

FEAS Corporate Governance Workshop

The Quest for Global Corporate Governance Standards; Lessons from Emerging Markets

Melsa Ararat
Corporate Governance Forum of Turkey
SABANCI UNIVERSITY

21 January 2010, ISE

AGENDA

- Background of CG reforms
- A short summary of CG reforms in Turkey
- The difference the ownership structures make
- Lessons learned: ISE-CG Index
- Looking forward

Background of CG Reforms

Investor protection affects:

- The value of public firms and their performance (Bhagat and Bolton 2008, Black 2006)
- The development of capital markets > economic development > growth (Claessens 2006, Levine 1999)
- Demand for metrics for evaluating the quality of CG in public firms (Gillan 2006)

A short Summary of CG reforms in Turkey

- 2001 Reforming the Banking Sector (BRSA)
- 2003 CMB Issues the CG Guidelines (based on OECD principles)
regulation of audit function
- 2004 CMB Issues the CG Guidelines Compliance Report Standards
- 2005 Compliance Reports becomes mandatory
- 2005 IFRS becomes mandatory, CG Index announced
- 2006 First company to receive a CG rating
- 2006-2009 Further Regulations (disclosure, major transactions)
- 2010 24 companies rated by 4 different companies by different methodologies

- Yener: OECD Principles focus on CG problems that result from conflicts of interest due to *separation of ownership and control*

Dilemma:

- Investor protection is better in developed countries
- McKinsey survey (2001): Investors pay a higher premium for better governed companies in countries where the investor protection is worse. So what?
- Existing commercial metrics are by indices covering predominantly
- the developed markets

Question: Is it possible to have single global governance metric for both widely held companies and controlled companies?

Answer: NO (Bebchuk and Haddami,2009)

The most influential indices:

Academic:

- Anti-Director Rights Index focused on widely held companies (LLSV, 1998)
- Anti-Self Dealing Index focused on controlled companies (Djankov, 2008)

Commercial:

- Model based : Risk Metrics- CGQ
- Investable: Bovespa - Nova Mercado

Anti-director Index components:

- Shareholders Voting Rights
 - o Whether the shareholders are required to deposit their shares before an AGM
 - o Whether the shareholders can vote by mail
 - o Minimum percentage of shareholding required to call a GM
- Pre-emptive Rights (first right to buy shares)
- Cumulative Voting
- Oppressed Minority Mechanisms (Rights of minority shareholders to object major changes)

Anti-Self-dealing Index components:

- Disclosure
- Public enforcement
- Approval of self-dealing transactions by disinterested shareholders
- Shareholders legal standing with respect to self-dealing transactions in court
- Shareholders ability to hold controlling shareholders and directors liable for self-dealing transactions

What are the differences?(1)

1. Separation of ownership and control versus overlap of ownership and control (nature of the agency problem)
2. Can shareholders challenge the management?
Yes in controlled companies, no in widely held companies
(proxy access fight in the USA)
3. Ability and incentives of the shareholders to exercise
4. Main mechanisms and manifestation of insider opportunism,
the means of constraining (case if business groups, pyramidal
structures, negative interest)

What are the differences?(2)

5. Allocation of power between the board and the shareholders

Strengthening the shareholders' ability to influence board decisions for widely held companies, or ensuring that the board can keep a distance from the influence of controlling shareholders

6. Director Independence: Independence from whom?

Examples of less meaningful metrics for EM:

- Shareholder approval for auditor, changes in bylaws
- Ability to determine who will serve on the board! (They may undermine the ability and willingness of directors to serve as a balancing power against controlling shareholder opportunism
- Super majority approval: Good or bad?
- Executive compensation: Non-issue for controlled companies
- Empire building: Non issue for controlled companies
- Hostile takeovers: Non-issue for controlled companies
- Voting Procedure: Non –issue for controlled companies
- Ability to determine who will serve on the board!

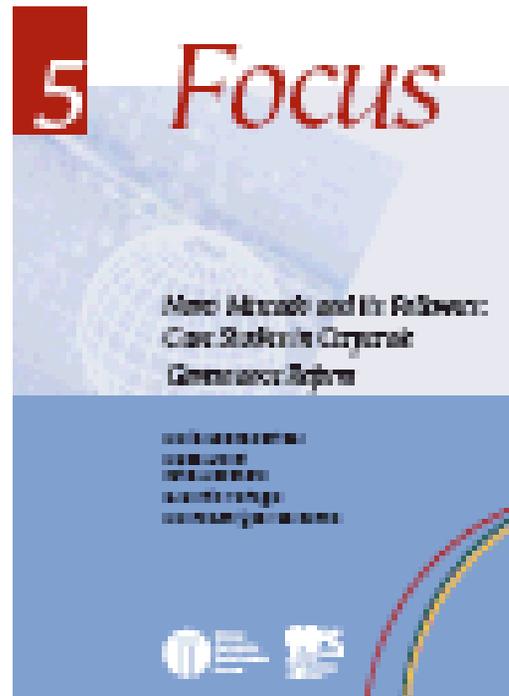
More meaningful metrics for EM:

- Limiting the powers of the controlling shareholder and empowering the minority shareholders (cumulative voting)
- Disclosure of self-dealing transactions
- Limiting controller's ability to influence the director nomination
- Majority of minority requirements
- Protection of directors from controlling shareholders (should the directors be easily removed from their duty?)
- Executive compensation might be viewed from a different perspective; are the directors' incentives promote entrepreneurship?
- Separation of cash flow rights from control rights
- Approval of related party transactions by disinterested shareholders

Bottom Line:

Is the Power contestable?

The story of CG ISE –Index



[http://www.gcgf.org/ifcext/cgf.nsf/AttachmentsByTitle/Focus+5/\\$FILE/Novo+Mercado+text+screen+4-21-08.pdf](http://www.gcgf.org/ifcext/cgf.nsf/AttachmentsByTitle/Focus+5/$FILE/Novo+Mercado+text+screen+4-21-08.pdf)

Issues:

- Not a rating of CG quality, but a rating of compliance with the CMB Guidelines!
- Many provisions of the Guidelines lack legal foundation, changes in bylaws are required
- Different weights assigned to the same criteria by different rating companies for more than 100 recommendations!
- Paid by the customer; moral hazard
- Investor interest?: No evidence
- Valuation premium?: No evidence
- Encouraging new IPOs?: Probably NO
- Who opts out? 82 of ISE-100
- Why get a rating: Listing fee discounts, prestige
- Did anyone fail?: Probably NO
- Average score: 8.20, max: 9.00, min:7.71
- Are they better governed than the rest of the firms: NO
Evidence: They do not rate better in disclosure when compared to the rest of the firms in ISE-100: NO (for 2006-2007 and 2008)
- Did it do any good: YES; learning

Lessons

- Understand the nature of the demand (engage investors in design)
- Think about the alternatives: A separate market with additional listing requirements
- In case of an Index approach, pay attention to:
 - Coverage (all investable companies)
 - Consistency – same research firm, same methodology
- Prioritization of key issues based on evidence
- Simplicity
- Availability of investment instruments
- Do not copy, but learn from others' experiences
- Regulate what really matters (e.g. significant asset sales or purchases, material events disclosure, mandatory tender offer)

LOOKING FORWARD

- Enforcement, enforcement, enforcement (public and private)
- Capital market development (tax reforms, minimizing informality, legal infrastructure-Commercial Code)
- Ownership concentration-capital markets development are in conflict!
- Growth! (but low carbon!)

melsaararat@sabanciuniv.edu