td>UK</td>
<td>38%</td>
</tr>
<tr>
<td>Continental Europe</td>
<td>21%</td>
</tr>
</tbody>
</table>

text at www. dcgn.dk). The Euroshareholders guidelines are interesting in
that diverse shareholders all agreed that the corporate objective is to max-
imise long-term shareholder value (notwithstanding the continental tra-
dition of emphasising employee inter-
est).

**Governance guidelines and codes of best practice**

In addition to the emergence of the OECD Principles, the past decade has
seen a proliferation of corporate governance guidelines and codes of best
practice prepared by a wide range of national government committees (list-
ing bodies, associations of investors and individual companies as industry
models).

In-house counsel can play a vital role in:

- Distilling the principles in these
documents and advising officers and
directors on the similarities and differ-
ences that may impact on important
cross-border deals, such as mergers
and acquisitions and joint ventures.

- Assisting boards to adapt relevant
principles into individual company
guidelines, suitable for the company’s
or group’s specific operations and cir-
cumstances.

The significance of these codes, and
the management of issues such as the
corporate objective, board responsibil-
ities, board composition, board com-
mittees, corporate decision making
and disclosure are all explored in the
second part of this feature, which will
appear in the October issue of Global
Counsel.