1998

The Search for Global Standards

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Idle words or constructive dialogue? Jayne Barnard comments on the OECD’s Corporate Governance Project

On 2 April 1998, the Organisation for Economic Co-operation and Development (OECD) received a report from its Business Sector Advisory Group recommending that it commence drafting a set of global guidelines on the subject of corporate governance. The report — Corporate Governance: Improving Competitiveness and Access to Capital in Global Markets — was prepared by a team of distinguished executives headed by US lawyer Ira Millstein. The executives represented the management elite of Britain, France, Germany, the US and Japan.

Already, the Advisory Group has become known as the six ‘wise men’ and already their report has been dismissed as ‘pointless’ and, as an article in The Daily Telegraph puts it, indicative of the OECD’s ‘endless quest for things to do’. In fact, the Advisory Group report contains some valuable insights into the ‘core principles’ of good corporate governance, and also demonstrates some shrewd political thinking about how improvements in corporate governance can be achieved.

The report itself is a model of diplomacy. On the one hand, it emphasises the primacy of shareholder interests over those of other constituencies. Without shareholder protection devices and a clearly stated commitment to permit businesses to seek long-term growth and profit, capital will not flow into a nation’s economy. On the other hand, the report recognises that ‘corporations must function in the larger society’ and sometimes shareholders’ interests must give way to those of other constituencies. At times, the report concedes, businesses may need to submit themselves to ‘broader collective objectives’ than mere profit.

Enforcing Standards

This kind of accommodation is necessary when the member nations’ experiences with corporate governance are so diverse. In the US, for example, the experience includes a highly regarded government regulator, the Securities and Exchange Commission (SEC). It also includes: a clear legal bias in favour of shareholders’ interests; widespread use of shareholders’ derivative suits; exacting standards for financial disclosure; outspoken – and organised – institutional investors; shareholder suffrage on a one-share, one-vote basis; simplified proxy voting, available to all; access to the ballot under the SEC’s ‘shareholder proposal’ rule; boards of directors comprised largely of independent outsiders; a tradition of board committees with responsibility for audit, nomination, compensation, and compliance with the law; and a vigorous, probing business press.

In Japan, France and Germany, by contrast, the national experience with corporate governance has been quite different. ‘Other constituencies’ receive far more deference in those countries than is customary in the US; the regulatory structures are less obtrusive; accounting standards are less demanding (and hardly uniform among neighbouring countries); the behavioural expectations of directors are less well-defined; directors are seldom truly ‘independent’; there is more ‘patient capital’ in the sense that non-arms-length investors may be willing to defer their gains, sometimes indefinitely; and (although this may be changing) the sense of shareholder entitlement and a need for protective mechanisms is less pronounced than in the US.

The ‘next tier’ of OECD countries and other emerging economies, however, present the greatest challenge to creating uniform standards of corporate governance. In many of these countries, corporate
governance practices can range from limitations on the number of shares an equity owner may own or vote; to refusal to accept proxy votes by mail; to physical intimidation of shareholders who appear at annual meetings! In most of these countries, one finds huge boards of 'neutered' directors who make no claim to independent empowerment and, in fact, who seldom meet; vast cross-shareholdings and interlocking directorates; nepotism; cronyism; no tradition of board committees for important matters such as nominating, audit or compensation; compensation practices that bear no relationship to corporate performance; complete subjugation of minority shareholders (including having no right to notice of shareholders' meetings); and a woeful lack of any meaningful financial disclosure.

Though the Advisory Group report suggests that these differing experiences can be harmonised, largely through voluntary action, of course they cannot, at least any time soon. However, rather than despairing of the difficulties inherent in trying to force convergence in corporate governance norms, the Advisory Group report takes the wiser tack of attempting to reduce the principles of corporate governance to an irreducible minimum. A few changes must be required by governments; others must be made by business leaders in response to market demands. To a large degree, by staying at this level of abstraction, the Advisory Group succeeds in setting out a framework, and offering an exhortation, for the future evolution of global corporate governance standards.

