Corporate Governance in IFC Financing and the Corporate Governance Development Framework: the IFI Perspective

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Corporate governance definitions

OECD

- Corporate governance involves a **set of relationships** between a **company's management,** its **board of directors, shareholders** and **other stakeholders**.
- Corporate governance provides a **structure** through which the **objectives** of the company are set, the means for achieving of those objectives are defined and which provides **monitoring** of **performance**.
- Good corporate governance should provide appropriate **incentives** for the board of directors and management to attain the **goals** which are in the interests of the company and its shareholders and which should provide effective monitoring, thus encouraging the firm to most **efficiently use its resources** […]

IFC

- Corporate governance refers to the **structures** and **processes** for **the direction** and **control of companies.** Corporate governance concerns the **relationships** among the **management, Board of Directors, controlling shareholders, minority shareholders** and **other stakeholders.**
- Good corporate governance ***contributes to sustainable economic development*** by enhancing the performance of companies and ***increasing their access to outside capital***

Why does IFC care about corporate governance?

- **IFC's Development Mandate**: alleviating poverty, boosting shared prosperity; largest DFI for private sector; promoting sustainable development through ESG

- **IFC as Investor:** risk management of diverse global portfolio; equity exit planning; as an investor, IFC convinced of corporate governance value (in line with CG funds, rating agencies, active institutional investors)

- **Reputation:** IFC needs to manage its reputational risk

- **Value Proposition for Clients**
  - ✓ Providing access to/lowering cost of capital (including our own)
  - ✓ Increasing value and valuation
  - ✓ Enhancing company reputation
  - ✓ Increasing operational efficiency/management of risk

- **Other DFIs - Corporate Governance Development Framework**

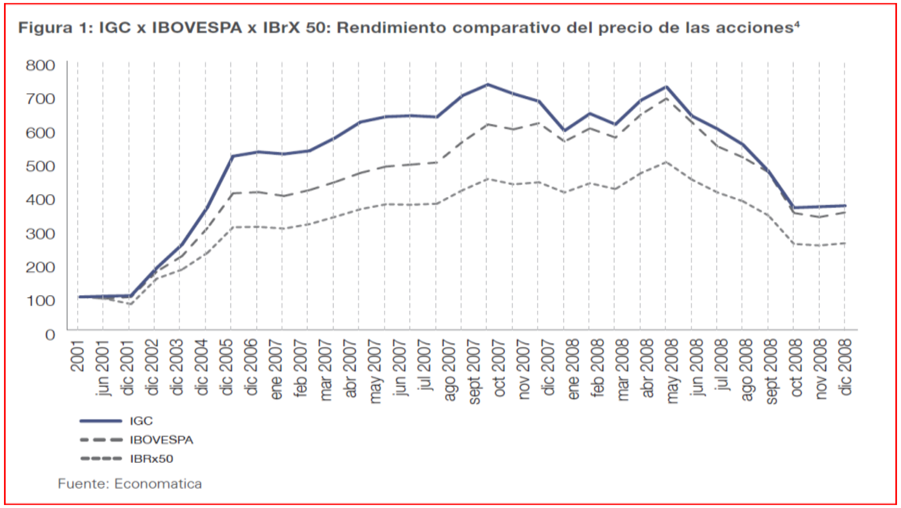
Why does IFC care about corporate governance?

Well-governed companies critical for sustainable investment; poorly governed firms are a financial and reputational risk for investors

- ✓ **Attracting investors:** well-governed companies attract **premium valuations** (research shows that emerging markets investors are willing to pay premium for good governance)

- ✓ **Reducing cost of capital:** well-governed companies get **lower borrowing** costs

