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LESSONS LEARNED SERIES

corporate governance

better companies, better societies

Sharing Expertise on Developing Corporate Governance Codes

To increase the number of experts who can help countries develop and improve their corporate governance codes, the Forum organized a knowledge management workshop on "Supporting the Development of Corporate Governance Codes of Best Practice." This is the first of a series of such workshops the Forum will be organizing based on its toolkits and experience gained in the field worldwide. These workshops are targeted at IFC officers from around the world and the Forum's partners in capacity-building efforts for the developing and transition countries.

At the Forum's event in Washington D.C. on September 18-19, 2008, more than 30 persons from 16 countries participated.

The diversity of experiences informed discussions to identify common regional problems, develop solutions, and share good practices.

"We are all facing the same kind of problems," observed one participant. "Exchanging experiences helps to clarify ideas and concepts. From this process, solutions emerged," another participant said.

During this two-day, highly interactive workshop, participants discussed why corporate governance codes matter, key milestones for the development process to succeed, the consultants' roles, lessons learned from South Africa and Egypt, and different enforcement mechanisms.

"The workshop provided a highly valuable platform to learn the nuts and bolts of corporate governance codes and to exchange experiences with top-level practitioners on the design, implementation, and impact of codes. A key benefit was also the access to a wide range of Forum publications that serve as practical tools for companies."

Elena Suhir, *Program Officer, Eastern Europe and Eurasia,* Center for International Private Enterprise

Participant shares experiences during a breakout session

"Corporate governance codes work. They influence company behavior, often under pressure from investors and investment bankers. Prerequisites for a code's success include: clarity, ownership by institutions and individuals, and proper legal underpinnings. Codes must be tailored to entities. Further, they must be clear and sufficiently detailed so that companies can respond constructively to the recommendations. Local codes must be linked to international norms or internationally recognized best practices—but adapted to local circumstances to ensure relevance. These pre-requisites do not necessarily exist in developing countries to the same extent that they do in developed countries."

Stilpon Nestor
Corporate Governance Advisor Principal, Nestor Advisors Ltd.

Global Corporate Governance Forum

The Global Corporate Governance Forum is an International Finance Corporation (IFC) multi-donor trust fund facility located within IFC Advisory Services. The Forum was co-founded by the World Bank and the Organisation for Economic Co-operation and Development (OECD) in 1999.

Through its activities, the Forum aims to promote the private sector as an engine of growth, reduce the vulnerability of developing and transition economies to financial crisis, and provide incentives for corporations to invest and perform efficiently in a socially responsible manner. The Forum sponsors regional and local initiatives that address the corporate governance weaknesses of middle- and low-income countries in the context of broader national or regional economic reform programs.

Donors to the Forum include the IFC and the Governments of Canada, France, Luxembourg, the Netherlands, Norway, and Switzerland.

IFC International Finance Corporation
World Bank Group

Rationale for a Corporate Governance Code

The scope and type of corporate governance codes varies quite a lot. They can be: national, regional, based on the OECD framework, sector-specific, a stock exchange listing requirement, SMEs/SOEs/family-owned enterprises code, listed/non-listed companies code, and corporate secretaries/directors codes. Countries' needs vary, requiring a mix of different documents and code provisions.

The first step for a code development task force is to define the code's objectives and targets. Why is a code needed? What is expected to be achieved? What are the main problems to be addressed? What companies should be targeted as a priority? To answer these questions, the Forum's toolkit, *Developing Corporate Governance Codes of Best Practice*, sets out a step-by-step approach that stakeholders could follow to develop, implement, and review a code. (See box for more information about the toolkit.)

The task force must review the state of corporate governance in its home country. Here, various regional or country assessments (e.g., World Bank's Reports on the Observance of Standards and Codes, Organisation for Economic Co-operation and Development white papers, or IFC corporate governance surveys) can provide guidance.

Once the task force is clear on the rationale for a code, it should look at other codes and review international best practice. The OECD principles have served as the main international benchmark for code development. These principles emphasize fairness, clear accountability, transparency, and responsibility.

As countries move forward, they need to define what kind of code is most relevant to the issues that must be addressed. Countries can choose from many different products to guide their work, ranging from sample codes to guidelines to manuals, toolkits, and white papers.

