



# CORPORATE GOVERNANCE: AN ANTIDOTE TO CORRUPTION

The 10th International Anti Corruption Conference took place in Prague, Czech Republic, 7-11 October, 2001 with the theme "Together Against Corruption — Designing Strategies, Assessing Impact, Reforming Corrupt Institutions." Organized by Transparency International, this event brought together thousands of international anti-corruption practitioners for an exchange of information and experiences, training, agenda-setting and networking. Through a set of plenary sessions and workshop discussions, the conference aimed at developing an anti-corruption agenda for the international anti-corruption movement for the next two years. The conference intended to serve a broad constituency of professionals from all parts of the anti-corruption movement and all regions of the world through discussions on a wide range of topics.

The involvement of the Center for International Private Enterprise in the conference is an effort to highlight successful approaches to anti-corruption, as implemented by its global reform partners. CIPE has not only acted as a co-sponsor of the event, but also lead a workshop examining the linkages between corporate governance and anti-corruption. Effective strategies for anti-corruption initiatives on the part of the private sector were elaborated. The workshop addressed why corporate governance needs to be of direct concern to countries focusing on democratic development, and especially on corruption/rule of law issues. Corporate governance ultimately depends upon public-private sector cooperation to create a competitive market system and the development of a non-corrupt, law-based democratic society.

## Participants:

- John D Sullivan, Center for International Private Enterprise, Washington DC
- Despina, Pascal, Strategic Alliance of business Associations, Romania "Business Ethics and Corporate Codes"
- Alexander Ikonnikov, Investor Protection Association, Russia "Addressing the Supply Side of Corruption through Corporate Governance"
- Peter Brew, International Business Leaders Forum, United Kingdom "Corruption and Governance: The Challenge for Business Leaders"
- Jane L Wexton, GE Capital — Global Consumer Finance, USA "Corporate Governance and Anti-Corruption at GE Capital"
- Sam Mensah, African Capital Markets Forum, Accra, Ghana
- Boris Begovic, Center for Liberal Democratic Studies, Serbia
- Kathryn Gordon, International Investment Division, OECD

Edited by Aleksandr Shkolnikov

Presentations of participants found in Appendix I

## Executive Summary

Corruption has established itself as a problem of a main concern throughout the world community. Many things have been said about the negative effects of corruption on countries, on the performance of their economies, both private and public sectors. Few will argue against the fact that it hampers overall economic development, and that fact is more evident now than ever before.

In a recently published Transparency International's rankings of the most corrupt countries, those who are most corrupt are also poorest in terms of economic and institutional development. And while it is hard to say whether they are corrupt because they are poor, or they are poor because they are corrupt, it is clear that something has to be done about the high levels of corruption in those countries before they will be able to enjoy any kind of growth and prosperity.

The reality is - corruption takes place in every economy, in every type of political system and in every part of the world. To think that some countries are safe is to make a mistake – even the most advanced democratic countries with well-developed institutions have recently faced corruption scandals. Scandals that exposed both politicians and business executives that were involved in illegal activities. Those scandals not only question the legitimacy of democratic institutions in developed countries, they also have become a major barrier to economic development of transition and developing economies (republics of the former Soviet Union, ex-communist states of Central and Eastern Europe, countries in Africa, Latin America and Asia). Yet, in many of those countries the problem is so grown into economy and society that corrupt behavior is accepted and is not questioned.

A number of different anti-corruption measures have been proposed by think tanks and development institutes around the world. Many have accepted these measures and, to some degree, they have been successful in combating corruption. However, recent financial disasters in Asia and Russia have raised a new perspective on anti-corruption initiatives.

At the center of both the Asian and Russian crises were corporations and governments that failed to create a system of fair, honest, transparent, market based principles of business practices. Backdoor dealings and favoritism became centerpieces of the crises. The crises once again proved that anti-corruption measures should not only be targeted at limiting the ability of government officials to exercise discretionary powers. There is also another way.

Corruption cannot be blamed on unethical government officials alone – after all, someone has to pay the money, provide kickbacks and "grease the wheels". Corruption should also be fought against from the side of the private sector - the business community, which is an equal participant in the illegal practices. In this sense, the mechanisms of corporate governance are the measures that should be taken to try to eliminate the possibility of businesses getting involved in corrupt activities.

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**-James Wolfensohn  
President, The World Bank**

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Corporate governance is generally defined in the context of issues and problems that result from separation of ownership and control in organizations. Corporate governance sets up a system of institutions that govern the relationship between investors and creditors on one side, and managers on the other side. What it does is very important for companies trying to succeed not only in domestic markets, but also in markets abroad – it provides for competition that is based on fair, transparent and responsible practices.

Corporate governance sets up a system that not only governs the relationship between owners of capital and managers. An important aspect of corporate governance is the fact that much attention is being paid to relationship between managers and other stakeholders, protection of shareholder rights and independent supervision over activities of a business entity. Importantly, corporate governance sets up a system where rules are reinforced not only by written regulations, but also by moral standards of business ethics and by responsible corporate behavior.

Corporate governance strongly depends on the institutional development of a country, since a system cannot be set up under a weak or non-existent framework of rules and regulations. In this context, establishing these mechanisms in developing economies is a much greater challenge. In many cases, developing and transition countries lack strong and sound institutions that are vital to the development of such mechanisms. Therefore, establishing corporate governance does not only set up a means of combating corruption, but it goes far beyond that.

Not only sound system of corporate governance helps attract foreign investment that is vital to the growth of the private sector (especially in the developing world), but by reinforcing values of rule of law, transparency and fairness, it also improves domestic investments and stops capital flight. It helps in creation of a healthy private sector, which is one of the key elements in successful economic development.

## **OECD PRINCIPLES OF CORPORATE GOVERNANCE**

### **1. The rights of shareholders**

The corporate governance framework should protect shareholders' rights.

### **2. Equitable treatment of shareholders**

The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders.

### **3. The role of stakeholders**

The corporate governance framework should recognize the rights of stakeholders and encourage active co-operation between corporations and stakeholders.

### **4. Disclosure and transparency**

The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation.

### **5. Responsibilities of the board**

The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.

High rates of return alone are not the attraction for investors. The Asian Financial Crisis proved once again that high rates of return without political and economic stability and predictability to back them up should not be the sole determinants for investment. By developing country's institutions and improving market conditions, and by fighting against corruption and improving the investment climate, corporate governance helps facilitate the overall goal of economic development of nations and it reinforces democracy-building.

Establishing a direct link between corporate governance and corruption is an important task. While many seem to concentrate on combating corruption among government officials in the area of licensing, public procurement contracts, tax exemptions and subsidies, it is important to realize that the discretionary powers of government is not the only problem here. Every issue has two sides to it, and corruption is no exception to this rule. Just as public officers are liable for receiving corrupt payments, the private sector is liable for providing those payments. To put it simply – if the private sector would not provide financial capital to government officials, bribery could not exist. And corporate governance is trying to do just that. It creates a system where the illegal flow of capital from the private sector to the pockets of government becomes impossible.

Realization of the benefits of corporate governance, especially in combating corruption, has led to increased attention to the issue in every part of the world. As James Wolfensohn, the President of the World Bank pointed out, "The governance of the corporation is now as important in the world economy as the government of countries."

Increasingly, developing countries are working on establishing corporate governance systems and drafting codes of corporate governance. Business community in those countries has to adhere to those codes, since they have no other choice – in today's business environment, where consumers and investors demand fair and transparent operations, you have to play according to rules. If you don't accept the rules then you are not going to succeed.

### **Survey Investigating Corruption and Corporate Governance Perceptions**

Preparing for the conference, the Center for International Private Enterprise conducted a survey investigating corporate governance and anti-corruption perceptions among its network of think tanks, business associations and policy development institutes around the world. The findings further reinforced the direct link between corporate governance and anti-corruption initiatives.

Interestingly, while most respondents realized corruption is a problem in their countries, there is a general understanding that in developing countries certain groups are not interested in solving the problem since they will lose if anti-corruption measures are put in place.

Those surveyed highlighted corporate governance mechanisms – accounting standards, financial market and ownership regulations, independent judiciary, privatization and public sector restructuring – as key tools in combating corruption. The striking element is that corporate governance, as a concept, is not widely used in the surveyed countries, even though there is a general awareness of the certain single mechanisms involved.

Moreover, corporate governance and corruption issues often lack media coverage, and in some countries in the Middle East and Africa the topic is a taboo. However, think tanks and business

associations are constantly working to raise public awareness of the problem in their countries. They are involved, together with representatives of public and private sectors along with members of the international community, in drafting voluntary codes of corporate governance.

The survey also reinforced another well-known fact – the openness of the corporation greatly affects its performance. Fully privatized enterprises are perceived to be more committed to mechanisms of corporate governance rather than state owned enterprises. (For detailed results of the survey, see Appendix II.)

### **Corruption: Sources and Effects on Countries**

The world has witnessed a new focus being placed on corruption through a series of headlines publicizing the ousting of political leaders. Accusations of corruption have been leveled at officials around the world, including some in the US, France, Germany and other developed countries.

The lack of communication and opaque markets have been identified as major contributors to the Asian crisis, which grabbed the attention of even the most developed markets. Today corruption is one of the leading causes for the lack of foreign investment in Russia and Ukraine. No one is arguing that corruption doesn't occur every-

where to some degree; however, there is a fundamental difference in how it affects developed versus transitional or developing economies. In developed countries the fight against corruption is a fight for fairness and increased efficiency in markets that are already well-structured. On the other hand, in developing countries, anti-corruption programs are a struggle to establish basic institutions, without which the development of those countries is not feasible. In developing and transitional countries corruption can be so pervasive that it undermines the state and hinders development of democratic values and market systems.

Corruption is now an acknowledged barrier to development. No continent has gone unscathed and countries undergoing democratic and economic transition are hardest hit. Simply put, corruption wastes resources, acts as an extra tax on transactions, creates inefficiencies within the market and undermines public confidence in democracy. As recognition of the need to combat corruption grows, so does the need for information exchange among the

## **DANIEL KAUFMANN'S SOURCES OF CORRUPTION**

- Issuing licenses, permits, customs and border-crossing documentation, banking licenses.
- Implementing price controls.
- Blocking new firms and investors from entry and providing monopoly power.
- Awarding public procurement contracts.
- Granting subsidies, soft credits, tax exemptions, and allowing tax evasion.
- Imposing foreign-exchange controls
- Allocating real estate.
- Selectively enforcing socially desirable regulations
- Maintaining obscure or secret budgetary accounts by government officials.

Daniel Kaufmann is the Senior Manager for Governance, Finance and Regulatory Reform at the World Bank Institute.

Daniel Kaufmann "Anticorruption Strategies: Starting Afresh? Unconventional Lessons from Comparative Analysis," in R.Stapenhurst and S.Kpundeh (ed.), *Curbing Corruption*, The World Bank, 1999, p. 94.

increasing number of institutions involved in combating corruption. Combating corruption is, of course, important in its own right since left unchecked, it has a corrosive effect on democracy and the general well being of a nation. In addition, combating corruption can serve as a tool for bringing about broader economic reforms and creating a level playing field on which business operates. These additional benefits can become an important part of the effort to mobilize support for anti-corruption programs. As society begins to realize that corruption harms everyone through lost jobs and lower incomes, it becomes easier to arouse public support for anti-corruption measures.

Corruption in terms of public-private sector transactions can be broadly defined as abuse of a public office for personal gain. For example, most would agree that bribing a civil servant is corruption. However, hiring relatives (nepotism), giving contracts to supporters (cronyism), abusing privileged information to buy or sell stock (insider trading), and other such practices are viewed differently around the world. Following the Asian and Russian financial crises, the trend seems to be in the direction of a more inclusive definition of corruption rather than strictly limiting it to bribes. One of the major breeding grounds for corruption can be found in the area of governmental applications of laws and regulations including, but not limited to, labor law, tax rules, customs and currency regulations, and health and safety laws. You cannot get at the root causes of corruption by merely weeding out corrupt individuals, be they public procurement officers, politicians, or business people. Corruption thrives in markets where legal systems are ambiguous, the rule of law is not embedded within cultural norms, and where laws and the judiciary allow employees opportunities to exert discretionary authority throughout various levels of government.

## **Center for Liberal Democratic Studies: "Corruption in Serbia"**

As a part of a CIPE/NED supported project to address the decade-long institutionalization of corruption in Yugoslavia, the Center for Liberal Democratic Studies (CLDS) has completed a survey of business community and public perceptions about corruption in Serbia. CLDS concluded its work by launching a 210-page publication that not only presents a concise picture of the current Serbian dynamic in regard to corruption, but also explores the consequences and devastating effects of corruption on the welfare of society.

"Corruption in Serbia" goes into great detail describing corruption in Serbia - from cultural roots and causes to anti-corruption strategies. Among the major centerpieces of this publication are the surveys conducted by CLDS examining corruption and its consequences both in private and public sectors. The findings show that 10% of those surveyed believe the issue of corruption is the number one priority in the country. As for causes of corruption, the majority of those surveyed believe that there is an overall "crisis of morality" in the society due to growing poverty levels and lack of respect for the rule of law. Some also point to inheritance of the problem from the communist system and government intervention as causes for corruption. The survey of the public sector also found that citizens believe that corruption is most often used in circumnavigating legal obligations and norms, changing and misrepresenting them. The surveyed representatives of the private sector highlight corruption in the judiciary as a great problem. Also, inefficiency of public services is listed as one of the reasons for widespread corruption among public servants.

The list of areas where the private sector encounters corrupt activities includes licensing, registration and inspection, tax administration, federal and local government contracts, customs documentation and currency transactions. Dissemination of the report to both domestic policymakers and international organizations active in Serbia is underway, and this dynamic tool will likely have a strong impact on policy development in this area in Serbia.

"Corruption in Serbia" can be downloaded from CLDS and CIPE websites: [www.clds.org.yu](http://www.clds.org.yu) and [www.cipe.org](http://www.cipe.org)

### **Two Sides of Corruption: Supply side vs. Demand side**

Before the efforts to curb corruption can be proposed, it is important to understand the nature of the problem and the parties that are involved. Corruption has two sides to it, the supply-side and the demand-side. The supply-side of corruption involves those parties that are providing money payments, gifts or any other forms of expressing gratitude for services. The demand side of corruption, in turn, is represented by those who are accepting different forms of payment and consequently providing some form of service or a favor in return (it can also include a denial of a service).