The Report's Strengths
First, the overall principles stressed in the Advisory Group's report — fairness, transparency, accountability and responsibility — are surely desirable in any corporate governance environment, regardless of cultural or regulatory differences. The call for common accounting standards is essential in a global marketplace.

Perhaps the greatest contribution can be found in the Advisory Group's treatment of boards of directors' practices and objectives. According to the report, every corporate board, regardless of the country in which it operates, and regardless of the legal structure to which it is confined, should share

the following features: it should provide leadership in setting corporate strategy; it should provide active oversight of management; its members should be independent of management; it should have control over the audit function and ensure that financial accounts are in order; it should control its own succession; it should assume responsibility for the company's compliance with the law; and its members should regularly engage in self-criticism and evaluation.

Given these guidelines, the Advisory Group report is clearly committed to building an 'independent board culture' in businesses throughout the world and that is admirable. Though observers may differ on who qualifies as truly 'independent', or on how independence should be enforced, or whether independence even matters when it comes to the bottom line — to reduce strong corporate governance to its most essential core is to insist upon independence at the board of directors level. True reform is not about remedies, or specific forms of financial disclosure, or mandatory audit committees, or the voting rights of pension funds. It is about the willingness of corporate directors to act independently, to enforce ethical standards and to eliminate those executives who refuse to honour the board's directives. The Advisory Group delivers that message perfectly.

The second key message then becomes obvious. For a corporate governance system to work effectively, it must keep in mind the legitimate concerns of investors. 'Shareholders require reasonable assurances that their assets will be protected against fraud, managerial or controlling shareholder self-dealing, and other [forms of] "insider" wrongdoing,' the Advisory Group asserts. 'Policy makers ... should provide clear, consistent and enforceable securities and capital market regulations designed to protect shareholder rights.'

To some extent, of course, shareholders will assert their own rights, or withhold their capital. Current activities in Asia make clear that where money is desperately needed, investors' demands for more protection can be accommodated by private agreement.
The Advisory Group is wise, however, in suggesting that national governments be supportive of these efforts. It is even wiser to recognise that there is only so much that legislation can accomplish and that too much legislation, too inflexibly written, can be counter-productive and actually hinder corporate governance reform.

The Advisory Group’s report makes three additional contributions, especially to the political discourse in ‘adolescent’ economies: (1) it states clearly that acceptable corporate governance practices can have a powerful impact on a nation’s economy; (2) it reminds policy makers that capital suppliers throughout the world increasingly care about corporate governance issues; and (3) it suggests that, sometimes, a country must endure ‘short-term social costs’ in order to achieve long-term economic success. All of these points need to be made – whether the OECD will prove a credible source for them (as opposed to, say, the IMF) is, of course, another matter.

The Road Ahead
It now looks as if the OECD hierarchy will take up the call to draft global guidelines for corporate governance practices. In doing so, the organisation should seek to avoid one of the mistakes of the Advisory Group: investors themselves were not represented. One must wonder why, when at least three organisations representing international investors – the US Council of Institutional Investors, the California Public Employees Retirement System (CalPERS) and the Geneva-based International Corporate Governance Network – have already expressed their concerns about differing governance standards throughout the world, and are devising their own sets of ‘best practices’ guidelines to help them in making trans-boundary investment decisions. To have excluded these voices, and the values they have expressed, from representation on the Advisory Group was surprising and unfortunate – especially since the last time Ira Millstein went through an exercise like this in the US, he included representatives of three significant institutional investors among his task force members. These investors’ views should receive close attention in further OECD actions.

No one should imagine that national legislation or traditional business practices will change overnight, and if they do, it will have more to do with the demands of capital suppliers than the suggestions of the OECD. Nevertheless, the Advisory Group’s shaping of this issue, and its measured suggestions to national policy makers, can only be viewed as constructive and a help in accelerating the necessary reform process.

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