

REPORT ON THE OCTOBER 18, 2005 INTERNATIONAL CHAMBER OF COMMERCE ROUNDTABLE ON CORPORATE GOVERNANCE

The topic of the October 18 International Chamber of Commerce (“ICC”) roundtable on corporate governance in London, England was the role of regulation in promoting effective corporate governance. The roundtable consisted of three panel discussions, a keynote address by Peter Strueven of the Boston Consulting Group (“BCG”), and a summary panel discussion led by Victor Chu, Chairman of the roundtable.

This roundtable is part of a series of conferences organized by the ICC to explore how to improve the corporate governance practices of international companies. As part of this project, the roundtable explored what good corporate governance means to companies operating in different regions of the world, being governed by different legal regimes and having different ownership structures.

The main lesson of the roundtable is that different countries apply different regulatory models to promote good corporate governance. These models tend to range from strict regulation of corporate governance through corporate codes to a more laissez-faire approach where there is a greater reliance on the capital markets to ensure companies adopt optimal corporate governance practices. The reason why “one size does not fit all” is that the conditions affecting the corporate governance practices of companies vary greatly among companies: whether the company is private (which includes family-owned) or public and whether the investor base is more retail or institutional.

The first panel was entitled “Regional/cultural approaches to market regulation.” Speaking on the panel was Güler Manisali-Darman, who is based in Turkey, Mark Daniell, who is based in Singapore, and Nader Mazloomi, who is based in Iran. Consistent with their diverse geographic backgrounds, the panelists remarked that their respective jurisdictions approached the regulation of corporate governance in very different ways. On one end of the spectrum, Iran is putting into

place its first comprehensive corporate code. Without an active public market, Iran does not yet have the opportunity to look to more market-oriented regulatory strategies. On the other end of the spectrum, Singapore has a highly sophisticated, international capital market. Mr. Daniell describes the Singaporean view of corporate governance as the protection of the interests of all of the various stakeholders in the company. Turkey falls in the middle. About 70 percent of Turkish companies are categorized as family-owned, but Turkey is also in the process of revising its commercial code to make Turkish companies more attractive to outside investment.

The second panel focused on corporate governance regulation from the perspective of the stakeholder. This panel consisted of Shahira Abdel Shahid, who is based in Egypt, Peter Butler, who is based in the United Kingdom, George Dallas, who is based in the United States, and Simon Wong, who is based in the United Kingdom. Messrs. Shahid and Butler focused their comments on the prospect of large institutional investors as being the stakeholders who have the greatest interest in, and influence over, a company's corporate governance practices. Mr. Shahid noted that institutional investors are very active in the Egyptian market, perhaps the most active of any market in the Middle East. Mr. Butler adopted a more cautious tone about relying on fund managers to ensure that a company implements appropriate corporate governance practices. In particular, Mr. Butler noted that fund managers and managers often work to cross purposes. Fund managers seek first to maximize their fees and usually have little skill in managing companies. In the alternative, Mr. Butler proposed a partnership between managers and institutional investors to make sure that the two groups work together. Mr. Butler concluded his remarks with the observation that a market-oriented approach to regulating corporate governance requires attributing some value to good corporate governance. As of yet, the capital markets have not developed an agreed upon metric for valuing corporate governance. Mr. Dallas noted that improved disclosure by companies of their corporate governance practices is necessary for stakeholders to play a larger role in evaluating corporate governance practices. Finally, Mr. Wong described the management consulting firm McKinsey's approach to evaluating corporate governance effectiveness – looking at how boards of directors spend their time and evaluating the quality of information boards receive from management. The speakers in general agreed that identifying a company with superior corporate governance is not a “tick the box” exercise. As a result, it is difficult to expect stakeholders to determine if a company maintains appropriate

corporate governance without more information about the operations of the company and the working relationship within the board and between the board and management.

The third panel discussed in broad terms the challenges facing companies, stakeholders and investors. This panel consisted of Alum Bati, who is based in Azerbaijan, Robert Hodgkinson, who is based in the United Kingdom, and Kasemit Pathomsak, who is based in Thailand. Mr. Bati described the challenge of maintaining good corporate governance in a transitional economy like Azerbaijan. In the end, Mr. Bati noted, good corporate governance is really about trusting the corporate managers. In a transitional economy, having independent directors is the best way to establish this trust, but there is often a shortage of qualified candidates who can serve as independent directors. Facing this problem, foreign investors often try to find alternative safeguards, but legal opinions and other legal protections provide cold comfort in a transitional economy. Mr. Bati also noted that it is extremely difficult to find advisers knowledgeable about the local economy, let alone who can speak the local language. Mr. Hodgkinson also sounded a note of caution about corporate governance reforms. In his view, there is a general consensus that good corporate governance reforms include having a sufficient number of independent directors, an independent audit committee and independent auditors, but this consensus does not take into account differences in local corporate governance models (for example, there are significant differences in corporate governance practices between the United States and the United Kingdom even though the US and UK economies and legal systems are relatively similar) and large disparities in the capacity of companies to implement certain corporate governance reforms.

