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Why Corporate Governance Matters for Vietnam

OECD/ World Bank Asia Roundtable on Corporate Governance

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Morning Session: Corporate Governance – A Working Definition

Teresa Barger, Director, IFC/ World Bank Corporate Governance Department

Corporate Governance – A Working Definition

Teresa Barger
Director
IFC/ World Bank Corporate Governance Department

Good morning and greetings to all of you.

I am very pleased to be here today and want to thank our co-host, the Ministry of Finance, for all of their work organizing this meeting and for their coordination of invitations, materials and speakers today. I am certain that today will be a very constructive session, a good review and starting point for what we hope to be a very interesting two year IFC-OECD program of activities in corporate governance. As you can see from the agenda, this meeting will cover a broad array of corporate governance themes and the application of good corporate governance practices in many types of business organizations. Future sessions will focus on more specific topics such as the role, composition and functioning of the board of directors, shareholder's rights, internal and external audit and transparency and the disclosure of financial information. Activities focused on the corporate governance of particular types of enterprises may also be undertaken.

As this is the first meeting, I would like to give you IFC's point of view on why corporate governance is important, not just for us as outside investors, but for the Government of Vietnam, for Vietnam's long-term economic success, and for the benefit of individual companies themselves. Good corporate governance in a business enterprise promotes operational efficiency, professional management, clear lines of authority and good risk management, all of which promote business success and improved profitability. Companies who turn to outside sources of capital, as some of you no doubt are currently contemplating, will need to demonstrate sound governance to investors and lenders. Outside investors, like IFC, equate good corporate governance with operational success and lower investment risk, and therefore are more likely to work with companies that have made strides in this area. Governments, and the people they serve, benefit from better corporate governance by increased transparency, leading to a more fair collection of tax revenues, and the development of a level playing field for fair competition. Fair competition leads, ultimately, to faster economic growth as individuals and companies see that their investments will be protected, allowing them to invest in increased productive capacity. Investment in production leads to better technologies, better products, increased employment and a growing economy better able to support an improving social infrastructure. So corporate governance and investment are part of a virtuous circle.

I am the Director of the IFC/WB Corporate Governance Department, and as such, I would like to first tell you a little bit about our work. Though my Department is relatively new, IFC and the WB have been working both separately and in cooperation on corporate governance issues for many years. As the private sector investment arm of the World Bank Group, IFC developed and is constantly improving its methodology for analyzing and addressing corporate governance in companies with whom we are partnering. Corporate governance is an important part of our decision-making process and we work with our clients to find practical solutions to corporate governance challenges. The World Bank is also working diligently on corporate governance, and supplies governments with unbiased assessments of their corporate governance infrastructure. We are working with the Ministry of Finance to get started on just such a review for Vietnam. Corporate governance has also been an issue of special attention for the World Bank's local office. Its Vietnam office has conducted training of directors, a survey of corporate governance in

Vietnam and is now working on a corporate governance banking program with the State Bank of Vietnam - another active partner in improving corporate governance. The Mekong Private Sector Development Facility (the "MPDF"), established by IFC, is working together with CIEM on the Unified Company Law. Representatives from the MPDF will present some preliminary survey results related to this work later today. Finally, IFC is planning a new corporate governance technical assistance program for Vietnam which will have as its focus the provision of assistance directly to private companies to improve their corporate governance. This effort will be a topic of continued discussion and will benefit from financial support from donors. We expect it to be an important contribution to developing a culture of good corporate governance in Vietnam.

So, what is corporate governance? Why is the term "corporate governance" now being repeated in meetings of this sort all around the world? Is this some new discovery on the part of investors and business people?

Quite the contrary. The term "corporate governance" came out of a seminal analysis by two American academics in the 1920s who were looking at the growing separation of ownership and control in the modern corporation. When ownership takes the form of disbursed shareholding, and professional managers take the place of the family structure or the government in running a company, there needs to be a system of control over those managers to ensure that the company is run in the interests of the shareholders and society at large. In fact, a much-quoted definition of corporate governance comes from Sir Adrian Cadbury, father of the core of the UK Combined Code on corporate governance which regulates corporate governance in UK companies. His definition of corporate governance is “the system by which business corporations are directed and controlled” - it is as simple as that. The OECD Principles of Corporate Governance, which Daniel just spoke about, and which are the basis of our meeting here today, grew out of the Cadbury definition and stipulate that any assessment of corporate governance in a country should encompass the roles, duties and powers of shareholders, the board of directors and company management, and should also include transparency and disclosure as well as the place of the corporation in society at large.

