

Unlisted Companies as Drivers of Economic Growth: The Role of Good Governance

Why is governance important for Unlisted Companies? Long term success

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Thank you for this opportunity, I'm delighted to be here with all of you for the launch of this first ever corporate governance guidance for unlisted companies in Europe.

First question I'd like to answer is why the OECD, an inter-governmental organisation based in Paris has focused some of its recent work on corporate governance of unlisted companies?

Who are we and what do we do? A couple of words about the OECD. Established in 1961, today with 31 member countries, the OECD brings together the governments of countries committed to democracy and the market economy from around the world to:

- Support sustainable economic growth
- Boost employment
- Raise living standards
- Maintain financial stability
- Assist other countries' economic development
- Contribute to growth in world trade

How? The Organisation provides a setting where governments compare policy experiences, seek answers to common problems, identify good practice and coordinate domestic and international policies. I also sometimes refer to our work as group therapy, as practitioners are really able to exchange their experiences on what works and doesn't with their peers in a quite open fashion.

So why did we dedicate our scarce resources to the issue of corporate governance of unlisted companies, when our work focuses primarily on listed companies? Its simple, when we can, we try to respond to demand and in this case, it came from our work with non-OECD countries, from the emerging markets where the OECD has been active since 1999 in promoting the use of the OECD Principles of Corporate Governance. I initiated this project in 2005 and then it was taken over by another colleague as I got pulled more heavily into our work with Asia. So I've done my best to brush up on what's been done since but don't claim any personal glory for the latest results.

Second, I'll summarise very briefly the key outcomes/conclusions of OECD's work in this area. I will speak from a policy angle, and look forward to hearing from others in the panel about their 'real life' anecdotes and experiences.

We looked at closely held unlisted companies, generally large firms/relative to their economy, that are by choice unlisted but have financial stakeholders (equity and/or credit) besides their controllers. Key features : small number of shareholders, no ready market for corporate stock, substantial shareholder participation in management, direction and operation of the firm. A variety of firms were identified, ranging from family-owned companies to private equity backed firms, group-owned companies, joint ventures, state-owned enterprises etc.

The issues at the outset were broad, we looked at different ownership and control structures, the role of professional management and transparency requirements, challenges in accessing outside capital, corporate governance strategies for succession planning and conflict resolution, the role of legal and contractual mechanisms in the emergence of good corporate governance practices, and the task of policymakers to facilitate better corporate governance and performance in unlisted companies.

Given the diversity of unlisted companies and their very different ownership structures and financing, corporate governance issues vary from company type and across countries. We had two focus groups that looked at specific groups of unlisted companies, family-owned and private-equity backed firms.

First focus group in 2006, as most unlisted companies in emerging markets are family-owned companies, they have attracted the most attention in the first discussions. The governance of these firms is in many ways more complex, given the additional layer of managing family relationships. There are also greater risks of subordination of boards to management, self-dealing, manipulation of accounts, related party transactions, and lack of transparency in allocating finance.

Participants stressed that minority shareholders in these firms have to find other ways to restrict this behaviour and detect fraud that is usually available to listed firms. These unlisted firms have to rely on different techniques and prevent, resolve conflicts among owners, the board and professional management. Participants also discussed the merits and costs of disclosure. The role of independent directors , very rare in a family owned firm, was debated from the perspective of improving decision-making, accountability and providing the ability to improve handling of conflicts of interests and insider dealings, including related party transactions.

A key policy conclusion was that the focus should be on having flexible company law that enhances private ordering and makes it possible to emulate the most efficient contractual corporate governance mechanisms. Policymakers can become more engaged in provide unlisted companies with a governance framework that will foster effective decision-making, accountability, transparency and ultimately, firm performance.

The second focus group in 2007 discussed the benefits and possible weaknesses of private equity firms as corporate owners. Participants reviewed cg practices of PE funds in their portfolio companies in order to reduce information asymmetries and to provide effective incentives for managers. They identified cg challenges faced by unlisted PE-based firms such as equitable treatment of share minority shareholders and potential conflicts of interest among managers, board members and shareholders. It was clear that the private equity industry is filling a financing

gap for unlisted firms seeking to raise capital (e.g. In India in 2007, for example, PE comprised the largest component of FDI), also that it benefits capital markets through the good CG they bring to unlisted firms...this is all now of course a live question/debate in view of recent global financial crisis.

Looking at case studies in OECD (France and UK) and non-OECD countries (China, Indonesia, Brazil, Russia) senior practitioners from family and private-equity backed funds identified four main CG changes experienced by unlisted firms when PE acquired a significant stake : reporting requirements and information rights, board composition strategy to set up an active and professional board; cash flow and control rights used by active investors to provide managerial inputs, when project works badly, and incentive packages for the top management. PE funds contribute to improve CG at a pre-investment stage.

I'd like to conclude by leaving you with a key message : While governments play a central role in shaping the legal, institutional and regulatory climate within which individual corporate governance systems are developed, the main responsibility lies with the private sector. