THE ROLE OF STAKEHOLDERS
IN CORPORATE GOVERNANCE

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“The corporate governance framework should recognise the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between entities, including family owned businesses and state-owned/controlled enterprises, and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.”

Draft of Corporate Governance Principles
Benefits To Society

- Helps create competitive, modern and healthy companies
- An effective tool against corruption
- Helps attract investment
- Helps foster healthy competition
- Helps prevent banking crises
Perspective of the Corporation

Maximizing value subject to meeting the corporation’s financial, legal and contractual obligations. Board of directors must balance the interests of shareholders with stakeholders: employees, customers, suppliers, investors, communities in order to achieve long-term sustained value. (World Bank)
Figure 1: Modern corporations are disciplined by internal and external factors

Internal

- Shareholders
  - Reports to Board of Directors
  - Appoints and monitors

- Board of Directors

- Management
  - Operates

- Core functions

External

Private
- Stakeholders

Reputational agents
- Accountants
- Lawyers
- Credit rating
- Investment bankers
- Financial media
- Investment advisors
- Research
- Corporate governance analysts

Regulatory

- Standards
  - (for example, accounting and auditing)
- Laws and regulations

Financial sector
- Debt
- Equity

Markets
- Competitive factor and product markets
- Foreign direct investment
- Corporate control

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1. Reputational agents refer to private sector agents, self-regulating bodies, the media, and civic society that reduce information asymmetry, improve the monitoring of firms, and shed light on opportunistic behavior.

Source: The World Bank Group

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Defining Stakeholders

With regard to identifying relationships with stakeholders there is a difference between “taking into account” and being “accountable to” stakeholders. (The Economist)
Stakeholders to be “Accountable To....”

- Banks and creditors
- Institutional investors
- Employees
Defending Stakeholder Interests: Banks and Creditors

- Transparency -- or full disclosure of financial and key performance information
- Laws/regulations preventing conflicts of interest involving boards of directors and managers
- Procedures for bankruptcy
- Enforcement of creditor rights
Defending Stakeholder Interests: Institutional Investors

- Transparency and disclosure
- Duties of the auditor and professional care in the conduct of audits
- Protection of minority shareholder rights
- Procedures for bankruptcy
- Access to information
Defending Stakeholder Interests: Employees

- Transparency and disclosure
- Ethical codes for directors and senior management
- Whistleblower protection
- Well-defined role for employees in corporate governance structures
Developing Countries Need Institutional Reforms

Corporate governance systems depend upon a set of institutions (laws, regulations, contracts, and norms) that create self-governing firms as the central element of a competitive market economy. These institutions ensure that the internal corporate government procedures adopted by the firms are enforced and that management is responsible to owners (shareholders) and other stakeholders.
Concentrated Ownership in Brazil

- CIPE/OECD survey revealed only 5% of large firms and only 33% of medium firms are widely held.

- Family Owned Firms:
  - Agency Conflict – in family owned firms occurs in successor generation and in relationship with banks.
  - Pyramid Structures – firms controlled by families holding small number of controlling shares.
  - Dual Class Shares – minority shareholder’s don’t have the same rights as majority shareholders.
Family Owned Firms in Colombia

- Ownership and control - 68% of corporations are family owned and out of those 59% are still managed by the founders.

- Poor survival rate – only 8.5% of family firms have specified procedures for managerial succession and only 13% of family business survive to 3rd generation.

- Little access to capital markets – only 124 out of 148,000 legal enterprises are listed.
Western Hemisphere Experience

- Brazil—Instituto Brasileiro de Governança Corporativa (IBGC)
- Chile—Universidad Católica/Chamber of Commerce/Center for Excellence in Governance
- Colombia—Confederation of Chambers of Commerce and Industry (Confecámaras)
- Peru—Procapitales and the Universidad de Ciencias Aplicadas (UPC)
Emerging Consensus

• For businesses to succeed in the world economy, they must have healthy corporate governance mechanisms including rule of law

• Building corporate governance in developing countries requires refashioning institutions

• Private sector must participate in developing governance mechanisms

• The reward is increased investment and growth
Strategy for CG Reform

1. Initial Assessment and Advocacy
2. Outreach and Institutional Development
3. Capacity and Institutional Development
4. Consolidation
Initial Assessment and Advocacy

- Assess corporate governance failures
- Rate country standards v. best practice
- Adapt OECD principles
- Build awareness at senior business and policy levels
- Identify stakeholders
- Create broader public demand for reform
- Public education campaigns
Outreach and Institutional Development

- Develop corporate governance codes and internal control mechanisms
- Foster shareholder activism
- Improve regulatory and enforcement frameworks
- Create informal corporate governance promotion networks within civil society, business, and regulatory bodies.
Capacity and Institutional Development

- Training and certification programs for managers and directors
- Establishment of Institutes of Directors
- Create corporate governance ratings systems for investors
- Training for financial intermediaries
Consolidation

- Further strengthen shareholder rights groups and Institutes of Directors
- Risk ranking by ratings agencies
- Reports on Standards and Codes (ROSC) – on going evaluation
- Legal and institutional enforcement