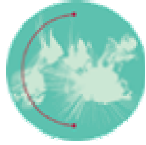


G U R N

Global Union Research Network



DISCUSSION PAPER No. 3

**Mapping Out the World Bank Approach
to Corporate Governance Reform
in a Trade Union Perspective**

**Creating Alternative Routes
to the
World Bank Highway**

By Pierre Habbard

**Project by the Trade Union Advisory Committee to the OECD,
funded by the Global Union Research Network and
the Hans Böckler Foundation**



**Hans Böckler
Stiftung** 

The Global Union Research Network (GURN) is a cooperating project of the International Confederation of Free Trade Unions (ICFTU), the Trade Union Advisory Committee to the OECD (TUAC), the ILO's International Institute for Labour Studies (IILS) and the Bureau for Workers' Activities (ACTRAV) of the ILO. The aim of the research network is to give union organizations better access to research carried out within trade unions and allied institutions.



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INTRODUCTION

We can now better see the failure of the privatization model that was pushed in the immediate aftermath of the reforms. There was a naïve belief in the shareholder theory. The ownership rights of the state would be transferred to a new owner, and that owner would then act to maximize the stock market value of the enterprise. In fact, the multiple principal agent model provided a better model of the firm. Transferring so called “ownership” from the central authority to a private owner left the other “owners” intact. Having been left out of the new dispensation, the other stakeholders responded in non-cooperative ways (e.g., predatory behavior from local officials and unproductive sullen workers) when, in fact, their full cooperation was needed to actually restructure the firms in the new environment. Many of the new shareholder-owners then just turned to looting—grabbing what they could while they could*.

**Joseph E. Stiglitz, Senior Vice President & Chief Economist, World Bank, Paris, June 1999*

The OECD and the World Bank are undoubtedly the two authoritative international institutions regarding policy dialogue on corporate governance reform. They set the tone of the debate, define what amounts to a “good” standard or practice, and enjoy the highest credibility in advising governments, policy makers, companies, investors, and supervisory authorities.

Such leadership role has gained importance as the governance of corporations has become a policy issue on its own, both within the OECD and in developing, transition and emerging economies. With the financial crises in Asia in the late 1990s, the Enron scandal in 2001, and a series of spectacular collapses in the US and in Europe, the keywords “corporate governance”, once an exclusive concept of the investment community and the academic world, are now a must in any government discourse on globalisation. Corporate governance has also been named a policy priority at the 2002 Monterrey Consensus World Summit on Financing for Development.

The above 1999 citation of Joseph Stiglitz¹, the then World Bank Chief Economist, may well retrospectively be one of the defining moments – or was it rather a missed opportunity? – in the elaboration of the World Bank corporate governance policy framework. In his address, Stiglitz acknowledged the Bank’s

¹ STIGLITZ 1999

failure to integrate a broader understanding of corporate governance in its policies for transition economies during the 1990s. In particular, he noted the shortcomings of the traditional “all shareholder value” approach to private corporations. His speech in Paris came just one month after the adoption, by the OECD, of the first ever international standard on corporate governance, the OECD Principles of Corporate Governance. This period was also marked by vibrant and influential academic debates, notably on the question of “convergence of corporate governance models” toward the sole shareholder value model. Seen in this context, Stiglitz call for a stakeholder approach (“multiple principal agent model”) was in direct opposition to the mainstream views held at the World Bank itself. Six years later, Stiglitz has left the Bank, and the latter’s road to reform has not modified its course: it is unswervingly shareholder value oriented.

This paper proposes a preliminary, labour-oriented analysis of the World Bank’s founding principles in its recommendations on corporate governance reform to its client states. Its aim is not to present a comprehensive critique of the implementation of World Bank inspired reforms in developing and transition countries in the past decade. Rather, its purpose is to identify broad elements of policy reform, which could subsequently help address country-specific problems in transition, developing and/or emerging economies. These key elements could also contribute to a renewed World Bank–Labour dialogue on corporate governance reform. This Paper should thus be seen as a first contribution to a possible new agenda, one that would open the door to more labour engagement on corporate governance; this would allow to view corporate governance in a broader perspective, as an integral part of poverty reduction and development agenda, both at country-level and in Washington.

The paper is structured in three parts. It first looks at the definition of corporate governance, the historical diversity of national regimes, the “shareholder value” model and its regulatory implications in particular (Part 1). From there, the paper presents the broad elements of the World Bank’s approach to corporate governance, including the OECD Principles of Corporate Governance, and their

implementation within the framework of the World Bank financial stability benchmarking exercise, the 'ROSC' (Part 2). These elements are then compared to alternative views on reform, including in particular the policy issues raised in the September 2005 Global Unions Discussion Paper "*Workers' Voice in Corporate Governance – A Trade Union Perspective*", a paper prepared by a project within the Trade Union Advisory Committee to the OECD (TUAC) and circulated among members of the ICFTU/GUF/TUAC Committee on Workers' Capital (Part3). In conclusion, the paper delineates several areas which would deserve particular attention from labour, both in addressing country-specific issues and in envisaging a new policy dialogue with the Bank.

This paper is the first of a series of labour discussion papers on corporate governance which will be drafted in 2006 as part of a project funded by the Global Union Research Network (GURN) and the Hans Böckler Foundation. This project is hosted by the TUAC Secretariat and is incorporated in the work plan 2006 of the Working Group n°2 "Corporate and financial market regulation and governance" of the ICFTU/GUF/TUAC Committee on Workers' Capital (www.workerscapital.org), and will be circulated within the GURN (www.gurn.org). The paper was drafted by Pierre Habbard, policy advisor at the TUAC Secretariat. The author would like to thank the following experts for their useful inputs at various stages of the draft: Ornella Di Iorio, Richard Tudway, Peter Bakvis, Allen Kaufman, Molly Mac Coy, Anne-Christine Habbard & Roy Jones.

National diversity, shareholder-value and the public interest

There is no consensus on the definition and objectives of corporate governance. As the term suggests, corporate governance deals with the rules and mechanisms that govern the relationship between the interested parties within a corporation. These rules and mechanisms are intimately linked with national laws, regulations and corporate practices. Based upon national perspectives, views will differ as to the respective rights and responsibilities of each constituency – shareholders, executive management, salaried workers and other stakeholders.

In this first chapter, we will present an overview of the current debate on corporate governance, as well as of the diversity of national regimes in the matter – a diversity resulting from the different weighting of the three core sources of law – capital market regulation, corporate law and labour laws. From there, we will describe the policy implications of the “shareholder value” model, which over the past two decade has become increasingly influential, at both firm and regulatory level.

Law, owners of capital, regulators and other interested parties

Corporate governance as a distinct policy issue is historically associated with a key regulatory innovation affecting the private sector: the introduction of the Limited Liability status of the private corporation in the 19th century and during the industrial revolution (nowadays the Ltd, SA, Inc, AG, etc). This corporate status was a breakthrough in the legal arrangements affecting the relationship between investors and entrepreneur. It regulated and institutionalised the separation of ownership (shareholders) and control (managers), in opposition to Adam Smith’s “owner-manager” model². It also secured ownership of the company’s assets by the company itself and not by its shareholders, who in turn had their liability to the company limited to the value of their shares. For example, in the extreme case of bankruptcy, shareholders merely lose their investment (shareholder value

² GAMBLE & KELLY 2000

collapses), but are not liable to the company's other claimants: the workers, the community, the creditors, etc.

Since then, several scholars have theorised the separation of ownership and control, and the appropriate governance mechanisms. "The Modern Corporation and Private Property" by Berle and Means, edited in 1932, is often considered as the first theoretical work on corporate governance.

From a judicial angle, corporate governance rests on three core sources of law:

- capital market regulation (how the corporation accesses external financing, supervision of debt and equity markets, of banks, of funds and other institutional investors),
- corporate law (birth, life and death of the corporation, including shareholders' rights, disclosure requirements, duty of directors), and
- labour law (contractual relationship of the company with management and workers, other regulatory and operational arrangements for the latter to be represented in the company)

Other sources of law will influence corporate governance regimes, such as competition law, environmental legislation, consumer protection regulation, etc. As the substance of those sources of law and the respective weight of each, vary from country to country, corporate governance regimes will be shaped differently. This in turn will affect the various accountability mechanisms to be set up within the firm, as it will affect the balance of power between the core constituents of the firm and external parties, in particular between:

- the owners of financial capital, the shareholders taking part at the Annual General Meeting (AGM),
- the owners of human capital, the executive management and the workers,
- external parties investing in the company (creditors, suppliers)
- regulators, supervisors and other market-based gatekeepers, such as auditors
- other stakeholders: customers, local communities, interested parties, etc.

The Board of Directors stands prominently in corporate governance. Its function is to serve as a “buffer zone” between all key parties. The Board determines the strategy of the company and oversees its implementation by the executive management. The composition of the Board of Directors, as well as its internal rules and leadership, will shape the company’s capacity to manage crises, its ability to prevent conflicts of interests and fraud, to ensure legal compliance, and, from there, ensure a proper business strategy in order to secure the long-term interest of the company and its key parties.

Law, hierarchy of standards in a globalised world

One of the issues to be carefully weighed in corporate governance, is the compatibility of the three sources of law (labour, corporate & capital market), and the methods of resolution in case of conflict. What authority should be the ultimate arbiter in case of conflict between workers’ rights, capital market rules, and according to what principles? What should the public authorities’ role be in shaping good governance regimes and enforcing them? These questions are merely an exemplification of broader issues linked to the hierarchy of standards in a globalised context³. It has often been argued that one of the main obstacles to the implementation of human rights, including core labour standards, has been the *de facto* – though not *de jure* – systematic inferiority of international human rights law to international commercial and trade law, in particular to WTO trade agreements. More generally, the separate and parallel development of these bodies of law has made it increasingly difficult to solve the issue of hierarchy in a legally satisfying manner. In strict legal terms, labour law, as a core pillar of international human rights law, should take precedence over and above any other body of law, including commercial and trade law⁴. The balance of power, and the implicit hierarchy, between capital market regulation, corporate law and labour law shapes the foundations of national corporate governance regimes.

³ The closure of Marks and Spencer supermarkets in France and Belgium in 2001 is an example. The announcement of the closure had been made without any prior consultations with the workers. The decision was an infringement of French and European law (incl. European Works Council Directive). Head management of Marks and Spencer, based in London, claimed that the British stock exchange rules prohibited it from informing the employees first. The case was brought by French and Belgian trade unions under the OECD Guidelines on Multinational Enterprises’ implementation mechanism, the government-hosted National Contact Points.