Typically, government officials who have a lot of discretionary powers and operate in those environments where the system of checks and balances is weak or non-existent, characterize the demand side. On the other hand, the supply side is usually represented by the private sector, which is willing [and sometimes is forced] to provide monetary and other forms of payment to the government officials for the services provided or denied.

The result of private sector participating and being forced to participate in corrupt activities is that it does not allow for fair competition and it keeps firms which are not necessarily healthy from a business stand point, on top roles in the market. By creating an uneven playing field, parties involved in corrupt activities create roadblocks for those companies, which are not willing or not able to provide corrupt payments. Thus, the market doesn't function on the basis of fair competition and equal opportunity.

### **Corporate Governance as a Tool to Combat Corruption**

Corporate governance is directly related to the topic of combating corruption. In many societies this is not a subject that is easy to deal with, both because of political sensitivities as well as legal inconsistencies. Yet corruption has to be dealt with in order to secure a position in the global economy and to secure the benefits of economic growth. The signing of the OECD anti-bribery convention is the beginning, not the end, of a concerted global anti-corruption campaign. Efforts to improve corporate governance, especially in the provision of transparency in corporate transactions, in accounting and auditing procedures, in purchasing, and in all of the myriad individual business transactions is a large scale effort. Sound corporate governance mechanisms target the supply side of corruption – the private sector. Corporate governance creates a system, where the whole process of providing corrupt payments or gifts is quickly exposed, and therefore becomes unsustainable. Corporate governance sets up mechanisms which not only combat corruption on a legal basis, but also in terms of business ethics. In the process of creating sound systems of corporate culture, corruption is bound to become an unacceptable ethical behavior. Thus, the private sector needs to become engaged in building effective anti-corruption strategies.

# **Corporate Governance at Work: The Case of RAO UES**

## **Alexander Ikonnikov**

Alexander Ikonnikov is the Executive Director of the Investor Protection Association. PhD. in Economics (Economics and National Economy Management); and formerly the Head of the Department of foreign economic activity and attraction of investments in oil & gas industries of the Ministry of Fuel and Energy of the Russian Federation.

Russia, unlike many developed countries, has a short but very intense period of private sector development, which saw its ups and downs. We will look at the restructuring of the Russian energy monopoly, the Unified Energy System or RAO UES of Russia, the largest Russian company. At the beginning of 2000, management of RAO UES proposes a complicated and nontransparent restructuring plan, which was developed without involvement of independent and recognized outside experts.

The restructuring was caused by the necessity to raise the efficiency of the industry companies, their competitiveness on energy markets as well as to create preferable conditions for resident investments. The plan is the creation of a multitude of generation, transmission and sales companies (totaling about 1,000 enterprises.) At the same time, the two-tiered structure pulled the asset reallocation beyond the control of shareholders and the boards of directors, which might have led to nontransparent deals with local industry and regional governments. Assets for sale were priced very low compared to other energy companies of the world. This practice, as well as the failure to use civilized corporate governance procedures, created a suspicion of corruption and asset stripping.

RAO UES hired international experts to devise the new restructuring plan and assemble a deal with the shareholders. The new restructuring plan approved by the Government was more transparent and provides much less room for corruption. The competence of the boards was broadened significantly through amendments to the charter. The list of deals requiring shareholder approval was extended as well as the list of corporate events subject to obligatory disclosure to shareholders.

A reforming committee was created by the RAO UES Board of Directors, and chaired by an independent director. The management announced the creation of a methodological base and arrangements for regular audits of finances and operations of subsidiaries and independent companies. This example shows that good corporate governance can really prevent or restrain corruption. However, in order to make this mechanism work in companies, the following condition must be fulfilled: the Board of Directors should have more controlling power over the management. Independent directors must be on the Boards as they prevent absolute concentration of corporate power, reducing potential corruption. The company should use outside independent expertise to evaluate management action and maximum transparency of corporate action for shareholders to prevent abuses and/or conflicts of interest.

## What exactly is corporate governance?

What exactly is corporate governance and by what means does it fight against corruption?

There are few topics that are more central to the international business and development agendas than that of corporate governance – a means whereby society can be sure that large corporations are well-run institutions to which investors and lenders can confidently commit their funds. Corporate governance is a critical focal point in creating safeguards against corruption and mismanagement, while promoting fundamental values of a market economy in a democratic society. These values include accountability, transparency, rule of law, fairness, responsibility, and ownership rights.

A series of recent events has placed corporate governance issues as a top concern for both the international business community and international financial institutions. Several high profile scandals in Russia, the Asian crisis and the recent scandal in the United States have brought governance concerns to the fore in developing countries and transitional economies. Further, national business communities are learning and re-learning the lesson that there is no substitute for getting basic business and management systems in place in order to be competitive internationally and to attract investment.

Concerns over corporate governance systems are not limited to developing countries. Even in the advanced industrial societies, there is a global trend toward strengthening accountability and responsibility on the part of enterprises. For example, in recent years the Cadbury Commission in the United Kingdom, the Vienot Commission in France, and the Organization of Economic Cooperation and Development (OECD) have each issued new guidelines. In all of these cases, the underlying concerns center around ways to accomplish the core values of corporate governance, and address the following key elements:

- Boards of Directors
- Audit committees
- Internal structure
- Shareholders relations
- Management control

However, a much broader perspective on corporate governance goes beyond the narrow view of interrelations between owners and managers of capital. To a greater extent, corporate governance results from a set of institutions (laws, regulations, contracts, and norms) that create self-governing firms as the central element of a competitive market economy. The key point here, is that the public and private sectors have to work together to develop a set of rules that are binding on all and which establish the ways in which companies have to govern themselves.

As countries build up strong systems of corporate governance, major benefits to society can be seen. Even in countries where most firms are not actively traded on stock markets, adopting standards for transparency in dealing with investors and creditors is a major benefit to all in that it helps to prevent systemic banking crises. Taking the next step and adopting bankruptcy procedures also helps to ensure that there are methods for dealing with business failures that are fair to all stakeholders, including workers as well as owners and creditors. Without adequate bankruptcy proce-

dures, especially enforcement systems, there is little to prevent insiders from stripping the remaining value out of an insolvent firm to their own benefit.

Recent research has also shown that countries with stronger protections for minority shareholders also have much larger and more liquid capital markets. Comparisons of countries that base their laws on different legal traditions show that those with weak systems tend to result in most companies being controlled by dominant investors rather than a widely dispersed ownership structure. Hence, for countries that are trying to attract financial capital, corporate governance matters a great deal in terms of bolstering the confidence and commitment of potential investors.

The benefits of committing to an outlined set of corporate governance mechanisms are clear: lower levels of corruption, healthy private sector, fair markets, institutional development and as a result of all this a healthy growing economy. However, the question remains are companies bound to accept these standards of governance? Establishing the right structure for corporate behavior may bring significant changes to the company's operating techniques and it may seem to only worsen the situation for some companies. Adopting new transparent, fair and honest ways of operating not only creates significant challenges in terms of restructuring business operations and adopting completely new business principles, this process, at times, can become very costly. However, there is no other way. We can now see many examples of successful performance by those companies that take on strong corporate governance structures. Notably, this does not only happen in developed economies. In developing and transition economies, where the establishment of corporate governance mechanisms is a much harder process to implement, there is also a realization of the benefits. Successful implementation of corporate codes of conduct builds a strong image of the fair, honest and transparent market player. Companies are not only pressured by the government, which adopts regulations forcing the corporate governance codes of conduct on businesses. Self-regulating or voluntary codes of corporate governance also play an important role. They prove that companies are willing to commit to fair competition.

There is also a large pressure exerted on a business community by consumers and investors. They are more and more interested in honest and transparent business operations, and since there is nothing more important than satisfying your investors, creditors and customers, and gaining a respectable name on the market, it can be said without a doubt that there is no other way. You are either in, or you are out.

# International Business Leaders' Forum

Peter Brew

Peter Brew is the Acting Director of Operational Policy of The Prince of Wales International Business Leaders Forum. Since 1999 he has carried out projects for the International Business Leaders Forum in Vietnam, Indonesia, Egypt and Russia.

The International Business Leaders' Forum is an advocate of corporate social responsibility, and we see corruption in governance as falling as part of that corporate responsibility agenda. We take the view that corporate social responsibility is actually a good business practice.

Whether companies want to address the issue or not, the fact of the matter is that major international companies today have no option. They are under very severe pressure from all of their stakeholders. Increasingly, shareholders are concerned to know: are there any inherent risks being run in the business as a result of corruption or any other bad practice? We are increasingly finding today that good employees are demanding that they work for companies in whom they can have pride, companies who they know are doing the right thing. Customers are putting pressure on companies to ensure that their behavior is acceptable. Equally, members of the supply chain want to be sure that the company that they are dealing with is fair, honest and reasonable; that they can depend on being paid a fair price for their part in the supply chain and that they can depend on being paid. They don't want to see corruption any more than anyone else does.

But quite apart from the pressure that is on business to perform and have good governance, it actually makes a degree of sense in relation to running the business. First of all, it is one sure way of protecting the company's assets. We have seen in many of the transition economies that a lack of understanding of the importance of protecting the assets of that business has been a major issue in terms of attracting foreign investment. It also can have a major impact on business costs. Clearly, if money is being paid to people that shouldn't be paid, it costs money.

Increasingly, businesses cannot stand on the sidelines and say they've cleaned up our own act - it's up to other people to clean up theirs. Business must continue the process of reporting openly all its activities so that it is not just satisfied that it is behaving properly, but it is seen to be behaving properly. It has got to show, with its internal procedures and controls, that it has the situation under control, and that where it discovers any form of corruption, it deals with it quickly and decisively. And finally, business has a role to show leadership in this whole field of corruption. For too long, it has been someone else's problem, or perhaps it has been, well, we don't certainly give bribes, but of course, in certain parts of the world, certain things are different, and we have to behave in a different way.

## **The Role of Think Tanks and Business Associations in Establishing Corporate Governance Mechanisms**

In many developing countries corporate governance is a new term for both business and civil society. One of the first steps in the process of establishing the system of corporate governance is building awareness and public support. Exposing the problems within corporate structures, highlighting the benefits of adopting effective corporate codes of conduct that both business and society can enjoy, is crucial.

Think tanks and business associations not only can, but also should accept the role of promoters of sound corporate structures. However, their involvement in the process doesn't stop there. Think tanks and business associations should be closely involved in setting up training and educational programs, promoting values of transparency, fairness, responsibility and others among corporate board members, managers, employees and the general public. Those programs, in turn, will supply important feedback in terms of the opinions, views and recommendations of the business community, which could be very beneficial in the process of drafting the code of corporate governance in the country.

Business associations also play another important role. They transform the business community into an effective anti-corruption tool. A single private sector representative is a non-existent force against corrupt activities. A single business trying to expose corrupt government officials risks being quietly eliminated, especially in the developing economies. However, business associations are able to bring those single voices together into one powerful force that is going to be heard and that will be able to make a difference.

Realizing the importance of think tanks and business associations in the development process, CIPE is sponsoring a number of think tanks and business associations in many different countries. They are actively involved in the process of initializing corporate governance reforms in their countries, as well as providing helpful expertise in the process of drafting the code of corporate governance. Training programs and communication strategies are also a part of their work on establishing well-functioning and effective corporate governance mechanisms.

# Romanian Strategic Alliance of Business Associations

Despina Pascal

Despina Pascal Currently works as a consultant with Axa International Consulting Ltd. - Managerial Consulting & Training company. Her fields of expertise include institutional building & organizational development, training and consulting on SMEs, NGO management, policy research on private sector development and gender issues.

It is recognized that corporate governance is one of the major challenges for the countries making the transition from state-owned, centralized economic systems to free-market economies. At the same time, it is agreed that there are many linkages between sound corporate governance and emerging private sector development. These linkages could be described as follows: lack of corporate governance distorts fair competition on the market and affects the entire competitive environment. Of course, in such an environment, small and medium-sized enterprises are most vulnerable, due to their limited resources in terms of capital and personnel.

Lack of corporate governance and sound practices in Romania generates lack of rule of law and economic democracies. The major challenge for Romania as a transition country is the effective democracy and building of the open and functioning markets, including building institutional framework in order to monitor corporate governance and business ethics. In this respect, the role of the business and trade associations and chambers of commerce and industry is essential.

Since it was set up in spring 1996, the Strategic Alliance of Business Associations played a leading role in increasing private sector activities. The assessment of the status of corporate governance in Romania revealed that the state continues to play a large role as owner, rule maker and the major economic player. Independent institutions to monitor how the approved rules are applied are still weak or non-existent. The emerging private sector is comprised primarily of micro-enterprises and their owners are closely involved in the strategic leadership and day-by day management of the firms. As result no "best practices" in corporate governance can be replicated and transferred from the emerging private sector into the newly privatized or still state-owned corporations.

The Corporate Governance Initiative for Economic Democracy in Romania was the first systematic effort to bring corporate governance issues into public debate. The project was supported by CIPE (both financially and methodologically.) Based on the consultative and participatory approach the National Task Force drafted the Corporate Governance voluntary Code. The Code is a collection of best practices and recommendations aimed at setting standards for corporate governance and was approved and adopted by SABA as a voluntary enforcement code. This has been followed up by a second project (also supported by CIPE), the purpose of which was to encourage participation by the companies in the public debate and to assess how many voluntarily adopted it. The project was also aimed at providing training to the board members. Overall, both the Corporate Governance Initiative and the Code of Corporate Governance were well received by media and by business community.

SABA's activism on corporate governance and its accomplishments until now has proven that the grassroots approach to corporate governance is the key element to a sustainable and successful approach, and that while business community efforts, as well as government level policies are important, there must be support at all level of society.

