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DEVELOPING AND IMPLEMENTING CORPORATE GOVERNANCE CODES

Foreword

Simon Wong's extensive experience informs his paper on developing and implementing corporate governance codes. He has worked with such codes as an investor representative, business consultant, and public policy analyst and achieved impressive results.

His commentary begins by reviewing the UK Combined Code, the Rolls Royce of corporate governance regulation, as an example for exploring the conditions that determine whether a code succeeds. He cautions against code "transplanting" from developed to emerging economies without regard for the specific ownership and control structures and for the economic environment that shapes firm structure and behavior. He also underlines the need for "walking the walk." Sadly, many codes sit on the shelves of their drafters because no local institutions have assumed any leadership role in promoting implementation. And, he clearly draws the line between legislation and code provisions. Pernicious behavior by management or board members must be prohibited by law.

So what are the key advantages of a code versus a mandatory approach to regulating corporate governance? In my view, there are three: knowledge dissemination, flexibility of corporate practice, and transparency.

- **Knowledge Dissemination**: Codes disseminate information about corporate governance best practices and the "know how" gained from implementing these practices. This second aspect is especially important for emerging and developing economies where, as Simon notes, examples of best practices are few and far between. In all codes, but especially in the case of the purely voluntary ones, the means of dissemination is not so much through the code itself but rather through the process of drafting and consultation.

- **Flexibility of Corporate Practice**: Most codes are the "comply or explain" variety. While they articulate best practices in detail, the codes do not mandate that companies adopt these practices. In doing so, they recognize that each company has a distinct institutional profile and represents a unique blend of history and legacy, managerial temperament, values, governance habits, and current needs and imperatives.

IFC International Finance Corporation World Bank Group

- **Transparency**: This is probably the most important value driver of corporate governance codes, at least when it comes to developed capital markets. An issuer must disclose whether it complies with the code and, if not, why not. In Europe, this mandatory disclosure requirement in an annual corporate governance report has recently been enshrined with changes in the Fourth Company Law Directive. As a result, a national, market-wide template for corporate governance has emerged. This facilitates comparison from a user perspective, which is key given that transparency is a two-way street.

This brings me to what I consider to be the most important takeaway from Simon Wong's piece: corporate governance codes, in contrast to regulation, are market creatures.

So what needs to be done?

Simon outlines several prerequisites for a Code's success. These can be summarized as follows:

- **Clarity**: This is a key attribute of any "comply or explain" instrument.

- **A legal underpinning**: From all the markets that I have worked in, only the UK has the requisite strength in its private market institutions to implement a comply-or-explain code without a legal underpinning.

  The existence of a legal foundation is particularly important in emerging markets, where issuers might be (and usually are) tempted to game the system more in the context of generalized institutional weakness.

- **Proper ownership and maintenance of a code**: The real work begins once a code has been adopted. There needs to be a clear owner, responsible for monitoring code implementation, regularly reporting on it, and proposing changes based on lessons drawn from its use. Determining stewardship of a code is more difficult than it looks. An institution led by a broad range of business representatives has better reflexes when it comes to implementing such a flexible instrument.

Simon rightly points out, that in many emerging countries, codes (other than purely voluntary best practice guidance) will be implemented by regulators or other quasi-regulatory bodies. But, even if a code has the regulator's support, it will not survive without market users.

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DEVELOPING AND IMPLEMENTING CORPORATE GOVERNANCE CODES

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This opinion piece is drawn in part from a presentation given at the 2007 Meeting of the Latin American Corporate Governance Roundtable, Medellin, Colombia, October 10–11, 2007. In addition, extracts have been taken from Why codes of governance work by Paul Coombes and Simon Wong (McKinsey Quarterly, 2004) and Policymakers struggle to balance laws and codes by Simon Wong (International Financial Law Review, 2005).

In recent years, **voluntary codes have been increasingly employed across the globe to drive corporate governance reform**. These guidelines, which emanate from stock exchanges, securities commissions, investors and investor associations, and supra-national organizations, set forth "best practice" recommendations across a range of topics that listed companies, shareholders, and other relevant parties are encouraged—but not obliged—to follow. Today, corporate governance codes are found in over 70 countries (see Exhibit 1).