During the workshop's group exercises to identify the reasons for codification projects in Cameroon, Malawi, and Senegal, the participants discussed whether these countries' local environments were conducive for a code to be drafted and implemented. "Codes may not be the best, or the only answer," one participant said. Some suggested that such tools as manuals, toolkits, and educational materials may also be important deliverables, either independently or in addition to codes.

"Corporate governance codes should be designed to address countries' particular circumstances, taking into account international standards. In the end, what matters is whether the initiative will work in the local environment," said Richard Frederick, a senior Forum consultant.

Forum Toolkit Provides Guidance

The toolkit, *Developing Corporate Governance Codes of Best Practice*, focuses on the various steps involved in crafting, disseminating, implementing, monitoring, and reviewing corporate governance codes of best practice.

The toolkit provides users with a variety of tools and examples that can help organizations and individuals produce codes that would improve corporate governance practices at the country level. Because codes have now been adopted in many countries, this toolkit draws attention to the importance of monitoring, updating, and improving existing codes.

The toolkit is a public good and can be downloaded from the Forum's Website (www.gcgf.org).

Private Sector Opinion: Why Codes Succeed

In a *Private Sector Opinion*, Simon C.Y. Wong, Head of Corporate Governance, Barclays Global Investors, addresses the key advantages of a code versus a mandatory approach to regulating corporate governance in three aspects: dissemination, flexibility of corporate practice, and transparency.

"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."

Wong cautions against code "transplanting" and emphasizes the need for a well-thought-through process that takes into account the economic and legal environment that shapes firm structure and behavior.

Codes succeed, Wong writes, where there is a:

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

Code Development Tips

- Support the work, but don't do everything
- Guide discussion on code's rationale but let the task force decide
- Alert them about missing skills, such as whether the task force is balanced
- Don't let two people from the same institution draft a code by themselves
- Help mediate conflicts involving the team
- Provide best practices and access to existing surveys and assessments
- Ask the right questions
- Help design the code framework, but don't do the drafting
- Push for the consulting process; get private-sector feedback
- Help ensure institutional support for planning and implementation
- Keep progress on target and inspire motivation
- Help establish a communication and dissemination strategy
- Encourage a public launch to build public awareness and endorsement
- Keep the media informed
- Ensure that a timetable has been set for the review of the code and possible revision once implemented
- Encourage the task force to discuss its future role once the code is adopted

Marie-Laurence Guy
Senior Projects Officer
Global Corporate Governance Forum

Enforcement Mechanisms

The starting point for drafting the code must be to evaluate the legal framework's quality and effectiveness. The code must be built on the legal framework, "as a glove does on a hand," as one participant put it, taking into consideration both the letter and the spirit of the law, and how the law is implemented.

"Codes should address the problematic issue of enforcement up-front. This has especially been an issue in Central Europe and Central Asia," said Gian Piero Cigna, Principal Counsel for the European Bank for Reconstruction and Development.

An authority (e.g., stock exchange, securities markets regulator) must endorse the code to ensure that it is effectively implemented. Where stock exchanges do not exist, banks can be a good vehicle for improving corporate governance practices.

European Union member-states have embraced a United Kingdom-style "comply or explain" approach that calls for listed companies to explain the extent of compliance with corporate governance codes or explain their deviations.

What are the benefits of "comply or explain?" This approach can help authorities obtain considerable information on the corporate governance practices with listed companies at little cost. Such information is invaluable to planning reform efforts, understanding what needs to be addressed, and creating relevant solutions.

Codes should be supported by laws and regulations. While codes may set up ethical principles and boardroom practices, there are laws and regulations against fraud.

Getting Started

- No single type of organization is best suited for initiating or developing a corporate governance code. Virtually every possible combination (government will or private sector interest) has resulted in the adoption of quality codes. What is essential is that all interested parties be involved in the process and represented on the drafting committee.
- Only in a few cases has the government actually played a leading role in developing a corporate governance code, preferring to keep a low profile in favor of the private sector. Regardless of its level of involvement, the government is often perceived to be an essential source of support.
- While it is important to have good representation on the drafting team, it is essential to involve some of the task force's most influential members. A broad range of stakeholders from professional organizations should also be included.
- Build a task force with the "right people," finding an appropriate mix of skills, knowledge, and motivation. Emotional intelligence is required on the task force, not just expertise.
- Consider the rationale and framework of code formulation prior to starting the code drafting process.
- Develop a master schedule, including an action plan and timeframe.