## **Establishing Corporate Governance in Developing Economies**

Establishing a sound system of corporate behavior is a much greater challenge in countries with developing or transition economies. Unlike their developed counterparts, they often lack simple structures and institutions, a fact that creates significant roadblocks to developing and implementing the mechanisms of corporate governance. Poor infrastructure, complicated tax systems, confusing accounting standards, absence of rule of law, politicization of the business sector, weak enforcement agencies and frail stock market mechanisms are just some of the problems that developing economies face. In this environment it is hard to convince companies of the benefits of fair and transparent market play – many face a danger of being eliminated from the market if they stop practices of rent-seeking and bribery. Every one else around you is doing it, so why wouldn't you?

Activities involving corruption between governments and the private sector in the developing world often become a normal part of day-to-day operations. Moreover, these practices are not only accepted by both parties, they spill over into the society, which is often also involved in illegal dealings with the government.

The result is the fact that companies on the market are not the best in terms of efficiency and effectiveness, they simply have more capital or more connections. Another result is businesses going into the informal sector, which in some developing countries can be as high as 75% of GDP. Consequently the country ends up with a weak and underdeveloped private sector, which is not able to compete in today's global economy. So whether some like it or not, systems limiting the ability of the private sector from becoming involved in corrupt practices should be put in place.

The costs are high, but so are the benefits. Not only companies will benefit from a healthy environment, but the economy as a whole will receive a boost if a fair and balanced playing field is created. It is a known fact, especially after the recent financial crises shocked the world community, that foreign investors recognize the meaning of stability and predictability. They are careful in choosing the destinations for their investments, and healthy business sector is on top of that priority list. Recognizing the fundamental importance of foreign investment in growth and development of transition economies, it is possible to say that sooner or later the companies will be forced to leave the illegal ways of conducting business operations behind.

Governments and businesses may realize the benefits of corporate governance mechanisms. But where do they go from there? How do governments actually make companies establish the mechanisms and commit to the governance codes? How do they enforce the codes in the private sector? How do they make companies behave in an honest and transparent way in a corrupt and weak system? How do they make them stand out among others?

The point that corporations in developing and transition economies try to make is that they have no other choice but to get involved in practices of illegal payments, rent-seeking and gift-giving. It is not only expected from them by the government officials, whose salary is so low that they consistently rely on "donations" from the private sector, it is also forced upon them by the other members of the private sector. Having companies around you indulge in corrupt activities forces you to do the same, especially when enforcement of the system of laws and regulations is weak or non-existent. If you don't participate, you lose out to those who get favoritism and insider-treatment.

Corrupt companies usually get submerged into an informal sector – shadow economy. And while for many it is the only way to exist, it is hard to argue that informal ways of doing business is much more difficult. If a company is stuck in the informal sector, it does not have access to banking and financial system, it does not have access to legal system, it can not participate in a law making process, and it has limited access to capital. Yet, many remain in the informal sector, many decide to continue with the illegal ways of conducting business and are just too afraid to become open, transparent and honest.

The question is: "How do you enforce governance systems in the private sector?" Some of the solutions that circulate in developing countries include an establishment of a rating system, whereby an independent audit firm rates companies on their levels of transparency, fairness, involvement in corrupt activities, etc. This will provide sound background information for financial markets, investors and creditors, consumers and suppliers. Markets will reward those who are honest and open. Investors will invest in healthy companies. Suppliers will work with those who can be an honest long-term partner. Customers will be loyal to those with a positive image.

Business associations and chambers of commerce may be more of a solution for medium and small companies. They enforce corporate governance mechanisms by addressing the problem of corruption in a different manner. While a single business is almost a non-existent force against corrupt government officials, business associations bring those voices together, and together they are much more effective in exposing corrupt practices.

The development of free and independent media is very important. If the message is consistently carried to the society, business associations can build strong support for non-corrupt practices and can create a social environment where corrupt practices are not tolerated within either the public or the private sectors. This environment will give a bad image to corrupt companies. It is hard to argue against the fact that image holds companies accountable, and bad image puts a company at a significant disadvantage. And while it is not easy to force companies to act honestly, and it is difficult to monitor their behavior, it is possible to create an environment that does not accept corruption and illegal activities on the side of the private sector.

# The Case of Africa

Sam Mensah

Sam Mensah currently works as a Executive Secretary in African Capital Markets Forum and also as a Managing Consultant at SEM International Associates Limited (Management Consultants). Received his PhD in Finance, University of Toronto.

I think in many ways, African economies are not far behind the so-called transition economies. Some of the peculiarities of the African environment are simply that the level of competition in the economies is very low. And we know that competition promotes good corporate governance, because bad companies know that they cannot be profitable in a competitive environment.

Until very recently, most of the sectors were state-controlled, and in the 1980s, as a result of liberalization, we started privatization, but there are still pockets of monopoly and oligopoly in various sectors of Africa's economy. When you have that kind of environment, there is a very high payout to rent-seeking. Secondly, we have very weak financial structures. And thirdly, the peculiarity of the African environment is the structure of the private sector, which is dominated by multinationals and state enterprises.

In most cases, the minority shareholders have little or no influence at all in the major decisions of these multinationals that are operating locally. So the problem of minority shareholders is quite severe, in a context that their rights are not very effective as far as the multinational companies go. The state-owned enterprises that operate in the private sector are exposed to serious political conflict: every government of the day wants to put their people on the boards of these companies. And then, beyond that, once you have your people on the board, then, you can secure procurement contracts for party loyalists and then pass on some of it to party campaign funds.

If you take the indigenous businesses, there is so much of an aversion to being part of the formal system, because in the formal system, they are forced to be transparent, and many of them enjoy this rent-seeking behavior. They like to operate outside of the formal system.

In many African companies today there are corporate governance schools, which have been developed with the help of experts. They reflect some of the OECD principles. However, the difficulty is that the compliance is very limited. And so, even though the corporate governance codes are in effect, we're not getting good results with these codes.

I think that African countries have to continue to reform their economies. In fact, what we need to do is to manage transition by opening it up to increased competition in all sectors of the economy, improve the regulatory framework.

# Corporate Governance at Work: GE Capital

Jane Wexton

Jane joined GE Capital's Structured Finance Group in March 1996, as a Senior Vice President and Director of Global Compliance. She is currently the Co-Chairperson of the American Bar Association's Corporate Criminal Liability Committee, and a member of the International Section's Task Force on the Foreign Corrupt Practices Act..

GE is a company that employs 320,000 people in over 100 countries. We do many things all over the world with a huge number of people. How is that possible? It is possible, because we operate on a particular set of principles. It is the rock and the foundation of all of the business we do throughout the world. We don't wink. There are no fake messages. We don't pay bribes. And the question is: how do you do that?

At GE, we have a bible, and this bible is called Integrity: the Spirit and the Letter. As you can imagine, when you have 320,000 people working all over the world, there are things that are going to go wrong. Instead of hiding those things, we have taken those examples and have used them to train. We have used stories from around the world.

We're driven, as is every other entrepreneurial company, to make the numbers, but making the numbers is not enough. If you don't make the numbers by the rules, you will not stay in the company. And so, from time to time, we have dismissals. We have people who don't get their annual bonuses. We make it very clear through actions that we take that that kind of behavior is not tolerated.

We have corporate audit staff that is constantly looking to see how we are running our compliance programs. This corporate audit staff goes into the guts of each of the organizations all over the world, and it gives us an eye into how is this particular division or this little segment being run. Staying within the bounds of the law and making sure that there is no corruption and no illegal payments is good business. If a country has got a major project that they want to have occur, and there is a choice between a company like mine, that has a reputation for being rock solid and having integrity, and one that will come in and make payments. You might ask: "Which one of those two companies will get the deal? And increasingly, we will find at GE that we win based upon our reputation. Countries that know that there is not going to be leakage of \$100,000 or \$100 million into the wrong pockets are interested in doing business with my company, because that's not going to happen. They are going to get the product that they've paid for.

## Corporate Governance and The Privatization Process

As countries in transition face the need for establishment of the private sector as a base for the market economy, the process of privatization is inevitable. Large government SOE's are often not able to compete by the rules of the free market. However, absence of corporate structures creates a number of problems in the privatization process. A privatization process not supported by corporate governance reforms usually ends up happening behind closed doors, among a "few" close to the decision-makers and influenced by them.

What also happens, is that managers and employees are the ones who gain control over the enterprise in the privatization process. This leads to insider control, which, in turn, is an open doorway to asset stripping, insider self-dealing and overall unwillingness to restructure, since jobs may be lost or

actions may be questioned. Moreover, an absence of corporate governance structures will almost always lead to the abuse of the rights of minority shareholders, and such actions are bound to undermine the legitimacy of the privatization process in the eyes of the public.

What can be the results of an ineffective privatization program? Almost always it includes underdevelopment of the privatized enterprises, which are not able to compete on the basis of fair competition with both domestic and foreign companies. And those underdeveloped enterprises become a burden for the governments that still adhere to protectionist policies and heavily subsidize them, trying to keep afloat inefficient companies even though they are destined for failure.

## **Privatization in Russia**

Corporate restructuring started in Russia in the early 1990's with the privatization process. There are a lot of debates on whether privatization was good or bad for Russia, its economy and society. Some believe that the process was needed for Russia and that the results of privatization were favorable for the future development of the Russian economy.

However, after privatization, the Russian economy was still dominated by highly industrialized institutions that were very inefficient. In addition to that, a large number of industrial institutions remained under the control of the state. The state did little to establish fair market rules within the business community. Competition between the businesses was not based on the naturally accepted business practices, but usually involved illegal and often criminal actions. Russian privatization also resulted in a concentration of property rights in the hands of few, who had no interest in restructuring the privatized SOE's. Massive giveaways of Russian important companies and enterprises on a "friendship basis" to the same circle of people concentrated power and control over some of the vital industrial institutions in the hands of those who were unable (and at times uninterested) to control, restructure and develop those enterprises. Those newborn oligarchs controlled not only businesses and business transactions, but also many aspects of the Russian social and political scene. The existence of the oligarchs only further damaged the development of the Russian business sector and postponed real changes until the mid-late 1990's.

Discrimination against foreign and outside ownership worsened the situation even more. While there is no clear answer to which structure of ownership is better (insider-based or outsider-based ownership), it is a fact that foreign-ownership discrimination has destructive effects on the development of enterprises since they lose out on foreign investments. Russia experienced low levels of foreign investment, and while there are a lot of reasons for that, one cannot underestimate the importance of troublesome privatization process.

Ineffective mass privatization in Russia led to a concentration of ownership in the hands of managers and employees. That, in turn, led to insider-self dealing, when those who controlled the operations were interested in improving their own financial situation, not the financial situation of the enterprise. Asset stripping by the insiders led to further destruction of the Russian enterprises, which were already weak and underdeveloped. In that sense the owners were forced to operate not according to the rules of the market, but according to the rules of bribery, crime and other illegal activities. Thus, corruption, bribery and crime became a large part of the business community operations.

# Conclusion

Corruption occurs in a number of ways: from gift-giving to bribing, denying a service to providing kickbacks, hiring relatives to awarding contracts. But no matter which form corruption takes, everyone agrees that it has negative effects on a country's economic and democratic development. And while corruption scandals in developed countries become more of a struggle to polish already existing laws and regulations, in developing countries corruption becomes a barrier to economic and social development and growth.

Corruption can be blamed on many factors such as weak legal and enforcement institutions, low wages of public officials, acceptance of corruption by cultural norms, an "everyone else is doing it" attitude and discretionary powers available to government officials. Blaming someone, however, does not help to solve the problem – solutions do.

Perhaps, one of the roots of corruption lies in the willingness of the private sector to provide payments and gifts to public officials. And if the possibility of such actions could be minimized, the whole existence of corruption could be reduced. That is where corporate governance mechanisms come in.

Corporate governance sets up a system whereby the money flow from the business community to the pockets of the government is strictly controlled. It sets up a system where the notion of a business getting involved in illegal dealings with the government officials is wrong, and where such illegal contacts are controlled and monitored by not only independent auditing committees, but by the general public as well.

Corporate governance is increasingly recognized as an effective tool to combat corruption. Yet, it is also important to look beyond corporate governance as an anti-corruption measure – corporate governance requires the development of important institutions and provides for a greater competition in the economy, which in turn enhances overall economic development and prosperity.

Increasingly, corporate governance is becoming a hot topic not only in the academic circles. Investors and creditors, suppliers and customers, chambers of commerce and business associations are no longer on the sides. They are actively participating in discussions on corporate governance and its role in economic development and growth.

Transition and developing economies cannot progress without establishing systems of corporate governance - institutions of control and enforcement. The world has witnessed too many mishaps in many different countries, from privatization in post-communist Europe and the former Soviet Union to a generally hopeless situation in African countries; from extremely high levels of corruption in Latin America to the recent financial crisis in Asia. It is time not only to recognize that corruption is bad, but it is time to take actions against the government sector as a recipient of corrupt payments and against the business sector as a provider and a starting point for corruption.

Developing countries have seen many failures in their attempts to privatize. Some did it too fast; some did it too slow. However, those who failed did not set up an institutional base for change – they did not set up mechanisms that govern the private sector, the way it operates and interacts within the country and on the international scene.

## Appendix I

### Presentations by conference participants

#### **Corporate Governance at Work: The Case of RAO UES**

*Alexander Ikonnikov*

*Alexander Ikonnikov is the Executive Director of the Investor Protection Association. PhD. in Economics (1998, specialization: Economics and National Economy Management); and formerly the Head of the Department of foreign economic activity and attraction of investments in oil & gas industries of the Ministry of Fuel and Energy of the Russian Federation. Previous to that, he was Director of the Moscow office of Yuganinvest Investment Company/Head of Section in the Securities Management Department of OJSC NK YUKOS.*

It is known that corruption is a serious disease, which exists within the government organisms at various levels. It creates obstacles for development of national economies around the world and stimulates business to move into shadow (informal) areas.