It is relatively straightforward to develop corporate governance codes. **The challenge lies in ensuring their effective implementation and enforcement**, as evidenced by the complaints heard in some countries that governance codes have not lived up to their promise to spur enduring improvements in corporate practices. The concerns voiced range from poorly written guidelines to inadequate levels of compliance by companies to "box-ticking" by investors.

This opinion piece will begin with an examination of the principal uses and key design characteristics of a corporate governance code. We will then discuss the essential attributes that have contributed to the successful implementation and enforcement of governance codes in the United Kingdom. Finally, we will conclude with comments on the unique challenges facing emerging markets in effectively implementing voluntary codes and illustrations of how policymakers in these countries are tackling them.

Principal uses and key design characteristics of a corporate governance code

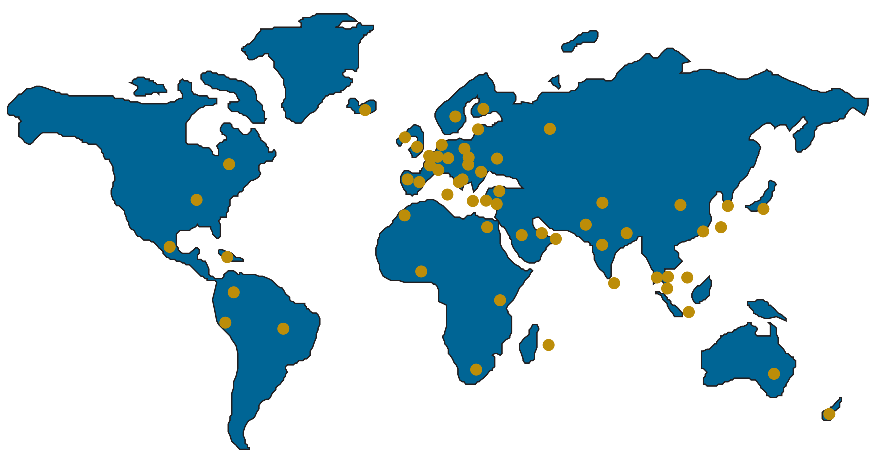
Governance codes have proved popular because they are seen as **flexible instruments that rely on market mechanisms** for their development, implementation, enforcement, and subsequent evolution. In contrast to the more rigid and prescriptive nature of mandatory legislation and regulation,[1] corporate governance codes not only accommodate—but in fact expect—some degree of non-compliance with their

[1] "Legislation and regulation" refers to company law, securities laws, stock exchange listing regulations, and other similar instruments of an obligatory nature.

provisions. As the late Sir Derek Higgs, who led the revision of the UK Combined Code on Corporate Governance in 2003, noted: "There will be circumstances where it does not make sense for a company to comply with every single principle or provision" of the code. Moreover, codes can be amended to reflect changing needs and circumstances much more quickly than legislation can.

Consistent with the trend in many countries to reduce government involvement in the economic arena, **a popular use of corporate governance codes is as a substitute for regulation**. For instance, the Cadbury Code, issued in the wake of corporate scandals in the UK in the early 1990s, was developed by the business community in response to the British government's threat to impose regulation if the private sector failed to take adequate steps to regain the trust of the broader public. Moreover, legislation, with the attendant possibility of civil and criminal sanctions, is not appropriate for many

Exhibit 1. Proliferation of Corporate Governance Codes



Date code published (latest code)

Pre-1997
- Australia (2007)
- Canada (2004)
- France (2004)
- Ireland (1999)
- New Zealand (2004)
- South Africa (2002)
- Spain (2006)
- Sweden (2005)
- UK (2008)
- US (2003)

1997–1998
- Belgium (2004)
- Finland (2003)
- Germany (2008)
- Greece (2001)
- India (2003)
- Japan (2004)
- Kyrgyz Republic
- Netherlands (2003)
- Sri Lanka (2006)
- Thailand (2006)

1999
- Brazil (2004)
- China, Hong Kong (2004)
- Italy (2006)
- Kenya (2002)
- Malaysia (2007)
- Mexico
- Portugal (2006)
- South Korea (2003)

2000/2001
- Argentina
- China, mainland
- Czech Republic
- Denmark (2008)
- Indonesia (2006)
- Malta (2005)
- Peru (2002)
- Philippines (2002)
- Romania (2002)
- Singapore (2005)

2002
- Austria (2007)
- Chile
- Colombia
- Cyprus (2006)
- Pakistan
- Poland (2007)
- Russia
- Slovakia
- Switzerland
- Taiwan