⁴ FIDH 1999

A brief historical overview of national systems of governance

There are thus different possible governance arrangements to run the ‘modern corporation’ and to operationalise the separation of ownership and control functions. The balance of power and patterns of relationship (confrontational vs. consensual, market-based vs. relationship-based, etc.) between parties depend on an indefinite number of variables relating to the legal context, the market structure, national industrial ‘culture(s)’ and, *in fine* the political understanding of the role of the private sector in society⁵.

Different periods have seen different models shape corporate governance over the past century. Broadly presented, since the ‘personal’ capitalism (where the owners of capital are also the managers) predating the industrial revolution, two broad systems have developed in parallel: one that is often labelled as ‘Anglo-American’ and the other labelled as the ‘Rhineland’ model. Annex 1 proposes a brief historical overview of the evolution of the two governance systems during the 20th century.

Simplified comparison of Anglo-American and Rhineland systems

Anglo-American	<	Systems	>	Rhineland
Common law	<	Law	>	Civil law
Liberal	<	Market organisation	>	Co-ordinated
High	<	Labour market turnover	>	Low
External	<	Acquisition of labour skills	>	Internal
Decentralised, company level	<	Collective bargaining	>	Centralised, sector level
Non-existent	<	Internal worker representation	>	Existent

Source: TUAC 2005

Such a diversity of regimes has been under threat over the past 20 years, with the gradual prevalence of one particular model, the “shareholder value” model. It was introduced in public policy debates in the US and the UK following the

⁵ See for example, ROE 2000

conservative “revolution” at the end of the 1970s. In the past decade, the shareholder value model has been extremely influential in the policy making process affecting the regulation of capital market and corporate law across the OECD. “Shareholder value creation” as the unique purpose of the company was the dominant theme in the investment community during the 1990s, singularly during the internet bubble in the years 1998-2002. Foreign investors played a key role, as the internationalisation of corporate ownership became prominent.

By the end of the 1990s, corporate governance and shareholder value modelling had become a research area of its own, attracting considerable interest as well as significant academic resources – and scholars agreed that there was a converging trend towards the generalised adoption of the model. Beside the global integration of capital market, such a consensus was based on the acknowledged “failure of alternative models of the corporation, including the manager-oriented model that evolved in the U.S. in the 1950s and 60s, the labour-oriented model that reached its apogee in Germany”⁶. A year before Enron collapsed, the “end of history of corporate law” was proclaimed⁷. Corporate law reform had become irrelevant since global markets had supposedly achieved the ultimate governance model.

⁶ Hansmann & Kraakman 2000

⁷ idem

Definitions of corporate governance

The following list cites examples of generic definitions of corporate governance. It shows the diversity of interpretation, and of schools of thoughts. The list begins with a citation of the UK Cadbury report in 1992, often considered as a landmark report, as it prompted a renewed debate on the issue in the following decade.

The catch-all definition:

“Corporate governance is the system in which companies are directed and controlled”⁸.

The financial profitability definition:

“Corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment.”⁹

The minority shareholder definition:

“Corporate governance is about the definition of property rights of shareholders and the mechanisms of exercising such rights”.¹⁰

The risk-management definition:

“One can define corporate governance as the range of institutions and policies that are involved in functions relating to corporations such as pooling resources and subdividing shares, transferring resources across time and space, managing risk, generating and providing information, dealing with incentive problems, resolving competing claims on the wealth generated by the company”.¹¹

The institutional definition 1

“Corporate governance involves a set of relationships between a company’s management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.”¹²

The institutional definition 2:

“Corporate governance refers to the structures and processes for the direction and control of companies. Corporate governance concerns the relationships among the management, the Board of Directors, the controlling shareholders, minority shareholders and other stakeholders”¹³.

⁸ CADBURY COMMITTEE 1992

⁹ SHLEIFER & VISHNY 1997

¹⁰ CAPAUL & FREMOND 2002

¹¹ CLAESSENS 2003

¹² OECD 2004

¹³ IFC 2005

The theory of the shareholder value and the 'bundle' of contracts

Broadly speaking, the shareholder value model¹⁴ assumes that the corporation is a private association of investors who, collectively, own a “bundle of contracts” linking the executive management with other corporate-related parties: creditors, workers, suppliers, tax authorities, and any other party who has a “claim” on the corporation. The corporation is assimilated to a sort of market within the market in which separate parties, pursuing separate interests, are linked by fixed contractual relationships, the sum of which constitutes the firm as such. If a party disagrees with the way the bundle of contracts is being handled by the management and/or if it believes its interest is not pursued under the current contractual relationship, a rational exit strategy for that party will be to break the relationship and take alternative opportunities on the market: a shareholder sells his shares and buys other assets, a worker (spontaneously) resigns and gets hired by another company, a creditor closes the credit line, etc.

As the model implies that all stakeholders (except shareholders) have their interests protected by market-based contractual relationships, alternative cooperative solutions bearing a certain degree of informality (or which cannot be fully transposed into judicial terms when things go wrong) are seen as un-reliable and obstacles rather than contributors to corporate governance. This translates into a certain degree of hostility, on the part of proponents of the shareholder value model, to mechanisms that allow for *ex-ante* stakeholder participation in governance (*i.e.* that allow for consultation prior to decision making) such as: works council, employee board representation, local community forum, and any broader co-determination principle-based solutions.

Although, the model concedes that the corporation does exist in principle and that its assets cannot be owned by outside parties, it nevertheless gives priority to the shareholders' relationship for the purpose of effective governance. The model considers indeed that shareholders are the only party entitled to a residual claim over the company, insofar as the value of their investment – the share – cannot be fixed in advance by contract, but is subject to market forces. In that sense, shareholders are the only party to be exposed to firm-specific risks that

are not covered by fixed contractual relationship (as opposed to generic risks, which can be covered by the market and thus fixed contracts). To cover that additional firm-specific risk, shareholders should have controlling rights over the company which would ensure the full protection of their interests. Aligning the interests of shareholders (“the principals”) and those of the executive management (“the agent”) becomes the starting and ending point of shareholder-centred corporate governance.

As all other relationships are covered by contract, maximising the interest of the company is equivalent to maximising the interest of its shareholders, which in turn is represented by the shareholder value. While directors’ duties are, in most jurisdictions, owed to the company itself, proponents of the shareholder value model have consistently sought to translate that requirement into the exclusive objective of the shareholder value financial interest.

Instability of shareholders’ interest and corporate externalities

To sum it up, the shareholder value model assumes that there is no such thing as a company’s own interest or, at least, one that would be distinct from the shareholders’, since the company is not understood to exist *per se*, but is merely considered as a “bundle” (nexus, network, market) of contractual relationships between different parties. It further assumes that directors and management have a duty of loyalty and diligence to act in “the best interest of shareholders”; the company’s strategy and implementation should primarily serve the interest of shareholders. Ever since its introduction, repeated objections have been raised as to the validity of the shareholder value model and its capacity to, in practice, modelise the governance of the firm. We will now focus on two sources of uncertainty in the shareholder value model:

- Directors’ duties to act by inference in the exclusive interest of shareholders,
- The corporation’s capacity to invest in long term productive assets, and to internalise all the costs associated with its activities.

¹⁴ See work of Michael C. Jensen between 1976 and 1983

A first objection to the shareholder value model revolves around the instability of the definition of a shareholder's interest. Directors are usually held to be liable for breach of three categories of legal obligations:

- compliance with legal or regulatory provisions applicable to the company and its activities (including in some instance extra-territoriality),
- observance of the articles of association of the company, and
- duty of care or of diligence in management.

John Parkinson has highlighted the challenge of regulating directors' duties in the British context¹⁵. Are the shareholders to be considered as an abstract "Universal" shareholder, whose interest would then be easily definable? Or is "the interest(s) of shareholders" the interests of those people who actually own the shares of the company at a given time? Does it imply maximization of dividends, or of the value of the share? Is it on short, medium, long term? Given the uncertainty, managers may be tempted to react to the short-term expectations of the market. The shareholder value model turns out to be a convenient managerial framework for corporate executives. Any consideration other than the shareholders' interests (and this holds true in particular for the interests of workers) shall fall into the "compliance with local regulation and laws" section.

By focusing on a short term shareholders' financial interest, corporate management can tone down, or even disregard altogether, the claims of other parties, including workers; they can also have part of such claims externalised to society. In the name of shareholder value, corporate management can decide against investing in the company's productive assets, and prefer dividends and other financial transfers made in the interests of shareholders. The now classic example is share-buy back programmes - companies buying and then destroying their own equity, in order to inflate the short-term value of their shares. Such programmes now often reach the level of the company's investments in research & developments – or even exceed them¹⁶.

¹⁵ PARKINSON 1993 & TUDWAY 2005

¹⁶ See LAZONICK & O'SULLIVAN 1997 on the short termist strategies of US corporations in the 1980-1990s.

Shareholder-oriented management can also make some strategic decisions, the implicit effect of which is to pass on to society some of the costs generated by the company's activities. An example would be the environmental costs of the closure of a power plant, which a company pursuing a strict shareholder value model is able to pass on to society; another would be the firing of workers in situations of highly profitable activities. Yet another is given by the shift from defined benefit- to defined contribution pension schemes of listed companies in pre-funded retirement systems (see box below).

Shareholder value and the shift from occupational DB to DC pension schemes

An increasing number of large corporations in the US and the UK are shifting their pension schemes from Defined Benefit (DB, i.e. the level of pension benefit at retirement is secured) to Defined Contribution (DC, i.e. the level of pension benefit at retirement is not secured). They do so for a calculated reason: massive DB pension liabilities might reflect poorly on the annual accounts, and thus impact shareholder value. However, given that DC offers no guaranteed retirement income adequacy, there is a real risk that the DC-covered workers, when reaching retirement, will be close to poverty lines because of insufficient retirement income, and will thus increase the pressure on public means-tested safety nets and 1st pillar public pension schemes (this would eventually imply raising taxes). If that is the case, the DB to DC shifting companies are partly externalising to society a claim (pension benefit) of a party of the company (the workers)¹⁷.

The shareholder model also takes certain assumptions for granted regarding the financial environment of the firm, the relation between corporate law and other sources of law, the management and other parties' claims over the company. In particular, it is predicated on a total transparency and a full flexibility of the markets of goods, services, labour and capital. If markets and/or contract enforcement institutions fail to achieve these objectives, contractual relationships between corporate parties will not guarantee the protection of corporate-related interests. In terms of regulatory framework, the model thus requires a certain degree of sophistication of market information and supervision. It also tends to

¹⁷ See "Pensions to Health Care: The New Corporate Outsourcing", Clifford Levy, The New York Times, February 13, 006; and Financial Times, 'FT Back', January 17, 2006

privilege the relationship between capital market regulations and corporate law, and to isolate that from other sources of law; this is due to the presumed exclusive relationship that binds management to shareholders. Here, labour and environmental regulations in particular are denied any proactive role in building corporate governance. Rather, they are seen as “technicalities” that management should address as administrative and legal compliance matters, rather than assets to the performance of the corporation.

