

# 3<sup>rd</sup> CSR Summit

## Role of Regulation in Ensuring Effective Corporate Governance

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# Role of regulation in ensuring effective corporate governance (1)

## 1. Voluntary compliance versus regulation

➤ Strict regulation through corporate codes –USA  
***If things are going wrong then, practice as usual, regulators step up with new rules to fix it***

➤ Principle based, (a more hands-off) “comply or explain” approach in UK and EU in general

***“It is through shareholders exercising informed influence over companies that their expectations and those of the wider community will be best met.” Consultation document OFR, UK***

Yet, we see more regulatory change in Europe in future. It is a gradual process.

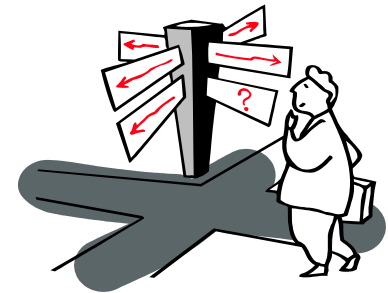


# Role of regulation in ensuring effective corporate governance (2)

## 2. Regional/cultural differences

- Countries with deep and developed capital markets, US and UK divided by common language

Case: Whistleblower conflict between CNIL of France, EU, and SOX of USA



# Role of regulation in ensuring effective corporate governance (3)

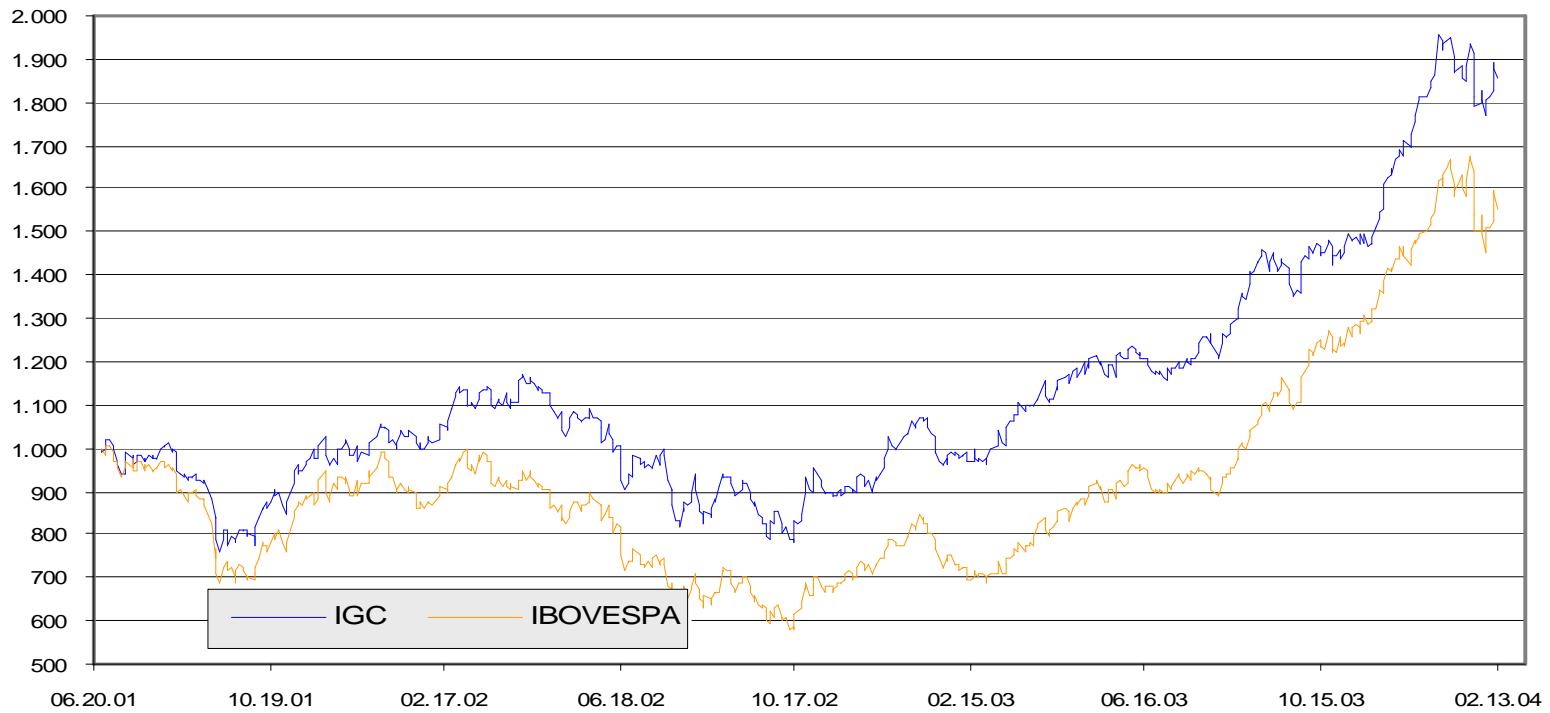
- Emerging financial markets like BRICs, Portugal, countries in the MENA region, Turkey....
  - Weak legal and regulatory systems – no specialized courts
  - Lack of international reporting standards and failure of auditing
  - Underdeveloped and unregulated capital markets-weak investment culture
  - Banking failures
  - Ineffective oversight by corporate boards
  - Failure to protect minority shareholder rights