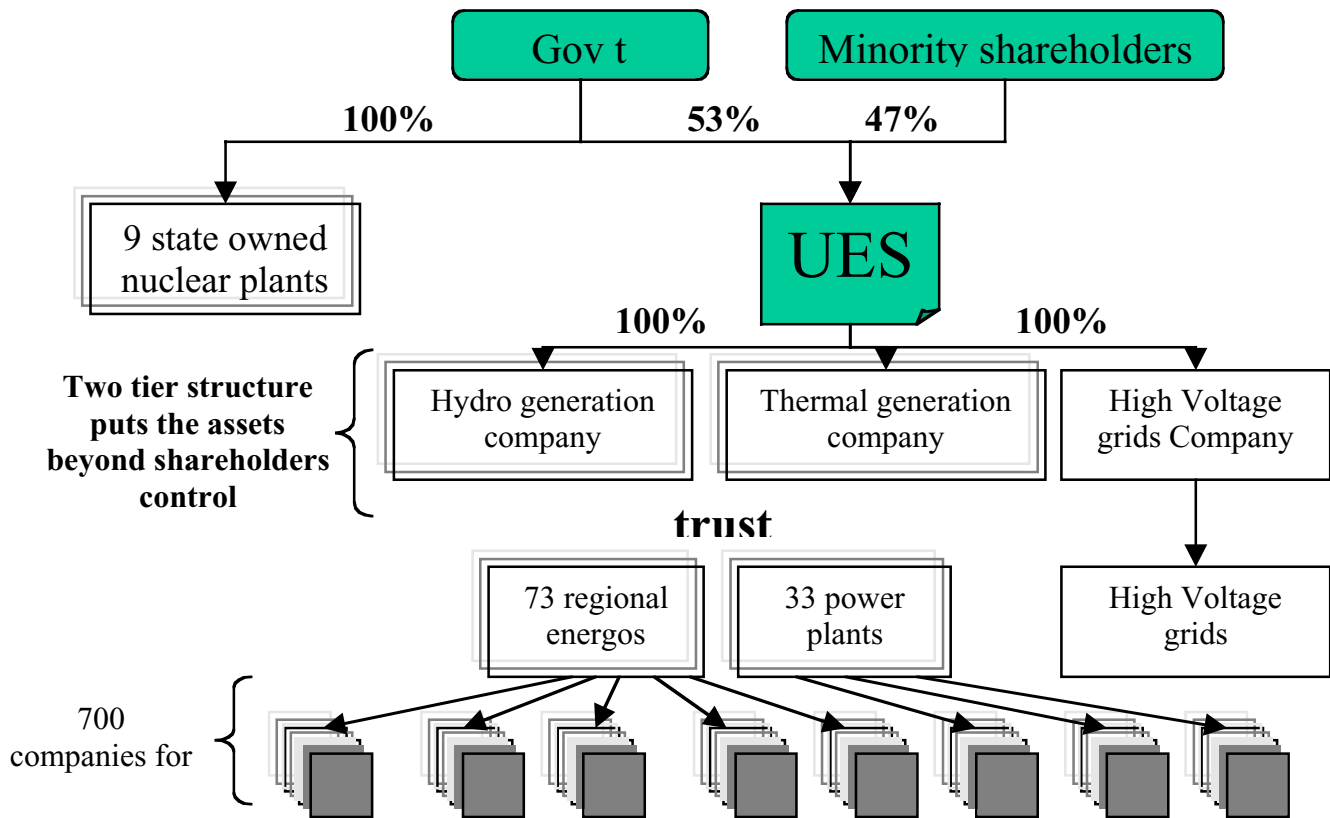
There are different treatments for this disease: creation of anticorruption laws; strengthening of fiscal authorities; enhancing the role of mass media in this struggle. However, as practice shows, it is very difficult to fight corruption. A much more efficient way is to create an environment where corruption cannot appear or will be strongly restrained. Everybody knows that prevention is always better than treatment.

One of the ways to prevent corruption at the private sector level is to create good corporate governance systems in companies. A good corporate governance system entails transparency of decision making; efficient shareholder controls; management responsibility and accountability. And also, shareholders expect that the management is acting in their best interests and is managing the company's assets properly on a daily basis. Under such conditions, on the one hand, shareholders have more confidence toward the company's activities, and possible conflicts of interest between managers and shareholders are reduced. On the other hand, the real mechanism of preventing corruption appears.

Russia, unlike many developed countries, has a short but very intense period of private sector development, which saw its ups and downs. But in spite of its young age, Russian business features rich intellectual and energetic potential. Our research and direct communication with the Russian business community has shown that most managers recognize the necessity to get Russian firms integrated into the international business community. They came to the conclusion that such integration is impossible without respect for generally accepted norms and rules, including the best corporate governance standards.

We will look at the restructuring of the Russian energy monopoly, the Unified Energy System or RAO UES of Russia, the largest Russian company. Following privatization, the government divided all non-nuclear generation and transmission efforts between the national holding company, RAO UES, and 73 regional power utilities, energias. Each energia was given a regional distribution monopoly and the bulk of the local generation assets, but all nuclear plants remained under state control. RAO UES is the centerpiece of the power sector. It owns the high-voltage transmission grid and 33 percent of power plant supply needs, and it has stakes in energias. The state owns about 53 percent in RAO UES, and the other 47 percent is held by minority shareholders. At the beginning of 2000, management of RAO UES proposes a complicated and nontransparent restructuring plan, which was developed without involvement of independent and recognized outside experts.

The restructuring was caused by the necessity to raise the efficiency of the industry companies, their competitiveness on energy markets as well as to create preferable conditions for resident investments. The plan is the creation of a multitude of generation, transmission and sales companies (totaling about 1,000 enterprises.) At the same time, the two-tiered structure pulled the asset reallocation beyond the control of shareholders and the boards of directors, which might have led to nontransparent deals with local industry and regional governments. Assets for sale were priced very low compared to other energy companies of the world. This practice, as well as the failure to use civilized corporate governance procedures, created a suspicion of corruption and asset stripping. So how were corporate governance mechanisms used to prevent possible corruption?



Shareholders started the restructuring plan and announced their disagreements. The markets reacted very negatively to the upcoming changes in the company, and from April until December 2000, the share price went down by 62 percent. Institutional investors also expressed their serious concern in their letter addressed to the President of the Russian Federation, Mr. Putin. Independent directors at RAO UES had managed to block the decision of the Board of Directors and banned all asset transactions until approval of the restructuring plan. The President, Mr. Putin, announced the cancellation of the original restructuring plan and set up a commission, including minority shareholders, to devise the new plan. The government, the main owner, agreed at the negotiations with minority shareholders to make changes in the charter of the company to present asset sales. The company management was forced to fashion a new restructuring plan based on civilized corporate governance practices.

RAO UES hired international experts to devise the new restructuring plan and assemble a deal with the shareholders. The new restructuring plan approved by the Government was more transparent and provides much less room for corruption. The competence of the boards was broadened significantly through amendments to the charter. The list of deals requiring shareholder approval was extended as well as the list of corporate events subject to obligatory disclosure to shareholders.

A reforming committee was created by the RAO UES Board of Directors, and chaired by an independent director. The management announced the creation of a methodological base and arrangements for regular audits of finances and operations of subsidiaries and independent companies. This example shows that good corporate governance can really prevent or restrain corruption. However, in order to make this mechanism work in companies, the following condition must be fulfilled: the Board of Directors should have more controlling power over the management. Independent directors must be on the Boards as they prevent absolute concentration of corporate power, reducing potential corruption. The company should use outside independent expertise to evaluate management action and maximum transparency of corporate action for shareholders to prevent abuses and/or conflicts of interest.

In conclusion, I would like to note that the market itself should clearly realize that corruption inhibits the normal development of national economies. Therefore, the market itself must introduce high ethical standards of corporate behavior; promote best practices of resolution of conflicts of interest; and shareholders must exercise their rights. On behalf of the Russian Investors' Association, I would like to ensure you that we will continue to contribute to the efforts, addressing these issues for the ultimate benefit of Russian business and the society in general.

## International Business Leaders' Forum

Peter Brew

*Peter Brew is the Acting Director of Operational Policy of The Prince of Wales International Business Leaders Forum. Retired from the Sedgwick Group at the end of 1998, having been Deputy Chairman of the international employee benefit services business. A 37 year career in employee benefits was served in Northern Ireland, the Republic of Ireland, the United States of America and London from where he was responsible for businesses in Asia, Australia and Latin America. He was formerly Vice Chairman of the National Pensions Board in Ireland and founder and Chairman of the Employee Benefit Forum for China. Since 1999 he has carried out projects for the International Business leaders Forum in Vietnam, Indonesia, Azerbaijan, Egypt and Russia and has been Acting Director of Operational Policy since July 2001.*

The International Business Leaders' Forum is an advocate of corporate social responsibility, and we see corruption in governance as falling as part of that corporate responsibility agenda. We take the view that corporate social responsibility is actually good business practice.

Whether companies want to address the issue or not, the fact of the matter is that major international companies today have no option. They are under very severe pressure from all of their stakeholders for a variety of reasons. Increasingly, shareholders are concerned to know, are there any inherent risks being run in the business as a result of corruption or any other bad practice? Is there a bad shock coming, which will dramatically affect the value of their holding? And indeed, increasingly, institutional investors representing pension funds and others are demanding an ethical part of their investment strategy, and again, increasingly, investment managers are coming under pressure to make sure that the individual holdings which they have within their portfolios are companies which are able to demonstrate good practice.

We are increasingly finding today that good employees are demanding that they work for companies in whom they can have pride, companies who they know are doing the right thing. So in very competitive market for high-quality employees, good company performance and governance is an essential.

Customers are putting pressure on companies to ensure that their behavior is acceptable, and we have many, many examples of customer reaction to companies who have been shown to have less than acceptable standards. Equally, members of the supply chain want to be sure that the company that they are dealing with is fair, honest and reasonable; that they can depend on being paid a fair price for their part in the supply chain and that they can depend on being paid. They don't want to see corruption any more than anyone else does.

And, of course, in all societies, we are seeing increasing regulation, and companies, again, whether they like it or not, are having to face the impact of regulation. And just in case anybody thought that they could get away with it anyway, modern media makes absolutely sure that as soon as bad practice is uncovered, it is spread around the world very quickly, so if anyone felt they had an easy hiding place, not anymore.

But quite apart from the pressure that is on business to perform and have good governance, it actually makes a degree of sense in relation to running the business. First of all, it is one sure way of protecting the company's assets. I think what we have seen in many of the transition economies, where perhaps state enterprise was becoming either wholly or partially privatized that a lack of understanding of the importance of protecting the assets of that business has been a major issue in terms of attracting foreign investment.

It also can have a major impact on business costs. Clearly, if money is being paid to people that shouldn't be paid, it costs money. That means the business costs are higher.

Of course, today, we all recognize that reputation is a major company asset, and acting in a way which is not in the best interests of society and your shareholders and stakeholders can do immense damage to your capacity to do business in the future.

I think it is important to just emphasize that in this whole issue of corruption, there is, an essential partnership. It is not possible for any one part of society to tackle corruption on its own. I think we have to accept that the business community, the multilateral agencies, civil society in general and government all have a mutual interest in tackling this problem in partnership. I think it is fair to say, that at the moment there is a growing recognition of that partnership. There is perhaps less understanding of how it can be turned into action, and there's a lot of work to be done to build trust between the various sectors to enable that to happen.

The role for business in dealing with this whole issue of corruption in governance consists of various things. I think business does have to recognize corruption and try and define it more clearly than it has in the past. There are interesting examples of running ethics workshops around the world where when you begin to discuss what might constitute corruption, sometimes, people are very surprised at practices which are regarded as unacceptable, and I think often, within businesses, there are practices which have been allowed to continue. It could be in taking gifts; it could be in the way travel and entertaining is dealt with, but companies today have to set down clear rules. They've got to embrace standards of practice, which start at the very top and go throughout the organization.

Increasingly, businesses cannot stand on the sidelines and say they've cleaned up our own act - it's up to other people to clean up theirs. Business must continue the process of reporting openly all its activities so that it is not just satisfied that it is behaving properly, but it is seen to be behaving properly. It has got to show, with its internal procedures and controls, that it has the situation under control, and that where it discovers any form of corruption, it deals with it quickly and decisively. And finally, business has a role to show leadership in this whole field of corruption. For too long, it has been someone else's problem, or perhaps it has been, well, we don't certainly give bribes, but of course, in certain parts of the world, certain things are different, and we have to behave in a different way.

I think we are coming to realize that there is a mutual understanding of what constitutes corruption, and I do believe business is in a position to show real leadership.

## Corporate Governance at Work: GE Capital

Jane Wexton

*Jane joined GE Capital's Structured Finance Group in March 1996, as a Senior Vice President and Director of Global Compliance. In February 2000 she joined the Global Consumer Finance unit as their Chief Compliance Officer and Counsel. Prior to joining GE Capital, Jane was a Vice President and Senior Attorney in the Legal Affairs Office at Citicorp/Citibank. She is currently the Co-Chairperson of the American Bar Association's Corporate Criminal Liability Committee, and a member of the International Section's Task Force on the Foreign Corrupt Practices Act. Jane has made numerous presentations on the topics of corruption, money laundering, organized crime and the role of corporate compliance programs in response to these threats all over the world. She has addressed government and business leaders, compliance officers, and the members of the law enforcement community in over 60 nations on six continents.*

GE is a company that employs 320,000 people in over 100 countries. We do many things all over the world with a huge number of people. How is that possible? It is possible, because we operate on a particular set of principles. It is the rock and the foundation of all of the business we do throughout the world. We don't wink. There are no fake messages. We don't pay bribes. And the question is: how do you do that? How do you make how do you make a corporation that is that big, 320,000 people in over 100 countries, how do you make them all toe the same line? How do you make sure that each and every employee is not cheating on travel and living expenses, is not paying to get the next piece of business? How do you create a culture where that becomes a given?

You start by writing policies and procedures and making sure that everybody comprehends and understands them. At GE, we have a bible, and this bible is called Integrity: the Spirit and the Letter. It is published in 28 languages, so whether you're an employee in Beijing or an employee in Jakarta, Indonesia, or you're in Sao Paulo, Brazil, or in Washington, D.C., or, in fact, working in Prague, you're reading this bible in your own language. So it's produced in Czech; it's produced in Thai; it's produced in almost every major language.

As you can imagine, when you have 320,000 people working all over the world, there are things that are going to go wrong. Instead of hiding those things, we have taken those examples and have used them to train. We have used stories from around the world. We did not dwell on any one region of the world. We have examples from Japan, China, South America and from other many different places. When our employees see fellow employees of different colors, speaking different languages, from different parts of the world talking about what happens when you don't follow the bible and don't follow the spirit and the letter of the law, it's very, very compelling. It is also important to note that when we train, we don't just train the bottom levels. It's a mistake that many companies make.