Monitoring and Evaluation Indicators Must Be Part of Project Management Tools

Frederick's presentation underscored the importance of having task force performance indicators to help guide planning and to later assess performance. Indicators are useful both for evaluating performance and helping the drafting groups focus on their objectives. Indicators are better suited for measuring the impact: (i) of drafting committees; (ii) on the governance framework and institutions; (iii) in companies; (iv) in the macro-economy; and, (v) in other areas.

"What we are trying to measure is an intangible value," Frederick said. A code drafting group differs from an investment project in a company. A governance reform effort seeks to create cultural change. This is an elusive goal and an intangible value that is difficult to measure. Indeed, performance on a set of indicators may be positive while the larger goals remain unachieved. Alternatively, a code drafting project may perform poorly on a set of indicators, while the overall acceptance and application of the code are good.

"The challenges in defining the right indicators should not discourage goal setting and the use of indicators. Having and using indicators is a good project management tool that keeps the eyes of the drafting group focused on its objectives," Frederick said.

How Corporate Governance Scorecards Work

Developing scorecards based on adopted codes can provide a useful tool for companies to self assess their level of compliance with the code. This analysis can give investors a better indication of a company's governance rating. Scorecards can also be used by investor associations and the media to either provide awards or "shame and blame."

Forum consultant Hassan El-Shabrawishi outlines the workshop agenda

Lessons Learned in South Africa and Egypt

Philip Armstrong, Head of the Forum, and Martin Steindl, Corporate Governance Program Manager of IFC PEP-MENA, made presentations on codification efforts in both South Africa and Egypt with a view towards extracting key lessons learned.

Corporate governance code development is often heavily influenced by the political context. The consultant needs to be aware of the "atmospherics," as one participant put it. Codes for state-owned enterprises, for example, can set the tone for corporate governance in a country because they often are the predominant entities in the national economy. They can have a very powerful "demonstration effect" on the private sector.

Developing a code takes longer than expected because a consensus must be built among all stakeholders. In South Africa, for example, the process was nearly two years to finalize King II.

The problems that arise in code drafting and implementation can often be linked to a faulty rationale for the project or insufficient appreciation of the political context and/or incentives. Participants shared examples where the rationale for codification appeared tenuous and required reconsideration.

"It would be useful to create a network of people working on codes development. If members have questions, they can simply send an inquiry to solicit others' views or experiences," one participant suggested.

While the need to strengthen the Forum's network was consistently highlighted during the seminar as being fundamental to achieving goals ("the product is the process," according to one participant), the discussion outcomes underscored that a code's substance and quality cannot be ignored. The two go hand-in-hand; the best outcome results when both are strong. It is, nevertheless, not imperative that the code be perfect.

Codification projects don't always work out as expected. The goal of company implementation is not always achieved. This may disappoint project officers, consultants, and locals alike, but represents the reality. Financial, organizational, competitiveness, inadequate expertise, and economic difficulties may cause a company to adhere to a limited number of a code's provisions. Comprehensive planning may increase the likelihood of success. Consultants should be aware of other means to encourage corporate governance reforms.

Even if the code does not have an immediate and profound impact, codification projects serve to educate and raise awareness. Thus, projects that do not lead to immediate returns can create an important foundation for future work. Improving corporate governance is tantamount to trying to change local business culture and will, understandably, take time.

"Corporate governance is there to make investments more sustainable," Armstrong noted. "Directors are more aware of their companies' impact on the communities in which they work. Acting responsibly enhances sustainability."

The Egyptian code was among the first in the Middle East North Africa region and also one of the first to be revised. Codes are flexible tools and should be revised regularly to incorporate changes in the legal framework and international best practices. The revision of Egypt's code allowed for extensive consultation that resulted in broader ownership and better implementation. Caution should also be taken not to create a preponderance of special purpose codes, but rather to develop a code that covers the general principles of good business practices and perhaps amplifies (e.g. in the annex) any specific aspects that are relevant to unique to sectors.

Defining the Consultants' Roles

Many committees decide to engage the services of an experienced local or international consultant to assist in researching and drafting a code's content or monitoring the development process. Before deciding on hiring a consultant, the committee must first assess its needs and draw up a list of specific tasks that the consultant would do.

A consultant typically facilitates the process and provides expertise. The consultant/advisor should give working groups and/or the task force the tools but they should not do the entire drafting of the code themselves.

