

Corporate Governance

A Private Sector Perspective

November 2017

The views expressed in this presentation are the views of the author/s and do not necessarily reflect the views or policies of the Asian Development Bank, or its Board of Governors, or the governments they represent. ADB does not guarantee the accuracy of the data included in this presentation and accepts no responsibility for any consequence of their use. The countries listed in this presentation do not imply any view on ADB's part as to sovereignty or independent status or necessarily conform to ADB's terminology.



What is Corporate Governance?

- Mechanisms, processes and relations by which companies are controlled and directed
 - Roles and responsibilities of corporate boards
 - Rules and process for sound decision making

What is Corporate Governance?

- Deal with the distribution of rights and responsibilities amongst different stakeholders
 - Equitable treatment of shareholders
 - Directors, managers, owners/shareholders, creditors, auditors, regulators, employees, customers, suppliers
 - Considerations of corporate, social and environmental sustainability

What is Corporate Governance?

- Risk Management and internal control
- Performance measurement and management
- Culture: Integrity and ethics
- Disclosure and transparency

CG Considerations are important to both debt and equity investors

Why is Corporate Governance Important?

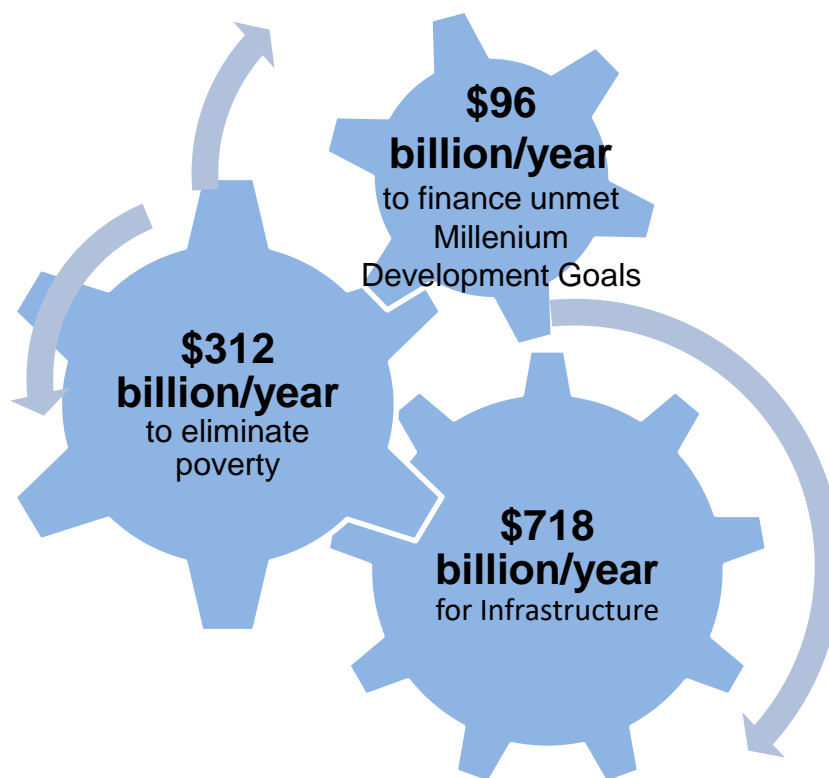
- Private enterprise and investment is a key driver of economic growth and opportunity in developing markets
- Increasingly transnational organisations such as the **World Bank** and the **OECD** have encouraged regulators across the world to see codes of corporate governance as a **necessary condition for development**

Why is Corporate Governance Important?

- Research shows clear links between:
 - Good governance norms and economic growth, competitiveness and prosperity
 - Bad governance norms and economic waste and decline
 - Good governance and lower investment risk
 - Bad governance and higher risk

APAC Development Needs.....

\$ 1 Trillion
per Annum
In Asia and the Pacific



Source: ADB. 2015. Making Money Work: Financing a Sustainable Future in Asia and the Pacific.

