



New Corporate Standards for Emerging Markets

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interviews

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December 21, 2004

Corporate governance scandals in developed countries and the increasingly obvious lack of the appropriate institutions in other countries – property rights, the rule of law, etc. – necessitated the OECD revise their principles for corporate governance, originally issued in 1999. The improvements made in 2003 incorporated input from emerging markets to address the prevalence of family-owned business, privately held firms, and others not traded publicly on stock market. Adopted voluntarily, corporate governance standards and corporate citizenship practices, as well, do not become a burden on employers, but a sustainable way to engage the leadership of business to help shape a better society and healthy private sector.

This interview originally appeared in the Russian-language Company Management Magazine (www.zhuk.net) in December 2004.

IB: The Organisation for Economic Co-operation and Development (OECD) has adopted a new edition of its corporate governance principles. Why was such an action necessary?

JDS: The original OECD principles were written by Ira Millstein and a group at the Business Industry Advisory Committee in response to a general observation that an international standard on corporate governance needed to be created. The OECD initiative was undertaken as part of the response to the Asian Financial Crisis and the Russian ruble exchange rate crisis of 1998. The new corporate governance principles are integrated, along with twelve other such standards, into what is becoming part of the framework of globalization.

However, the principles were written with a very general conception, because there are a number of different ways in which corporate governance can be put into place. The participants who wrote these standards were generally thinking of developed market economies, where the rule of law, property rights, and other key features for a market economy are firmly in place.

Two things drove the revision of the principles: first, it was felt that, given the corporate scandals that emerged in Enron, WorldCom, Parmalat, and a number of cases in developing countries, it was time to take a fresh look to see if new emphasis on any of the individual principles, such as shareholder rights and duties or the duties of boards of directors or audit committees, for example, might be necessary.

The Center for International Private Enterprise is a non-profit affiliate of the U.S. Chamber of Commerce and one of the four core institutes of the National Endowment for Democracy. CIPE has supported more than 800 local initiatives in over 90 developing countries, involving the private sector in policy advocacy, institutional reform, improving governance, and building understanding of market-based democratic systems. CIPE programs are also supported through the United States Agency for International Development.

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But in a second instance it became obvious, that the emerging markets don't have the institutional structures of property rights, rule of law, and other essential institutions that are so strongly embedded in the developed markets: the OECD countries. So the non-OECD countries really needed additional guidance on the institutional structure necessary to make corporate governance work. In that sense, a good part of the revision of the OECD principles – the first several pages, in fact – focuses on how these principles can be put into place in emerging markets to extend the reach of this global standard beyond simply the developed OECD countries.

IB: What is new in the new edition as compared with the version of 1999? What is most important in the new ideas on corporate governance put into the new edition?

JDS: I think the most important thing was to extend the reach of the OECD principles into the emerging markets. And, in part, this came out as the result of an excellent series of OECD roundtable meetings that were held in Russia, Eastern and Southeastern Europe, and Latin America, as well as meetings that the Center for International Private Enterprise (CIPE) co-sponsored with the Global Corporate Governance Forum for the Middle East and Africa.

The first idea that came out of these meetings was the need for an emphasis on institutional reform, in other words, the rules and norms that create market economies. But, there was also a feeling that the OECD principles needed to be extended beyond companies traded on exchanges.

If you look at the composition of companies that issue stock in developing countries, you find that many of them are not publicly traded. They are family companies or they are companies with dominant shareholders who have sold shares or stock privately. We need to bring them into the idea of corporate governance, which requires a different approach.

In addition, the whole issue of the corporate governance relationship between banks and/or sources of debt, generally speaking, and companies needs to be looked at.

Finally, and most importantly, it became obvious that in the second and third generation of family firms, there were some significant corporate governance issues that needed to be addressed.

So, all of these issues are coming under discussion in the new edition of the corporate governance principles, but, also, and more importantly, in the ancillary discussions that are being held. For example, the OECD held a series of meetings in Paris in November of 2003 during which emerging market representatives were invited into the dialogue in a formal way. CIPE helped to organize that review. Now there are a series of follow-on meetings being conducted now to review regional white papers. During these meetings the revised corporate governance principles are being introduced in Latin America, the Middle East, and other developing-country regions, including, of course, Russia and the countries of the former Soviet Union.