2003/2004
- Bangladesh
- Egypt
- Hungary (2007)
- Iceland (2005)
- Lithuania
- Mauritius
- Norway (2007)
- Oman
- Slovenia (2007)
- Turkey
- Ukraine

2005/2006
- Estonia
- Jamaica
- Jordan
- Latvia
- Lebanon
- Luxembourg
- Nigeria
- Saudi Arabia
- Trinidad/Tobago
- United Arab Emirates

2007/2008
- Bulgaria
- Morocco

Source: European Corporate Governance Institute; press clippings corporate governance issues, such as director appointment processes and the induction/on-going training of non-executive directors.

In addition, the inherent flexibility of codes has made them a popular instrument—particularly in emerging markets—to build awareness of corporate governance best practices among companies, investors, and other relevant parties.

Due to differences in ownership structures, legal and regulatory frameworks, and the nature of agency issues confronted, the specific provisions of a corporate governance code will vary from one country to the next. Most, however, focus on the same overarching principles:

1. ***Fairness*** to all shareholders, whose rights must be respected;
2. Clear ***accountability*** by the board and management;
3. ***Transparency***, or accurate, timely, and comprehensive financial and non-financial reporting; and
4. ***Responsibility*** for the interests of minority shareholders and other stakeholders, and for abiding by the letter and spirit of the law.

In the UK, where ownership of listed companies is diffused but where institutional investors collectively hold substantial stakes in them, the Combined Code focuses principally on the functioning of the board of directors, structure of executive remuneration arrangements, and responsibilities of institutional investors. Meanwhile, reflecting the prevalence of family ownership, the South Korean corporate governance code understandably emphasizes minority shareholder rights and responsibilities of controlling shareholders.

While codes can be used in place of regulation to address many issues, they do not supplant the law on all governance matters. Even in the UK, where a tradition of self-regulation provides broad scope for a corporate governance code, topics such as voting rights, pre-emption rights, and approval of related-party transactions are enshrined in the company law or listing regulations.

Yet, deciding where to draw the boundary between voluntary codes and mandatory law is not as straightforward as it may appear. This is due to, among other things, the contrasting approaches of countries on similar issues. For instance, the New York Stock Exchange requires listed companies to have independent audit, nominations, and compensation committees. In the UK and a number of other countries, board committee structure is a matter addressed in the local governance code, compliance with which is not mandatory. Such divergence of approach extends to other areas, such as board independence, board processes, and disclosure of voting records.

Given this disparity, how should policymakers define the dividing line between code and law? In general, **deciding between statutory prescriptions and voluntary codes requires balancing several considerations.**

In all countries, the most important "core" rules—such as voting rights, fiduciary duties of directors, and financial reporting standards—are established through laws and regulations while "secondary" matters—such as the separation of chairman and CEO roles and board appointment processes—are usually addressed in a code. Similarly, regulations can be used to lay down the minimum requirements while codes set loftier, aspirational targets. For example, the NYSE listing rules require a simple majority of members on a board of directors to be independent while governance codes issued by US institutional investors and other bodies set the bar at a substantial majority.[2]

Of course, **minimum requirements—and aspirational standards—vary from one country to the next**, and recent reforms have raised the baseline on many issues. Several years ago, the Hong Kong Stock Exchange lifted the minimum number of independent directors from two to three while the NYSE upped its requirements from three to a majority. Similarly, successive generations of codes issued by French employer association MEDEF have raised the recommended minimum on board independence from two directors in 1995 to one-third of the board in 1999 to one-half of the board in 2003.

Level of detail is yet another way in which laws and codes can complement one another. Under this approach, laws will set forth core rights and responsibilities (such as fiduciary duties and pre-emption rights) while codes elaborate on how companies and other affected parties can fulfill them. The UK Combined Code, for instance, provides guidance on how boards can discharge their fiduciary obligations to shareholders. Likewise, the UK Pre-Emption Guidelines spell out circumstances when a waiver of pre-emption rights may be appropriate.

A further consideration is the desirability or feasibility of uniform practice around a particular topic. If there is legitimate scope for differences among companies, a code might be the better instrument. On matters where a "one-size-fits-all" approach or uniform application is warranted, law may be more suitable than codes. In other words, **legislation is suited to areas the gravity of which outweighs all other considerations and where variance in practice among affected firms is deemed unacceptable**.

