International Finance Corporation
World Bank Group

Did You Know?

10 Intriguing Facts About Corporate Governance

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Corporate Governance Department

IFC/World Bank

Voting for Board Directors

1 Did You Know…

...that in the US, shareholders cannot vote against nominated board directors?

Look at your next proxy statement: you can vote "for" or "withhold". Therefore, it is possible to elect a director with one "for" vote.

This is a contentious issue among shareholder activists and has led to questions about using the US as a "model".

Family Business Corporate Governance

2 Did You Know…

...what steps family companies take when they get serious about corporate governance?

1. Establish a "family constitution"
2. Establish a family employment policy—and separate family members' rights and responsibilities as shareholders and as employees
3. If the firm will not pay dividends, set up a fund or other mechanism to buy out family shareholders who prefer, for example, annuity income over owning a growth stock
4. Create a succession plan for owner/founder/CEO/chairman
5. Develop transparent systems for financial accounting, management accounting, human resources and strategy development
6. Create a board which can seriously add value to the business itself

See IFC's Corporate Governance Department website for other tools and models pertaining to family business.

Board Duties

3 Did You Know…

...that board directors have two major "duties"?

1. Duty of Loyalty (first loyalty is to the company as a whole)
2. Duty of Care (full attention to all board matters)

In common law systems, judges can articulate as many as nine fiduciary duties of boards. Some are considered part of the duties of care and loyalty. These include the duty:

- of confidentiality (not to disclose company information)
- of candor (disclosure to the board)
- not to violate the law or the company's bylaws/constitution

Another duty that has been the subject of recent litigation and wider debate is the duty of good faith. This is the duty for board members to act conscientiously, honestly and without deceitful intent. IFC's indemnifications are prepared following common law models, and cover our nominees for suits against them as directors, but only provided they act in good faith.

In civil law systems, the duties of directors derive more directly from statutes, e.g., company laws and civil and commercial codes. However, the same basic principles of director responsibility are supported—after all, the corporate form is international.

Korea's Corporate Governance Premium

4 Did You Know…

...that well-governed firms in Korea traded at a premium of 160 percent to poorly governed firms?

This fact and many others are found in "The Irresistible Case for Corporate Governance." This one-pager shows that good corporate governance can lead to improved company profitability, reduced cost of capital, greater company valuations, and better access to IFC. Find it at IFC's Corporate Governance Department website.

Corporate Governance Ratings

5 Did You Know…

…that well-governed firms have a total shareholder return of almost twice that of poorly governed firms?

GovernanceMetrics International (GMI) recently rated 3,200 global companies' corporate governance practices on a scale of 1 (low) to 10 (high). Companies that scored high ratings (a 9 or better) had an average 15.9% return over the three years ended September 1, 2005. Firms with the worst-rated governance (scoring a 3 or below) only posted an average 8.7% return during that time.

For more studies demonstrating the power of good corporate governance, please see The Irresistible Case for Corporate Governance.

Companies Circle

6 Did You Know…

….that IFC has sponsored a "Companies Circle" of Latin American firms that have improved their corporate governance practices?

The Circle will share their experiences with the broader market of Latin American businesses and provide input from the corporate perspective.

These companies have realized excellent value from their corporate governance improvement efforts:

1. **CCR (toll roads, Brazil):** CCR was the first company to go public on Brazil's good governance listing segment, the Novo Mercado. Its market cap increased about 400% from February 2002 to December 2004.
2. **Suzano Group (paper, chemicals; Brazil):** The firm increased its daily share trading volume from less than R$1M in 2003 to about R$6M in one year. Its market capitalization increased by five times in two years since the company's 2003 listing on Level 1 of the Novo Mercado.
3. **Natura (cosmetics, Brazil):** The firm made its IPO on the Novo Mercado in 2004. The IPO was 14 times oversubscribed.
4. **Argos (cement, Colombia):** Its share price rose 108% over the 18 months through August 2005 when it adopted a code of corporate governance.
5. **Buenaventura (mining, Peru):** The company converted all of its shares into a single share class prior to its 1996 IPO. Since then, its market cap has risen more than five times. The firm has complied with Sarbanes Oxley since July 2005.
6. **Ultrapar (chemicals, gas; Brazil):** One year after its 1999 IPO, the firm granted 100% tag-along rights to all shareholders. Since the IPO, EBITDA grew 27% and net income increased 45%. The company is working on complying with Sarbanes-Oxley. It joined Level 1 of the Novo Mercado in October 2005.