Performance of Companies with Strong vs. Weak CG Practices



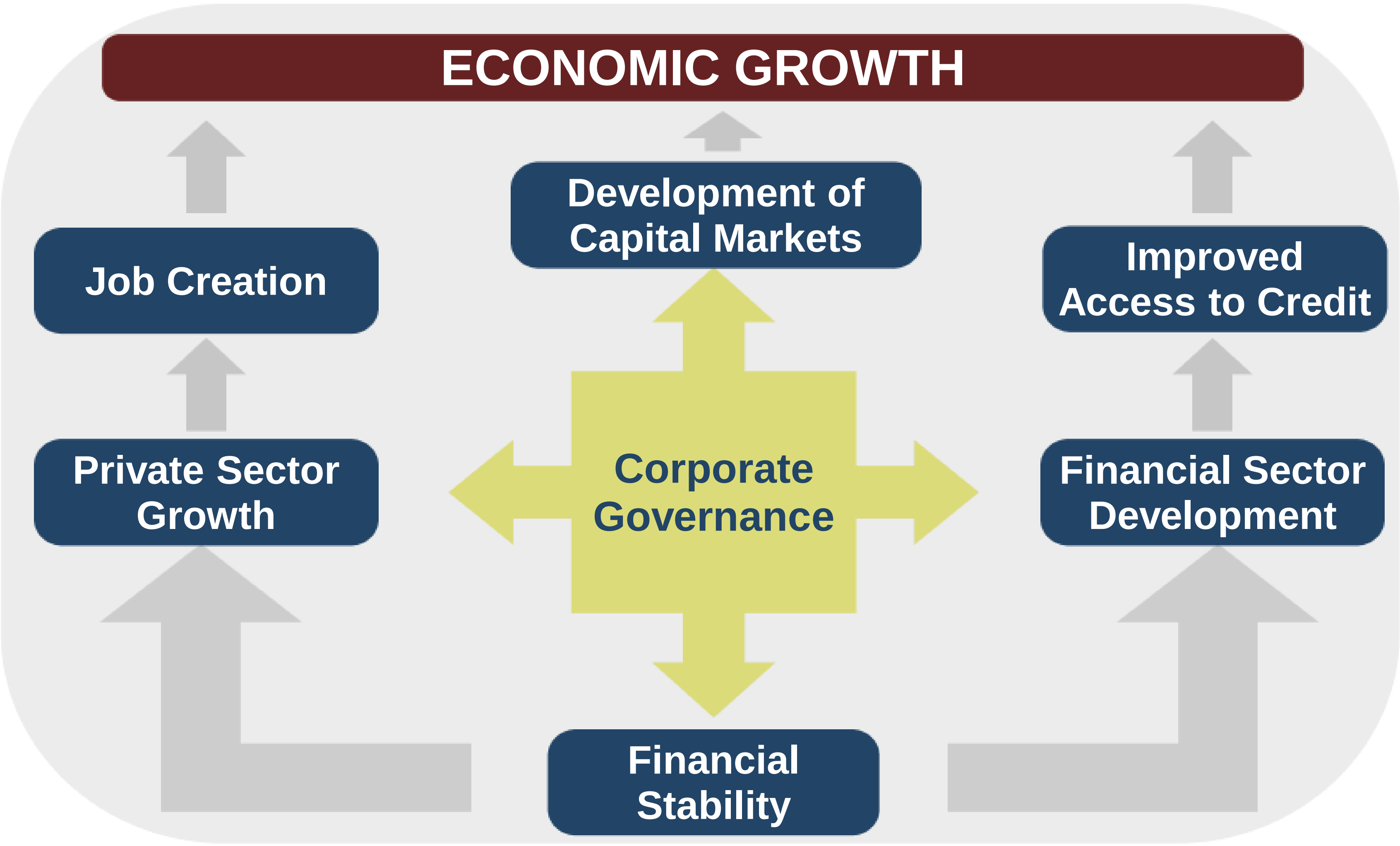
Source: Economatica

- ✓ **Improving performance**: Well-governed companies **outperform competitors** (e.g. Brazilian firms on IGC listing of BOVESPA with better CG performed substantially higher over time than those with weaker practices)

- ✓ **Fewer failures:** recent crisis in the banking sector confirms that better governed companies, especially those with robust risk management mechanisms, experience **fewer losses**

It is a financial and reputational risk for IFC to invest in companies that are not well-governed

Why does IFC care about corporate governance?



Introduction

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How does IFC approach corporate governance?

- Established component of **investment and advisory** offer
- IFC Corporate Governance Methodology: process of analyzing client governance **structures, policies and processes** through application of **developed tools**, supporting investment arm, outlining steps within **appraisal** process and providing **value-added** resource for clients
- Level of corporate governance analysis dependent on
  - risks involved
  - size and equity/debt investment structure
  - complexity of client corporate governance framework

- Analysis of not only risks but also **opportunities**
- Defining **risk mitigation** measures and **improvement** recommendations
- Helping clients with **implementation**

How does IFC approach corporate governance? Six-Step Approach

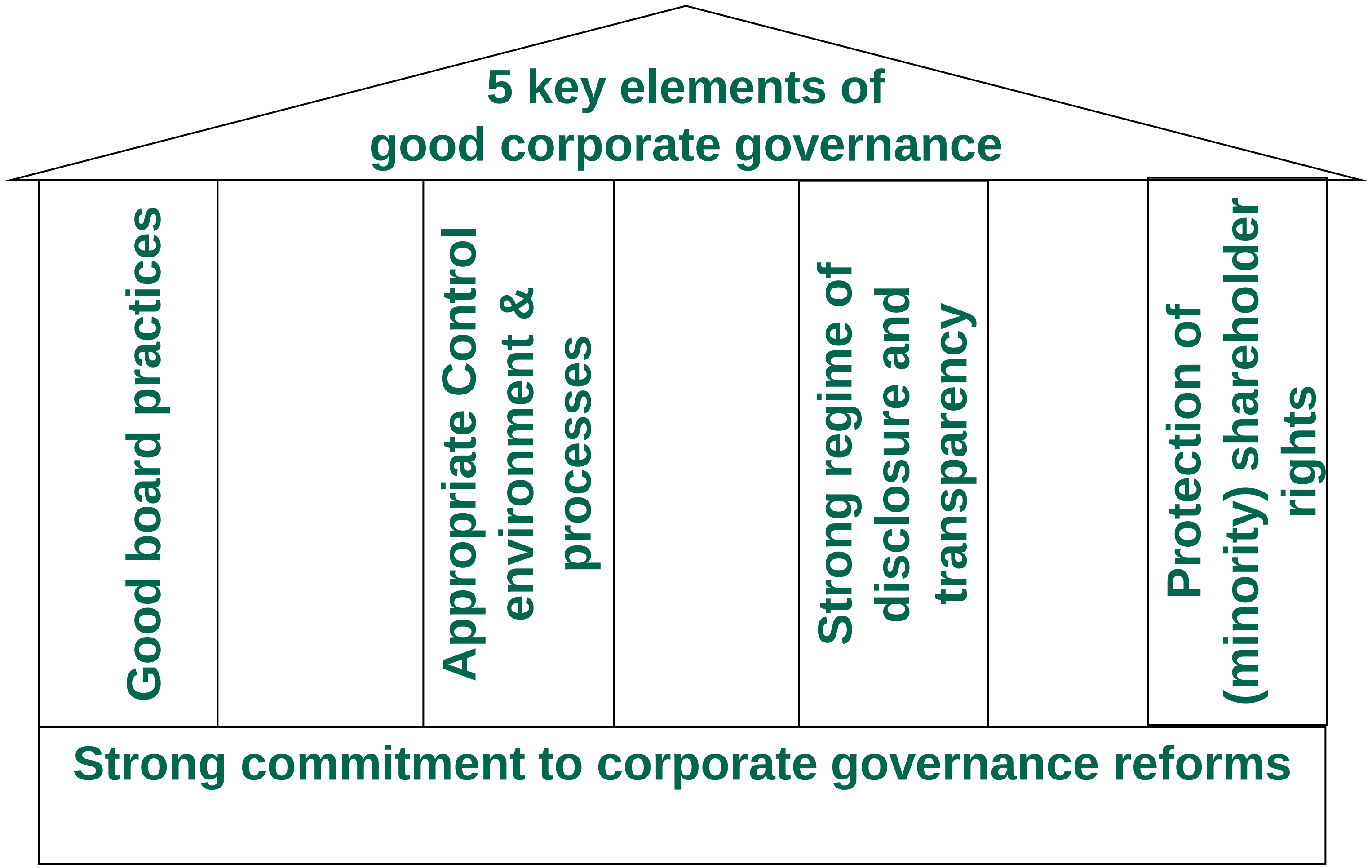
- **First Impressions**
  - **Initial view** whether CG poses special risk/opportunity for value-addition
  - Selection of **Governance Paradigm (listed, family-founder, FI, privatization (transition economy), SOE)**
  - Identification of **specific issues**