IB: Recent corporate governance scandals, especially in the United States, make many people believe that the voluntary approach and application of best corporate governance principles should be replaced with more mandatory tools. What do you think of that? Do you see this tougher approach in the OECD corporate governance principles? If not, why? What view on this issue is most widespread in the United States?

JDS: Well, it's not a one-size-fits-all approach. That's the essential thing to keep in mind as you generalize beyond an individual market to all of the different markets in the world. I don't believe that there is a general consensus that all corporate governance principles should be made mandatory or that mandatory enforcement of corporate governance principles should be the norm in all cases. Clearly, there are some parts of corporate governance that have to be mandatory such as the requirements for independent audits. However, other standards need to be tailored to different types of enforcement, through stock exchanges for example.

First of all, if you look at the U.S. market, of course, the new Sarbanes-Oxley law, as well as some other pieces of legislation, created a national law on corporate governance for the first time. Prior to that, corporate governance was based on precedents set in the court system. Many of those precedents were of a binding nature, so we can't say that it was purely voluntary in the past. There were things like the business judgment rule, which says that companies and boards of directors, in particular, have a duty to the company to use their best judgment. And if they fail to do that duty, as

many did in, for example, Enron, there are significant penalties attached to it. So, there is some enforcement aspect prior to Enron, WorldCom and the like.

What is different now is that the Sarbanes-Oxley legislation pulled this into legislation for the first time. However, that same approach would not be appropriate, for example, in a country like Russia. As we discussed earlier, corporate governance reform has to be tailor-made for the type of institutional framework that exists in different countries. In countries with weak legal enforcement through the courts, for example, a watchdog agency might be more appropriate.

Every country has to design its own corporate governance approach keeping in mind the institutional capacities of that country. You can't simply take a piece of legislation, like Sarbanes-Oxley, from the United States, which has both mandatory and voluntary features; or the New York Stock Exchange listing requirements; or other similar codes and acts and try to export them to other countries.

The approach that we use at CIPE, in cooperation with our partner organizations – like the Russian Institute of Directors – is to become an expert as much as we can in all of these different trends. But then it is essential to go through a deliberate process of consultation with the business community in-country; to identify obstacles, issues, things that need to be addressed, such as the family-firm structure, the publicly traded structure, the state-owned structure, or minority shareholders in non-traded companies. Each of these issues has to be dealt with on its own terms.

Our recommendation is not to take a one-size-fits-all approach, but to take a concept and design it specifically to address the issues in the country. Now, having said that, there are certain aspects of corporate governance which have been mandatory in most societies and will become more so. One of those, as I mentioned, is the need for an independent audit and for other kinds of disclosure rules.

But, again, how these are done, how they are worded, and what standards are applied really is going to have to be done country-by-country.

IB: In Russia, the issue of social responsibility of business is now high on the agenda. We have known that in Europe businesses have been more socially oriented than in the United States. What does it mean, what do you think of that? What are the main trends and social responsibility and citizenship of businesses in the United States?

JDS: Well, social responsibility and social citizenship mean very different things than corporate governance. Corporate governance has to do with how the company is managed and directed. Social responsibility, or corporate citizenship, which is the term that we prefer, has to do with how companies see their role in the society. It also has to do with how companies comply with or come to terms with issues like environmentalism, consumer satisfaction, workplace issues, and relationships with NGOs (non-governmental organizations) in their local communities.

I don't think there are a lot of generalizations that one can make about Europe versus the United States. In certain European countries, it is, for example, quite common for companies to issue social responsibility reports. At the same time, one of our most competitive companies in the United States, Starbucks Coffee, issues an annual report that is very well-received and highly praised by the social responsibility community. And I would invite you to go to the Starbucks website and take a look at it (www.starbucks.com/aboutus/csrannualreport.asp). It covers a variety of different issue areas.

A number of websites now have been dedicated to cataloging and helping companies come to terms with all of the various approaches out there because there is no industry standard on what social responsibility is or is not. One of these websites, CRS Wire (www.csrwire.com), is an excellent starting point. There you will find reports from European companies, but you will also find reports from companies like Ford Motors, which has for years been a leader in this field. So I think it's a bit of a mistake to generalize this.