We are a company that is proud of making the numbers, and when we promise the public and our shareholders that we're going to make the numbers in a quarter, we do. We're driven, as is every other entrepreneurial company, to make the numbers, but making the numbers is not enough. If you don't make the numbers by the rules, you will not stay in the company. And so, from time to time, we have dismissals. We have people who don't get their annual bonuses. We make it very clear through actions that we take that that kind of behavior is not tolerated.

We have corporate audit staff that is constantly looking to see how we are running our compliance programs. This corporate audit staff goes into the guts of each of the organizations all over the world, and it gives us an eye into how is this particular division or this little segment being run. There are a series of tests that we run, much in the same way as if we were from one of the big five accounting firms, only these people are very trained in how we run our operations, and they know what they're looking for. So people know that we are monitoring for behavior that will not be accepted.

Staying within the bounds of the law and making sure that there is no corruption and no illegal payments is good business. If a country has got a major project that they want to have occur, and there is a choice between a company like mine, that has a reputation for being rock solid and having integrity, and one that will come in and make payments. You might ask: Which one of those two companies will get the deal? And increasingly, we will find at GE that we win based upon our reputation. Countries that know that there is not going to be leakage of \$100,000 or \$100 million into the wrong pockets are interested in doing business with my company, because that's not going to happen. They are going to get the product that they've paid for. They're going to make sure that the people of their nation get what the tax dollars are paying for or what the individual dollars are paying for, and it's that reputation that continues to be our competitive advantage in the world of business.

## **Romanian Strategic Alliance of Business Associations**

*Despina Pascal*

*Despina Pascal Currently works as a consultant with Axa International Consulting Ltd. -Managerial Consulting & Training company. Her fields of expertise include institutional building & organizational development, training and consulting on SMEs, NGO management, policy research on private sector development and gender issues. She was a founding member of the International Center for Entrepreneurial Studies (1991); founding member of Partners for Change (1997 -Gender NGO); and Member in the Project Appraisal Committee (1996-1997), SOROS Foundation for an Open Society. She also served as a Consultant for the World Bank Mission in Romania and coordinated activities required for the preparation of the Romanian Development Fund.*

*The Romanian Strategic Alliance of Business Associations (SABA) was created in 1996. Business associations, employers' associations, professional associations and chambers of commerce, which are members in this alliance, have decided to set it up as an informal network in order to improve communications among them but also to try to foster their interest and their rights. Last year, SABA was involved in the implementation of the first initiative on corporate governance in Romania.*

It is recognized that corporate governance is one of the major challenges for the countries making the transition from state-owned, centralized economic systems to free-market economies. At the same time, it is agreed that there are many linkages between sound corporate governance and emerging private sector development. These linkages could be described as follows: lack of corporate governance distorts fair competition on the market and affects the entire competitive environment. Of course, in such an environment, small and medium-sized enterprises are most vulnerable, due to their limited resources in terms of capital and personnel. Lack of corporate governance and sound practices in Romania generates lack of rule of law and economic democracies. The major challenge for Romania as a transition country is the effective democracy and building of the open and functioning markets, including building institutional framework in order to monitor corporate governance and business ethics. In this respect, the role of the business and trade associations and chambers of commerce and industry is essential.

Since it was set up in spring 1996, the Strategic Alliance of Business Associations played a leading role in increasing private sector activities. The assessment of the status of corporate governance in Romania revealed that the state continues to play a large role as owner, rule maker and the major economic player. Independent institutions to monitor how the approved rules are applied are still weak or non-existent. The emerging private sector is comprised primarily of micro-enterprises and their owners are closely involved in the strategic leadership and day-by-day management of the firms. As result no best practices in corporate governance can be replicated and transferred from the emerging private sector into the newly privatized or still state-owned corporations.

The Corporate Governance Initiative for Economic Democracy in Romania was the first systematic effort to bring corporate governance issues into public debate. The project was supported by CIPE (both financially and methodologically.) During the project implementation 10 regional roundtables with Boards of Directors and local stakeholders were organized. All gathered inputs related to the Corporate Governance status were processed and background papers were presented during two national workshops. Based on the consultative and participatory approach the National Task Force drafted the Corporate Governance voluntary Code. The Code is a collection of best practices and recommendations aimed at setting standards for corporate governance and was approved and adopted by SABA as a voluntary enforcement code. This has been followed up by a second project (also supported by CIPE), the purpose of which was to encourage participation by the companies in the public debate and to assess how many voluntarily adopted it. The project was also aimed at providing training to the board members. Overall, both the Corporate Governance Initiative and the Code of Corporate Governance were well received by media and by business community.

SABA's activism on corporate governance and its accomplishments until now has proven that the grassroots approach to corporate governance is the key element to a sustainable and successful approach, and that while business community efforts, as well as government level policies are important, there must be support at all level of society.

## The Case of Africa

Sam Mensah

*Sam Mensah currently works as a Executive Secretary in African Capital Markets Forum and also as a Managing Consultant at SEM International Associates Limited (Management Consultants). Received his PhD in Finance, University of Toronto.*

I think in many ways, African economies are not far behind the so-called transition economies in terms of their structures. Some of the peculiarities of the African environment are simply that the level of competition in the economies is very low. In an economy where there is competition, competition promotes good corporate governance, because bad companies know that they cannot be profitable in a competitive environment.

Until very recently, most of the sectors were state-controlled, and in the 1980s, as a result of liberalization, we started privatization, but there are still pockets of monopoly and oligopoly in various sectors of Africa's economy. When you have that kind of environment, there is a very high payout to rent-seeking, in the sense that efforts expended in trying to get favors from governments in the area of licensing and contracts and so forth are very high-paying. And so, this is a key characteristic of the African economic environment.

Secondly, we have very weak financial structures. Financial markets are disciplinary environments for companies. Whenever you have a stock market company that has poor governance it gets punished with low prices, and a company that has good governance gets rewarded with good prices. And when you don't have a well-developed financial sector, again, corporate governance is compromised.

And thirdly, the peculiarity of the African environment is the structure of the private sector, which is dominated by multinationals and state enterprises. I call it private sector, because many SOE s are actually producing goods and services that would otherwise be produced by the private sector. So they are competitors with the private sector in that sense. We also have quasi-SOEs. These are companies in which government is either the minority or majority shareholder. And then, there are indigenous businesses. Now, each of these has peculiarities that create constraints for good governance and breed corruption. For example, if you take the multinational companies (if you look at any African country) you see that the vast majority of companies there are subsidiaries of multinationals. And in many cases, they have their companies listed on the local stock exchange with the parent multinational holding maybe up to as high as in some cases 70 percent and with 30 percent of the shares being sold to the locals.

And in most cases, the minority shareholders have little or no influence at all in the major decisions of these multinationals that are operating locally. So the problem of minority shareholders is quite severe, in a context that their rights are not very effective as far as the multinational companies go.

The state-owned enterprises that operate in the private sector are exposed to serious political conflict in that every government of the day wants to put their people on the boards of these companies, because it becomes a framework for providing patronage to political loyalists. And then, beyond that, once you have your people on the board, then, you can secure procurement contracts for party loyalists and then pass on some of it to party campaign funds.

Now, the government itself has some shares, minority or majority shares, in many companies. For example, in Ghana, we have the government holding 20 percent of Ashanti gold fields and a golden share, which enables them to veto major management decisions. And the same goes for some of the banks. And in these companies, essentially, the minority shareholders are not particularly effective in enforcing their rights, and therefore, governance is not very effective.

If you take the indigenous businesses, there is so much of an aversion to being part of the formal system, because in the formal system, they are forced to be transparent, and because many of them enjoy this rent-seeking behavior, they don't like to be part of the formal system. They like to operate outside of the formal system.

Many of the governance principles that I have outlined are universal, and in terms of their implementation, we, in Africa, have weaknesses of institutions, economic structures and so forth. In many African companies today there are corporate governance schools, which have been developed with the help of experts. They reflect some of the OECD principles. The Commonwealth Secretariat has assisted many African countries to put in place corporate governance codes.

The difficulty is that the compliance is very limited. And so, even though the corporate governance codes are in effect, we're not getting good results with these codes.

I think that African countries have to continue to reform the structures of their economies. In fact, what we need to do is to manage transition by opening it up to increased competition in all sectors of the economy, improve the regulatory framework. And I think we need to promote more efficient financial sectors, especially an efficient capital market. Because companies that have good governance will get rewards from the market.

Stock exchanges, of course, must enforce compliance of listed companies with existing corporate governance codes. I think that business associations, regulatory agencies and governments can also do a lot to help us enforce these codes which are currently existing just on paper. For example, I believe that government can enforce compliance with governance codes as a condition for contracting with the government for business. Regulatory agencies such as banks, insurance regulators and so forth can make compliance a condition for license; business associations can make compliance a condition for membership.

So we need to move on several fronts, taking into consideration the particularities of the African environment. We, in Africa, are dealing with a very, very difficult situation.

## Center for Liberal Democratic Studies: Corruption in Serbia

*The Center for Liberal Democratic Studies is an independent think tank based on the cooperation of numerous leading experts in social sciences in Serbia. The Center was founded to promote democracy, individual liberty, economic development, and the rule of law in Yugoslavia. CLDS activities include reform of the political system, economic transition issues, building civil society, protecting human and minority rights, and educating the citizenry in and beyond Yugoslavia.*

*Boris Begovic is the Vice-president of the Center for Liberal Democratic Studies and ex-professor at Department of Economics, University of Belgrade. Chief Economic Advisor to Miroljub Labus, Deputy Prime Minister — Federal Republic of Yugoslavia. Fields of expertise are industrial organization, economics of regulation, economics of public utilities and urban economics. He has been involved in numerous consulting projects in Yugoslavia in various industries, mainly public utilities.*

*He was also a member of World Bank mission for Yugoslav industrial sectors. He has published two books: Economic Approach to Optimal City Size (1991) and Economics of Town Planning (1995).*

As a part of a CIPE/NED supported project to address the decade-long institutionalization of corruption in Yugoslavia, the Center for Liberal Democratic Studies (CLDS) has completed a timely and informative survey of business community and public perceptions about corruption in Serbia. Earlier this year, CLDS concluded its work in researching corruption issues in Serbia by launching a 210-page publication that not only presents a concise picture of the current Serbian dynamic in regard to corruption, but also explores the consequences and devastating effects of corruption on the welfare of society.

Corruption in Serbia goes into great detail describing corruption in Serbia - from cultural roots and causes to anti-corruption strategies. Among the major centerpieces of this publication are the surveys conducted by CLDS examining corruption and its consequences both in private and public sectors. The findings show that 10% of those surveyed believe the issue of corruption is the number one priority in the country. Socially, corruption is the number four issue after poverty, political instability and crime. As for causes of corruption, the majority of those surveyed believe that there is an overall crisis of morality in the society due to growing poverty levels and lack of respect for the rule of law. Some also point to inheritance of the problem from the communist system and government intervention as causes for corruption. The survey of the public sector also found that citizens believe that corruption is most often used in circumnavigating legal obligations and norms, changing and misrepresenting them.

The surveyed representatives of the private sector highlight corruption in the judiciary as a great problem. Also, inefficiency of public services is also listed as one of the reasons for widespread corruption among public servants. The list of areas where the private sector encounters corrupt activities includes licensing, registration and inspection, tax administration, federal and local government contracts, customs documentation and currency transactions.

These findings have been crucial in formulating CLDS's strategy for fighting corruption in Serbia. The resultant anti-corruption strategy for Serbia is based on the following concepts:

- Deregulation
- Introduction of formal procedures
- Administrative (civil service) reform
- Education of the public
- Public campaign and advocacy
- Political determination to fight corruption

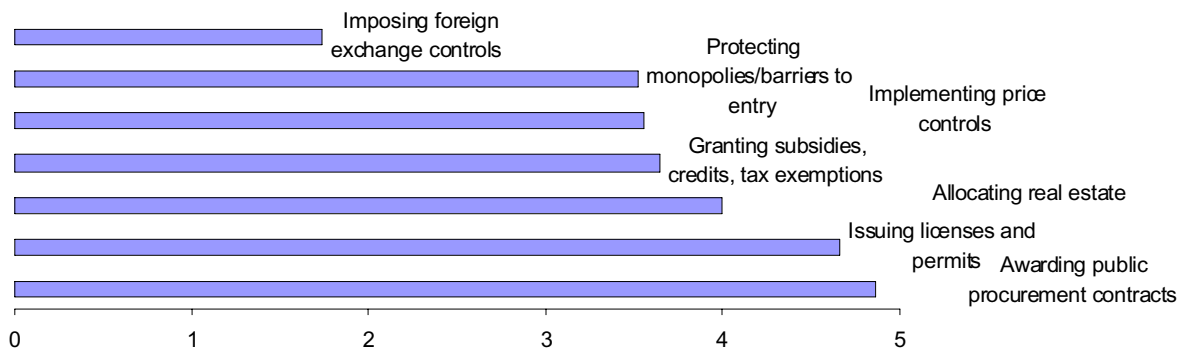
In a situation where corruption is as widespread and pervasive as in Serbia, crucial reform choices must be understood and addressed immediately. Based on this study CLDS identified two future paths for Serbia: one leading toward a sound market-oriented democracy and a productive economy, and the other leading toward political intransigence, spreading organized crime and socio-economic collapse. Certainly, the second path is highly detrimental to both Serbia and the rest of the world community.