As an example, it may be entirely appropriate for firms to adopt different processes on director nomination to fit their particular circumstances. But on issues such as disclosure of executive remuneration on an individualized basis or CEO certification of the integrity of financial statements, the choice is largely binary. Either a matter is considered to be sufficiently important, in which case a uniform standard will apply to all companies, or it is not, in which case no obligation is imposed on any firm. There appears no legitimate justification to introduce regulations that will permit variance among firms on these matters. In Canada, which applies the principle of proportionality to its corporate governance regulations, the government has decided that all companies, regardless of size, must have their financial statements certified by the CEO and CFO.

[2] TIAA-CREF, The Conference Board, and The Business Roundtable, for instance, recommend a "substantial majority" of independent directors while the Council of Institutional Investors advocates a two-thirds majority or higher.

Then there is the **issue of which party is most qualified to evaluate the performance of a company on corporate governance.** As most governance codes rely on investors to monitor and enforce compliance with them, codes should address topics which shareholders—in light of their financial investment and understanding of individual companies—are comparatively better positioned than government to evaluate. In many developed markets, these would include such issues as determining whether a board is sufficiently independent of management and whether a company's executive compensation arrangements adequately align the interests of management and shareholders. By contrast, investors are generally not competent to decide such matters as whether the board has fulfilled its fiduciary duties. Issues falling into this category should therefore be dealt with through legislation rather than a voluntary code.

More broadly, where outside investors are few in number, focus excessively on short-term returns, or otherwise do not maintain a strong interest in corporate governance matters, codes will be less effective in ensuring that companies that should comply will do so and legislation may be required.

Lastly, **the feasibility and cost of implementation must be taken into account**. Recognizing that smaller companies may experience difficulties recruiting outside directors, the requirement in South Korea that a board of directors should have at least 50% independent directors applies only to the largest companies.[3]

Clearly, **the dividing line between legislation and code will shift over time**. As past reforms have shown, corporate scandals will usually spur demand for a more stringent legislative approach. However, the reverse can occur as well. In Finland, for example, separation of the chairman and CEO roles as a requirement under the company law has been abolished and is now addressed as best practice in the corporate governance code.

In the end, **policymakers must always be mindful of evolving practices and needs**, and be willing to make periodic adjustments as circumstances require.

Essential attributes for effective implementation and enforcement of a corporate governance code—the UK experience

In the UK, a collection of codes—with the Combined Code the most well-known—govern such matters as board composition, executive remuneration, voting disclosure, and institutional shareholder responsibilities (see Exhibit 2). Since their introduction in 1992, these codes have sparked real improvements in UK governance practices.

The increasing independence and professionalism in British boardrooms, for one, can be attributed to the influence of the Cadbury Code and its progenies. Take the splitting of chairman and CEO roles, which was practiced by 50% of large UK companies when the Cadbury Code was issued in 1992. Today, 95% of the FTSE 100 companies

[3] Defined as companies whose total assets exceed two trillion Korean Won.

Exhibit 2. Key Corporate Governance-related codes in the UK

Title	Issuing Body	Scope/focus
Combined Code on Corporate Governance	Financial Reporting Council	Board of directors, execution remuneration, auditing, and institutional shareholder reposnsibilities
Disapplying Pre-emption Rights – A Statement of Principles	The Pre-Emption Group	Waiver of pre-emption rights
Execution Remuneration – ABI Guidelines on Policies and Practices	Association of British Insurers	Remuneration committee role, structure of executive remuneration arrangements, and share-based incentive schemes
Statement of Principles on the Responsibilities of Institutional Shareholders and Agents	Institutional Shareholders' Committee	Engagement responsibilities of institutional investors
Framework on Voting Disclosure	Institutional Shareholders' Committee	Options for disclosure of voting decisions by institutional investors

have different individuals occupying these posts. Moreover, reflecting the heightened focus on board independence, the previously common practice of elevating the CEO to chairman is now a rare occurrence.

Equally important, these codes have facilitated constructive dialogue between companies and their shareholders. Today, chairmen and CEOs meet regularly with their companies' largest shareholders to discuss strategy, performance, corporate governance, and other important matters. While UK governance codes do not work perfectly, they are generally perceived to be effective and enjoy broad support.