Confronting the model in the context of civil law jurisdictions

The consequences of the introduction of shareholder value model in civil law based economies are also deeper and more disturbing than under their original common law jurisdictions. This jurisdictional divide becomes particularly acute when considering the issue of directors’ duties as outlined above. It is often argued that civil law jurisdictions – common to the French, Nordic and German legal systems – specify the duties of directors to the company itself (and/or a broader community of parties than the shareholders¹⁸) more forcefully than common law jurisdictions. In civil law based countries, and notably in continental Europe, all parties of the firms are under a general legal requirement to act in the interest of the firm as such, and not to its shareholders in particular. There is no doubt that such a judicial obligation is not easy to translate into precise, legally guiding, recommendations, and it is often reported that, ultimately, it is up to the directors and other executives to interpret this provision in order to operationalise the company’s “own interest”. However, its very existence does form a strong barrier against all-out shareholder value behaviour.

More broadly, it is argued that the fundamental difference between common law and civil law jurisdictions lies in the very definition of the public good and the public interest. Under common law understanding, the public interest is defined as the aggregation of individual and private interests. The accumulation of jurisprudence, and case-by-case dispute settlements in courts as well as private

¹⁸ In fact common law jurisdictions, such as in the Delaware state, do consider that board members, as fiduciary agents of the corporation, are required to act in the “best interests of the corporation and its shareholders”. However, in judicial practice that distinction between the company’s and the shareholders’ interests only comes into effect in cases of extraordinary transactions such as mergers and acquisitions. In these cases, directors should act in the interest of *all* shareholders (here assimilated to the “corporation’s interest”) and not of a specific group of shareholders/investors. see BALDWIN, BAGLEY & QUINN, 2003

or market-based conflict resolution mechanisms, are the primary sources of the law, and the origin of its legitimacy; it allows for forming a judgment on the public interest, which weighs the respective private interests of all parties. In contradistinction, in civil law jurisdictions, the public interest is considered as a value-based, autonomous, “general interest”, which is dissociated from the particular interests involved in the corporation. Conflict in this system is *a priori* an indication of a failure of the law.¹⁹ In a broader political approach, the shareholder value model may also be seen as the natural heir of the general political and historical framework within which these companies operate – political liberalism²⁰.

¹⁹ MEISEL 2004:

²⁰ Although one should be cautious in linking political philosophy with corporate governance and management theories, there are nevertheless some striking commonalities between the two conceptual approaches. Basically, in the shareholder value model, a company is viewed as a minuscule version of liberalism’s social contract, whereby autonomous individuals freely contract to form an association in order to further their private interests. In this model – as theorised by Tocqueville or Locke – the public interest is not only viewed as perfectly compatible with private interests, but it is above all considered as an extension, or an emanation, of the furtherance of these very interests. Furthermore, majorities are invariably seen as oppressive forces for minorities. Hence the predominant role granted to contractual relationships and the recurrent emphasis on the protection minority shareholders’ interests.

The Principles, the ‘ROSC’ exercise and the minority shareholder

The past decade has seen a new agenda on harmonisation of rules and practices, and the development of a normative approach to corporate governance. Codes, principles and other benchmarks have proliferated, aiming at aligning governance practices. There has until recently been a clear division of labour at the international level between the World Bank and the OECD in supporting such a move toward harmonisation. The OECD sets the standards – the Principles of Corporate Governance established in 1999 and revised in 2004²¹ – which are in turn used by the World Bank as a benchmark for its own methodological policy dialogue with client (developing and transition) countries. This occurs within the policy framework of the Report On Standards and Codes (ROSC) exercise, the standards of International Finance Corporation (IFC), regular publications such as the annual report “Doing Business”, and other World Bank-led initiatives, such as the Global Corporate Governance Forum.

In this second chapter, we will look at the content of the OECD Principles, the World Bank ROSC corporate governance assessment and the IFC methodologies. We will proceed to discuss key policy elements of WB recommendations stemming from those assessments, specially relating to capital market infrastructure, and to the implicit ownership structure favoured by the Bank.

The reference: OECD Principles of Corporate Governance

The OECD Principles of Corporate Governance are a set of non-binding standards on corporate governance principles, which rules at both company and regulatory levels. The Principles include requirements that affect corporate parties – Board of Directors, executive management, employees, shareholders – and broader market and regulatory institutions, such as supervisory authorities, external auditors, specific categories of shareholders (institutional investors in fiduciary capacity), financial analysts, rating agencies, legal advisers, other market intermediaries. The Principles are divided in six chapters:

²¹ OECD 2004

- *Ensuring the Basis for an Effective Corporate Governance Framework* sets out the broad objectives of the regulatory framework, including integrity, transparency, consistency and enforceability of the regulatory framework, as well as the respective responsibilities of the various authorities.
- *The Rights of Shareholders and Key Ownership Functions* lists key basic recommendations regarding the organisation of the Annual General Meeting of the shareholders (AGM), the nomination and remuneration of directors, rules on corporate control²², institutional investors active ownership (transparency policies regarding AGM voting and conflict of interest prevention), communication between shareholders.
- *The Equitable Treatment of Shareholders* follows on the previous chapter in addressing the specific situation of concentrated ownership and the opposition between controlling shareholders (who may take undue profit from dominant position) and minority shareholders (who may not). It requires equality of right per class of shares, calls for prevention of direct or indirect abuse by controlling shareholders (disclosure of conflicts of interests by shareholders, and by directors), and protection of minority shareholders.
- *The Role of Stakeholders in Corporate Governance* defines the basic rights of employees, creditors and other stakeholders to participate in corporate governance. Most of it, however, relates to employees' rights to participate in corporate governance, including their rights to information and consultation, the right of redress for violation of their rights, and the right to whistleblower protection. The version revised in 2004 expands on the sources of rights – they go beyond law, to include any form of mutual agreements (including collective agreements). It also “permits” the development of employee participation mechanisms.
- *Disclosure and Transparency* includes management and board disclosure requirements of financial and governance information (conflict of interests, remuneration, nomination process, other directorship). The chapter also addresses broader market integrity issues, such as the duties of auditors

(they should be accountable to shareholders, but also owe a duty to the company), and the integrity of market information and analysis.

- *The Responsibilities of the Board* touches upon the heart of corporate governance, through the issue of the transparency of board nomination and remuneration (to be “aligned with the longer term interest of the company”), board organisation and independence (from management). In an attempt to conciliate civil-law and common law systems, the chapter requires the board to act in the interest of the company *and* the shareholders.

Assessment of the Principles

The Principles were, and remain, very shareholder-rights oriented. While their Preamble does recognise that there are alternatives to the shareholder value model²³, such recognition of diversity is regrettably lacking in the Principles themselves. For example, it is stated that directors should act in the “best interest of the company and shareholders”²⁴ in an apparent attempt to reconcile common law jurisdictions (duty to act in the interest of the shareholders) and civil law jurisdictions (the company has a stand-alone interest). However in the first paragraph of the annotation (i.e. the text that is meant to give further explanation and background to the Principles), the reader is immediately warned that “acting in the best interest of the company should not permit management to become entrenched”. One could have expected a more engaging statement on regulatory frameworks that formally recognise a company’s *own* interest.

The Principles recurrently stress the need to prevent or to disclose situations in which key governance institutions – members of the board, auditors, shareholders – are, or risk being, in situations of conflict of interests which would affect their judgment in dealing with the governance of the corporation. The Principles are also very explicit on the need to ensure the protection of shareholders’ rights, and in particular of minority shareholders’ interests. On the

²² including a call for “anti-takeover” devices not to be instrumentalised to the benefit of “entrenched” management

²³ For instance, it states that corporate governance is not “simply an issue of the relationship between shareholders and management” and that “in some jurisdictions, governance issues also arise from the power of certain controlling shareholders over minority shareholders” and “in other countries, employees have important legal rights irrespective of their ownership rights.”

²⁴ OECD 2004, Principle VI.A

other hand, there is no mention of responsibilities that shareholders may have with respect to their investment, except for institutional investors with fiduciary duties (i.e. pension funds), who are required to disclose their potential conflicts of interest and voting policies.

Beyond that, the Principles lack direction when it comes to the organisation, responsibilities and duties of the board. Regarding the composition of the board, the OECD standard proposes a discursive account of various scenarios the Board may adopt to ensure its “independence of judgment”. The essential requirement to separate CEO and Chair functions is absent. So is the equally important issue of “interlocking directorships” and “cross-directorship” (a typical cause of dysfunctional boards), despite the call from leading activists of the institutional investment community²⁵. Regarding the directors’ remuneration policy, the Principles ask for its disclosure and “alignment to the long term interests of the company and its shareholders”. However, nothing is said on the consistency of the board remuneration schemes with the general remuneration policy of the firm, or on nomination processes in which other parties than shareholders may have a say (such as employees, or local authorities). While it notes that the board should consider stakeholders’ interests, it does not require a dialogue with such stakeholders to discuss their concerns and interests in the formulation and implementation of the firm’s strategy.

On external auditors, the Principles require them to be accountable to shareholders, and emphasise their duty to exercise “due professional care to the company”. External auditors certify the accounting of companies to ensure market integrity; as such, they are exclusively accountable to public authorities, and not to shareholders. Neither do the Principles require the company to disclose potential conflicts of interest (for example arising from the double role of the audit company as an auditor and as a consultant for other businesses). Regarding other market intermediaries, such as financial analysts, the Principles are limited to a vague requirement for the invested company to have an “approach that addresses and promotes the provision of analysis [...] free from

²⁵ Letter of Colin Melvin, Director of Corporate Governance at Hermes Investment Management Ltd, to the Chair of the OECD Steering Group on Corporate Governance, 4 February 2004

material conflicts of interests”. Nothing is said on how a company should implement such an “approach”. In addition, the omission of important actors, such as legal advisors, is a missed opportunity. Legal advisors produce the internal operating rules of the firm, and are key advisors on extraordinary financial operations such as mergers and acquisitions, as well as on financial disclosure practices and rules.

The World Bank’s use of the Principles and the IFC toolkit

Interestingly, the Principles enjoy no form of implementation process within the OECD. In particular, one of the key instruments of the OECD, the Peer Review Process (i.e. the national regulatory assessment of an OECD member by a troika of three other members, with support from the OECD Secretariat) has not been envisaged. On the other hand the OECD is very keen to promote the Principles outside its borders. Since 2000, *Regional Corporate Governance Roundtables* as well as issue-specific workshops have taken place on a regular basis in South-East Asia, Russia, Latin America, Eurasia and South-East Europe²⁶. Although the impact of these roundtables should not be underestimated, the real promoter of the Principles at the international level is the World Bank.