*Corruption in Serbia can be downloaded from CLDS and CIPE websites: [www.clds.org.yu](http://www.clds.org.yu) and [www.cipe.org](http://www.cipe.org).*

## Appendix II Survey Findings

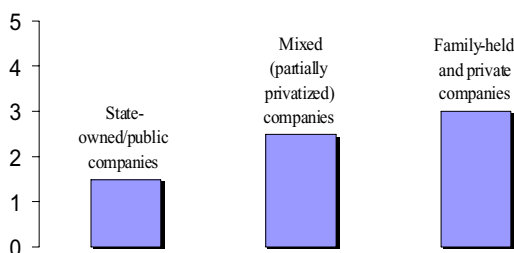
### Perceptions on Corporate Governance and Corruption

- Corporate governance is not commonly used term by those outside the business community. Of those surveyed, 23% said that the term corporate governance was used sometimes by government officials in their country, and only 44% stated that the media used the term. By contrast, 51% stated that business leaders use the term on a sometime basis.
- Overall, 64% said that companies in their countries have independent board members, 73% said that companies have regular independent audits, and 84% said that companies have regular shareholder meetings. However, only 68% of the time did companies publicize those shareholder meetings in advance.
- Ranking sources of corruption from 1 —5 (1=lowest, 5=highest)

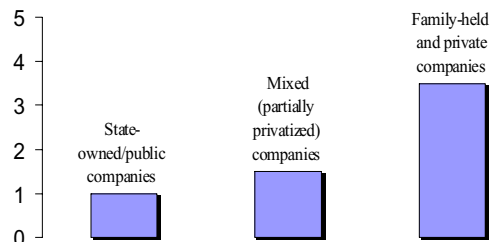


- Policy priorities in order of importance
  1. (Tied) Independent judiciary
  1. (Tied) Privatization and public sector restructuring
  3. Accounting standards
  4. Tax and financial disclosure
  5. Transparent corporate ownership
  6. Financial market regulations
  7. Boardroom politicization
- Internationally accepted accounting standards were used by 46% of respondents and 59% stated that accounting standards inhibit corruption.
- The national customs administrations were found to be the most corrupt branch of government by 95% of respondents.
- The media was seen as more effective at reporting on corruption issues (64% stated that media is somewhat effective in this regard) than in reporting on corporate governance violations (50% stated that the media is not effective on this subject).
- Levels of transparency and accountability among companies from 1 (low) to 5 (high)
- Perceived effectiveness and independence of company boards of directors from 1 (low) to 5 (high)

Transparency and Accountability



Effectiveness of Boards of Directors



**CENTER FOR INTERNATIONAL PRIVATE ENTERPRISE**  
**Survey on Corporate Governance and Corruption**  
**August 2001**

The Center for International Private Enterprise conducted a survey investigating corporate governance and anti-corruption perceptions among its network of think tanks, business associations and policy development institutes around the world.

Questionnaire:

1. What country do you represent?
  
2. To what degree is the phrase corporate governance used or referred to in your country by:
  - a. government officials?
 

Often <input type="checkbox"/>	Sometimes <input type="checkbox"/>	Seldom <input type="checkbox"/>	Never <input type="checkbox"/>
--------------------------------	------------------------------------	---------------------------------	--------------------------------
  - b. business community leaders?
 

Often <input type="checkbox"/>	Sometimes <input type="checkbox"/>	Seldom <input type="checkbox"/>	Never <input type="checkbox"/>
--------------------------------	------------------------------------	---------------------------------	--------------------------------
  - c. civil society representatives?
 

Often <input type="checkbox"/>	Sometimes <input type="checkbox"/>	Seldom <input type="checkbox"/>	Never <input type="checkbox"/>
--------------------------------	------------------------------------	---------------------------------	--------------------------------
  - d. representatives of the media?
 

Often <input type="checkbox"/>	Sometimes <input type="checkbox"/>	Seldom <input type="checkbox"/>	Never <input type="checkbox"/>
--------------------------------	------------------------------------	---------------------------------	--------------------------------
  
3. In general, do companies in your country:
 

a. have independent Board members?	Yes <input type="checkbox"/>	No <input type="checkbox"/>
b. have regular independent audits?	Yes <input type="checkbox"/>	No <input type="checkbox"/>
c. report to a shareholder registry?	Yes <input type="checkbox"/>	No <input type="checkbox"/>
d. have regular shareholder meetings?	Yes <input type="checkbox"/>	No <input type="checkbox"/>
e. publicize their shareholder meetings in advance?	Yes <input type="checkbox"/>	No <input type="checkbox"/>
f. publish publicly-available annual reports?	Yes <input type="checkbox"/>	No <input type="checkbox"/>
  
4. Identify which of the following government responsibilities you see as a source of corruption in your country by rating them on a scale of 1 to 5 (1=low corruption; 5=high corruption).
 

a. Issuing licenses and permits	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>
b. Implementing price controls	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>
c. Protecting monopolies/blocking new firms and investment from entering the market	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>
d. Awarding of public procurement contracts	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>
e. Granting subsidies, credits and tax exemptions	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>
f. Imposing foreign-exchange controls	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>
g. Allocating real estate	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>
h. Other (specify)					
  
5. Please rank the following categories from 1 to 7, identifying what order of importance you think these elements should be focused upon in your country. (For example, if accounting standards is the most important of the categories, label it 1. If it is the least important, label it 7.)
 

a. Privatization and public sector company restructuring	_____
b. Accounting standards	_____
c. Independent judiciary	_____
d. Transparent corporate ownership	_____
e. Boardroom politicization	_____

- f. Tax and financial disclosure \_\_\_\_\_
- g. Financial markets regulation \_\_\_\_\_

6. Please share any thoughts that you have on how your answers to questions #4 and #5 relate to each other (i.e. would international accounting standards be effective to halt corruption?).

7. (a.) Are accounting standards in your country at internationally accepted levels? Yes  No   
 (b.) To what extent, in your experience, do accounting standards either foster or inhibit corruption?

Foster  How?

Inhibit  How?

8. Customs is often an area where corruption is rampant. In your experience, is this true in your country?  
 Yes  No

Why or why not?

9. Many people believe that turning state-owned companies into the corporate form should not slow down privatization. What do you think?

10. (a.) How effective is the media in reporting on corruption in your country?  
 Very Effective  Somewhat Effective  Not Effective

- (b.) How effective is the media in reporting on corporate governance violations in your country?  
 Very Effective  Somewhat Effective  Not Effective

11. Based on your personal knowledge, on a scale of 1 to 5, how would you rate the following (1= low; 5=high):

- a. Provision of financial information provided by companies in your country  
 1  2  3  4  5  Don t know

- b. Levels of transparency and accountability among companies in your country within the following ownership categories:
- |  |                            |                            |                            |                            |                            |                                     |
|--|----------------------------|----------------------------|----------------------------|----------------------------|----------------------------|-------------------------------------|
| (1) State-owned/public companies           | 1 <input type="checkbox"/> | 2 <input type="checkbox"/> | 3 <input type="checkbox"/> | 4 <input type="checkbox"/> | 5 <input type="checkbox"/> | Don t know <input type="checkbox"/> |
| (2) Mixed (partially privatized) companies | 1 <input type="checkbox"/> | 2 <input type="checkbox"/> | 3 <input type="checkbox"/> | 4 <input type="checkbox"/> | 5 <input type="checkbox"/> | Don t know <input type="checkbox"/> |
| (3) Family-held and private companies      | 1 <input type="checkbox"/> | 2 <input type="checkbox"/> | 3 <input type="checkbox"/> | 4 <input type="checkbox"/> | 5 <input type="checkbox"/> | Don t know <input type="checkbox"/> |

- c. Perceived effectiveness and independence of company boards of directors (in your country) within the following ownership categories:
- |  |                            |                            |                            |                            |                            |                                     |
|--|----------------------------|----------------------------|----------------------------|----------------------------|----------------------------|-------------------------------------|
| (1) State-owned/public companies           | 1 <input type="checkbox"/> | 2 <input type="checkbox"/> | 3 <input type="checkbox"/> | 4 <input type="checkbox"/> | 5 <input type="checkbox"/> | Don t know <input type="checkbox"/> |
| (2) Mixed (partially privatized) companies | 1 <input type="checkbox"/> | 2 <input type="checkbox"/> | 3 <input type="checkbox"/> | 4 <input type="checkbox"/> | 5 <input type="checkbox"/> | Don t know <input type="checkbox"/> |
| (3) Family-held and private companies      | 1 <input type="checkbox"/> | 2 <input type="checkbox"/> | 3 <input type="checkbox"/> | 4 <input type="checkbox"/> | 5 <input type="checkbox"/> | Don t know <input type="checkbox"/> |

12. (a.) Please provide suggestions you may have for projects that would address the supply side of corruption in your country.

(b.) Please inform us of any case studies, activities, or programs in which either your organization or other groups in your country have been involved that focus on promoting corporate governance and/or fighting corruption.

## Appendix III

### Corporate Governance as Anti-Dote for Corruption

Examples/lessons learned in Bulgaria and transition countries

*Todor Yalamov*

*Boyan Belev*

*Center for the Study of Democracy, Bulgaria*

The phenomenon referred to as corruption comprises the sundry forms of abuse of power — economic, political and administrative — which all result in obtaining personal or collective benefits to the detriment of the rights and lawful interests of an individual, groups or the whole society. Corruption hinders development virtually everywhere, thus harming the social, political, and economic life of any society. It distorts choice, increases costs of products and services, promotes unproductive investment, contributes to decline of living standards and undermines democracy and societal integrity.

Corruption is not solely a disease; it is rather a symptom. It indicates poor governance — both in public administration and business. Lack of transparency, discretionary power and low accountability are considered as the three main causes for corruption worldwide. Corruption in transitional context is also a response to the institutional gaps that meets new demands of people and firms.

Existing corruption in business-to-business relationships is a symptom of poor corporate governance. A full range of examples of corporate governance failures that are associated with corruption, fraud and cronyism in support of the hypothesis outline above could be found in the Asian and the Russian economic crises of the late 1990s.

Corporate governance problems in the context of transitional or developing countries go beyond the classical problems that result from the separation of ownership and control. Following the new institutional economics approach, the effectiveness of a particular corporate governance system is interdependent with the set of institutions (regulations, contracts and norms) which create self-governing firms in the economy. Among the core issues to address in the attempts to build sound corporate governance in transition countries we should mention transparency of financial and performance information, conflicts of interest, procedures for bankruptcy, property rights, contract enforcement, etc. It is also absolutely necessary that the public and private sector cooperate in order to develop a set of rules which would establish the ways in which companies govern themselves.

Good corporate governance is a counterbalance to corrupt practices in the private business. Sound corporate governance practices attack the supply side of corrupt relationships by raising transparency, reducing discretionary power, and holding decision-makers accountable. In the course of corporate governance reform new norms, trust and integrity are built which limit the space for corrupt activities.

**On the basis of the Bulgarian experience, we could say that good corporate governance can provide effective instruments in the fight against corruption — instruments which are equally applicable in other countries within the context of transition to a competitive market economy and increased importance of civil society in political and social affairs. The numbers used in it are courtesy of Vitosha Research ([www.online.bg/vr](http://www.online.bg/vr)) — a major Bulgarian polling agency which has conducted multiple surveys on corruption and corporate governance.**

#### 1. Transparency Reduces Fraud and Corruption

In addition to creating direct obstacles to legitimate actions, shortcomings in transparency have indirect adverse effects by providing room for unjustified discretionary behavior. Lack of adequate disclosure has been widely regarded as a major factor which brought about the Asian crisis a few years ago. The following examples demonstrate that low disclosure standards induce or permit fraud and corruption regardless of the time and place:

A small shareholder of a Bulgarian company was informed of facts showing that the management was not trying to maximize shareholders' value — it was targeting private gain instead. This shareholder wanted to convene a general assembly meeting (GAM) to discuss the evidences she had, to obtain further information and eventually undertake remedy measures together with the other shareholders. The law provides that someone holding at least 5% of the capital could litigate a case against the management. The company management, however, rejected the idea of convening a GAM claiming that only shareholders of more than 10% have the formal right to convene a meeting; on top of that it refused to make available the list of all shareholders on record. In addition, the Central Depository, which has all this information, was not willing to cooperate. Thus, the small shareholder had either to bribe the Central Depository or leave the corrupt behavior with no reaction.

In another case a GAM of a company was held at a hotel. The announcement, however, did not include detailed information about the exact place of the meeting at the hotel, so representatives of the holders of more than 34% of the capital couldn't attend in spite of being on the premises of the hotel. As a result, capital increase was voted in their absence, their holdings were diluted and they lost blocking power.

Another case which attracted public attention was holding a GAM of state-owned enterprises in the course of the privatization process which increased the number of shares owned required to elect members of the board. This decision was not disclosed properly and made it impossible even if a private investor acquired more than 50% (in some cases up to 66%) to make changes in the board of directors and the management of the company against the will of the government. Further appointments of new board members were possible only after extensive negotiations involving corrupt practices. After a strong negative public response to this the government was forced to pull back.

Disclosure of information exerts a disciplining effect in corporate governance provided that the information disclosed is available to investors in a fast, easy and inexpensive manner. Unfortunately, most of the public companies in Bulgaria do not comply with the transparency requirements.<sup>1</sup> Serious problems exist with the disclosure of management and board members remuneration - only a few companies do this properly. Virtually no disclosures of conflict of interest exist. In a broader context, even the statutory requirement of publishing annual financial statements (balance sheets, income statements and cash flow statements) is often violated. Access to disclosed information is rendered difficult for a number of reasons: information is not consolidated; much of it is not submitted in an electronic version; low awareness of the requirements for access to public information in general, etc.

## **2. Discretionary Power Creates Incentives for Corruption**

Discretionary power is manifested in all areas of corporate actions: convening general assembly, capital increase, nominating board members, contracts, etc.

If we come back to the first case mentioned, shareholders ultimately managed to get together and demanded to convene a general assembly meeting. If the management does not respond positively within a month, then the court can convene this meeting. At the time of the case it was not specified in the law within what timeframe the GAM had to be held and the management convened the meeting with a delay of one year, thus preventing earlier resolution of the issue in spite of the court decision.

A few privatization funds exercised their discretionary power provided by the Commercial Code to convene general assembly meetings at locations difficult to reach (for example villages in the mountains where no public transportation exists) or even abroad. These meetings usually resulted in dilution of shareholder value for those who could not attend as a result of the capital increase voted at the meetings. In this respect 11.6% of the public companies in Bulgaria admit to have increased their capital at least once in disregard of proportional participation of all shareholders.

