Structuring Corporate Governance Projects

IFC's corporate governance program assists businesses throughout the Middle East and North Africa region in improving their corporate governance practices. The program has five core objectives, namely to provide: advisory services to banks and companies on implementing corporate governance; assistance to investors to incorporate corporate governance into their investment decision-making; policy advice to the public sector on regulatory reforms and drafting national codes of corporate governance; sustainable institutional capacity for corporate governance, including corporate governance institutes and educational institutions; and training on corporate governance for the financial press.

BACKGROUND

There is a clear business case for corporate governance. A 2004 study of S&P 500 firms by Deutsche Bank showed that companies with strong or improving corporate governance practices outperformed those with poor or deteriorating governance practices by about 19 percent over a two-year period. In its 2005 global survey, Governance Metrics International found that the stock prices of the 26 enterprises it ranked highest in corporate governance outperformed their benchmark indices in one-, three-, and five-year periods. Both studies demonstrate the effect that corporate governance practices have on the overall value of a company.

Yet, while most clients intuitively state that corporate governance matters, few really understand what corporate governance means. According to IFC, corporate governance refers to a set of structures and processes for the direction and control of corporations. Corporate governance affects the distribution of responsibility and accountability among the main participants in the corporation—including shareholders, directors, and managers—and the rules and procedures for making decisions on corporate affairs. Corporate governance thus provides the structure through which corporate objectives are set, implemented, and monitored. A well-governed company is marked by: a strong commitment to good corporate governance; a professional, independent, and vigilant board of directors; a robust control environment; a strong framework for disclosure and transparency; and a culture of protecting shareholder rights, in particular of minority shareholders.

Corporate governance matters to the region. Many Middle Eastern and North African enterprises, as well as those in other regions, have reached a stage in their corporate life where adopting corporate governance has become crucial to their future growth and competitiveness, in particular as they transition from mid-size family-owned enterprises to large companies with regional ambitions. By improving their corporate governance, these companies may improve their ability to access outside capital, lower their cost of capital, improve their performance, and build public trust, confidence, and goodwill.

Corporate governance also matters to IFC. IFC has worked on corporate governance in more than 80 countries, and this extensive experience has positioned IFC as a global authority on governance issues for the private sector in emerging markets. Corporate governance matters to IFC's investment services, as it helps minimize portfolio and reputational risks, adds value to IFC's clients, and helps develop capital markets.

The following lessons learned are based on experience from implementing corporate governance advisory projects in Russia and across the MENA region.

LESSONS LEARNED

1) Corporate governance is a journey, not a destination.

Corporate governance projects should be structured to last at least three, ideally up to five, years, depending on the level of private sector development. Corporate governance reforms are ultimately based on changes in behavior, notably those of shareholders, directors, and managers—and indeed in a corporation's culture. Such change is not made overnight. As Peter Drucker, the famous management theorist, once stated: "Culture is process over time." And so changes to a corporation's governance policies, procedures, and processes can positively affect a company's corporate governance culture and the behavior of its agents. This extended time period will also allow the project team to better monitor project outcomes and impacts.

2) Obtain the godfather's blessing, but avoid the kiss of death.

A corporate governance project should receive formal support from both the private and public sectors before being formally launched. This holds particularly true in emerging markets with powerful groups that are happy with keeping the status quo. Indeed, absent a strong commitment by both the public (relevant ministries or authorities, such as the capital markets authority and/or central bank) and private sectors (leading industry or business associations), corporate governance reforms are likely to be reduced to a "box-ticking" exercise, and the project is thus unlikely to achieve its intended impacts.

A word of warning, though, when interacting with government: public sector backing may provide legitimacy and lend support to deliver corporate governance advisory services in a country (the "godfather's blessing"). It also may be accompanied by meddling and interference, which could jeopardize a project's ability to engage with the private sector as an "honest broker" (a project's "kiss of death") or to help the public sector reform a country's legal and regulatory framework.

For example, the Russia Corporate Governance Project's work to help develop the regulatory framework in Russia was limited in part due to the nature of its relationship with the Securities Regulator. A number of private sector companies also cited their uneasiness about cooperating with the project absent public sector support. The Egypt Corporate Governance Project, in turn, forged a strong, yet arm's-length, relationship with the Egyptian Ministry of Investment and Capital Markets Authority, which in turn facilitated the project's ability to launch a series of advisory services for the private sector, as well as the region's first institute of directors and the world's first country code of corporate governance for state-owned enterprises.

Practically speaking, signing a Memorandum of Understanding rather than a formal agreement with the project's public sector counterparts is often the best way forward. This allows the relevant government counterpart to take ownership and offer support, yet also keep a healthy distance from the public sector.

3) Remember that the sum is greater than its parts.

When structuring a corporate governance project, it is important to target all key stakeholders involved in the reform process. While companies have the difficult task of implementing corporate governance, a number of other stakeholders have an important role to play in ensuring sustainable reforms. For example, in Pakistan, the project team is training the local press and financial media to ensure that the quality of reporting on corporate governance improves. It is also working with both banking and company regulators to improve the overall corporate governance framework.