..... Private Sector Capital

**Official Development Assistance
of \$26 billion**

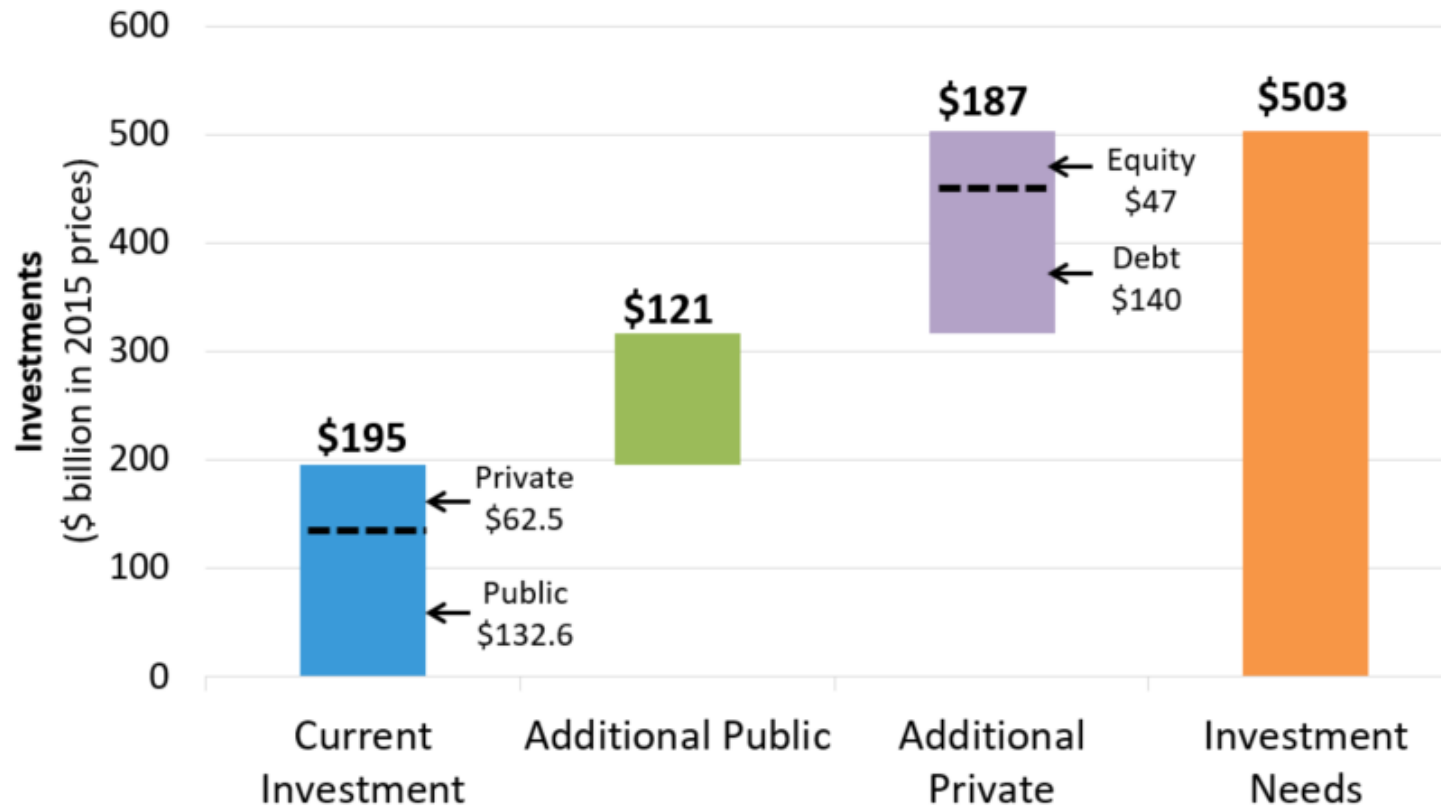
**Private sector
sources of about
\$10 trillion**

- **\$6.2 trn** from private savings
- **\$3.5 trn** from sovereign wealth and pension funds
- **\$1.3 trn** from insurance premiums
- **\$205 bn** from remittances
- **\$39 bn** from philanthropy
- **Increased tax revenues**

Source: ADB. 2015. Making Money Work: Financing a Sustainable Future in Asia and the Pacific.

Private Sector Capital “Gap”

Infrastructure investment by financing source, excluding PRC,
* 2016–2020, (annual average, \$ billion in 2015 prices)



Source: ADB (2017) Meeting Asia's Infrastructure Needs

The need for equity finance

- Equity is a key source of long-term financing for high-growth companies.....better than increasing leverage
- Equity finance helps make development finance projects “bankable”
- and an increasing population of FIs need additional capital given the economic headwinds they have faced

Equity finance is the primary form of risk bearing capital. Investors need improving CG to reduce that risk and therefore the cost of equity to firms

Is equity becoming scarcer?

