How Do You Get Companies to Comply with Voluntary Legislation? Develop the Legislation With Them

How do you promote better corporate governance when companies operate in a regulatory vacuum? How do you encourage them to comply with voluntary guidelines in the absence of legislation? IFC's Ukraine Corporate Development Project found that getting the public sector's help in developing those guidelines from the start is key to creating a sense of public ownership and, consequently, the incentive to follow the guidelines.

BACKGROUND

The situation in Ukraine in the early 2000s was typical of former Communist Bloc transition economies: thousands of new joint-stock companies and millions of shareholders emerging from the privatization process and operating in a regulatory vacuum. In Ukraine, these companies were loosely governed by a handful of provisions in the Law on Business Associations, which dated from 1991 and left much to be desired.

A new joint-stock company law had been in development for years, but its adoption was constantly getting postponed or disrupted by government officials—particularly those who had interests in businesses and did not want transparency.[17] Ukraine's president issued a decree mandating corporate governance reforms, and the Securities Commission felt pressured to deliver. They approached the Ukraine Corporate Development Project. Motria Onyschuk-Morozov, Project Manager at the time, recalls that one of the commissioners called the team in for a meeting and said, "We've decided to adopt a Corporate Governance Code for Ukraine. Can you get us a draft by next Thursday?"

IFC discussed this request at some length, since ideally a country would adopt a good corporate law first and a code later. However, the project team felt that helping the government develop a voluntary corporate governance code could lay the groundwork for the law and would, in the meantime, provide best practice guidelines for companies to follow. But, this would not (and should not) happen in a week! The key was to ensure that the process of developing this voluntary code would be transparent, and that companies would be included in its development.

LESSONS LEARNED

1) Guide the process, but let your government partner be in the driver's seat and take the spotlight.

IFC had been in Ukraine long enough to know that the best approach to policy reform efforts is to maintain low public visibility as an international institution—you make more progress when you work through a local champion. Project staff guided the Securities Commission behind the scenes by providing sample codes from other countries and sharing best practices on how the process should work. To bring international experience and expertise to the table, IFC arranged an international video conference with corporate governance code experts from around the world (with funding from the World Bank Institute's Global Distance Learning Network program).

The project decided that the Securities Commission's corporate governance task force would be the ideal group to take the code work forward. Already in existence, the task force included representatives of various stakeholder groups such as stock exchanges, investment funds, self-regulating bodies, think tanks, and law firms. Working through the task force gave the initiative legitimacy by having multiple stakeholders involved in the process. IFC's team remained in the background, drafting sections of the code and providing advice on international best practices.

2) Build public awareness of corporate governance codes before starting work on the policy document—to begin the process of public ownership and buy-in.

Prior to starting the drafting process, the project, in partnership with the Securities Commission, set up workshops on corporate governance codes in five cities around Ukraine. The workshops were open to directors and managers of all companies.

These workshops covered topics such as the role of country codes and the Organisation for Economic Co-operation and Development's Corporate Governance Principles, to create a greater understanding of the need for a corporate governance code.

Participants were then asked to talk about how a code could apply within the Ukrainian context, and to present their ideas to government officials at a series of roundtables set up by the project. Issues such as

Meeting of the Securities Commission's corporate governance task force.

conflicts of interest and related party transactions were particularly relevant to Ukraine. Giving companies the chance to voice their opinions early in the process helped encourage buy-in and build demand for a corporate governance code.

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>
> *—Member of Ukraine Securities Commission to IFC Corporate Development Project Team*

3) Give the public the ability to offer comments and suggestions for the draft. This further increases a sense of ownership of the document.

Following extensive review, the draft code was approved by the Securities Commission task force. Then it was circulated widely to state bodies and stakeholders such as joint-stock companies and investment funds. (See box for a list of key stakeholders.) In line with its strategy, IFC funded the publication of the draft but let the commission do most of the distribution. In addition, a copy of the draft was uploaded onto the project's Web site to invite comments and suggestions online.

Knowing that the document they were considering was a draft gave individuals and groups a powerful sense that their input was valued and that they were being brought into a transparent process to which they could contribute. To build on this enthusiasm in the private sector, IFC also worked with the Securities

Commission's regional offices to co-organize a series of smaller public roundtables around the country. Initially, 23 meetings were held in different oblasts of Ukraine, but interest and demand were such that the Securities Commission later organized 100 additional meetings. A total of 128 public discussions of the draft code were held in 24 oblasts of Ukraine, attended by 4,370 people, including executives of joint-stock companies, professional stock market participants, academics, public servants, and others.

Two recurring themes at these roundtables were whether the code should be mandatory or voluntary and how the code was to be implemented by local companies. In particular, the commission was more inclined to try to enforce the code and make it mandatory, given the absence of a good law. Project staff provided concrete examples of how codes work in other countries. In the end, the commission decided to adopt a voluntary code to set an example of best practice for local companies.

KEY STAKEHOLDERS IN THE PROCESS

- Directors and managers of companies
- Shareholders
- Securities Commission
- Stock exchanges (seven exist in Ukraine, but only two have any influence)
- State Property Fund and other ministries (due to the number of companies still owned by the state)
- Nongovernmental organizations, a few of which were already part of the task force on corporate governance

> "This was a critical process that gave us a chance to reflect our own needs in a document that was essentially for us and not handed down from Parliament."
>
> —*Yakiv Goldenberg, Ukrnafta*

After the public review process, IFC helped the task force organize a concluding roundtable to summarize the feedback. The review resulted in very few changes to the final version of the code, since most of the comments related to implementing the code and whether it would be a mandatory or voluntary document. However, such wide involvement by various parties ensured that all who were affected by the document were familiar—and comfortable—with it and, most importantly, felt that they were part of the process.

4) Don't stop with the adoption of the document. Give companies the tools to implement it properly.

The final version of the code, officially called the Ukrainian Corporate Governance Principles, was adopted and signed by the Securities Commission in December 2003 and published in March 2004. Corporate sponsors, many of which were involved in discussing the code, even funded the cost to publish and distribute 8,000 copies of it throughout the country.

Although IFC could have stopped with the passage of the code, the project decided that companies would be more likely to adopt it if they had good implementation tools. IFC drafted a sample charter and bylaws for open joint-stock companies, which included the best practices outlined in the code. These documents—used by the project team and refined based on feedback from clients over a number of years—were further discussed by the task force and adopted by the commission. This way, companies had a complete set of ready-to-use templates they could customize to help them comply with the code.

One of the first companies that began implementing the code, and even drafted its own company-level corporate governance code, was Galnaftogaz, a growing Ukrainian gas company. This step, combined with other corporate governance improvements, helped Galnaftogaz receive an IFC investment in 2005. The project team, together with Galnaftogaz, publicized this success story to send a signal to other companies in the market that corporate governance reforms can lead to investment.

CONCLUSION

Ukraine still has not passed a joint-stock-company law, although a draft law was passed in the first reading in May 2007. In its absence, most companies make reference to the Ukrainian Corporate Governance Principles as the key document that sets the corporate governance agenda in the country. And, according to the Securities Commission, about 70 percent of public companies have adopted elements of the code into their company charters, even though the code is voluntary.

Currently, the commission is in the process of amending the code to reflect the latest changes to the OECD Corporate Governance Principles. With a revised draft in hand, the commission is following the process that IFC set out earlier, by arranging for national-level public discussions and roundtables before official adoption.

ABOUT THE AUTHORS

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