The World Bank has two instruments at its disposal with regard to institutional dialogue on corporate governance reform:

- at country-level, the joint IMF/World Bank ‘Report On Standards and Codes’ (ROSC);
- at company level, the World Bank IFC methodology.

The ROSC is a joint exercise undertaken by the IMF and World Bank to benchmark financial systems of client states according to a set of twelve internationally recognised standards²⁷, including corporate governance. In conjunction with the Financial Sector Assessment Programme, the ROSC exercises have since 1999 been applied to over 80 client countries. However, only 33 countries have seen their ROSC assessment cover corporate

²⁶ OECD 2003

²⁷ Covering: data dissemination, fiscal transparency, transparency in monetary and financial policy, banking supervision, securities regulation, insurance supervision, payments and settlements, corporate governance, accounting and auditing, insolvency and creditor rights, anti money laundering and combating the financing of terrorism.

governance regime (a ROSC may not necessarily cover all 12 standards). The World Bank uses a Template checklist on compliance with the OECD Principles as a diagnosis tool²⁸. The Checklist comprises 316 questions on the implementation of the 57 individual principles. Evaluators are requested to qualify each question by a multiple choice table (“Observed”, “Partially observed”, “Not observed”, “Not Available”) and, where appropriate, to provide additional comments.

Assessment processes are usually followed by World Bank and IMF regulatory ‘support’ reforms, to bring their client states’ regulatory frameworks in compliance with the Principles. In most cases, key recommendations will translate either into binding conditionalities on IMF or World Bank loans, or into grants touching upon *inter alia* corporate law reform, securities and capital market regulation, re-organisation of capital market supervisory authorities. In addition, several support actions can be implemented. This can include direct or indirect technical or financial assistance to capital market authorities (World Bank experts or contracted consultants), agencies and government (treasury), as well as financial support for private institutions (typically the business- or employer-federation-owned Directors’ Institute).

In parallel to government-level policy dialogue, the World Bank IFC has developed its own framework in 2005 to assist client companies in handling corporate governance issues in their investment: the IFC Methodology²⁹. Although the IFC – like other World Bank agencies – officially considers the OECD Principles of Corporate Governance as a framework for its work, its new methodology departs to some extent from the structure of the Principles. The ‘methodology’ consists of several assessment checklists that IFC clients are invited to apply on the state of governance of individual companies. There are specific checklists for several kinds of companies: publicly listed companies, founder- and family-owned firms, financial institutions, and newly privatised companies.

²⁸ WORLD BANK 2005a

²⁹ Applying the IFC Methodology <http://ifcln1.ifc.org/ifcext/corporategovernance.nsf/Content/Approach>

Each checklist comprises several instruction sheets that describe key corporate governance tools and how they should be used in the course of the review. In particular an IFC ‘progression matrix’ maps out the gradual improvement of governance in four selected areas: “commitment to good corporate governance”, the “board of directors”, “transparency and disclosure”, and “shareholders rights”. Last but not least, the IFC toolkit includes a standard definition of what should amount to an ‘independent director’, the requirements of which are so strict that it in effect excludes for the director any form of relationship, not only to the management, but arguably to the company as a whole and its related activities.

Strengthening capital market governance: protecting minorities at all cost?

Reading from individual ROSC assessments and OECD regional roundtables outcomes, the most common policy concern revolves around strengthening the governance of capital market and, more simply, the effective enforcement of established rules and laws. World Bank evaluators often report discrepancy between the letter of the law and actual practices. In proposing their reform actions, supervisory agencies – by opposition to courts – are seen as the priority institutions to be strengthened in terms of financial, human capacities, and most of all in terms of prerogatives and enforcement power. As noted by two World Bank officers in 2002,

Securities regulators have little direct power to enforce penalties. Enforcement of prevailing rules and regulations is mostly the responsibility of the courts. This leads to poor enforcement of the rules and regulations underlying corporate governance. In countries with weak regulatory environments, concentrated enforcement through the market regulators may be preferable to enforcement through the courts.³⁰

Beyond capital market governance, corporate governance as a whole is viewed as instrumental in reshaping the equity market, by putting the emphasis on the investors’ decision-making and risk-management process, rather than being considered as a framework for companies themselves. Such a capital market vision is clearly visible both in the OECD Roundtables and the World Bank key ROSC assessment outcomes. In line with the above-mentioned priority to capital market infrastructure, the most frequent policy recommendations – and in fact

³⁰ CAPAUL 2003

their near exclusive focus – are devoted to financial market transparency and supervision infrastructure, and to the protection of minority shareholders' interests in concentrated ownership structures. These two policy concerns are seen as mutually supportive. As noted by World Bank officers:

In most countries surveyed, business transactions have traditionally taken place on the basis of relationships and trust and little attention has been paid to publicly available information. Corporate governance reform is a way to extend this trust to all market participants via enforcement of shareholders rights.³¹

The World Bank does not hide its preference for companies that are listed on the stock exchange with a highly dispersed ownership, possibly with a high level of trading (to allow markets for corporate control, and hostile takeovers to be effective). Any capitalistic arrangement that differ from dispersed shareholder structure, such as family-owned and other forms of highly concentrated shareownership or state-ownership, are seen at worst as sources of potential governance failures and conflicts of interests, and at best as 'special cases' needing specific scrutiny and regulatory treatment.

Such a clear preference for dispersed ownership – which is quintessential for the shareholder value models to be relevant – is partly explained by the authoritative 1996 (revised several times since) “Law and Finance” model, also known as the LLSV model³². The LLSV methodology uses an index to measure the quality of shareholders' rights in a given jurisdiction. Common law countries, which typically have dispersed ownership and highly fluid capital markets, are found to score well on the index, while civil law countries (Germany and France in particular), which are characterised by more concentrated ownership and debt financed corporations, are rated poorly. LLSV also values private enforcement of securities law over and above mandatory court-based corporate law.

The LLSV study has been, and still is, extremely influential in current debates, as well as within World Bank circles. It is used as the backbone for the World Bank Investor Protection index in its annual “Doing Business” publication. However,

³¹ idem

³² LLSV 1998

since 1996, several researchers have come to oppose the model as being too simplistic, omitting implicit rights granted to shareholders in continental Europe³³.

The insistence of the World Bank to promote dispersed ownership appears questionable, as there are arguably benefits to concentrated ownership. Concentrated shareownership is obviously a powerful capitalist arrangement to ensure that the long-term interest of the company is pursued, and not diverted by short-termism. True, concentration may also present the risk of resource diversion and insider trading when a shareholder – or a group of shareholders – is in a position to single-handedly influence the executive management of the company³⁴. Whereas the OECD and the World Bank do acknowledge that concentration may have some merits, their recommendations will systematically point to the weaknesses of concentration and family-based structures. In doing so, the main policy recommendation is *not* to prevent abuse by controlling shareholders, but to protect minority shareholders from such abuses, and to dilute concentrated ownership. The very fact that diversion of resources may impact on other parties than minority shareholders, and on the interest of the company itself, is not envisaged in the OECD and World Bank framework. One could go as far as to argue that this prevailing model would not object to controlling shareholder abuse... as long as it does not affect a minority shareholder. As we will develop in the next chapter, the implicit agenda appears to aim at promoting dispersed shareholdings and to see the growth of institutional investors buying and selling through stock markets, the true purpose of corporate governance – governance mechanisms between corporate parties for the long term interests of the company itself – being somewhat lost down the road of reforms.

³³ COOLS 2004

³⁴ OMAN 2001

Labour and the World Bank framework

The issue of reform has become a relatively politically sensitive issue since the Enron scandal in 2001 and the implosion of the High-tech led financial market bubble. The history of capitalism is filled with scandals and frauds, but there is little doubt that the current series beats all previous standards, by the sheer magnitude of the scandals and their frequency. Financial news wires report on a daily basis on “mini-Enrons” happening below the radar screen: CEOs benefiting from multi-million golden handshakes and parachutes days before / after massive downsizing and bankruptcy, corrupted auditors serving the interest of a few executives, no market integrity in general, controlling shareholders looting the company’s assets. The investor community and international organisations were quick to associate fraud and greed with developing, emerging and transition economies. There was a broad consensus that such events could not happen within the sophisticated OECD market systems. However, they did happen, and the recent scandals have revealed a lack of regulation, or rather the existence of regulatory loopholes.

The weak post-Enron response

Governments and the international community did nonetheless react to the crisis, and tried to address its causes. In most countries, financial market transparency and supervision, as well as oversight of the auditing profession, have been strengthened, as have the means by which executives can be held to account: enhance shareholders’ rights and require the independence of the board from management. Most of these initiatives have taken place on a soft-law, voluntary basis (such as ‘comply or explain’) or, in a minority of cases, by binding regulations. The most emblematic case in the latter category is the Sarbanes Oxley Act, which was supported by the American labour movement³⁵. However, despite such reactions by governments, the many soft-law initiatives and the (very few) transparency binding regulations, public trust in the corporation does not seem to be back, at least in OECD economies. Perhaps the roots of the

³⁵ SOX is the first ever US federal regulation to address the heart of corporate governance: the composition of the board of directors (i.e. SOX requirement of majority of independent directors in the audit committee). Until then, state-level

problem are deeper than that of a “few bad apples”, as some commentators have suggested. They are perhaps to be found in a very simple, yet still un-answered, question: what is the fundamental purpose of the corporation?

It is noteworthy that governmental debates often get bogged down into (retrospective) comparative law analysis, and lack political direction on regulatory reform and quality. That was for instance the case with the negotiations on the revision of the Principles, as witnessed by the TUAC Secretariat. OECD member state representatives would typically adopt a defensive stance to the proposals of revision put forward by the OECD Secretariat. They would be chiefly concerned with the compatibility of these proposals with their own current national jurisdictions (and in the case of federal states, with as many state-level jurisdictions). Despite the non-binding and voluntary status of the Principles, the representatives would seldom reflect on the appropriate framework of rules and practices that would help *future* regulatory reforms for the development of ‘good’ companies. In its assessment of the revision of the Principles in 2004, the TUAC noted that:

Despite initially ambitious inputs by the OECD Secretariat, the process became increasingly narrow. The discussions rarely touched upon the broader picture of corporate governance and accountability, or fundamental questions relating, for example, to the economic or social mission of a corporation, or how to craft the Principles such that they ensure effective accountability to all relevant constituents, irrespective of the national regulatory framework. Neither did the Steering Group address current and past corporate scandals. Those issues were raised by the trade union participants; however there was rarely a response from the government side. Rather, government representatives agreed early that the original Principles were simply in need of some fine tuning, and that many issues that could not be ignored could be buried within the annotations. Discussions were confined to point-by-point comments on the successive draft proposals developed by the OECD Secretariat, with government officials also concerned to ensure that agreed revisions were either weaker than or in conformity with their domestic systems³⁶.