Peter Strueven presented to the roundtable two recent and important studies conducted by BCG that address the question: Is there such a thing as perfect corporate governance? The first BCG study interviewed 132 chief executive officers around the world about their views on the role of non-executive directors. Sixty percent of the interviewees said that independence was important. Among US CEOs, however, only 50 percent said that independence was important. While 75 percent of the interviewees said that it was important that the non-executive directors be “highly qualified,” only 38 percent of UK CEOs said that non-executive directors actually understand the strategic vision for the company. In exploring how well the directors should know the future

CEO of a company, only 15 percent of the CEOs based in Asian countries thought the directors should know the future CEO. Finally, in response to questions about the amount of time directors should devote to their duties, most interviewees suggested that a director should spend 20 to 40 days out of the year to his or her duties. Mr. Strueven summed up the CEOs' responses in the following way: "We want highly-independent board members who are highly-qualified and spend a significant amount of time in a position that is not his or her main job." Mr. Strueven noted that there are a limited number of board candidates who can meet such a standard.

In the second BCG study, BCG examined those companies involved in the 25 largest corporate fraud cases since 1998 and compared the companies with 25 similar companies that did not experience fraud. After evaluating the corporate governance practices of both sets of companies, BCG found that the corporate governance "scores" of the two sets of companies were identical. Instead, BCG noted the following differences between these two sets of companies: (i) compensation of CEOs (including issuance of stock options) was much higher in the 25 companies that were involved in fraud cases; (ii) the 25 companies involved in fraud cases were mentioned more often in the press (not including press coverage related to the fraud cases) than the other group of companies; and (iii) the 25 companies involved in fraud cases had excessive growth rates and announced higher growth expectations.

Several lessons can be drawn from the BCG studies. First, boards of directors, in their entirety, need to be more knowledgeable of the operations of their companies. Second, boards of directors need to be more inquisitive and active in reviewing the operations of the company and actions of management. As one step to achieve this goal, Mr. Strueven recommended changing the meeting culture of the board. For example, the board should reject 100 page technical reports in favor of shorter, more concise reports that are more accessible to directors with various backgrounds and expertise. Board meetings should not be tightly scheduled, but left open-ended so that there is adequate time and opportunity for free discussion and inquiry. Third, in order to accomplish these goals, boards of directors need to find ways to spend their time more efficiently so that they can accomplish more in the same limited amount time.

Based upon the comments of the various roundtable participants, four observations can be made regarding the role of regulation in ensuring effective corporate governance:

1. ***No Single Model of Good Corporate Governance.*** All of the panelists strongly reiterated that “one size does not fit all.” There are vast differences among the different countries of the world. Some countries are still developing their corporate law infrastructure and are only now beginning to set forth rules and regulations pertaining to corporate governance. In these same countries, managers, directors and stakeholders are just beginning to consider the value of effective corporate governance. In other countries, traditional approaches to regulating corporate governance are proving inadequate as the nature of their capital markets and corporate ownership structures change. Even in the countries with the most sophisticated capital markets, there remains uncertainty as to how to measure good corporate governance practices.

2. ***Regulation Does Not Guarantee Good Corporate Governance.*** There needs to be a balance between market mechanisms and regulation in promoting good corporate governance practices. Corporate governance regulation generally has consisted of three types: prescriptive regulation, independence requirements and disclosure requirements. First, prescriptive regulation consists of specific requirements on companies pertaining to their corporate governance. As the roundtable participants widely agreed, such a “tick the box” approach does not provide adequate assurance that the company is not a medium or fraud or otherwise following good corporate governance practices. Second, regulations that require the independence of directors, auditors and other advisers and gatekeepers is helpful in ensuring that there are corporate actors who have the ability to monitor and question poor corporate decisions. But these requirements do not guarantee that independent actors are capable and effective in preventing corporate fraud. As certain roundtable participants noted, the performance of directors and other participants is also a function of the quality of information they receive, the amount of time they spend in carrying out their responsibilities and their levels of expertise. Third, regulation can force companies to provide needed information to the market place about company matters, especially financial statements and executive compensation. Disclosure, however, is costly to companies, and there is no consensus on what information is necessary.

3. Need to Improve the Operation of the Market. The best hope for ensuring companies adopt optimal corporate governance practices is if managers, directors and stakeholders believe that good corporate governance enhances the value of the company. Intermediaries such as rating agencies serve a valuable role in monitoring the corporate governance practices of public companies. Roundtable participants noted, however, that investors have not developed a way to measure the degree to which certain improvements in a company's corporate governance practices increases corporate value.

4. Good Corporate Governance Consists of a Dynamic Relationship Among Managers, Directors and Stakeholders. The fourth conclusion that can be drawn from the roundtable is that good corporate governance is about an active board that dedicates sufficient time and resources to following and understanding the operations of the companies, a responsive management willing to share information and consult with the board, and a shareholder base willing to support the efforts of the board. In short, evaluating whether a company is following good corporate governance practices is not made by taking a snap shot picture of the company to see if the company has certain corporate governance mechanisms in place, but rather monitoring the on-going relationship between management, directors and stakeholders.