Why Corporate Governance?
What Is Corporate Governance?

Corporate governance refers to structures and processes for the direction and control of companies. Corporate governance concerns the relationships among the management, board of directors, controlling shareholders, minority shareholders, and other stakeholders. Good corporate governance contributes to sustainable economic development by enhancing the performance of companies and increasing their access to outside capital.

The G20/OECD1 (2015) Principles of Corporate Governance provide the framework for the work of IFC in this area, identifying the key practical issues: 1) the rights and equitable treatment of shareholders and key ownership functions; 2) institutional investors, stock markets, and other intermediaries; 3) the role of stakeholders, disclosure, and transparency; and 4) the responsibilities of the board. The G20/OECD Principles of Corporate Governance are universally applicable to all types of corporate governance systems in countries at all levels of economic development. The challenge for IFC is to take this framework of international best practices of corporate governance and use it to add value to the wide spectrum of our client companies in emerging markets.

Why Does Corporate Governance Matter for IFC Clients?

• Improving access to capital. Much of policymakers’ and academics’ attention to corporate governance issues in emerging markets has focused on the role of governance in improving emerging-market companies’ access to global portfolio equity. An increasing volume of empirical evidence indicates that well-governed companies receive higher market valuations; however, improving corporate governance will also increase all other capital flows to companies in developing countries—from domestic and global capital, from equity and debt, and from public securities markets and private capital sources.

• Improving performance. Equally important, good corporate governance leads to better performance for IFC clients. Improved governance structures and processes help ensure quality decision making, encourage effective succession planning for senior management, and enhance the long-term prosperity of companies, independent of the type of company and its sources of finance.

Why Does Corporate Governance Matter for IFC?

• Adding value. Corporate governance is a priority for IFC, because it presents opportunities to manage risks and add value to clients. Besides benefiting individual client companies, IFC’s work to improve corporate governance also contributes more broadly to its mission to promote sustainable private sector investment in emerging markets. IFC collaborates with clients that identify and manage environmental and social risks and that pursue environmental and social opportunities and outcomes in their business activities with a view to continually improving their sustainability performance. IFC recognizes the relationship that a strong culture of corporate integrity and governance has with sustainability performance—and that a company’s management and board of directors play important roles in driving risk management and sustainable growth. IFC believes that this approach helps improve the financial, social, and environmental sustainability of investments and enhances the public trust in its operations.

• Reducing investment risk. It is in IFC’s interest to reduce the risk of investments by improving the governance of investee companies. In the worst corporate governance environments, poor standards and weak enforcement continue to be barriers to investment even for IFC with its mandate to work in frontier markets. Improving the corporate governance of investee companies allows IFC to work in higher-risk environments. It may also bring an increase in the market valuation of companies and attract more investors, which together increase the opportunities for IFC to exit its equity investments on favorable terms. In recent years, IFC has worked with some of our highest-profile clients to improve their governance and to better communicate the quality of their governance to markets.

• Avoiding reputational risk. If IFC does not work to improve the corporate governance of client companies, then it takes on not only

1 OECD = Organisation for Economic Co-operation and Development.
investment risk but also a reputational risk for involvement with companies with poor governance or, in the worst cases, corporate scandals. This reputational risk is particularly serious where stakeholders and equity investors stand to lose from governance abuses, such as with banks and insurance companies.

• **Creating capital markets.** Improving corporate governance contributes to the development of the public and private capital markets. Poor standards of governance, particularly in the area of transparency and disclosure, have been a major factor contributing to instability in the financial markets across the globe. This was seen in the 2008 financial crisis, where corporate governance shortcomings, particularly in the area of control environment (internal audit, internal controls, risk governance, and compliance) interrupted economic growth.

**IFC’s Comparative Advantage in Corporate Governance**

• **IFC’s experience.** Although the term “corporate governance” has become widely used only in recent years, IFC has worked on the key issues of corporate governance at the grassroots level for decades—structuring client companies, appraising investment opportunities, and nominating board members. This practical experience allows IFC to tailor global principles to the realities of the private sector in developing countries. Development banks and other investors working in emerging markets now look to IFC for leadership on corporate governance issues in developing countries.

• **Global leadership.** In addition to working directly with client companies, IFC plays a leading role in the global policy dialogue on corporate governance and provides technical assistance to regulators, stock exchanges, and others, including the network of development finance institutions. IFC manages a set of large donor-funded technical assistance projects in Central and Eastern Europe, China, the Middle East, and other key emerging markets. IFC helps bring together corporate governance professionals worldwide. It co-sponsored the OECD Roundtables in Latin America and Eastern Europe and helped establish networks of Institutes of Directors in East Asia, Central and Eastern Europe, and Latin America. IFC’s methodology for evaluating corporate governance risks and opportunities has been distilled into the “Corporate Governance Development Framework,” a common approach that was adopted by 35 development finance institutions for use in their investment processes. The institutions that signed the Corporate Governance Development Framework cover most emerging markets around the world, including Africa, Latin America and the Caribbean, Asia, Middle East, and Europe and Central Asia, and represent assets of more than $850 billion altogether.

**Sustainability and Corporate Governance**

Corporate governance is one of the pillars of IFC’s focus on sustainability, following environmental and social sustainability. Better corporate governance increases the likelihood that the enterprise will satisfy the legitimate claims of all stakeholders and fulfill its environmental and social responsibilities. Effective corporate governance processes contribute to the long-term, sustainable growth of client companies. A company that is well-governed is one that is accountable and transparent, and that engages appropriately with its shareholders and other stakeholders (including contracted workers, primary-supply-chain workers, suppliers and contractors, and local and international nongovernmental organizations and civil society organizations).