- **Client Self- Assessment**
  - Against **Progression Matrix**
- **Corporate Governance Assessment**
  - Information and Documentation Request
  - Completing Questionnaire + Provision of relevant documents
  - On-site: Company Interviews + Documentation Review
  - Preparation of **Assessment**
- **Corporate Governance Improvement Program**
  - **Tailored advice** on bridging gap between best practice and company reality
- **Documentation and Implementation**
- **Supervision**

OECD – IFC Parameters

OECD Parameters	IFC Parameters
• Ensuring Basis for Effective Corporate Governance Framework • Rights of Shareholders and Key Ownership Functions • Equitable Treatment of Shareholders • Role of Stakeholders in Corporate Governance • Disclosure and Transparency • Responsibilities of the Board	• Commitment to Corporate Governance • Structure and Functioning of Board of Directors • Control Environment and Processes • Transparency and Disclosure • Treatment of Minority Shareholders

Corporate Governance Pillars



Corporate Governance Parameters

II. Structure & Functioning of Boards of Directors

Roles/Responsibilities (vis-à-vis management)
Composition, Structure (inc. committees)
Independence and Skills
Remuneration and Evaluation

III. Control Environment

Internal Audit Functions
Internal Control Systems
Risk Management
Compliance

I. Commitment to Good CG

Dedicated CG Officer
Written CG Code
Discloses on CG

IV. Transparency & Disclosure

Financial reporting
Information disclosure

V. Treatment of Minority Shareholders

Shareholders' meetings and Share voting
Representation and Fair treatment
Access to Information

A practical investment-driven definition

Progression Matrix

Core Tool: Simple Progression Matrices

	Level 1	Level 2	Level 3	Level 4
CG Attributes	**Acceptable**	**Extra Steps**	**Major Contributions**	**Leadership**
Commitment to Good CG				
Structure and Functioning of the Board of Directors				
Control Environment				
Transparency and Disclosure				
Treatment of Minority Shareholders				