One privatization fund, known among investors and the public for the worst corporate governance record in Bulgaria, used the provision for allowing a shareholder with 5% of the capital to file a court case against a company solely for blackmail of the management and the controlling shareholders. It also used the lack of clarity in terms of

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<sup>1</sup> This conclusion was reached by Vitosha Research on the basis of a study in 2000 of 268 listed companies with authorized capital over BGN 200,000 (response rate of 59%).

holding general meetings to take over the management by not allowing the majority shareholder to attend the meeting. Further, it obtained that these illegitimate decisions were registered with the court with the help of insiders and started siphoning off the company. The problem was ultimately resolved after the diplomatic involvement of a foreign government (the majority shareholder was a foreign investor) and the media putting pressure on the judicial system.

Presently, a number of Bulgarian public companies suffer because controlling shareholders siphon off funds to their own private companies. For example, a public company strikes a sweetheart deal (often regarding advertising, consulting or even supply of raw materials or distribution of goods) with a company wholly-owned by controlling shareholders. Under the present law this is not totally illegal. The only regulation concerning conflict of interests is included in the Commercial Code and relates to the exercise of the voting rights at the general assembly meeting. Thus, shareholders or their representatives are prevented from voting on resolutions for claims against the major actors in such practices or initiating actions for enforcement of these actors' liability to the company.

Another important area where discretionary power exists is the nomination of board members. It often results in nepotism, cronyism and low representativeness. At present, there are no rules or criteria concerning who should serve on boards, nor the balance between internal and external directors. For example, participation of government representatives at boards where the government has no shares is an indicator of (possible) corrupt practices or unnecessary politicizing of purely economic decisions.

In a number of cases representatives of the government which was holding shares in the company voted explicitly in favor of a private majority shareholder, against the interests of their principal and the mandate they had received. In most cases these people have not been held accountable for their actions.

### **3. Low accountability and responsibilities feed corruption**

Even when decisions, relevant information and behavior are transparent corruption would still widely exist if the people involved are not accountable for their actions. Accountability is shaped by the legislation and enforced by the judicial system. The judicial system in Bulgaria, however, is usually slow to act. Still a missing element of the puzzle is the self-control of private business exercised, for example, through companies' regulations of their management and employees' conduct.

The Commercial Code and the Law on Public Offering of Securities do not spell out the responsibilities of the governing bodies and fail in this respect to draw a distinction between public and private joint-stock companies. Presently, the liability of the members of governing boards is limited to three month compensation. Sanctions are possible only in cases of failure to comply with the reporting requirements with regard to the commercial register and the requirements of the State Securities and Exchanges Commission.

Internal control is a valuable tool to prevent corrupt behavior. There is a clear lack of understanding of how boards should be structured and different committees (on compensation, appointments, etc.) should be formed. To date, 75.8% of the public companies in Bulgaria have no auxiliary committees in their managing bodies; if such committees exist, their efficiency is assessed as low. Moreover, the institution of outside directors has not yet been established.

The capital market usually plays the role of an external disciplining mechanism for managers and directors, but as it is underdeveloped in Bulgaria it cannot adequately perform this role. Self-regulation within the private sector (for instance, through Codes of Best Practices) can probably be a substitute for the lack of an effective checks and balances system.

### **4. Building trust and new institutions can curbs corruption**

Corruption has flourished in the transition context and due to the inefficiency of the existing institutions. It is the lack of trust in these institutions and their inadequacy to the new needs of individuals and firms what accounts for the existing situation; for this, effective strategies to curb corruption should work toward improving the existing institutions and building new ones which could be up to the challenge. These new institutional forms can be country-specific - the Corporate Governance Initiative (CGI) ([www.csd.bg/cgi](http://www.csd.bg/cgi)) in Bulgaria represents a good

example of effective strategy of public-private partnership in combating corruption, a coalition in which the Center for the Study of Democracy has played a key role.

CGI adopted a strategy of assisting in the elaboration and the implementation of practical and policy instruments which would bring trust, accountability, transparency and sound business practice in a transition economy, promoting public awareness of best corporate governance standards and their practical importance for economic growth and social progress, setting up a framework for policy dialogue between private and public sector institutions with the goal of introducing sound corporate governance structures and procedures.

CGI proposed a number of institutional innovations as tools in combating corruption. They include:

- Endorsement by private business of a Best Practices Code. This Code would address the public expectations of equal treatment of shareholders, including protection of minority shareholder interest; design a clear mechanism for management and control focusing on the responsibilities and motivation of governing bodies (boards); set clear standards on disclosure and dealing with conflict of interest; adequately address the issue of transparency of business activities and disclosure of corporate information.

Establishment of an institution for intermediation and non-judicial settlement of corporate governance disputes. This institution would ensure confidentiality, free access, speed, quality and cost efficiency.

## Appendix IV

### INTERVIEW OF DR. JESUS ESTANISLAO, PRESIDENT AND CEO THE INSTITUTE OF CORPORATE DIRECTORS (THE PHILIPPINES)

The lack of corporate governance standards to ensure that enterprises are run in the interest of their owners is a growing issue worldwide. For developing and transition economies, a weak corporate governance culture and regulatory framework acquire added significance given the prevalence of nebulous legal regulations and limited enforcement capabilities in those nations. In the following interview, Jesus Estanislao, President and CEO of the Institute of Corporate Directors in the Philippines and former Finance Minister in the early 1990s during the administration of former President Corason Aquino, details how weak corporate governance structures have undermined the ability of East Asian economies to establish sound and sustaining economic growth.

*To many observers, the Asian financial crisis in the late 1990s resulted from the lack of sound corporate governance practices in the region's economies. Do you agree with this assessment?*

**DR. ESTANISLAO:** My view of the East Asian financial crisis is that it unmasked the imbalance between what has been happening in the field of trade and in the field of finance, between what was occurring at the macroeconomic and microeconomic levels. The crisis of 1997-98 demonstrated that most economies in the region moved quite far in terms of trade liberalization, but they had failed to move concurrently in the area of financial liberalization. They also failed to strengthen the institutions needed to cope with the stresses, opportunities and challenges of much more open economies. In short, these East Asian countries liberalized trade, but most of them did not really liberalize in terms of finance.

The same thing can be said on the macroeconomics front. We've emphasized macroeconomic fundamentals such as high savings rates, low budget deficits, growing imports, low inflation, and high GDP growth rates. But these accomplishments were like the "tip of the iceberg" hiding quite a lot of weak structures at the microeconomic level. For example, banks were not liberalized and tended to operate as oligopolies with all the problems of oligopolies because they weren't open to competition. At the corporate level, ownership was concentrated in the hands of patriarchs who bound themselves to traditional, "imperial" practices and really did not bother very much with accountability and transparency. As a result, the macroeconomic fundamentals that everybody was focusing on tended to hide the many weaknesses that had been allowed to persist and even get worse with the passage of time. Banking structures and financial supervision were weak and inconsistent with the open, competitive markets that East Asian economies were trying to create. Concurrently, improper corporate governance practices that are no longer consistent with open economies prevailed.

The East Asian financial crisis has reminded regional governments and the public about one key principle: consistency. If you open up your markets, you also better open up other aspects of your economy, and possibly other aspects of your society—as Indonesia has found out. The principle of consistency between macroeconomic liberalization and microeconomic liberalization is a key lesson to be learned from the East Asia experience.

*What would you say are the key corporate governance issues that need to be tackled in Asia?*

**DR. ESTANISLAO:** In many economies of the region—not only in China— there are many state-owned enterprises, and the government is very influential directly and indirectly in the way businesses are run. In addition, there is a very close relationship between the people who hold political power in the government and the bureaucracy and those who hold economic power. They tend to defend and mutually support each other, especially against competitive intrusions coming from anywhere else. In this ownership situation, accountability really is not given any premium whatsoever. The tendency is, simply put: since we hold the power, we call all the shots. You call the shots for your individual and group interests, and not really for the interest of the system that you are trying to build and the markets that you are trying to grow.

Since we have paid quite a lot of lip service to developing new and competitive markets, there have been quite a number of IPOs without worrying about the fundamentals. Many small investors have entered the stock market,

purchased shares and become minority shareholders. However, nobody is paying any attention to protecting their interests against abuses by either the governments or the patriarchal families that have majority control or almost total control over the equity shares of these corporations. Auditing standards have not been observed. Even most banks have failed to report their financial statements properly. In short, there has been very little disclosure of what is really going on. According to a study by the Asian Development Bank, there is a very strong correlation between the paucity of information that has been disclosed and the risk of failure of many banks and companies in East Asia. If there is no disclosure, there can be no accountability, and if there's no accountability, there is no proper and fair treatment of small investors. Three key principles of modern corporate governance have been abused. Transparency, fairness and accountability have been absent to a large degree.

*How important is the institution of these types of reforms to the development of democracy in the region? Do you see a strong link between corporate governance and democracy?*

**DR. ESTANISLAO:** There is a definite linkage. When you talk about liberalization, you are really talking about opening up your economy, your society and your polity. When the opening process begins, decision-making powers become diffuse as occurs in a democracy with its guiding principle of one person, one vote. There is accountability and transparency because elected leaders must hold themselves accountable to the people.

This should apply as well to financial processes and to corporate practices. The moment a corporation or a publicly listed company goes to the stock market and issues shares it is opening itself up because each shareholder has to be given a vote. Every shareholder of the same class also must be given the same treatment, the same vote. The shareholders elect the representatives who must act for the entire corporation, not just for any single vested group, labor, or management. Corporate directors are chosen to oversee and monitor the executives running the corporation, and these executives are accountable to the board, which must ensure transparency by requiring that proper systems be instituted. In short, corporate practices have to be open, democratic, fair, and transparent, and they require a high degree of accountability from both a corporation's managers and its board members.

*How does the reform of corporate governance practices fit into the need for broader institutional reforms in developing and transition economies? How should governments reform themselves in ways that would strengthen corporate governance?*

**DR. ESTANISLAO:** I see corporate governance as a basic foundation of reform, which really strengthens and modernizes an economy that is wired into the global marketplace. Without corporate governance reforms, the alternative would be monopolies which are, in my view, imperial, dictatorial type of decision-making entities. By contrast, the corporation must be a separate, autonomous, juridical personality with rights, duties and responsibilities. It gets protection from the state, and the state in turn has a vested interest in its proper working because the corporation can create a tremendous moral hazard: employees, suppliers, other creditors, and the local community are all dependent on it.

Banks are a clear example of this. The percentage of equity in many banks in the Philippines, for example, is very small in relation to their total assets and resources. The rest of their resources come from the banking system and the general public. This is why it is essential that the banks are required to follow closely the rules and regulations imposed by good corporate governance practices and by the official regulatory authorities. Certain standards of prudence must be observed to prevent abuses. Standards also are essential because banks are institutions with a public trust given that they take deposits from the general public and also draw a lot of resources away from the overall banking system.

Ownership does not grant absolute rights. It gives the person certain rights that must be exercised relative to his broader responsibilities and the mission of the corporation that he owns. Corporate governance reforms are not only part of a modern open economy that is wired to the global marketplace. They constitute an essential building block of such an economy.

*How capable are East Asian companies of policing themselves, and what role should the government play in setting and regulating corporate governance standards?*

**DR. ESTANISLAO:** I really think that if you pursue corporate governance reforms anywhere, but particularly in East Asia, you have to take a systemic approach. Most reforms will have to come from the top down. Governments will have to change or create the necessary laws and regulations, as well as ensure that there are regulatory agencies capable of enforcing them. The other thing that must be done—and which is likely to be more difficult—is to change people’s mindset to make sure that they are fully aware that those who break the laws and regulations will be pressured, threatened and pay a price for their misconduct. Finally, there must be rewards for good behavior. Companies that over time practice proper corporate governance will derive benefits. Such companies can go to the financial markets and enjoy premiums on their borrowings and stock prices.

I think it is a question of striking a proper balance between punishments and rewards. The tendency in the past has been to think in terms of what governments must do, and I consider that it is an important, crucial component of corporate governance reform particularly in East Asia. But one should not stop there. Education of corporate directors, pressures from professional organizations and adoption of voluntary codes of conduct are also needed.

*It sounds as though societal and institutional reforms are also important in this. For example, would an independent judiciary be part of the required framework?*

**DR. ESTANISLAO:** Yes, very much so. That is why the reform process must be very systematic, as we have come to realize that there are ways to speed up the change process through mechanisms of mutual assistance, peer review and market pressure.

An increasing number of people in East Asia are demanding changes and reforms. When given an opportunity to actually speak out, they speak with reason in support of reform and progress. They desire to be on par with the best.

*Do you think the forces of globalization are putting pressure on governments in East Asia to implement international governance and financial standards?*

**DR. ESTANISLAO:** I definitely think these forces are helping the process along. I can speak from the experience of the Philippines. The biggest pressure for corporate governance here is the lack of foreign direct investment. Stock markets are down, and there is little confidence by either local or foreign investors. If the former flee the local markets, so do foreign investors. If foreign investors come, then the locals also invest. Globalization means there is now very little distinction between foreign investor sentiment and domestic investor sentiment as both are attracted or diverted by the same considerations. It is in this sense that globalization certainly is helping the process of change.

*Companies in Asia are often not listed on stock exchanges, and when they are, they have convoluted management or ownership structures that make it difficult to know exactly who owns the company. Ownership also tends to be concentrated in the hands of the few. What measures can be taken to change these patterns?*

**DR. ESTANISLAO:** These are structural problems that have existed for a very long time, so it is a question of how to begin. Perhaps we have to start with the banks and publicly listed companies as a first step. For example, the banks should institute risk- management systems that will enable them to properly weigh the risks of the larger accounts on their books. A few banks are also beginning to observe modern corporate governance practices. Since most financing in East Asia still occurs via the banking system, instituting corporate governance reforms in the banks could be a major way of speeding up the reform process throughout the economy.

Publicly listed companies must be evaluated to assess what sort of additional rules need to be implemented. In the case of the Philippines, we are instituting a uniform rule for a listing on the stock market requiring that 20% of the shares of all publicly listed companies be available for open trading instead of the current 10-20% range. We’re going to review whether this change makes a significant difference and provides greater liquidity for shares. The point I’m making is that you’ve got to take steps that are concrete and practical. You must then evaluate each reform after an adequate period of time and then consider what additional steps need to be taken.