- Back in 2011 McKinsey Global Institute predicted a \$12.3trn potential global “equity gap” in 2020
 - Investment patterns are changing in developed markets
 - Growing wealth in developing markets is concentrated in bank deposits (or invested in developed markets) – need developing market investors to significantly increase investment into equity
 - FDI patterns are distorted by Quantitative Easing

Equity is already scarce!

Global Free-Float Stock-Market Capitalization by Country, in \$ Billions



Source: Bank of America Merrill Lynch, Transforming World Atlas, August 4, 2015

Investor Views

- International and domestic private investors are increasingly focused on these issues when considering their risk appetite
 - An assessment of governance is becoming a key part of the investment or credit decision
 - A Company's approach to governance often indicates approach to financial control and risk
- Investors like “good governance” economies, with regulatory certainty, clear investor rights, good disclosure, and financial markets built on trust and probity

The Importance of listed markets

- The main mechanisms through which stock exchanges can contribute to development:
 - Mobilising resources for sustainable economic growth and development
 - Promoting good governance, e.g ESG reporting
 - SME development

The Importance of listed markets

- “The ability of exchanges to perform these roles is dependent on the existence of a **combination of relevant enabling policies, processes and institutional structures**”.
- “[T]here is a preponderance of research that suggests that financial development is integral to economic development...”

Broadening the investor base is good!

- Better investor protection and broader ownership levels help re-cycle capital
- “Our findings support the view that weak protection of property rights and investors and high aggregate ownership concentration are negative factors for resource allocation and new firm formation. **Ownership concentration and weak institutions reduce new firm formation.**”

Broadening the investor base is good!

- “For most countries, however, **the most reliable and stable investor base will be local**. Nurturing domestic investible asset pools via pensions, insurance, and savings vehicles for individuals to deploy into capital markets is critical for local sustainable capital market development. **Pension reform, development of the local insurance industry, and an increase in household savings are often part of a comprehensive capital market development program.**”
- Legal and regulatory environment and corporate governance practice need to give investors comfort

Broadening the investor base is good!

- Markets inter-mediate between lenders (savers) and borrowers (users of funds)
- Developing domestic markets can help manage shocks – FX & volatile capital flows
- MDBs can act as anchor investor in developing and growth companies

Institutions and frameworks matter

- “If there is a single message from our survey this year, it is that the ecosystem of corporate governance (CG) in any market is not just important, it is ***the differentiating factor between long-term system success and failure***”.
- “[R]egulators have made a huge amount of progress in building stringer CG regimes in Asia over the past 15 years. The next 15 years needs to be about developing a more open corporate mindset around dialogue with shareholders and relevant stakeholder groups.”

Private Sector Challenges

- Corporate governance is a complex and deep topic
- Good governance is a long journey
- A developing practice: Lack of CG practitioners/experts & board level management with requisite experience, an issue even in “developed” markets
- Bribery & corruption undermines good governance
- Little incentive for change for SOEs where no policy push from the state and financial support comes from local (SOE) banks

Family firms – a strength and a challenge

- The prevalence of the dominant owner/family business
 - Make a significant economic contribution, but are they sustainable long-term with out good governance?
 - But, there is often weak governance standards and/or conflicts between interests and succession planning which impacts sustainability
 - Improving governance is often a key phase in enabling a company to grow and expand – it helps companies access domestic and international capital markets

What Counts as Good Governance?

- Company specific factors go beyond compliance
- “[S]ix governance variables with an academically proven positive impact on performance”:
 - Board Independence – increases objectivity in decision making
 - Board diversity – but not forced diversity
 - Remuneration – align interests of managers and shareholders

What Counts as Good Governance?

- CEO characteristics
- Oversight – engaged owners
- Ownership structure – institutional engagement

Private Equity Views

- “As early-stage investors, requiring founders to follow corporate governance best practices is critical to fostering transparency and setting a strong foundation for the business as it grows and looks to further rounds of funding.”
 - Alex Katz, managing partner at ff Venture Capital

Source: KPMG Board Leadership Centre, <https://boardleadership.kpmg.us/relevant-topics/articles/2017/06/why-good-governance-attracts-investors.html>

You're in good company....