Labour and the political challenge of reform

Corporate governance and its reform are ultimately a political question, in the broad sense of the term. The starting point of corporate governance reform is

jurisdictions enjoyed almost a monopoly on corporate law, and in particular Delaware State jurisdiction, where circa half of US listed companies are registered)

³⁶ TUAC 2004

thus the very concept of the “corporation”. The definition of its nature, as well as of its economic and political implications, will to a large extent decide the policy orientation and the scope of reform.

The fact is that a growing number of citizens see large corporations as acting as free-riders of globalisation – whether this judgment is essentially true or not is another matter (see Annex 3). The roots of such mistrust are to be found in the definitional vacuum in which societies are when it comes to the purpose of the corporation. One could argue that if trust is to be found again, the first step would be to enlarge the circle of the debate on corporate governance, and to precisely ‘trust’ the citizens in their representative bodies to contribute constructively to a public debate on the purpose of the corporation. Unfortunately, and despite the post-Enron ‘popularity’ of the concept, there is a tendency among global decision-makers and institutions (the OECD in particular) to consider corporate governance as a topic to be exclusively dealt by “high level” experts and business representatives. With a few exceptions, non-business parties, and labour in particular, have been excluded from the national and international policy dialogue processes. And where labour and broader civil society does effectively raise its voice, it is usually as a result of intensive advocacy and campaigning activities.

Yet labour is a natural key party to corporate governance. In most industrialised OECD countries, trade unions have actively and diversely contributed to reform measures to prevent corporate scandals, and give workers a say in corporate decision-making. The specificity of domestic situations, including that of the regimes of industrial relations, means that these labour strategies are framed nationally or regionally, or that they rest upon common cultural, economic and political features. Two variables typically shape labour input into corporate governance: social dialogue at company level (confrontational vs. consensual and cooperative), and retirement system (pre-funded vs. PAYG). The differences between the various labour strategies in the OECD countries are noticeable in this respect:

- In continental Europe where a tradition of social dialogue prevails, labour strategies have mainly focused on protecting and modernising the mechanisms of worker representation, notably works councils and board level employee representation.
- In the US, Canada, Australia, UK and more recently in Northern Europe, trade union strategies have revolved around promoting labour-oriented stewardship of the investment policies of private pension funds where they have leverage.

The Global Unions Discussion Paper

The TUAC and members of the ICFTU/GUF/TUAC Committee on Workers' Capital³⁷ have over the past two years launched an internal dialogue on corporate governance reform, the outcome of which has been the release, at the end of 2005, of a Global Unions Discussion Paper "Workers' Voice in Corporate Governance – A Trade Union Perspective"³⁸. This Discussion Paper calls for the constitution of a trade union platform on corporate governance reform which would help bridge the different labour strategies at national level, and, where appropriate, facilitate mutually reinforcing dynamics.

The starting point is to question the "shareholder value" model, and, more broadly, the assumption that the corporation is a private property "owned" by private associations of investors. The Paper argues that the corporation is irrevocably established as a matter of public policy to serve the public purpose of generating revenues and profits, as well as of creating wealth to ultimately satisfy the needs of the society in which it has its activities. A first step in building such a platform is to reassert workers as core constituents of the corporation and to make sure that the firm-specific risks they bear and the investments they produce are recognised. Fixed contractual relationships do not adequately protect workers' interests, nor do they constitute incentives to maximise firm-specific investment in human capital. As noted in the Global Unions Discussion Paper:

³⁷ Through the ICFTU / GUF / TUAC Committee for International Co-operation on Workers' Capital ("CWC"), international labour movement representatives are developing strategies for joint action using worker's capital. The Committee's areas of work include capacity-building (trustee education), policy and research (corporate and financial market governance), and campaigning (corporate accountability through shareholder activism).

³⁸ TUAC 2005

Workers in particular acquire firm-specific expertise, knowledge of the assets they use and of the organisation and its “culture”, which cannot be transferred and valued on the labour market, at least not at its true value. The value of this investment evolves over time, and the combination of human capital and corporate assets can generate firm-specific innovation. [...] Fixed contractual relationships between employees and the firm do not adequately protect workers’ interests, nor are they incentives to maximise firm-specific investment in human capital or ensure workers’ commitment to the company and its strategy. The implication of the stakeholder approach for corporate governance is that workers, like other stakeholders whose interests are not fully protected by law and contract, bear residual risk in the corporation. They too can claim a representative role in governance. Their risk stems from specific capital invested in the corporation, financial capital for shareholders, labour (or human capital) for workers and managers. In fact the nature of workers’ investments is much more ‘sunk’ than shareholders who typically spread their investments over many companies precisely to diversify their risk. If stakeholders are not represented, they will under-invest in the enterprise for fear of being expropriated by those who are represented. Such under-investment compromises firm performance and weakens its capacity to face up to crisis and manage change. Thus under-representation of workers in corporate governance violates the public purpose for which corporations exist.

The Paper proposes four policy areas for labour-oriented corporate governance reforms. Aside from a descriptive analysis of each pillar, the Paper includes specific reform proposals regarding:

- reinforcing worker representation within the company,
- strengthening the accountability of the board of directors,
- encouraging responsible shareholders, and
- Ensuring compliance through an enforceable regulatory framework.

The objective of corporate governance should not be limited to the efficiency of the financial markets, it should also include contributing to the public mission of creation of wealth. Such objectives do give an indication as to the broader regulatory approach that is needed beyond capital market and corporate law entrenchment, and the mere requirement to act in the interests of shareholders as framed by the World Bank. In the following sections, we will compare the key elements of the Discussion Paper with the World Bank’s approach to the implementation of the OECD Principles.

Workers' representation beyond contractual relationship

The main recommendation of the Discussion Paper is to re-consider the corporate governance debate in favour of workers as a key constituency of the corporation, and a constituency which needs to be involved in the governance of the corporation beyond contractual relationship and collective bargaining. Works councils are the principal legal mechanism for worker representation within corporate decision-making. They enjoy rights ranging from information and consultation up to negotiation on issues related to the organisation of the workplace, on employment conditions as well as on extraordinary issues such as restructuring and new technology. Board-level employee representation is a complementary mechanism for ex-ante worker participation in improving communication with the board and the CEO. Employees participating in the board are by definition directors independent of the management. As we will see below, the latter qualification is of crucial importance with regard to the composition of the board, and in particular to the need to ensure the board's independence from the management of the company.

Having a representation in the corporate decision-making process is, however, not a guarantee that it will be exercised effectively. Hence, employee representatives must be in the conditions to exercise their rights: they must have time off from work, they must be informed properly and on time. Moreover, an adequate system of sanctions for representatives that fail to meet their responsibilities should be put in place.

The World Bank consideration of the issue of workers representation as treated in the OECD Principles is a cause of concern. Firstly, it appears that the stakeholder sections of the Principles are not always included in the World Bank ROSC reports. Several of them have simply omitted applying the assessment to the Chapter on the role of stakeholders (see annex 4). Secondly, while traditional participatory mechanisms are referred to in the Principles, namely Principle IV.C ("Performance-enhancing mechanisms for employee participation should be permitted to develop"), in the World Bank checklist, they are dealt with in another section, Principle IV.A, which merely requires general respect for rule of the law. This odd interpretation (see annex 5) does not deal with worker participation in a

dynamic and developmental approach, as suggested in Principle IVC (“permitted to develop”), but limit assessment to the legality of current practices. The World Bank’s understanding of the IV.C is limited to envisaging employee financial incentives, such as stock options distribution to executive managers (which incidentally means that these are considered by the World Bank as ‘workers’).

The contribution of the OECD Roundtables to the discussion on the role of workers in corporate governance is limited as well. Beyond general recommendations on improving the enforcement of existing laws and regulations to close the gap between formal provisions and actual implementation, the roundtables are extremely prudent in addressing the added value of workers. The most progressive recommendations note the need to improve the functioning of works councils and other mechanisms of stakeholders’ participation, but stop short of specifying how such ‘improvements’ can be achieved. In fact, some of the Roundtables’ proceedings have adopted a most surprising approach by concluding that the main concern about the lack of respect of stakeholders’ rights was that it deprives... shareholders of important information about corporate operations and its future liabilities.

The IFC methodology adopts a distinct approach to employee representation – it simply omits this very possibility. IFC merely mentions the possibility that employees own shares of the firm, and the only request in this regard concerns the disclosure of this practice. The participation of stakeholders in corporate decisions through any mechanism is not taken into consideration. In addition, the presence of stakeholders, and in particular of employees, in the board of directors is far from being considered a positive and fruitful measure for the firm, let alone a right. Much to the contrary, it is viewed with scepticism: according to IFC, employees are by definition non-independent board members, and their presence on the board must hence be limited.

Overall, the World Bank framework adopts a wobbly approach to stakeholder participation and to workers’ input in particular. Workers are mentioned either as a legal compliance matter or as a highly elitist stock options mechanism for executive management: a company should ensure compliance with laws to the

extent that the company does not risk additional liabilities (e.g. workers seeking redress for violation of their rights) which may impact the return on equity of shareholders.

Encouraging responsible and long term shareholders

A key message of the TUAC Discussion Paper relates to the financial market regulatory environment. The paper calls for robust binding incentives that ensures that shareholders investment policy be designed in accordance with the public purpose of the invested corporation and the imperative requirement of market stability and integrity. The Discussion Paper further differentiates between long term and short-term shareholders. Shareholders who look for short-term gains and who are therefore indifferent to the long run interests of the firm should not be granted special authority in corporate governance. On the contrary, institutional investors in fiduciary capacity and particularly pension funds have to be granted rights, but also responsibilities. Pension funds have indeed a 20 to 30-year investment horizon because of the specific nature of their liabilities (funding retirement of workers). As such, they naturally aspire to long-term investment mandate and should be regulated to avoid short-termist behaviours³⁹.

The paper also addresses an alternative worker capital investment mechanism: employee share-ownership plans (ESOP). It stresses the risk of exposing twice the worker to firm specific risks: risk as an employee, risk as an investor. Where such schemes do exist however, the corporate governance framework must facilitate the collective organisation of employee shareowners in the form of employee shareowners associations, and its independent representation from management at the Board of directors.