Consultants may find themselves in the difficult position of refusing to do the work and suggesting that the task force do it by itself. On the other hand, if the consultant writes the code, they also take responsibility for the quality and implicitly accept the blame for a failure. The ultimate responsibility should lie with the codification committee.

How should the terms of reference be drawn? Project officers should phrase the precise nature of the deliverable so consultants do not feel pressured to write the code. Officers should emphasize in their briefing of a consultant that they should only facilitate the task force's work, providing knowledge, guidance, and materials needed to produce a code.

Code Drafting Tips

1. **The choice of the draftsman** is important and difficult. A single draftsman should not monopolize the process.
2. **The preamble** can potentially be used to address difficult large-scale issues while the annex can be used to provide explanatory text, nuance, or highlight what is best practice.
3. **Open and civil discussions** are key to the work of an effective code task force, but endless discussions over details can also derail the drafting process. It is useful to reach an agreement on the principles before working on the details.
4. **Simplicity and clarity** should be a goal.
5. **Use words like "should" and "recommended" precisely and consistently**. Define what the power of these words is in the document's context. Grey and black lines can be used to underscore the hierarchy of normative statements.

The Private Sector Advisory Group and peer review groups play important roles in providing practical counsel that is informed from their experiences with the companies they manage or countries implementing codes.

Forum Head Philip Armstrong outlines the lessons learned from the Forum's code development work in South Africa

What Goes Wrong: Building a Checklist of the Risks and Issues Faced by Consultants and Project Managers

"There are many different ways to do it right, yet there are probably more ways to do it wrong. Something will likely go awry; however, being aware of risks will help to avoid some problems and react constructively when problems occur," said Richard Frederick.

These risks include:

Time: If the process is too long or too slow, momentum is lost. If the process is too fast and not well thought through, an opportunity may be lost to change the governance culture.

Commitment: Lack of commitment from task force members is a risk. Twenty people may come to the first meeting but only five may remain throughout the process because the others have lost interest. To mitigate this risk, clarify early the amount of effort involved in code development.

Getting lost in details: Code drafting becomes a process of incorporating detail to clarify what is meant by the code provisions. Be careful not to allow details to overwhelm and block progress.

Conflicting positions within the task force: Members may have strong and different views; provide mechanisms to resolve disputes quickly and effectively.

Language barriers: Discussions may often be in English but those involving code drafting need to be held in the local language. International advisors and project managers need to plan accordingly.

Borrowing best practices: Task forces shouldn't reinvent the wheel. If a specific best practice is well worded in another code, task forces should borrow it. However, copying a full code but just changing the heading won't work.

Committees: Some task forces establish committees to either work on specific aspects of governance for inclusion in the code or on various type of companies or organizations. The result, though, may be that each committee produces a code subsection that doesn't mesh with the other committees' work. The task force chair must be closely involved throughout the drafting to ensure that the committee's individual components are well integrated into one code.

Rationale: If the rationale is weak, the task force may soon be questioning its purpose, leaving task force members frustrated or in conflict with one another. At the start, task force members must understand why they are developing a code and its need for their country.

Length: A code must be simple, practical, and reader friendly – not a manual or a summary of research.

Keeping things going: One of the biggest risks is that, once the code is adopted, everyone involved may think the job is done. They should, however, consider establishing a standing commission to monitor the code's impact, stay abreast of changes in the national corporate governance framework and international best practice, advise regulators, and both review and revise the code as the need arises.

LESSONS LEARNED

- **Assess current corporate governance practices – the incentives and obstacles towards gaining widespread adherence to best practices**
- **Codes may not always be the best and only answers. Developing manuals, and other educational materials may be equally important to raise awareness and improve corporate practices**
- **Define what kind of code is most relevant to a country's specific issues**
- **Engage a broad range of stakeholders early in the process and foster ownership of the development process and the code**
- **Learn early how a code may conflict with local company law and consider approaches to encourage changes in those laws**
- **Engage experts to comment on the code drafts but not the writing of code provisions**
- **Monitoring and evaluation is important to demonstrate progress and chart the way forward**

LEARN MORE

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NEXT ISSUE:

The Private Sector Advisory Group helps guide implementation of corporate governance practices in developing countries and emerging markets, drawing from their personal experiences in business and their expertise in corporate governance.