So, why have corporate governance codes worked comparatively well in the UK? In essence, a handful of attributes have contributed to their success, namely:

- Tradition of self-regulation and consensus on the utility of a code
- Clearly defined standards
- Availability of information regarding code compliance
- Interested and informed shareholders and other constituencies
- Supportive legal framework

Tradition of self-regulation and consensus on the utility of a code

Self-regulatory instruments are ubiquitous in the UK capital market, covering matters from corporate governance to takeovers to dealings among market participants. With a tradition of self-regulation stretching back hundreds of years, **the UK provides a highly conducive environment for voluntary codes**. Within both the government and the private sector, there is a general preference for economic activities to be governed, where feasible, through industry-based tools rather than statutory and regulatory instruments.

With respect to governance-related matters, companies value the flexibility of the Combined Code on such issues as the separation of chairman and CEO roles, composition of the board and its committees, and director appointment processes. At the same time, notwithstanding the additional responsibilities imposed on them, institutional investors prefer codes on these matters because they believe they are generally better positioned than the government to assess the most appropriate governance arrangements for each company.

The consensus within the UK business community on the superiority of industry-developed solutions, coupled with opportunities for all parties to contribute to their development, gives non-mandatory instruments such as corporate governance codes legitimacy and helps ensure that they will work as intended as each side understands and generally accepts its roles and responsibilities. The Combined Code, for instance, is reviewed every couple of years to ensure that it is up to date and, on each occasion, feedback is sought from companies, investors, and other interested parties.

The long history of code-based regulation in the UK also means that protocols have been established on many matters. Take voting at shareholder meetings, where it is well-understood that institutional investors will contact the company in question if they have concerns that may lead to a vote against or an abstention on a proposal. Similarly, the majority of companies will consult their largest shareholders when proposing significant changes to the board of directors and remuneration arrangements.

Clearly defined standards

For a governance code to be effective, the standards and behaviors expected of companies, shareholders, and other relevant parties must be clearly defined. This encompasses not only written guidance but also exemplary practices in the local market that others in the same community can emulate.

As a document that encapsulates best practice, the Combined Code is drawn from actual examples at leading British companies. On matters ranging from the role of the senior independent director to the appropriate structure of executive remuneration arrangements, the “gold standard” can usually be found within the UK.

The availability of local best practice examples is important because it signals domestic support for a particular practice, and shows how compliance can be achieved in reality as well as circumstances under which deviation from the code would be justified. For example, although UK companies should normally separate the chairman and CEO roles, it is now generally accepted for a firm in crisis to temporarily combine these two positions.

Availability of information regarding code compliance

Effective monitoring and enforcement of a code begins with the availability of information on the corporate governance practices at individual companies. In this regard, the real innovation of the Cadbury Code rested less in its substantive recommendations—which reflected governance practices at large UK companies at the time—but more in the mechanism proposed to ensure adequate disclosure of compliance to the public. In its report, the Cadbury Committee asked the London Stock Exchange to require listed companies to reveal in their annual reports whether they were complying with it—and, if not, why**.** The ensuing LSE rule of mandatory disclosure—called "comply or explain"—has made the corporate governance practices of British companies much more transparent and has forced companies to think about them carefully, since **any departure from the code has to be publicly justified**.

"Comply or explain" has since spread to dozens of countries, including Australia, Canada, the Netherlands, Argentina, and Singapore. However, not all countries mandate such disclosure. For instance, there are of a number of corporate governance codes in the US but listed companies are not required to disclose whether they comply with any of them.

Once information on code compliance is in the public domain, the British **media plays an important role in analyzing it and informing investors of significant code breaches.** For example, earlier this year all of the major UK newspapers reported extensively on the decision by an iconic British retailer to combine the chairman and CEO roles. Coverage of this story spanned several months, from the initial announcement to the subsequent dialogue between the company and its institutional investors to the voting results for the re-election of the executive chairman at the annual general meeting. While some people may have felt that the media had exceeded its mandate and unnecessarily fanned the controversy, there was no doubt that the press had played a crucial role in facilitating the public debate.

The key challenge with "comply or explain" is ensuring that quality information is disclosed and, correspondingly, there is quality analysis of the disclosed information. In the UK, the quality of disclosure by companies has improved over time, although boilerplate and ambiguous disclosures on some issues—such as board evaluation findings and why non-executive directors who have exceeded the recommended nine-year tenure should continue to be regarded as independent—are not uncommon. Likewise, as discussed further below, the analysis of company disclosures has become more thorough in recent years.