Case: Novo Mercado, Brazil

Case: Portugal merger with Euronext



# IGC – IBOVESPA 26/6/2001 – 16/2/2004



# Regulation led to the transformation of corporate governance - the upside

- ✓ More transparency
- ✓ Not any more only academic - business realize they have to get it right
- ✓ More emphasis on internal control and risk management, Turnbull report(2005)-UK; 8th directive-EU, SOX section 404
- ✓ Increased sensitivity of accounting and auditing profession to conflicts of interest and public interest
- ✓ Executives adjusting their decision according to what shareholders are thinking-market forces e.g. Deutsche Borse affair
- ✓ Convergence in IFRS to reduce double reporting, harmonization with US GAAP
- ✓ Separating the role of CEO and the Chair



# The pressure of regulation-unforeseen ramifications - the downside (1)

- Compliance burden
  - SOX Section 404 171 words long, interpretation by PCAOB 20,000 words, guidance 100,000 words
  - estimated compliance cost \$91,000, actual; \$1.613ml for external auditors + \$1.894 ml for internal compliance
  - Consequence 2005 listings; 129 in LSE,  
6 in NYSE  
14 in NASDAQ

NYSE → Euronext  
NASDAQ → LSE

**Is excessive & costly regulation having a stifling effect on capital formation and economic growth??**



## The pressure of regulation-unforeseen ramifications - the downside (2)

- Companies going to private
- Difficulty in exit routes for minority shareholders
- No differences with multinationals, medium-sized companies, or even start-ups
- Accounting companies becoming more introverted-auditors risk-averse
- Risk of best practices being interpreted as “rules” by law companies
- EU 8th Directive and Transparency Directive ≈ SOX of Europe??



# Regulation From the Perspective of Shareholders-the Investors

*Upside,*

- Higher confidence
- Better access to better information

*Downside,*

- Money-wise costs of improved corporate governance

*Needs further improvement*

- Cross-border voting, proxy voting

***Ambiguity***

**Good governance**



**better performance**



# Voluntary Compliance or Regulation -Stakeholders-

1. Responsible business conduct to ensure;
  - Company reputation and public image which add to the company value
  - Open dialogue with gatekeepers
2. Transparency and accountability in
  - Labour relations
  - Environmental management
  - Social issues such as human rights, consumer protection
  - Ethical issues such as fighting bribery and corruption



# Voluntary Compliance or Regulation -Private Companies-

1. Can have considerable impact on the economic health of the country
2. Not immune from the problems listed companies face
3. Being private does not constitute an obstacle to having set of best practices for running an effective company
4. Private equity investors ask for more transparency and accountability in their investments in the non-listed companies
5. Changes & developments are on the way; OECD, New Commercial Law-Turkey, Buysse Code-Belgium



# Conclusions (1)

1. No single model of good corporate governance but convergence in basic principles
2. More harmonization needed in the operation of checks and balances
3. Despite all the anger, regulation (SOX), led to more transparency, and better corporate governance
4. Yet, regulation based only on documentation on controls does not guarantee good governance - avoid box ticking exercise
5. Rules trigger more rules for their clarification & people break rules, but principles embrace judgement



## Conclusions (2)

1. Flexibility is needed; global multinationals, medium sized companies
2. Need to operate market forces more
3. Regulatory initiatives should take into consideration the dynamic relationship among managers, directors and stakeholders
4. Need to raise awareness more in corporate responsibility in managing business risks – especially non-financial ones
5. Corporate responsibility is the linchpin of the global market system



## Conclusions (3)

1. Shareholders also have to assume responsibility, and not react with short-term perspectives – should become “share-owners”
2. Regulators should learn to look beyond differences, and find a way to walk the path together
3. Regular maintenance of the good governance is the main issue
4. The future might be easier but with more complexity
5. Awareness is better than being broken by experience