In the modern corporation, there are three levels of control of the business. At the highest level, the shareholders are the owners of the assets and liabilities of the corporation. Importantly, their personal liability is limited to the amount of their financial investment in the corporation. They may have become shareholders by providing the initial funding to start the company, or because they founded and built up the company themselves. More often, shareholders buy shares of the company on an organized market as a financial investment in order to receive dividends from the profits of the company or to benefit from the rise in the value of the company as the business grows. In Vietnam, many citizens have become shareholders through the equitization process or by starting and growing their own businesses. As owners, shareholders need a system which allows them to provide input into the overall strategy and direction of the business and to ensure that they will benefit from the growth of the business through increased dividends and the growth in value of the company overall, which is reflected in the price of its shares. This is the top level of governance in any corporation and the power of the shareholders, the company's owners, is exercised through the formality of the general meetings of shareholders. The powers of a meeting of shareholders are outlined in both company law and the charter of the company.

However, shareholders cannot meet every week, or even every month, so they must appoint a second layer of control empowered to oversee the managers who run the day-to-day operations of the company. This second level, the Board of Directors, is elected by the shareholders to protect their interests. The powers and responsibilities of the Board of Directors are also defined both in law and in the charter of the company. Board members must act always in the best interest of the company as a whole, rather than for the benefit of particular shareholders or outside influence. They must put the financial success of the company before their own interests, especially if they are shareholders themselves. The central role of the Board of Directors must therefore be to ensure that the company fulfills its responsibilities to shareholders, the government, the company’s business partners, lenders, suppliers and customers, and also to society at large. When in the judgment of the Board of Directors the management of the company is not fulfilling these obligations, it is the Board's obligation to intervene and ensure that the interests of shareholders and other stakeholders are served.

There will be much discussion in these meetings about the ideal composition of Boards of Directors, with an emphasis on independent directors playing an essential role by contributing an unbiased view of what is best for the company as a whole. Shareholders may focus only on dividends, government officials may focus on increasing tax collection or employment, bankers may focus only on the repayment of loans, but it is the responsibility of each Director to reach a balance of all these influences which will allow for the growth of the company while protecting the interests of all parties with valid claims on the activity of the corporation.

Boards of Directors and their committees meet throughout the year and provide guidance and oversight to the managers of the corporation. They are responsible for the selection, evaluation and compensation of management.

This brings us to the day-to-day operators of the corporation - the management. Often with titles like Chief Executive Officer and President, the top executive of the company is given considerable freedom by the shareholders and the Board of Directors to run the business operations of the corporation. This freedom of operation is very important as it provides for a clear chain of command within the operations of the company and ensures that it is the top executives who can be held accountable for the performance of the business. It is the responsibility of the executives, whether or not they are shareholders, to manage the affairs of the company in the interest of the company as a whole. If they achieve success, they are rewarded by the Board and by shareholders. If they fail, they are held accountable as well.

These three bodies, shareholders, the Board of Directors and management, account for the basic structure of a corporation. However, the success of several other functions of the corporation are also critical to the effective and legal operation of the business, and as such, we must also consider these functions when we discuss corporate governance.

These additional corporate functions include internal and external audit to ensure quality accounting and transparency of the financial condition of the company and its transactions. As a function of the day-to-day operations of the company, the responsibility for accurate accounting lies with management. However, checks on management in the area of accounting are to be made by an external auditor under the supervision of the Board of Directors. The shareholders must also approve the financial statements of the company on an annual basis. Good systems and impartial analysis are key to ensuring financial transparency in a public company which has the separation between ownership and control that I discussed earlier.

Other important issues include careful succession planning for senior executives; so that the company has an orderly succession of leadership should problems occur. Thoughtful strategic planning is of vital importance to the long-range success of the company so that market changes and opportunities are recognized and acted upon. Fair compensation for managers and board members is important to ensure that they are rewarded for success and loyalty to the company. Access to quality information about the company is important to shareholders so that they can understand what is happening with their investment and make investment decisions according to fact. Finally, all of these bodies of governance of the corporation must work together to ensure that the corporation is functioning within the law and in compliance with all government regulations and laws. Violations of law can lead, as we have seen in the case of Yukos in Russia, to the destruction of the company when law enforcement officials take action on the non-payment of taxes and non-transparency of operations.

So it is with great attention that I will listen to the presentations today as I hope to learn from all of you about the current state of corporate governance in Vietnam. We at IFC and the OECD hope to play a constructive role in the development of corporate governance in Vietnam and we are happy, along with the Ministry of Finance, to bring you all together. However, it is very important to the success of this forum that you, as participants, ask questions and present your views on how best to develop Vietnam's corporate sector. Your comments and questions will be used to determine the topics to be addressed in future meetings. Finally, if the issue of corporate governance can be addressed as companies are equitized and the Vietnamese market grows, we at IFC are certain to be present here as investors and partners in Vietnam's future.

Thank you very much for your attention and your hospitality. I now turn the meeting back over to our moderator so that we can begin our first panel.