The OECD Roundtables' recurrent message is the lack of rights of shareholders in developing and transition countries. Expanding shareholders' rights serves a double function. First, it supports an enabling framework for the protection of minority shareholders from controlling shareholders abuse. Much of the OECD and World Bank framework, and the IFC methodology in particular, will give great

importance to that issue (leaving aside the protection of other parties from those forms of abuse). Second, the objective of enabling shareholders in general, be it minority ones or controlling ones, is seen as a powerful alternative to public regulation of the board independence and accountability. Empowered shareholders can indeed be instrumental in ensuring the right system of checks and balances in the organisation and functioning of the board of directors, this in a more efficient way (i.e. the market way), than by binding public regulation.

Unlike the stakeholder chapter, the ROSC exercise includes every detailed requirement mentioned in the OECD Principles as far as shareholders' rights and in particular the need for active institutional investors, is concerned. The framework makes a strong case for implementing class action suits in the national regime. The ROSC methodology specifically calls for disclosure requirements concerning voting policy and activities, and for an active use of the share voting rights. The emphasis on the role of institutional investors, and on pension funds in particular, should also be seen in the broader context of the push of the World Bank to privatise pension systems and shift from tax- and solidarity based PAYG systems to marked and pre-funded based systems. Reforms that dismantle public tax-based systems and replace them with private market-based pre-funded systems help improve future budget constraints and above all, increase national savings. Politically, they offer better guarantees of security, as assets are protected by legal property rights. This is where corporate governance plays a key role in the World Bank framework. To solve the increasing market risk exposure of reformed and privatised pension systems (as a substitute to the political risks of PAYG systems), corporate governance is viewed as a crucial instrument that helps tighten the investment policy of funds, protects them from market risk and downturn, and thereby contributes to pension sustainability. For example, at a recent 'ROSC' meeting in Poland, a World Bank official noted that:

³⁹ This discussion on the need for regulatory environment and practices that facilitate pension funds' long term investment strategies and at the same time combat financial short-termism has been very well developed by several TUAC affiliates, including the British TUC (TUC 2006).

Poland is at an advanced state of corporate governance dialog and reform. These recommendations would further strengthen corporate governance practices. *With the increasing role for private pension funds*, corporate governance should be an important priority for further reform.⁴⁰

The corporate governance is seen as a powerful tool to contribute to the sustainability of pension funds, as it strengthens their capacity to mitigate investment risks.

Strengthening the accountability of the board of directors

On board accountability, the Paper calls for binding regulation, which is necessary to ensure that boards, not the management, are in a position to discuss, approve and supervise the implementation of the corporation's operational policies, which, taken together, constitute its long-term strategy. The process should be designed to empower core constituents who make firm-specific investments and have a demonstrated interest in the long-run success of the company. Such binding regulation should cover the composition, the organisation and the responsibilities of board, with a view to ensure the diversity of profiles, the capacity to take into account all the corporate constituencies' interests, as well as the ability to understand the market forces that drive the corporation's activities. The Paper lists several key regulatory measures:

- There must be a balanced mix of executive directors and non-executive directors. In one-tier systems, the non-executive ones must be the majority.
- The Chair of the board must be completely independent of executive directors.
- Directors' remuneration policy must be disclosed and it must be consistent with the employees' remuneration policy, including departure and pension arrangements.
- The granting of stock options should be banned, unless they are part of the same program as employees' share ownership plans. A committee composed exclusively of non-executive directors (or the supervisory board in the two-tier system) should assure this.

⁴⁰ The World Bank Reviews Corporate Governance in Poland - Corporate Governance ROSC Dissemination Workshop, Dec 14-15 2005 (World Bank website path: Home > Countries > Europe and Central Asia > Poland > Corporate Governance ROSC Dissemination)

On Board issues, the World Bank is essentially concerned with the independence of the directors. The ROSC requests a definition of “independence”, particularly as regards the effective independence from the management and from majority shareholders; however, it does not mention the separation of Chair and CEO. Concerning the Board nomination and election process, the ROSC focuses mainly on transparency issues. There is no specific requirement for the board remuneration to be aligned on the long-term interests of the company and of its shareholders. The World Bank merely calls for the existence of a law or regulation setting the board remuneration, and for a role to be played by shareholders in this process. However, contrary to the provisions in the OECD Principles, there is no requirement that compensation should be in keeping with the long-term interests of the firm. In addition, the World Bank does not ask for the independent non-executive directors to control the remuneration policy.

The IFC addresses at length the need for complete independence of the directors, and strongly advocates that they should form the majority of the board. Its definition of independence is very restrictive, as it prohibits any form of direct or indirect relationship with (and thus knowledge of) the company. The IFC is clearly advocating an “outsider” model of board governance. Any link to employees, former employees, customers, suppliers and other parties having or having had a stake or some relations with the firm is considered to be detrimental to the Board. Such a definition consequently rejects the idea that employees might be independent directors.

The World Bank highway to reform

In analysing the post-Enron situation, the Discussion Paper calls for “overcoming the internal and external auditing deficits”, and in particular a strengthening of the regulation of auditing firms. More broadly, the Paper argues for a real effort in securing an enabling regulatory environment for responsible investors (strong incentives to adopt long-term ownership policies) and simultaneously for corporations to “formulate and communicate to shareholders in a way that is designed to attract long-term investment strategies”. The Paper also argues in favour of measures that can reduce the volatility in trading of shares and short-term speculation, as well as build a stable and long-term shareholding structure.

Apart from regulating the audit profession, the World Bank does not address the issue of long-term investment incentives. As we have seen in chapter two, its focus on investor protection and transparency, within the conceptual LLSV model, leaves no space for such a comprehensive approach. In addressing regulatory reform, two policy assumptions can be challenged:

- the almost organic link between protecting minority shareholders and achieving high economic growth;
- a negative perception of non-common law jurisdictions, in particular jurisdictions having French legal origins, in achieving appropriate capital market governance.

The causal link between minority shareholders and growth appears in a very simple way: protecting minorities ensures active, open and deep capital markets, which in turn reduces the cost for the private sector to access external finance, and thus stimulates economic growth by increasing the flows of capital into the country. This ensures an optimised allocation of that capital into the most efficient companies. Such a causal link between shareholders' right and growth has been – rather unexpectedly – challenged by the OECD Secretariat. Indeed, in an “issues paper” dated March 2005, which was never released in the public domain, the Corporate Affairs Division of the OECD Secretariat expressed its scepticism at the LLSV:

[T]he key finding [of the LLSV model], that common law promotes dispersed ownership, has been subject to numerous criticisms from both a theoretical perspective (see below), as well as with respect to the relevance of its conclusions for policy. Indeed, the “methodological framework” is quite simple: protection of minority rights promotes dispersed ownership by lowering the risk premium demanded by investors, leading to deeper external capital markets. They in turn lead to higher growth through more efficient allocation of savings, increased start-ups and a more rapid diffusion of technology. At each point of the causal chain, a number of questions important for policy discussions are raised but the means of addressing the questions are under-developed. For example, suppose the question is ensuring control and thereby reducing agency costs and hopefully the cost of capital. In this case, block-holders might be necessary which would be expected to maintain strong powers over the board and to lobby governments for such corporate law. Such appears to have been the case in Europe in the late 19th century.⁴¹

⁴¹ DAFE 2005

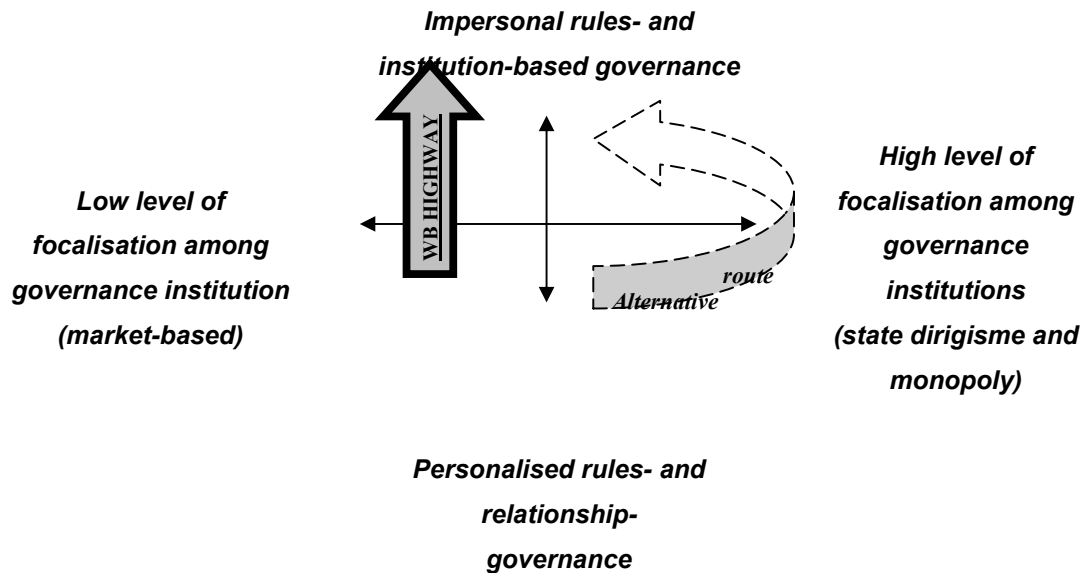
As observed in chapter two regarding the shareholder value model, the World Bank does not hide its preference for common law systems. The investor Protection index that appears in the annual Doing Business report shows that common law jurisdiction rate far higher than other legal origins. A graphic representation of Index sorted by legal-origins (French, English, German, Socialist, Nordic) for OECD and non-OECD countries is reproduced in Annex 2. It clearly shows the presumed superiority of English legal origin jurisdictions. In fact, the World Bank can be very explicit in qualifying civil-law systems as anti-development and anti-poor judicial doctrines. In that same annual Doing Business report in 2004, the World Bank stated:

Common law countries regulate the least. Countries in the French civil law tradition the most. [...] Heavier regulation is generally associated with more inefficiency in public institutions— longer delays and higher cost — and more unemployed people, corruption, less productivity and investment, but not with better quality of private or public goods. [...] The countries that regulate the most—poor countries—have the least enforcement capacity and the fewest checks and balances in government to ensure that regulatory discretion is not used to abuse businesses and extract bribes.⁴²

There are, however, different regulatory paths to corporate governance reform. As Nicolas Meisel⁴³ explains, governance cultures differ from one another according to two governance parameters: (i) the degree of formalisation of the corporate governance regime and rule-based governance relationships between market players and (ii) the role and importance of the state in the economy by opposition to market-based institutions.