Progression Matrix

ATTRIBUTES	LEVEL 1 *Acceptable CG Practices*	LEVEL 2 *Extra Steps to Ensure Good CG*	LEVEL 3 *Major Contribution to Improving CG nationally*	LEVEL 4 *Leadership*
A. COMMITMENT TO CORPORATE GOVERNANCE	- The basic foundations of corporate governance are in place. - The Company has a written articulated set of policies or code of corporate governance addressing, at a minimum, the rights and treatment of Shareholders, the role of the Board of Directors and transparency and disclosure.	- The Company has a designated officer responsible for ensuring compliance with the corporate governance code and policies of the Company, and for periodic review of such code and policies. - The Company periodically discloses to Shareholders its corporate governance code and practices and the extent to which such practices conform to voluntary codes of best practice in this country.	- The Company meets all applicable recommendations of the voluntary code of best practices of the country. - The Board has a Governance Committee.	- The Company is publicly recognized as a national leader and among the global leaders in corporate governance.
B. STRUCTURE AND FUNCTIONING OF THE BOARD OF DIRECTORS	- The Board of Directors meets regularly, and deliberates independently of the executive management of the Company. - Board members are provided with adequate information and sufficient time for analysis and deliberation to exercise their duties of oversight and development of company direction and strategy. - The Board includes Directors who are neither executives of the Company or its affiliates nor members of the controlling shareholder group.	- The Board includes two or more Directors independent of management and controlling Shareholders. - The Board has an Audit Committee with a majority of independent Directors that recommends the selection of external auditors to the Shareholders' meeting, reviews and approves the reports of the external and internal auditors and is responsible for overseeing implementation of auditor recommendations. - Board composition (competencies/skill mix) adequate to oversight duties. Annual evaluation conducted.	- The Audit Committee composed entirely of Independent Directors. - A Board committee composed entirely of independent Directors is required to approve all material transactions with affiliates of the controllers, directors or management. - Other Board specialized committees address special technical topics or potential conflicts of interest (i.e. nominating, compensation, risk). - The Board is fully elected on an annual basis.	- The Company's Board is composed of a majority of independent Directors.
C. CONTROL ENVIRONMENT AND PROCESSESS	- The Company has in place an appropriate system of internal controls and internal auditing that regularly interfaces with the external auditors and is responsible to the [illegible] Directors.	The Company prepares and presents financial statements which have been audited by a recognized accounting firm in accordance with International Standards of Auditing.	- The Company's internal control, internal audit and external audit practices are in accordance with highest international standards.	
D. TRANSPARENCY AND DISCLOSURE	- The Company [illegible] are prepared in accordance with an internationally recognized system of accounting and audited by a recognized independent auditing firm. -The Company complies with all disclosure requirements under applicable law, regulations and listing rules (fair disclosure). Investors and financial analysts are treated equally regarding information disclosure.	- The Company publishes [illegible] quarterly reports including segment reporting as well as results per share [illegible] practices to be[illegible] listing requirements. - The Company prepares and presents all financial statements and reporting in accordance with IFRS or US GAAP.	- The Company's financial and non-financial disclosure practices are in accordance with highest international standards. - All disclosure and communications with Shareholders are made available on the internet in a timely fashion.	
E. TREATMENT OF MINORITY SHAREHOLDERS	- Minority Shareholders are provided with adequate notice and agenda of all Shareholders' meetings and permitted to participate and vote at Shareholders' meetings. - The Company treats all Shareholders of the same class equally with respect to voting rights, subscription rights and transfer rights. - All securities holders are treated equally regarding information disclosure (fair disclosure). - Shareholders are provided with accurate and timely information regarding the number of shares of all classes held by controllers and affiliates (ownership concentration).	- Effective representation of minority Shareholders is provided by cumulative voting or similar mechanisms. - The company has clearly articulated and enforceable policies with respect to treatment of minority Shareholders in changes of control. - The Company has a well understood policy and practice of full and timely disclosure to Shareholders of all material transactions with affiliates of the controlling Shareholders, Directors or management (conflicts of interest) and complete, timely and accurate disclosure is made of all material shareholder agreements. - The Company's annual report discloses the principal risks to minority Shareholders associated with the identity of the Company's controlling shareholders, the degree of ownership concentration, cross-holdings among company affiliates, and any imbalances between the controller's voting power and overall equity position in the Company.	- The Company has in place effective shareholder voting mechanisms (which may include super-majority requirements or "majority of minority" provisions) to protect minority Shareholders against unfairly prejudiced actions of controllers when ownership is especially concentrated or controlling Shareholders may have strong conflicts of interest.	The Company's history of equitable treatment of Shareholders evidences consistent conformance with international market expectations.

PROGRESSION

Corporate governance ‘Mainstreaming’ for IFC financing

- **Mainstreaming** requires that corporate governance issues are considered in a consistent structured manner in each **investment**
- **Checkpoints** in transaction cycle for corporate governance evaluation and facilitation of client discussion
- **Tools** for investment team to structure analysis and reporting of corporate governance additionality and risk
- **Specific linkage** between risk-tiering of investment and level of corporate governance intervention
- **5 specific areas** of corporate governance additionality and/or risks to be reviewed and approved

Corporate governance ‘Mainstreaming’ for IFC financing

Mitigation of Corporate Governance Risks

RISK 1 Board not up to overseeing strategy, management, company performance

No proper “check and balance” of managers; succession planning/key-man

RISK 2 Risk management/controls insufficient for sound stewardship of assets and compliance with regulation

Operating systems failure; inadequate/non-existing internal audit

RISK 3 Financial disclosures not relevant, faithful, timely representation of its economic transactions and resources

Fraudulent numbers shared with investors/capital markets

RISK 4 Minority shareholders’ rights are inadequate or abused

Minority shareholders’ rights trampled or they need courts for recourse

RISK 5 Potential investee/its shareholders have not demonstrated commitment to implementing high quality governance policies and practices

Much of what investors see is window-dressing

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DFI Corporate Governance Development Framework

Common Corporate Governance Approach for Investors in Emerging Markets

- IFC methodology distilled into *Corporate Governance Development Framework*, a common approach adopted by 31 DFIs for use in *investment processes* – evaluating/improving governance practices, risks and opportunities in investee companies