Another project component is to build sustainable capacity. Thus, many of the project activities are being channeled through the Pakistan Institute of Corporate Governance, a nascent institute that IFC

hopes to build and make sustainable. Finally, the project team in Pakistan is engaging directly with the private sector, conducting a series of awareness-raising events, technical workshops, and company-specific interventions. Given the challenges of introducing improved corporate governance practices in form rather than theory and on a sustainable basis, only an interaction of all stakeholders is likely to produce the desired development impacts.

4) Do not outsource your core competency.

The success of a corporate governance project will ultimately depend on the quality of project staff—both international and local. Human resources are core to IFC's business model, and hiring the right individuals with real and practical corporate governance expertise, leadership qualities, and communication (presentation and public speaking) skills poses a serious and time-consuming, yet not insurmountable, challenge.

It is best to launch the hiring process at the earliest possible stage, ideally between the PDS-Early Review and PDS-Approval stage and once funding has been secured. Hiring outside corporate governance consultants to support the project team in carrying out its work is an option, in particular when staffing constraints exist or when project teams are inexperienced (to transfer knowledge). For example, during the program's extremely brief ramp-up phase, a number of consultants were hired to support the local IFC team to reach a greater number of banks and companies and thus help ensure that impacts and success stories were developed from the get-go. However, IFC's additionality—its unique mix of "global" corporate governance expertise and "local" knowledge—should and must not be compromised and outsourced, lest IFC lose its reputation as a global leader in corporate governance for emerging markets.

Dr. Ashraf Gamal El Din, Executive Director of the Egyptian Institute of Directors, and Sebastian Molineus, Program Manager, IFC Corporate Governance Program in the Middle East and North Africa, discuss corporate governance issues around a joint IFC – EIoD event

5) Remember the top-down, not bottom-up approach.

It is important to hire the project officer/manager first, prior to hiring other project staff, allowing the project officer to lead the selection process for key positions within a project. While perhaps obvious to most, the pressures from senior management or donors of recruiting a project manager during a very short time frame may lead program management to overlook this important step. In the end, the consequences of hiring (and then possibly firing) the "wrong" staff comes at great human cost to the staff in question, and will wind up costing even more time. This occurred in Russia, where the project manager was hired after a significant number of local staff had been hired and an operational structure put in place, both of which had to be changed to allow the project to achieve its results.

6) Educate, educate, and then educate.

Staff training is of great importance from the outset and should be included in the budget. Corporate governance is a complex topic, combining a multitude of different disciplines such as corporate and securities law, finance and accounting, economics, and other specialized fields, including risk management and internal control. It will likely prove difficult to find an individual with in-depth expertise in all disciplines. A training program on corporate governance may well prove to be a key success factor in minimizing the project's operational (and ultimately reputational)

risk, enabling project staff to provide quality services to client companies from the start. IFC's Corporate Governance Department plays an important role in providing training, not least of all on IFC's Corporate Governance Assessment Methodology, and in carrying out assessments. An exchange program between advisory staff is another possibility.

7) Replicate successful country projects at the regional level.

Rolling out existing IFC products across the region on a "light-touch" basis, once successfully piloted and "standardized" in a country, is an effective means of ensuring that a product is able to reach other stakeholders beyond a project's immediate focus, and can help corporate governance spill over into other countries. Such light-touch interventions will typically consist of identifying a successful product such as a bank training program for directors developed in Egypt and partnering with a regional institution such as the Union of Arab Banks that is mandated to identify and invite local, country-based institutions like national banking institutes. This regional institution can then organize a series of events for the local institutions to transfer the product: workshops on how to tailor the product to local conditions and train-the-trainer events on how to teach the bank training program. Then IFC staff can participate and share their insight and experience without significant time input.

8) Avoid the "tree falling in the forest" syndrome.

Before developing the monitoring and evaluation framework, ensure that your project has a clear goal; set of objectives that are specific, measurable, actionable, realistic, and time-bound; and action plan. Only then will the project teams be able to link project goals to impacts, objectives to outcomes, and activities to outputs. Then it is best to request that project staff look beneath the numbers of the monitoring and evaluation framework to ensure that they understand the underlying rationale: what, how, and when to monitor and evaluate. Finally, ensure that you have a budget set aside for this, including for a mid-point evaluation. In the end, what you cannot capture or measure will not be evaluated and, worse, cannot be proven (like a tree that falls unnoticed in the forest). For example, the MENA program recently conducted a corporate governance review for an IFC investee client in Algeria. Because the costs and time commitment were considered minimal, the work was not captured in a PDS document and hence is not formally included in most internal or external communications.

9) Define the exit up front.

During the final months of the Russia Corporate Governance Project, the wealth of information and experience the project team had gathered was to be filed into folders, which in turn were to be placed in boxes, which in turn were to be stored in the World Bank's basement. Rather than follow this traditional path of shutting a project down, the project team decided to transfer its know-how and resources to a local institute of directors. However, this transfer was only partially successful, mainly due to the short time period to effectuate the transfer and unwillingness of local staff to move to the institute. A project's exit strategy should thus be considered at the earliest possible stage, ideally at the project conception stage. In fact, the project's exit strategy is best made a project objective. At the same time, the exit strategy should not tie the project to a specific partner institution; rather, the project team should be allowed the necessary flexibility and time to work with and test the various project partners in a particular country.

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