

Instruction Sheet – Listed Companies

The Governance of Listed Companies

Publicly listed companies provide the most commonly cited paradigm for analyzing corporate governance. Most of the attention of policy-makers, the media and investors, as well as the bulk of the academic literature, has focused on the governance of publicly listed companies.¹ Policy reforms and other corporate governance initiatives in East Asia, Latin America and, most recently, in the United States were responses to governance scandals in listed companies, where public shareholders lost their investments and the integrity of the public capital markets was undermined. In the United States and the United Kingdom, the fundamental governance issues in listed companies typically concern the principal-agent relationship between atomized shareholders and dominant managers. In contrast, across the emerging markets and even in most other developed markets, a more fundamental governance issue is usually the treatment of minority shareholders by the controlling shareholders. The standards expected of listed companies should also be applied by the investment staff to private companies that have plans for public share offerings in the short- to medium-term.

Using the CG Tools

There are seven key CG Tools that are used for analyzing the governance of potential IFC investee companies. The Instruction Sheets, Progression Matrices, Information Request Lists (which depending on the client and project characteristics can be the DDR Report Generator² or the FGA Tools) and the Sample CG Improvement Programs have been adapted for the Listed Company paradigm. The explanatory note “Why Corporate Governance?”, the Model Independent Director Definition and the Supervision Checklist are applicable across all five paradigms without any adaptations.

- 1) **Instruction Sheet - Listed Companies** The purpose of this Instruction Sheet is to describe each of the key CG Tools, how they should be used and who should be interviewed in the course of either a Full Governance Assessment (FGA) or a Due Diligence Review (DDR). (A full description of the Step-by-Step Process for analyzing the governance of companies is provided in the section of the website “Applying the IFC Methodology”.)
- 2) **Why Corporate Governance?** This note explains IFC’s approach as value-added for clients. *This explanatory note should be given to the client at the earliest opportunity in the pre-appraisal.*
- 3) **Progression Matrix – Listed Companies** The Progression Matrix relates the five areas of governance (Commitment to Good CG, the Board of Directors, Control Environment and Processes, Transparency and Disclosure and Shareholders Rights) to four levels of achievement. The use of a matrix framework emphasizes the importance of ongoing improvements in the governance practices of clients, rather than trying to apply rigid and static minimum standards. In particular, the Progression Matrix allows clients to assess the governance of their own company against a simple framework. *The Progression Matrix should be given to the client at the earliest opportunity in the pre-appraisal.*
- 4) **Information Request List – Listed Companies** This list of questions and requests for documentation forms the basis for the Corporate Governance Review of an IFC client. The Information Request List is organized along the same lines as the five areas of governance in the Progression Matrix. *For a FGA the Information Request List should be circulated to the company at least three weeks in advance of the on-site visit.* The company should identify a single officer who will be charged with responding to the Information Request List by providing brief written answers of one or two paragraphs to each of the questions and deliver these to IFC *prior to* the on-site Corporate Governance Review. For the DDR, the investment officer must collect the required information from the documents or from interviews during the appraisal. If the IO elects to send a specially prepared DDR information request ahead of the site visit, an amended “questions-only” version of the Report Generator should be sent to the client. Discussions relevant to IFC’s understanding of the governance of a company will arise throughout the appraisal and diligence process. Therefore, IFC Investment staff are encouraged to edit the information requests (FGA or DDR) as necessary before sending it to the client, so as to avoid duplication.
- 5) **Model Independent Director Definition** Perhaps the most frequent governance recommendation is to increase the Board’s independence from both the management and the controlling shareholders. However, to achieve genuine Board independence, it is crucial to carefully define what it means for directors to be “independent”. This Model Independent Director Definition is often used during discussions with the client to clarify the assessment of the current Board and its future needs.
- 6) **Sample CG Improvement Programs or Sample Decision Book Section (for DDRs) - Listed Companies** A FGA results in the drafting and negotiation of a Corporate Governance Improvement Program (CGIP) to be implemented by the client. This CG Improvement Program should always be tailored to the circumstances and priorities for the company. However, these Sample CG Improvement Programs give a good idea of what has been negotiated with clients in the past and, therefore, they can be used as a reference point in the drafting process. The DDR always generates a section for the Decision Book and sometimes this will include recommendations for improvements. This Sample DDR Decision Book Section provides a useful reference point for the IO’s use.
- 7) **Supervision Checklist** The Supervision Checklist provides a list of key issues that should be considered by investment staff while supervising IFC investee companies and, in particular, those companies undertaking CG Improvement Programs.