- Signatories cover most emerging markets (Africa, Latin America and Caribbean, Asia, Middle East, Europe and Central Asia) representing assets of more than $850bn

- Result of extensive collaboration among members of DFI Corporate Governance Working Group (representatives of several IFIs)

Who signed up? Thirty-three signatories

AFRICAN DEVELOPMENT BANK GROUP

AFREXIMBANK African Export-Import Bank *The Trade Finance Bank for Africa*

ADB Asian Development Bank FIGHTING POVERTY IN ASIA AND THE PACIFIC

BCIE

BANCOLDEX BANCO DE COMERCIO EXTERIOR DE COLOMBIA S.A.

bio Development through Investment

Black Sea Trade & Development Bank

BNDES O BANCO DO DESENVOLVIMENTO DE TODOS OS BRASILEIROS

CAF DEVELOPMENT BANK OF LATIN AMERICA

CDC CAPITAL for DEVELOPMENT

COFIDES

DBSA Development Bank of Southern Africa

DEG KFW BANKENGRUPPE

European Bank for Reconstruction and Development

European Investment Bank

VNESHECONOMBANK

FINNFUND

FMO Entrepreneurial Development Bank

IDB

IDC Industrial Development Corporation

nacional financiera Banca de Desarrollo

IFC International Finance Corporation World Bank Group

ifu

IIC Inter-American Investment Corporation Member of the IDB Group

NORFUND

OeEB

Proparco GROUPE AGENCE FRANÇAISE DE DÉVELOPPEMENT

SIFEM SWISS INVESTMENT FUND FOR EMERGING MARKETS

BMI SBI

PTA BANK BANQUE DE LA ZEP

SOFID

Swedfund

Corporate Governance Development Framework: Milestones

- **Paris, June 2004:** Introduction and sharing of IFC Corporate Governance Methodology
- **Amsterdam, March 2007:** DFI Corporate Governance Approach Statement/Corporate Governance Working Group
- **Tunis, October 2008:** Strengthening corporate governance collaboration among DFIs
- **Rio de Janeiro, November 2009:** Assessment/agreement on creating common Corporate Governance tools
- **Jeddah, January 2011:** Introduction of DFI Toolkit on Corporate Governance
- **Washington DC, September 2011:** Signature of Corporate Governance Development Framework by 29 DFIs
- **Cologne, February 2012:** Introduction of Corporate Governance Development Framework
- **Manila, February 2013:** Implementation of Corporate Governance Development Framework and 2 New Signatories
- **Washington DC, March 2014:** Annual Meeting and 2 New Signatories

Corporate Governance Development Framework: Key components

Integrate Corporate Governance analysis into investment operations

- ✓ Adopt corporate governance procedures and tools in line with Framework methodology
- ✓ Conduct corporate governance assessments of investees; develop action plans
- ✓ Monitor progress of implementation of corporate governance action plans

Ensure internal responsibility

- ✓ Assign internal function responsible for implementation of the Framework

Provide or procure training

- ✓ Ensure capacity-building/knowledge-transfer to staff for implementation and further development of Framework

Collaborate with other signatories

- ✓ Share experience and resources in training and implementation

Report on implementation

Development Framework Signing Event, September 23, 2011 - World Bank/IMF Annual Meetings