Reports from the OECD and other sources on the long-term competitiveness of American versus European companies deal more with hours worked, productivity standards, and use of technology. I think there is a general consensus that American firms have been relatively more agile than companies in continental Europe in adopting technology and weaning productivity gains out of that investment. I think that is more the source of competitiveness in the United States versus Europe, for example, than, perhaps, social responsibility would be. And, certainly, the recent McKinsey Report on

Productivity Gains, which measures gains in hard competitiveness, would tend to argue that case. And that's very well profiled on the McKinsey & Company website (www.mckinsey.com).

IB: In emerging and transition countries, businesses are less rich than businesses in advanced countries. Wouldn't high social responsibility de-motivate business, make it switch more to the shadow or informal sector if it becomes too burdensome and costly and cut its competitiveness, compared with advanced countries?

JDS: Again, that depends on what you mean by social responsibility or corporate citizenship. Certainly, the findings that we have come across – and I think this is true of a large part of the corporate citizenship organizations, whether it's the International Business Leaders Forum or the CSR Wire that I mentioned a moment ago – believe very much in the voluntary approach to corporate citizenship and on a company-by-company basis.

The big danger I see is when corporate citizenship becomes an additional tax for which individual companies have to set aside a certain percentage of their income. Most often this has been seen in the financial system, where – as in India – the banking system has been told that a certain percentage of their loans have to be made for certain socially targeted parts of the community. This does tend to distort the flow of financial systems. And, in my mind, it's that kind of mandatory direction that really takes away from government its proper role and places it on the company.

Democracies – and I think it's the goal of most countries – really expect our legislative and parliamentary processes to come up to and to deal with these questions of how do we develop our society.

Now, certainly, the corporation has a role and a responsibility as a citizen to express its views, to take its part, and to pay its fair share. But, to move from a voluntary corporate governance approach, where companies engage in order to help develop the communities they work in, just as do NGO groups and citizens – to the mandatory-type structure, is, I think, where developing countries really should have the greatest fear.

A mandatory structure is simply going to increase the tax burden on companies, which, in turn, can only result in higher product costs, lower productivity, or fewer jobs. So those would be the concerns I would want people to think through as they move to embrace some kind of strong social responsibility-mandated approach.

IB: Could social responsibility and corporate citizenship be economically effective or will this be an expense part if accounts and businesses should just accept this? What does it mean? How can one prove that social responsibility and corporate citizenship are economically effective?

JDS: Our approach at the Center for International Private Enterprise has always been to say that corporations' fundamental role as part of its citizenship requirement is to become a key part of the system. Companies can do this by joining business associations, think-tanks, and NGOs that help shape and provide leadership to government and the general public on how to best develop society and on how to develop the economy.

For example, in the United States many years ago, we were having a huge problem with graduates of our educational system being unqualified for the job market. So the corporate community, led by a number of active CEOs, took a very strong stand that we needed to develop a national effort to improve our school systems. That's just one small example of corporate citizenship. To my way of thinking, that's a model of how corporate citizenship can play out. Now, there are a number of other areas that would be very similar to this.

Looking at developing countries, corporate citizenship could play a strong role, for example, in Russia. As you look across Russia, the Russian Chamber of Commerce and the Russian organization OPORA (Union of Business Associations) are partnered with CIPE, in what I think is a very good example of corporate citizenship: efforts to remove barriers and lower the burdens on the informal economy and on small business so that those sectors can grow and become a vital and productive part of society.

It is a huge problem for a country's development if a large part of the economy operates outside of the legal system, without legal protection, without access to credit, and without access to the court system.

In this case, it is vital that the business community – the formal business community – is taking a leadership role in helping to resolve that problem by looking at barriers, by looking at what needs to be done to bring property rights to the average citizen of Russia, to allow people to choose to be entrepreneurs. That effort is just as important for the development of Russia as the development of the educational system was in the United States to our companies back in the early 1980s. It's a huge boost to productivity, and it's a huge boost to economic growth.

So, to my way of thinking, corporations in emerging markets in developing countries can come together voluntarily through associations like the Russian Chamber of Commerce or OPORA or through very good and active think-tanks or other social organizations. Business can provide the leadership to identify pressing national issues, come up with business-oriented solutions, identify market-friendly approaches, and help provide the impetus for passage of legislation. During the implementation stage, which is even more vital – business organizations should work with local governments and local citizen organizations to make sure that these things get put into place.

So, corporate citizenship can be thought of as something that gets sent to the public relations department, as an extra tax burden, or as engaging the leadership of business to help shape a better society. I would very much recommend the voluntary-based idea of corporate citizenship as leadership for development.

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