⁴² WORLD BANK 2004

⁴³ MESEIL 2004



Source: MESEIL 2004

The vertical axis represents the degree of personalisation or of formalisation of the functioning of governance institutions. The horizontal axis reflects the degree of competition between sources of governance (as opposed to monopoly). In this diagram, industrialised countries would tend to be placed 'north' (impersonal rules and institution-based) and 'west' (market-based governance). Developing and transition countries would stand in the 'south-western' part; characterised by lack of state structures and by heavy interpersonal relationship and information systems. Modernisation of their economies would require reform to 'move up' to institution-based model, whose governance would be founded on explicit, formal and depersonalised rules.

Meisel's framework seems to suggest that the preferred path by the World Bank is to 'jump' directly from relationship-based to institution-based governance on the west side of the chart (ie. low-focalisation) – symbolised in the above chart by the arrow "World Bank Highway", that is to focus reform on capital market infrastructure and de-regulation, while leaving aside the potential contribution of the state interventionism and active state-ownership to promote corporate governance reforms.

Meisel argues that there are alternatives. Heavily relationship-based societies incur very high fixed collective costs when trying to move directly to the

institutionalised systems: they need substantial investments to create a legal and judicial infrastructure, to set up the surveillance and regulatory bodies needed to define and enforce codes, norms, property rights, commercial laws, et. al. In some circumstances, reaching out directly to the 'north' may prove un-productive for developing countries. Instead, he suggests an alternative route, whereby reform would go through the reinforcement of state power and ownership before turning 'west' towards a rule-based governance. Meseil takes the experience of France's state dirigisme during the post-war 30 years-growth, as a successful example of such an alternative route to reform.

Conclusion: creating alternatives routes

As a distinct policy area, the World Bank's understanding of corporate governance appears to be essentially dictated by the broader objective of deepening and/or opening a given country capital market. This is illustrated by the Bank's emphasis on the protection of minority shareholders' interests, which are thus viewed as a stakeholder category of strategic importance. By securing and promoting the interests of minorities, the Bank targets active dispersed ownership of firms – and, from there, the expansion and the internationalisation of stock market capitalisation – to lower the cost of corporate financing. This would ultimately fuel higher economic growth and more efficient allocation of capital.

This approach appears particularly consistent with the World Bank's established doctrine on pension reform which privileges pre-funded private scheme solutions at the expense of tax- and solidarity-based public schemes. The shift from public budget to capital market management of national retirement systems mechanically increases the latter's exposure to market risk, and in particular to equity investment risk (a privileged asset class for pension funds). In this context, corporate governance becomes, in the eyes of the Bank, a risk-management tool to accompany its advocated pension privatisation policies.

Clearly, the original aim of corporate governance to ensure appropriate governance mechanisms in order to secure the long-term interest of the company seems to be of secondary concern. Apart from access to finance matters (dispersed ownership and capital market infrastructure), the relationship between, on the one hand, the Board of Directors and the management, and, on the other, other legitimate parties in the firm, falls under legal compliance matter – as seen, for example, in the World Bank "Doing Business" annual reports.

This is particularly true as regard the rights of workers in the firm. The World Bank's wobbly approach to stakeholder participation (i.e. either as a legal liability matter or as a highly elitist stock options mechanism for executive management) is a serious source of concern. As we have seen, the Bank's interpretation of the

OECD Principles of Corporate governance's section on the rights of worker appears to be minimalist, if not biased.

Last but not least, there is no political dimension associated with corporate governance, no fundamental vision on the role of private corporations to create wealth in society, and in particular no articulation with the broader notions of public interest and public good (outside capital market transparency). There is further evidence that the framework advocated by the World Bank is in opposition to non-common law jurisdictions.

In conclusion, the World Bank's approach to corporate governance – its 'highway to growth' – should be addressed in depth by labour, as it has far-reaching implications in terms of financing for development, of workers' pension systems, of workers' rights to participate in the firm's governance, and of diversity of legal regimes around the world. To offset those threats, the centre of gravity of corporate governance should be shifted from the protection of shareholders' rights to the pursuance of the company's own long-term interest, and its wealth contribution to society. In particular, the following issues and objectives could be addressed:

- To analyse more carefully the linkage between corporate governance and economic growth, by considering total wealth creation by firms, rather than focussing on their access to finance;
- To separate the agendas on corporate governance reform that of pension reform;
- To reconsider more fundamentally the organisation, composition and the duties of the Board of Directors, as the central forum where all core constituencies of the firm are represented;
- To examine seriously worker participation as a positive and dynamic factor of wealth creation process in the governance of the firm, and not a legal liability concern for management;
- To promote the role of shareholders as contributors to the corporations' strategy rather than as short term rent-seekers, and to promote long-term

responsible investors, irrespectively of the shareholder structure, be it dispersed or concentrated;

- To ensure that the discussion on corporate law reform leaves space for a diversity of legal approaches to corporate governance.

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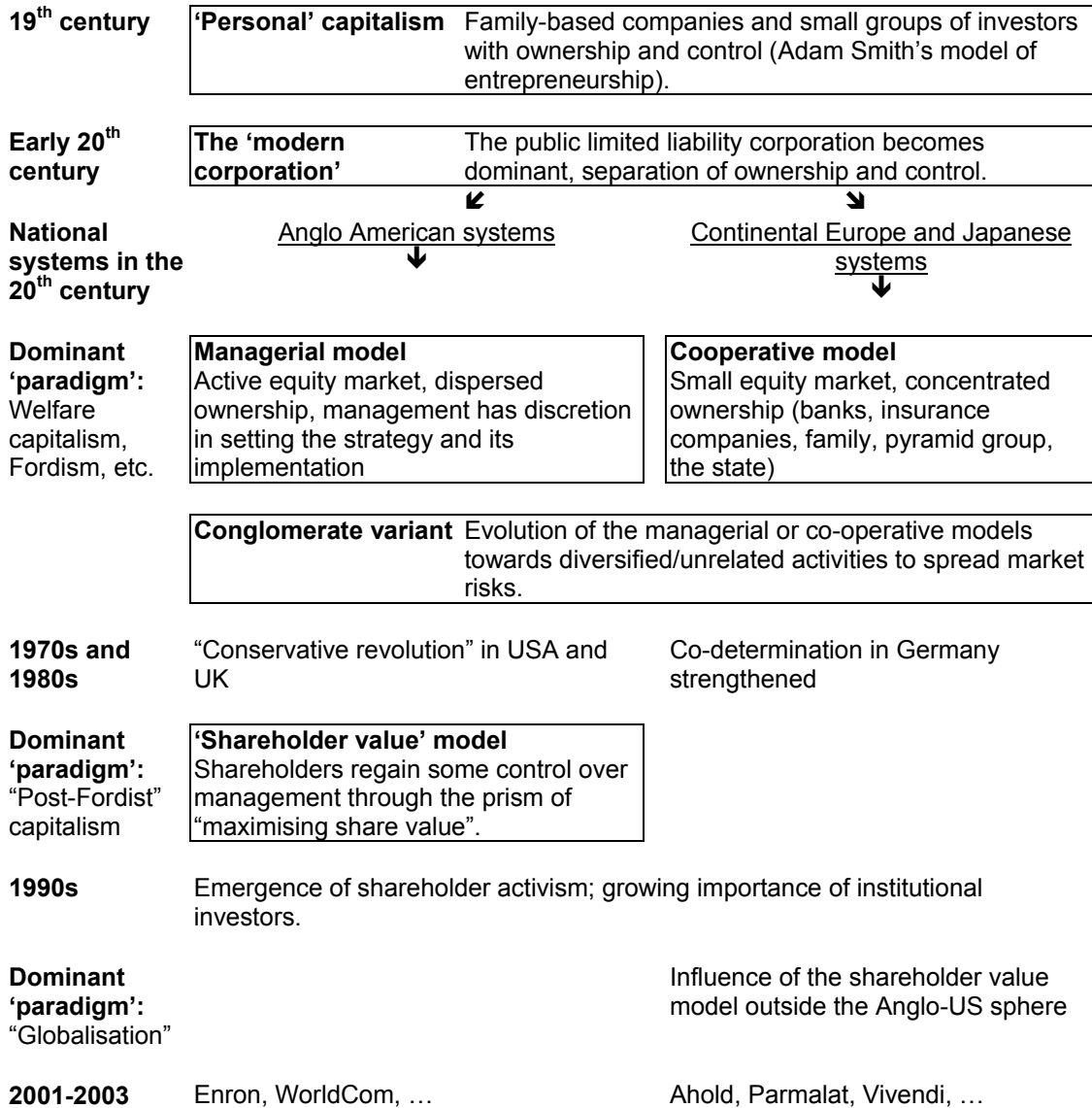
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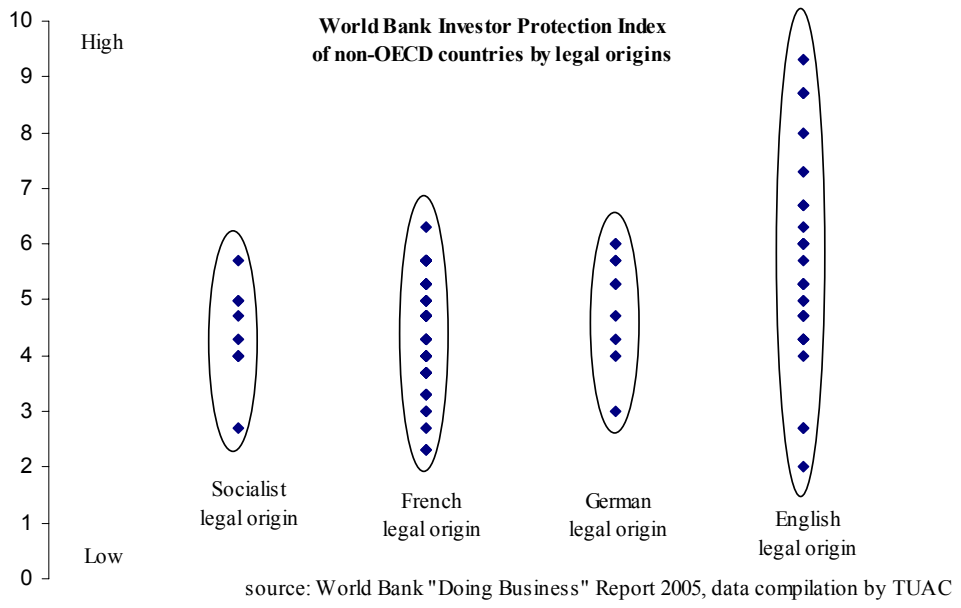
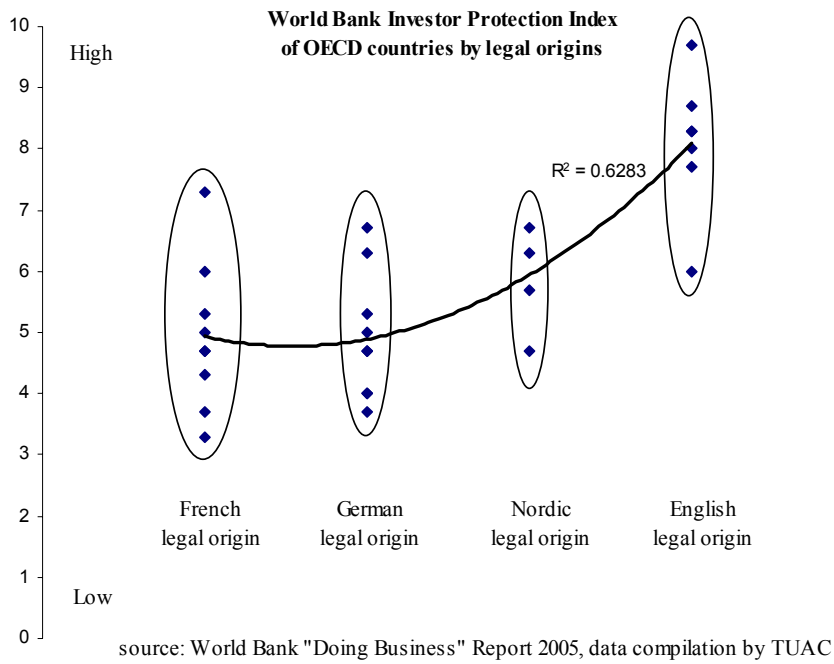
Annex