Interested and informed shareholders and other constituencies

Most countries rely on shareholders to monitor and enforce compliance with the corporate governance code. In the UK, this task is undertaken principally by large institutional shareholders—pension funds, insurance companies, and asset management firms—with assistance from the media and proxy voting research providers.

Institutional investors all over the world have been accused of excessive passivity on voting and other corporate governance matters, choosing instead to sell their stakes when they have concerns or relying on others to take action when problems arise.

While not all institutional investors in the UK carry out their shareholder responsibilities diligently, many of the largest ones—particularly those possessing a long-term orientation—appear to do a respectable job.

The relatively high degree of attentiveness the UK institutional investor community devotes to monitoring and enforcing compliance with the Combined Code is attributed to several factors. Firstly, institutional investors own between 60%–70% of the UK stock market, providing them with reasonably strong incentives to monitor[4]. Secondly, the institutional investor community is relatively small and tight-knit (concentrated in London and Edinburgh), making it easy for them to communicate with one another as well as to hold each other accountable. Through representing the collective views of their memberships on policy matters and facilitating discussions between companies and shareholders when matters of contention arise, shareholder bodies such as the Association of British Insurers play a substantial role in building and maintaining a sense of cohesiveness among institutional investors.

Thirdly, as discussed above, given the UK's self-regulatory tradition, most large institutions understand the responsibilities expected of them and strive to play their part. The collective responsibility of the investment community has also been formalized through the Institutional Shareholders' Committee Statement of Principles on the Responsibilities of Institutional Shareholders and Agents, which sets out the obligations of institutional investors to exercise their shareholder responsibilities diligently (see Exhibit 3). Lastly, some asset managers believe that diligence on corporate governance matters will differentiate them from their competitors and, consequently, have assumed leadership roles in this arena.

For a "comply or explain" approach to work, shareholders must devote sufficient time and resources to understanding individual situations and should support departures from the Code when well-reasoned explanations are provided. This means that "explain" must genuinely be an acceptable form of adherence to a code. Otherwise, the key strength of a governance code—flexibility—will be lost and "comply or

Exhibit 3. Institutional Shareholders' Committee Principles

Key institutional responsibilities
Set out policy on how they will discharge their responsibilities
Monitor performance and where necessary establish dialogue with investee company
Intervene where necessary
Evaluate the impact of engagement
Report to clients/beneficial owners

[4] Equally important, a substantial portion is held by long-term oriented institutions. However, there are indications that the aggregate size of their holdings is shrinking, replaced by investors with shorter time-horizons and who appear to take less interest in upholding the "comply or explain" approach.

explain" will be reduced to "comply or else." Viewed through this lens, **100% compliance with code provisions may not be optimal** because it may indicate boilerplate affirmation of compliance or intentional misstatements by companies, excessive focus on strict compliance by investors, or irrelevant code provisions.

UK institutional investors seek to inform themselves in three ways. Firstly, they subscribe to proxy voting research. Presently, there are five major proxy voting research firms providing coverage for different segments of the UK stock market. With large portfolios that may exceed 1,000 holdings in the UK alone, institutional investors rely on proxy voting research to help them identify complicated or contentious issues efficiently, although some of the research can be formulaic at times and shareholders have also been accused of relying excessively on them. Secondly, UK institutional investors often consult each other on complex or controversial matters—either one-to-one or in a group setting—to share information and exchange perspectives.

Thirdly, institutional shareholders will endeavor to engage with a company when contentious issues arise and, when they are major shareholders in a company, on an on-going basis.[5] For instance, the initial uproar over the recent decision by the above-mentioned British retailer to combine the chairman and CEO roles was defused through discussions between institutional investors and the chairman, senior independent director, and CEO of the company. In the end, the company provided investors with a detailed, written explanation for the move and sought to allay shareholder concerns by agreeing to put the executive chairman up for re-election annually and to appoint additional independent directors. In addition, the firm gave assurances that the consolidated role would be a temporary measure.