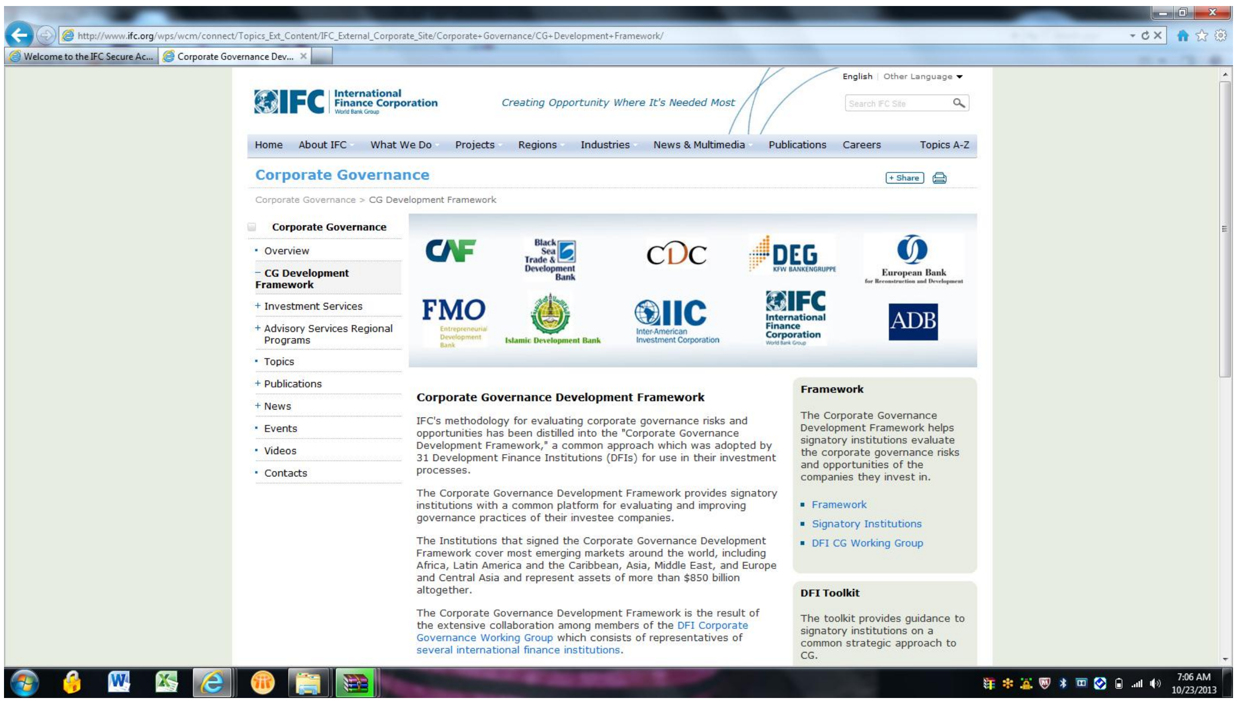
*"By **adopting a common approach**… we will be setting **consistent standards** for corporate governance due diligence and **common expectations** from our clients…thereby **raising the bar** for corporate governance in emerging markets."*

Lars Thunell, Sept. 23, 2013
IFC, Executive Vice-President

Development Framework: More information

www.cgdevelopmentframework.org

www.ifc.org/cgdevelopmentframework



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Corporate Governance Features in Western Balkans

- **IFC Role, 2006:** company work; framework; capacity-building; awareness-raising; regulator support
- **Conflicts** between **insiders/outsiders**, **controlling/minority** shareholders (less so owners/managers)
- **Privatization legacy** and **reality; state-owned** enterprises; **unreformed public sector**
- Weak **Boards**, non-professional management
- **Non-disclosure** of beneficial ownership; weak financial disclosure and transparency practices
- Passive **shareholders; lack of activism**
- **Family business** domination - key economic sector; lack of succession-planning
- Laws and codes generally adequate – implementation, enforcement weak
- Relevance of ‘comply-and-explain’?
- Company laws often changed in patchwork approach
- Countries generally seek to be open to ‘best’ international/European practices
- Some have advanced laws that are stated as coming into force on EU accession
- **Capital markets** are weak; resources lacking for implementation; minimal benefits from being listed; mentality is bank resort; business case can be lacking; ‘race to bottom’?
- **Central banks** generally strongest and most committed – but only FIs, real sector often decade behind

Common issues: Possible responses

Concentrated ownership: agency problems between controlling and minority shareholders	Clearly Articulate Shareholder Treatment Policies
Ineffective Boards (poor capacity, passive approach, low independence)	Strengthen Boards (e.g., composition and procedures)
Conflicts of Interest; RPTs	Introduce Board Committees and Other Mechanisms to Handle Conflicts
Minority Shareholder mistreatment, especially in change of control situations	Strengthen Internal Controls and Risk Management
Succession / Family Business Issues	Clear succession policy, introduce family governance organs
Transparency / Internal Controls / Internal Audit Function	Introduce Audit Committees (Financial professionals to improve accounting and auditing

Thank you

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www.ifc.org/corporategovernance