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Presentation of Synthesis Note on International Experts Meeting on Corporate Governance of Non-listed Companies

By

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Background

- International Experts meeting on Corporate Governance of Non-listed Companies (NLCs) held in Istanbul on 19-20 April 2005 organized jointly by OECD and Government of Japan to:

Discuss policy implications of the on-going debate on corporate governance of NLCs.

Shed light on relevance of OECD principles of corporate governance in countries where NLCs and family/founder-owned companies play pivotal economic and social role.

Analyse and discuss the corporate governance challenges and opportunities for NLCs in the search for external capital.

Important Policy Issues (arising from Meeting)

- The corporate governance characteristics of NLCs.
- The driving forces for changing corporate governance practices in NLCs.
- The role of a public policy framework in supporting good corporate governance of NLCs.

Corporate Governance Characteristics of NLCs

- *The contemporary corporate governance debate*
- *Corporate governance and the variety of NLCs*
- *Internal and external mechanisms of good corporate governance*
- *Professional management*
- *Transparency requirements*

Contemporary Corporate Governance Debate

- Need for creating effective measures and improved institutions to stimulate social welfare and economic growth.
- A corporate governance framework elaborated for NLCs could help define internal and external stakeholders’ expectations *ex ante* and assist judiciaries, auditors, lawyers and other professionals in solving problems *ex post*.

Corporate Governance and the Variety of NLCs

- NLCs: Closely held companies whose shares, unlike those of public held companies, do not trade freely in impersonal markets, either because the shares are held by a small number of persons or because they are subject to restrictions that limit their transferability.
- A variety of NLCs were distinguished: family-owned, state-owned, group-owned, private investor-owned, joint ventures, and mass-privatised companies.
- NLCs are characterized by small number of shareholders, no ready market for company’s shares and substantial majority shareholders participation in management and operation.

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- Different internal and external corporate governance mechanism are employed by NLCs (*e.g.* size, board, management, supervision, legal business form).
- They are often unable to obtain bank finance due to high risk and rely on family for finance.

Internal and External Mechanisms of Good Corporate Governance

- An effective system of corporate governance for NLCs depends on presence of internal and external mechanisms that are sufficiently responsive to their governance problems.
- Incentive compensation and stock option can motivate managers to pursue risk-taking and bench mark performance in accordance with shareholders' expectations.
- In absence of market for corporate control for NLCs a more complex mechanism is required to control abusive and under performing managers and shareholders.
- Institutions like independent registrars and chambers of commerce, to be created and existing strengthened to ensure corporate governance compliances to increasing trust in market.

Professional management

- Need for strong board oversight. Independent non-executive directors can play key role.
- No simple solution to defining independence.
- Alternative - appointing competent rather than independent-outside directors (e.g. professionals), foster professionalism, competency and self-discipline by training, education etc.

Transparency requirements

- It was argued that giving shareholders full and timely access to information enhances the governance of both listed and NLCs and reduces imperfections and information asymmetries.
- Mandatory disclosures for NLCs was considered as costly against benefits in return, due to: loss of personal privacy, loss of competitive position, undermining of private property rights, direct compliance costs, and administrative costs.
- Others felt mandatory disclosure provides access to information to stakeholders other than shareholders and managers, encourages business participants to analyse and understand the business. Costs can diminish with open and clear communication. Disclosures prevent corruption and overly risky business activities.
- Transparency could serve as a risk management tool.

Driving Forces for Changing Corporate Governance Practices in NLCs

- *Access to capital and implications for corporate governance*
- *Succession planning and conflict resolution*

Access to Capital and Implications for Corporate Governance

- Increased information symmetry between the controlling shareholder and management creates a more secure and stable environment for long-term investment strategies.
- Debt viewed as a disciplining device to align managers' and shareholders' interests as defaults deprive managers from control.
- Private equity investors encourage the implementation of good corporate governance.
- Venture Capital Associations promulgate principles that held increase respect, integrity, transparency and confidentiality.
- Banks and Credit Agencies can promote good governance by insisting on observance as part of risk assessment process.
- More research is needed.

Succession Planning and Conflict Resolution

- Potential conflict of interest issues can be resolved by formalisation of the board's decision-making process that reveal information to shareholders and increase involvement of non-controlling shareholder.
- Family council can anticipate internal strife and disruption before occurrence.
- Overemphasis of legal and regulatory protection of minority shareholders might exacerbate potential conflict in family owned businesses.
- Careful and timely succession planning with a focus on training and education is crucial in a well-developed corporate governance system for family-owned firms.

Role of Public Policy Framework in Supporting Corporate Governance in NLCs

- Proper disclosure practices by boards – rights of inspection of company records.
- Accessibility and legal sophistication of judiciary and court system are essential to exercising shareholder rights.
- Within the boundaries of company law, business participants should have discretion to adopt through contracts voluntary governance structure for better mechanisms.
- Corporate governance codes usually based on OECD principles though framed for listed companies could provide improved framework for NLCs also.
- No separate code for NLCs was favoured.

Follow Up Action

The Kick-off meeting contributed greatly to better understanding of corporate governance problems and solutions of NLCs. However, many issues remain unresolved and further discussion and research is necessary. Discussions should continue at Regional Corporate Governance Roundtables. It was agreed:

- No requirement of a a separate set of corporate governance principles or guidelines. A code in addition to the existing local codes and OECD principles could easily overstretch regulators.

- Internal mechanisms for improving corporate governance in NLCs should address improving transparency of decision making process as well as training and education for managers and shareholders. OECD could play a useful role in creating awareness.

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- More research is needed also about the circumstances in which legal and regulatory mechanisms provide a more efficient alternative to the generally preferred contractual arrangements.
- International Finance Corporation’s corporate governance methodology for family-owned or founder-owned unlisted companies provides a useful tool that should be further discussed.

Thank You

Views and suggestions may be forwarded to Mr. Louis Bouchez at Louis.BOUCHEZ@oecd.org

Full text of the Synthesis Note is available on
www.oecd.org/daf/corporate-affairs