Annex 1: Historical overview of national systems of corporate governance



Source: TUAC 2005

Annex 2: World Bank Investor Protection Country Index regrouped by legal origin



Annex 3: post-Enron polls relating to public trust in the corporation

US poll CNN/USA Today/Gallup Poll, July 2002

People who can be trusted	Most can be trusted	Can't be too careful with them
People who run small businesses	75%	22%
CEOs of large corporations	23%	73%
Car dealers	15%	81%

Do top executives of a large corporation take improper actions to help themselves at the expense of the corporation?	
Never happens	1%
Occasionally happens	20%
Somewhat widespread	38%
Very widespread	41%

In your opinion which of the following will be the biggest threat to the country [US] in the future: big business, big labour, or big government?			
	August 1999	October 2000	July 2002
Big business	24%	22%	38%
Big labor	8%	7%	10%
Big government	65%	65%	47%
No opinion	3%	6%	5%

Flash Eurobarometer November 2003

For these actors, could you tell me if you trust them for ensuring that globalisation goes in the right direction?			
	Trust	Do not trust	Don't know
Multinationals	31%	64%	5%
Financial circles	33%	62%	5%
Trade unions	45%	51%	4%
European Union	61%	34%	6%
Consumer associations	67%	29%	4%

Annex 4: Stakeholder reference in the implementation of the ROSC corporate governance assessment exercise between 1999 and 2002

The table below summarises the corporate governance ROSC assessments conducted by the World Bank in its client states between 1999 and 2002. The table indicates that, unlike other sections, assessments of Principles relating to workers' rights ("Section III: The Role of Stakeholders in Corporate Governance") are frequently not available (ie. not addressed by World Bank evaluators).

Table 1: Summary Matrix

OECD Principles	Observed/ Yes	Partially observed	Not observed/ No	Not Available
Section I: The Rights of Shareholders				
<i>A. Basic shareholders rights:</i>				
(i) Ownership registration	*****	*****		
(ii) Share transfer	*****	*****		
(iii) Access to information	***	*****		
(iv) Participation and voting at AGM	*****	*****		
(v) Election of board	*****	*****		
(vi) Share in the profit	*****	*****		
<i>B. The right to participate in decisions on fundamental corporate changes</i>				
(i) Amendments to the statutes	*****	*****		
(ii) Authorization of additional shares	****	*****	*	
(iii) Extraordinary transactions (resulting in sale of the company)	****	*****		
<i>C. The right to be adequately informed about, participate and vote in general shareholder meetings (AGM):</i>				
(i) Sufficient and timely information about AGM	*****	****		
(ii) Opportunity to ask question and place items on agenda	**	*****	*	**
(iii) Vote in person or in absentia	*	*****		
<i>D. Disclosure of capital structures and arrangements enabling control disproportionate to equity ownership:</i>	****	*****		
<i>E. Efficient and transparent functioning of market for corporate control:</i>				
(i) Clearly articulated and disclosed rules and procedures, transparent prices and fair conditions	**	*****	**	
(ii) No use of anti-takeover devices to shield management from accountability	**	*****	*	****
(iii) Requirement to weigh costs/benefits of exercising voting rights		**	*****	***
Section II: Equitable Treatment of Shareholders				
<i>A. Equal treatment of shareholders within same class</i>				
(i) Same voting rights for shareholders within each class. Ability to obtain information about voting rights attached to all classes before share acquisition. Changes in voting rights subject to shareholder vote.	*****	****		
(ii) Vote by custodians or nominees in agreement with beneficial owner.	****	**	***	***
(iii) AGM processes and procedures allow for equitable treatment. Avoidance of undue difficulties and expenses in relation to voting.	*****	*****		
<i>B. Prohibition of insider-trading and self-dealing</i>	*****	*****		
<i>C. Disclosure by directors and managers of material interests in transactions or matters affecting the company:</i>	**	*****		
Section III: Role of Stakeholders in Corporate Governance				
<i>A. Respect of legal stakeholder rights</i>	*	*****		*****

OECD Principles	Observed/ Yes	Partially observed	Not observed/ No	Not Available
<i>B. Redress for violation of rights</i>	*	*****		*****
<i>C. Performance-enhancing mechanisms for stakeholder participation</i>	*	*****		*****
<i>D. Access to relevant information</i>		*****		*****
Section IV: Disclosure and Transparency				
<i>A. Disclosure of material information</i>				
(i) Financial and operating results	*****	*****		
(ii) Company objectives	*	*****	*	****
(iii) Major share ownership and voting rights	*****	*****		
(iv) Board members, key executives and their remuneration	**	*****		
(v) Material foreseeable risk factors		*****	*****	**
(vi) Material issues regarding employees and other stakeholders		*****	***	*****
(vii) Governance structures and policies	*	***	*****	**
<i>B. Preparation of information, audit, and disclosure in accordance with high standards of accounting, disclosure, and audit</i>		*****		
<i>C. Annual audit by independent auditor</i>	**	*****		
<i>D. Channels for disseminating information allow for fair, timely, and cost-efficient access to information by users</i>	*****	*****		
Section V: Responsibilities of the Board				
<i>A. Act on an informed basis, in good faith, with due diligence and care, in the best interest of the company and shareholders</i>	**	*****		
<i>B. Fair treatment of each class of shareholders</i>	***	*****		
<i>C. Compliance with law and taking into account stakeholders' interests</i>	**	*****		****
<i>D. Key functions:</i>				
(i) Corporate strategy, risk policy, budgets, business plans, performance objectives, implementation and performance surveillance, major capital expenditures, acquisitions, divestitures		*****		
(ii) Selection, monitoring, replacement of key management	**	*****		*
(iii) Key executive and board remuneration, board nomination	*	*****		*
(iv) Monitoring of conflict of interest of management, board members, and shareholders, including misuse of corporate assets and abuse in related party transactions.		*****	**	*
(v) Ensuring integrity of accounting and financial reporting systems, including independent audit, systems of control, compliance with law	*	*****	*	
(vi) Monitoring governance practices and making necessary changes	*	***	***	***
(vii) Overseeing disclosure and communication	***	*****	*	**
<i>E. Objective judgement on corporate affairs:</i>				
(i) Assignment of non-executive board members to tasks of potential conflict of interest (e.g. financial reporting, remuneration)	*	*****	**	*
(ii) Devote sufficient time to their responsibilities	*	*****	*	**
<i>F. Access to accurate, relevant, and timely information</i>	***	*****	*	**

(source CAPAUL & FREMOND 2002)

Annex 5: Extracts of the World Bank 'ROSC' Template for Corporate Governance Assessment

OECD Principles (2004)	World Bank Checklist (2005)
<p>IV. A. The rights of stakeholders that are established by law or through mutual agreements are to be respected.</p> <p>In all OECD countries, the rights of stakeholders are established by law (e.g. labour, business, commercial and insolvency laws) or by contractual relations. Even in areas where stakeholder interests are not legislated, many firms make additional commitments to stakeholders, and concern over corporate reputation and corporate performance often requires the recognition of broader interests.</p>	<p><u>Q 192 Do any laws provide rights to stakeholders to participate or have input in the corporate governance of the corporation? Does the corporate governance framework recognize those rights, or any other rights that may be provided as a result of mutual agreements?</u></p> <p>[Q193 on voluntary CSR codes]</p> <p><u>Q 194. Please provide a brief overview of labor relations and employee rights in your jurisdiction, including relevant legislation.</u></p> <p><u>Q 195. Please discuss any specific employee rights, e.g. the right to be represented on boards (supervisory board) or consultation with trade unions during restructuring.</u></p> <p>[Q 196. on CSR awareness]</p> <p>[Q 197. on mechanisms for stakeholders' redress in case of violation of their rights]</p>
<p>IV.C. Performance-enhancing mechanisms for employee participation should be permitted to develop.</p> <p>[...]. In the context of corporate governance, performance enhancing mechanisms for participation may benefit companies directly as well as indirectly through the readiness by employees to invest in firm specific skills. Examples of mechanisms for employee participation include: <u>employee representation on boards</u>; and governance processes such as <u>works councils</u> that consider employee viewpoints in certain key decisions. With respect to performance enhancing mechanisms, <u>employee stock ownership plans or other profit sharing mechanisms</u> are to be found in many countries. <u>Pension commitments</u> are also often an element of the relationship between the company and its past and present employees. Where such commitments involve establishing an independent fund, its trustees should be independent of the company's management and manage the fund for all beneficiaries.</p>	<p><u>Q 198. Are there mechanisms to allow for employees to participate in company profits, such as share ownership, share options or profit sharing schemes? (If so, please explain and provide examples.)</u></p> <p><u>Q 199. If share options exist: How are such schemes regulated?</u></p> <ol style="list-style-type: none"> a. Are they approved by shareholders at the AGM? b. Are they tied to specific performance goals? c. Are they disclosed in the notes to the financial statements? d. Are they expensed in the income statement? e. Are earnings per share calculated on a fully diluted basis?