Conversations between UK companies and their shareholders also take place over less controversial matters. For instance, the chairman of a publishing company recently discussed with its largest shareholders the board's plan to extend the tenure of the senior independent director for an additional year beyond the standard nine-year term for independent directors. During the one-to-one discussions, the chairman explained the rationale for the proposal and candidly responded to questions from investors. In the end, most shareholders supported the board's action.

While UK institutional investors have generally been effective monitors and enforcers of the Combined Code, their roles have not been free of criticism. One common complaint is that some institutional investors are "box tickers" who insist on rigid compliance with the Code without endeavoring to understand legitimate differences among companies.[6] At the same time, other institutional investors have been accused of excessive meddling in company affairs, particularly on senior appointments and remuneration matters. Lastly, a persistent irritation for companies is that UK institutional inves-

[5] These discussions often yield additional details that companies are unwilling to include in the annual report.
[6] This may be attributed to the failure of some institutional investors to allocate adequate resources to proxy voting and engagement activities, and who may therefore be over-reliant on proxy voting research providers or adopt a mechanical approach to voting.

tors do not always speak with one voice. Recently, a financial institution consulting its largest shareholders on a new incentive scheme found that investors were divided on whether earnings per share should be included as a performance metric and how it should be measured.

Supportive legal framework

The final essential attribute of the UK system is a supportive legal framework. In the UK, short of running afoul of concert party rules that would require shareholders holding a collective stake of 30% or more to make an offer for the targeted company, shareholders are normally allowed to communicate with each other on corporate governance matters. This not only facilitates discussions between individual shareholders but permits industry bodies and other collective forums to openly deliberate on matters of mutual interest and concern. **Allowing shareholders to communicate helps them to stay informed** and potentially gives them greater leverage in discussions with companies.

At the same time, UK companies are generally permitted to engage in one-to-one discussions with their shareholders, particularly those with the largest holdings.[7] Of course, companies must take care not to make investors insiders by sharing material, non-public information. Where shareholders are in receipt of such information, they must refrain from dealing.

Finally, the Companies Act endows shareholders in UK-incorporated companies with substantial powers, enabling them to act decisively when necessary**.** For example, 100 shareholders with an average par value holding of £100 and those with a collective stake of 5% or more are able to requisition an extraordinary general meeting to appoint or remove directors. In addition, shareholders have at their disposal other levers of influence, such as an advisory vote on the remuneration report.

Although these features are not considered exceptional in the UK, they have not been widely replicated in other jurisdictions. In some countries, there are significant restrictions—real and perceived—on inter-shareholder dialogue and communication between companies and individual shareholders. Moreover, **in many markets the ability of shareholders to bring about change to a company's boardroom is highly constrained**.

Strong shareholder rights, coupled with the view in the UK that votes against or abstentions on the remuneration report or the election of the chairman in excess of 15%–20% signify a rebuke of the board, have led many UK companies to be relatively responsive to the concerns of shareholders. For instance, when a proposal at a shareholder meeting is considered to be contentious, it is not uncommon for the chairman or senior independent director to telephone the company's largest shareholders to attempt to secure their support.

[7] The Combined Code, for instance, recommends that companies should discuss "governance and strategy with major shareholders" and consult "major shareholders" when they decide that the chief executive should become chairman.

For their part, UK institutional investors have rarely felt the need to exercise the full authority granted to them under the law. On the rare occasions when UK institutional investors have requisitioned an EGM, they have typically been preceded by unsuccessful efforts—sometimes spanning a year or two—to effect change through constructive discussions.

Besides providing an enabling environment via the Companies Act and related legislation, the British government has also played an important disciplinary role through its occasional threats to impose statutory solutions if the private sector fails to do its part. In fact, **a number of significant corporate governance reforms in the UK over the past two decades arose in response to threats by the government to enact legislation**. These include the original Cadbury Code, the guidelines on executive remuneration, and, more recently, the disclosure of voting records by institutional investors.

Takeaways and implications for emerging markets

For policymakers in emerging markets, looking at the experience of the UK in implementing and enforcing corporate governance codes may leave them feeling inspired as well as somewhat daunted. On the one hand, the UK provides an instructive example of how corporate governance codes can work in practice. On the other hand, it also indicates that **the challenges of successfully implementing corporate governance codes in an emerging market setting are undeniably greater, and that improving corporate practices will be a gradual and long-term process**.