When the bigger corporations, the banks and the publicly listed companies are properly managed, it is bound to have a positive impact on how other businesses are run. Our Securities and Exchange Commission has responsibility for both public and privately held companies, but we should first concentrate on the former because they represent a greater moral hazard.

*What role can journalists play in enforcing sound corporate governance practices?*

**DR. ESTANISLAO:** I think it is a very important issue, but it varies from economy to economy in the region because different countries have varying degrees of freedom of the press. As you probably know, it is not a problem in the Philippines, but other Asian countries do face problems in this area. Malaysia comes to mind. The press is important, and it can play its role much better in a genuinely free society.

My sense is the press is important but markets are even more important. I would put even greater emphasis on the markets, working to agree on a common framework to attain strong corporate governance standards. These may be slightly different from one economy to the next because of the basic differences that exist throughout East Asia. But if there is a common framework, two important things will be accomplished. First, it will emphasize the key ingredients of modern corporate governance reform that will have to be true in all economies. Second, a common standard will put pressure on corporations to regulate and evaluate themselves, and it will provide an essential yardstick for market analysts, fund managers and the rest of the business community to rate different companies.

## Appendix V

### CIPE s CORPORATE GOVERNANCE PROJECTS

#### AFRICA

##### Kenya:

- As part of a long-standing effort, the Private Sector Corporate Governance Trust (PSCGT) has launched an educational project to promote the importance of good corporate governance and the democratic principles of transparency, fairness, accountability and responsibility in Kenya s private sector. PSCGT will help foster sustainable economic development by working with shareholders and community leaders. This program will also assist in creating a new non-governmental association to defend shareholder rights in Kenya. (<http://www.corporategovernance.co.ke>)

##### Ghana:

- Building on recent anti-corruption and corporate governance initiatives, the African Capital Markets Forum (ACMF) is analyzing the linkage between corporate governance and corruption in Ghana. Based on a survey of private companies and state enterprises, ACMF will seek to demonstrate the effectiveness of sound corporate governance practices in reducing the incidence of corruption. The analysis will generate recommendations for strengthening corporate governance and combating private sector driven or "supply-side" corruption.

##### Regional:

- The Center for International Private Enterprise (CIPE) sponsored a two-day conference in Accra that brought together over 50 public and private sector participants from Ghana and Nigeria to develop strategies to improve corporate governance practices, policy, and education at the country level and define mechanisms for regional exchange and coordination. The conference was made possible with funding from the National Endowment for Democracy (NED) and Exxon-Mobile, and in cooperation with the Institute of Economic Affairs (IEA) in Ghana and the Development Policy Center in Nigeria.
- CIPE also organized the first-ever Pan-African event on corporate governance in Johannesburg in cooperation with Global Corporate Governance Forum, the Commonwealth Association for Corporate Governance, and many other leading African and global sponsors. The conference brought together over 220 business, government, and NGO leaders to build corporate governance awareness in the region and to discuss the challenges of implementing corporate governance practices and principles.

#### ASIA

##### Philippines:

- CIPE co-sponsored a three-day regional workshop in Cebu with the Institute of Corporate Directors to bring together market players in East Asia to push for corporate governance reforms throughout the region. The workshop identified corporate governance best practices among affected institutions, offered recommendations for reforms in Asia, and promoted a more transparent relationship between the public and private sectors.

##### Indonesia:

- CIPE formed a partnership with the Indonesian Chamber of Commerce and Industry (KADIN) to place corporate governance reform and business ethics in the forefront of the debate for institutional changes within Indonesian society. KADIN is developing a code for Indonesian firms based on international standards and will promote adoption of more stringent principles through its member trade associations.

#### China:

- CIPE and the Chinese Center for Corporate Governance organized a conference in Beijing on corporate governance reform. China is introducing new stricter standards of corporate governance for firms listed on its two securities exchanges, and this program will bring Chinese officials and business executives together with overseas experts and practitioners to discuss specific international standards that may be relevant to the Chinese context.

#### CENTRAL AND EASTERN EUROPE

##### Czech Republic:

- CIPE and the Central European University developed a program to build an understanding of the responsibilities of corporate governance, thus strengthening emerging corporate institutions in Central Europe. After testing the impact of the program in the Czech Republic the subsequent two phases concentrated on replicating the program through the training of instructors and the translation of materials for licensed courses to be taught in Hungary, Poland, Ukraine, and Russia.

##### Albania:

- Acknowledging the critical nature of effective corporate governance in ensuring successful privatization in Albania, the Center for Economic and Social Studies (CESS) has completed a comprehensive research and advocacy program on corporate governance and privatization. The success of privatization depends on the introduction of core system of corporate governance principles and practices that ensure these vital enterprises are managed in an open and responsible manner.

##### Bulgaria:

- The Center for Economic Development in Sofia conducted a program to provide a general introduction to corporate governance values and principles for specific interest groups including; State Owned Enterprises, capital market institutions, policy makers, and the media. CED organized and administered four one-day training seminars to address a variety of issues surrounding corporate governance and provide a discussion between CED researchers and affected groups as to the challenges they face in implementing corporate governance procedures.
- Over the past two years the Corporate Governance Initiative has influenced changes in legislation by building public/private partnerships as part of a broader advocacy strategy designed to promote corporate governance best practices. Spearheaded by the Center for the Study of Democracy, the CGI has completed the Corporate Governance Assessment Report and Corporate Governance Guidelines. These documents address critical issues such as: voting rights and equal treatment of all shareholders; board structure and the role of managing bodies; and disclosure and transparency. ([www.csd.bg/cgi/](http://www.csd.bg/cgi/))
- The Center for International Private Enterprise and the Center for the Study of Democracy organized a corporate governance regional conference, September 22-23, 2000 in Sofia. The conference allowed the business community and think tanks worked together to forge their own approach to corporate governance. This was complemented by a Corporate Governance Clinic that elaborated the main pillars of corporate governance codes.

##### Slovak Republic:

- The Center for Economic Development's project on corporate governance is based on previous research and advocacy programs sponsored by CIPE and the National Endowment for Democracy. CED is focusing on harmonizing corporate governance in Slovakia with current international standards and best practices. By analyzing relevant issues such as legislation and the education of supervisory boards this program facilitates the four key values associated with corporate governance: fairness, accountability, transparency, and responsibility. ([www.cphr.sk](http://www.cphr.sk))

#### Romania:

- Corporate governance reform fosters higher operating and reporting standards among private and public enterprises, helping to build stronger boards of directors, shareholder rights, and accepted standards for financial accountability and transparency. The Private Entrepreneurs Confederation of Timis County is a necessary, nonpartisan voice, providing local leadership on ethical business policies and practices. PECT works to extend the business knowledge and leadership skills of its members in cooperation with the Strategic Alliance of Business Associations and is organizing a Corporate Governance National Task Force.

#### Regional:

CIPE was awarded a USAID regional grant to promote corporate governance in Central and Eastern Europe and the NIS. The purpose of this Corporate Governance Initiative for the Transitional Economies is to increase awareness of the need for effective corporate governance policies and practices among policy makers, business leaders, and the financial market intermediaries. The project will also develop policy initiatives that could be applied in the region aimed at increasing investor confidence. The concept for the project is that corporate governance reform will succeed if the business community demands it. Activities include:

- The Marek Hessel Small Grants Program — A competitive grants project awarding up to six \$25,000 grants to organizations and coalitions wishing to promote corporate governance principles.
- Corporate Governance Training — Utilizing materials developed by CIPE and its partners to enable local training approaches for corporate governance. This may include support for the creation of Directors Institutes, distance education programs, and courses within existing educational institutes.
- Tool Kit for Corporate Governance — Creating a basic set of materials based on project experiences, that can guide those who wish to promote CG standards, with a variety of approaches and models on how to identify issues, build coalitions, and communicate recommendations.
- Networking of Organizations — Through conferences and a web-site, CIPE is working to build an informal regional network of business and policy groups focusing on these issues.

#### EURASIA

##### Russia:

- To enhance corporate governance in Russia, CIPE is working with the Moscow-based Institute for Stock Market and Management in developing training, examination and certification materials to educate corporate directors on fundamental corporate governance principles. The project targets directors to develop a corps of trained, professionals who can carry out their responsibilities on Boards of Directors. These directors will support democratic and corporate governance principles and best practices in Russian companies.
- CIPE and the Investors Protection Association (IPA) have developed a web site dedicated to corporate governance in Russia and includes information on corporate governance and protection of investors' rights in the Russian market. The web site, implemented within the framework of the OECD/World Bank - Russian Corporate Governance Roundtable, is available in English (<http://www.corp-gov.org>) and in Russian (<http://www.corp-gov.ru>).
- CIPE, the Investors Protection Association and the Russian Managers Association surveyed 300 Russian businesses to identify those with independent Boards of Directors. The survey generated considerable interest among Russian and international investors, and in the media, including The Financial Times (Wednesday, March 14, 2001). Russian businesses need to improve corporate governance practices to attract much-needed

domestic and foreign investment, but the survey suggests that executives of major Russian companies recognize this need and see value in independent directors.

- CIPE worked with two shareholder rights groups to hold a one-day seminar in February 2000 in Ekaterinburg, a formerly closed city in the Urals, nearly 900 miles east of Moscow. This seminar was a successful, in part, because Russians helped design, co-hosts, and speak at the event.
- CIPE teamed up with the OECD and the World Bank to co-sponsor a roundtable on Corporate Governance in Moscow that included over 100 participants and focused on property rights, disclosure information, shareholders rights, and preventing abusive self-dealing. The Public Committee on Shareholders Rights in Voronezh drafted a corporate governance charter based on information from this roundtable and is now working with local companies to adopt this charter and introduce its principles into the real-life practices of their businesses.

#### Kazakhstan:

- The University of International Business is working to build support among a coalition of non-governmental organizations on the need for corporate governance. "Building the Grassroots Foundation for Corporate Governance in Kazakhstan," will survey coalition members regarding the state of corporate governance and organize a conference for all stakeholders in Almaty.

For additional information on Corporate Governance in Central and Eastern Europe/Eurasia, please visit the following Web sites:

#### BULGARIA:

- [www.csd.bg/cgi/](http://www.csd.bg/cgi/) -- The Corporate Governance Initiative for Bulgaria (CGI) is a coalition of non-governmental organizations established in 1999. The main objective is to facilitate the adoption of relevant corporate governance standards and procedures that would ensure accountability and transparency in business.
- [www.ced.bg](http://www.ced.bg) -- The Center for Economic Development encourages the private and public sector to jointly work to improve corporate governance and promote enforcement of legislation. The CED has been working with the international, Bulgarian and other private sector organizations throughout the area to improve corporate governance practices and principles.

#### ROMANIA:

- [www.softchim.ro/cisa/StartEN.htm](http://www.softchim.ro/cisa/StartEN.htm) — The International Center for Entrepreneurial Studies offers a voluntary code of corporate governance developed by the Romanian Strategic Alliance of Business Associations and adopted in part by the Bucharest Stock Exchange.

#### POLAND:

- [www.pfcg.org.pl/pfcg/index\\_eng.htm](http://www.pfcg.org.pl/pfcg/index_eng.htm) -- The Polish Corporate Governance Forum is an independent, pro bono initiative of the Gdansk Institute for Market Economics. It provides up-to-date information on the most interesting papers, research activities and events in corporate governance in Poland and other Central and Eastern European countries.

#### RUSSIA:

- [www.corp-gov.org](http://www.corp-gov.org) -- Corporate Governance in Russia, A joint project of the Center for International Private Enterprise and the Investor Protection Association, implemented the Russian Corporate Governance Roundtable Series. Here you can find information on corporate governance and the protection of investors' rights in the Russian market, and share your own experiences.

- [www.rid.ru](http://www.rid.ru) — The Russian Institute of Directors focuses on putting in place efficient corporate governance principles in Russian companies, and includes the recently drafted Code of Corporate Conduct. Key partners of the Institute include the Federal Commission for the Securities Market in Russia, the OECD and the Institute for Stock Market Management, a long-time CIPE partner governance reform.

## LATIN AMERICA AND THE CARIBBEAN

### Colombia:

- The Colombian Confederation of Chambers of Commerce (Confec maras) is educating Colombian public and private stakeholders on sound principles of corporate governance through training programs, a web site, publications, and other outreach activities. The initiative is engaging policymakers, businesspeople and academics to formulate a Declaration of Corporate Governance Principles for Colombian business organizations. Confec maras is also advancing legislative recommendations regarding stock market regulations proposed by the Stock Exchange Commission of Colombia. To date, Confec maras activities have contributed to legislative reform concerning shareholders' rights, as well as conflict-of-interest issues, alternative dispute resolution methods, and board of director responsibilities.

### Regional:

- CIPE is building on its training experience, private sector networks, and past corporate governance programs in order to create greater openness and discourage cronyism. A comprehensive curriculum focuses on issues of transparency and anti-corruption and offers advocacy and implementation strategies with special transition case studies. CIPE will conduct a pilot training session in one country to encourage businesses to adhere to norms of transparency and accountability and to assume a leadership role in promoting democratic governance. This program will support the private sector's role in democracy and governance issues throughout Latin America.

## MIDDLE EAST AND NORTH AFRICA

### Egypt:

- CIPE and the Federation of Egyptian Industries, Egypt's largest business organization, brought together over 120 business leaders and policy makers to discuss corporate governance and the future of the country's economic and democratic development. Full disclosure of financial information; conflicts of interest involving boards of directors and managers; procedures for bankruptcy; property rights; contract enforcement; corruption and theft; and adopting good business practices were discussed in detail.
- The Egyptian Capital Markets Association is conducting a corporate governance program for the capital market community, and senior management staff of publicly listed companies about rules and practices of corporate governance and why it is essential to build a true market-oriented economy. A conference in Cairo, "Corporate Governance in Egypt: The Road Ahead," had over 400 including, regulators, brokers, public officials, and the media. Workshops included specific issues, such as standards for transparency and disclosure; preparation and publishing of financial statements; corporate strategy and future plans; stakeholders interest, and press and media relations.

### GLOBAL:

[www.cipe.org](http://www.cipe.org) — CIPE's award-winning website includes articles, project descriptions, and links to organizations undertaking corporate governance initiatives around the world.