¹ The term “listed companies” is a simplification: for example, not all “public” companies have equity listed on stock exchanges because they may have only offered debt securities to the public; on the other hand, a company can have a relatively large pool of outside shareholders, but not have securities traded on an organized exchange. Nonetheless, “listed companies” is a useful term for listed, broadly-held or public companies and the CG Tools for this paradigm can be applied to all such types of companies.

² The Report Generator is an integrated tool that has the 5 key CG risks, questions for the client, documents to requests and the mitigating features to identify in producing an appropriate Decision Book report with recommendations.

Corporate Governance Interviewees

To carry out a thorough a corporate governance analysis (FGA or DDR), IFC staff need to have direct discussions with people who play a variety of governance roles in the company. A list of the people who would normally be interviewed is provided below. However, companies may differ significantly in how they apportion responsibilities and in the titles they use for different positions in the company, so it is important that IFC staff meet with those who, as a practical matter, are responsible for the principal corporate governance functions, irrespective of their job titles.

- Representatives of controlling shareholders
- Representatives of other holders of significant blocks of shares
- Chairperson and members of the Board of Directors, including any “independent” Board members and the chairs of the audit and other special committees of the Board (and where applicable, members of the Inspection Committee: the Fiscal Board, *Commissaire*, Audit Commission, *Comisario* or *Revisor Fiscal*)
- Chief Executive Officer
- Chief Financial Officer (or senior accounting officer)
- General Counsel (or senior lawyer)
- Corporate Secretary
- Chief of Internal Audit and Internal Controls
- Chief of Investor Relations
- Independent External Auditors

Some special cases

a) Listed Companies in Supervisory Board Systems

IFC’s **CG** Tools for listed companies assume the company has a single-tier (or “unitary”) Board structure. However, for companies in Central Europe, the law follows the German corporate governance model and requires two-tiered Boards, with separate Supervisory and Management Boards. For these companies, IFC has developed a specialized **Information Request List – Listed Companies in Supervisory Board Systems**. Another very useful resource for these companies is the German Corporate Governance Code, available on the CG website.

b) Listed Companies in the People’s Republic of China

In recent years the Chinese Securities Regulatory Commission (CSRC) has undertaken significant efforts to try to improve the poor governance standards of Chinese listed companies and has issued far-reaching regulations. To reflect these CSRC regulations, the Information Request List has been adapted for the case of Chinese listed companies: **Information Request List – Listed Companies in the People’s Republic of China**. In addition, the website has more resources for working with Chinese listed companies.

c) Listed Family Companies

Particularly in the emerging markets, the controlling shareholders of listed companies are often families or groups of families and, therefore, not all “family firms” are private, unlisted companies. For listed family companies IFC staff should apply both the Listed Companies paradigm and the Family-Owned Unlisted Companies paradigm, so that the CG Review and CG Improvement Program cover issues concerning both public companies and family firm governance. For example, investment staff should select the most relevant questions from each Information Request Lists and should give the client both Progression Matrices.

d) Listed Financial Institutions

With more than a quarter of IFC’s portfolio in financial institutions, the CG Unit has developed a paradigm and CG Tools for these clients. Investment staff working with listed financial institutions should use the Financial Institutions paradigm, rather than the Listed Companies paradigm. Due to their financial complexity and, in most cases, the presence of public depositors, financial institutions pose special governance risks. The failure of financial institutions and, in particular, banking failures, can also have systemic implications. To cope with these additional risks, the governance of financial institutions is often more tightly regulated, with special requirements, such as credit committees and prescribed capital structures.

e) Listed Companies with ADR programs

Emerging markets companies with publicly traded ADR programs (NYSE or NASDAQ listings) are subject to most of the requirements of the 2002 Sarbanes-Oxley Act and the NYSE or NASDAQ listing rules. In the past, foreign issuers in the US markets were exempted from many of the governance requirements applicable to US domestic issuers, but from now on, these exemptions will be much more limited in scope. Therefore, emerging market companies with (or planning) ADR programs will need to improve their governance practices in a variety of areas, such as the independence of the Board and the role and composition of the audit committee. More generally, emerging market companies that aim to access the capital markets in New York, London or other developed markets, must strive to achieve international best practices of corporate governance. The IFC CG website has acquired many useful resources that summarize the regulatory requirements and investor expectations of the developed markets.