Fundamentally, the starting positions of the UK and most emerging markets—in terms of the ownership structure of companies, presence of institutional investors, experience with self-regulation, and so forth—are substantially different. Yet, **emerging market policymakers should not be deterred, as a number of countries have made steady progress** in improving corporate governance practices of listed companies through locally-tailored solutions and by recalibrating the balance between voluntary codes and mandatory laws.

Take the role of institutional investors and the media in monitoring and enforcing a corporate governance code. Given the prevalence of controlling shareholders and the underdevelopment of the asset management industry in most emerging markets, the pool of interested, involved, and long-term oriented institutional investors resembling those found in the UK is relatively small. Consequently, it may not be realistic to rely primarily on institutional investors to enforce a governance code.

Similarly, while their interest in corporate governance is growing, the media in many emerging markets still exerts insufficient pressure on companies to comply or to provide a satisfactory explanation for non-compliance.

Given these differences, **policy makers in some jurisdictions have rationally translated certain governance code recommendations into law or regulation**—for example, by requiring companies to have a minimum number of independent directors or an audit committee. In South Korea, the government has translated the code provision on independent directors into law for the largest companies. In South Africa, the stock exchange requires listed companies to split the roles of chairman and CEO.

In the absence of a mature institutional investor base, some governments have assumed the primary role for monitoring and enforcing codes. For instance, each year the securities commission in one Latin American country sends listed companies a questionnaire to inquire how they have complied with the local corporate governance code. While **the government might be an appropriate overseer in the short to medium term,** monitoring by shareholders—who have strong economic interests in the success of investee companies—is preferable in the long term, particularly if a code contains provisions that investors are better-positioned to evaluate.

Another challenge is that corporate governance codes in most emerging markets were formulated using models from developed markets, particularly the UK and US. **Transplanting codes from developed to emerging markets gives rise to the risk that concepts and practices that are well-established and accepted in the former will be alien to, or inappropriate for, the latter**. For example, it may be unrealistic to expect the board of an emerging market company with a controlling shareholder to perform the same oversight functions as their counterparts in the UK and US, where companies are more likely to have a dispersed shareholder base.

A further worry is the potential scarcity of actual examples of how principles borrowed from abroad should be put in practice in the local environment. A dearth of local best practice models will likely slow adoption rates, although this problem should become less acute over time as the list of local exemplars—facilitated by cross-listings and encouraged by foreign investors—grows. Today, companies such as Infosys in India, Singapore Telecom, and Wimm-Bill-Dann Foods in Russia, to name a few, serve as "leading lights" for their local and regional peers.

Lastly, **there is the matter of culture.** In the UK, there is a long tradition of complying with voluntary instruments. By contrast, it has been argued that voluntary codes consisting of high-level principles will not work in countries where companies are used to detailed guidance and mandatory rules enforced by regulators. Recognizing the enormity of this challenge, some countries have chosen to focus on raising awareness in the short term while starting to slowly inculcate the spirit of voluntary compliance.

At the end of the day, **each country—whether developed or emerging—must devise its own approach** to developing and successfully implementing corporate governance codes. While all governance codes should be benchmarked against international best practices to aid comparability, they must also be customized to work in the local environment. Careful consideration during the design phase of the principal objectives to be achieved, the broader societal and regulatory context, and the optimal allocation of monitoring and enforcement responsibilities—combined with periodic refinements after their introduction to remedy shortcomings and respond to new developments—will increase the likelihood that corporate governance codes will have the desired impact.

About the Author

Simon C.Y. Wong is Head of Corporate Governance in the London office of Barclays Global Investors (BGI), and Adjunct Professor of Law at Northwestern University School of Law in Chicago, Illinois.

At BGI, Simon oversees the voting of client holdings at shareholder meetings and leads engagement with boards of directors and senior management of investee companies on matters of strategy, performance, and corporate governance/sustainability. Through membership on the Association of British Insurers Investment Committee, service as chair of the Shareholder Responsibilities Committee of the International Corporate Governance Network, and participation in other forums, Simon also contributes to policy making in the areas of corporate governance and financial market architecture/regulation.

Previously, Simon was a management consultant at McKinsey & Company, where he served companies and governments in developed and emerging markets on a broad range of corporate governance, organisation, strategy, and financial regulatory matters. Simon started his professional career as a securities lawyer with Linklaters & Paines and Shearman & Sterling in London, and also worked at the Organisation for Economic Co-operation and Development (OECD) in Paris.

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