A new book of Companies Circle case studies is available on the IFC Corporate Governance Department's website in Spanish, English, and Portuguese.

Governance Codes Toolkit Available

7 Did You Know…

...that voluntary corporate governance codes of best practice are increasingly used to prod companies to shape up?

Codes are sets of nonbinding recommendations aimed at guiding companies' practice within a country's specific legal and business environment.

Benchmarked on international standards, codes of best practice can also help improve the country's investment climate and foster governance reforms.

Best practice guidelines have been introduced in at least 22 emerging market countries to curb corporate scandals and reduce the risk of financial crises. Picking up on this momentum, new initiatives are now underway in a number of our client countries either to develop new codes or revise existing ones.

If you want to learn more about codes, and how to develop, update and implement them, read our new Toolkit on Developing Corporate Governance Codes of Best Practice.* Elements of the Toolkit can be useful for sector- or even company-specific purposes. You can find it on the Global Corporate Governance Forum website.

**A Global Corporate Governance Forum Publication*

Happy New Year in India

8 Did You Know…

...that India's government is ushering in the New Year with major corporate governance requirements for its public companies?

Beginning on January 1, 2006, India's listed companies must comply with a raft of new corporate governance standards. The new requirements, set by India's securities regulator, include: more independent directors on boards and audit committees, a code of conduct for board members, more responsibilities for audit committees, and mandatory certification by the CEO and chief financial officer of the company's financial statements and of the effectiveness of internal accounting controls.

The reason for the changes is simple: to attract domestic and international investors. India is betting that if transparency and accountability improve, investor rupees will follow.

Early reports indicate that companies are not finding it easy to comply with the new requirements.

Business Failures and Ethics

9 Did You Know…

…that ethical lapses have led to some of Europe's biggest business failures?

Ethical breaches by management or employees caused 37% of high-profile business failures in Europe. A recent study of 60 European cases of formal bankruptcy or stock price free fall shows this remarkable impact of ethical lapses. In a large number of these cases, a dominant shareholder or manager with big ambitions was acting unethically, and his/her actions went unchallenged by the company and by the Board.*

Unfortunately we do not have data for emerging markets, where securities law enforcement tends to be even weaker.

Corporate governance codes of ethics can help guard against unethical behavior in companies. A performance review of the CEO by the board of directors can also help root out ethical problems before they lead to business failures.

**from "Classification and Analysis of Major European Business Failures", Maastricht Accounting, Auditing & Information Management Research Center, RSM Erasmus University. October 2005*

Mexico's New Securities Law

10 Did You Know…

…that a new securities law could help dramatically raise Mexico's corporate governance standards?

The new law introduces a host of changes aimed at improving investor protection in Mexico, which ranked a dismal 125th in the world in the World Bank Doing Business Report's most recent index of investor protection and corporate governance standards.

The new law will:

- Introduce a new type of corporation, called an SAPI *(sociedad anónima promotora de inversion)*, that gives much clearer rights for minority shareholders than other limited liability Mexican companies do. Companies can become SAPIs, but once they do, they have three years to list on an exchange.
- Give minority shareholders more protection. For instance, it will take fewer investors' votes to call a meeting, to file a civil legal action, or to oppose a resolution from a shareholders' meeting.
- Impose duties of care and loyalty on board directors
- Improve financial reporting. SAPIs and listed companies must issue simplified annual reports, annual audited financial statements, and quarterly financial reports.
- Make clearer, harsher penalties for violations such as insider trading

These are certainly steps in the right direction for Mexico. However, the changes are being made via securities law, and not by a companies act. Therefore, it will be interesting to see how the courts interpret the new securities law requirements, especially in the context of various existing companies laws.

Resources

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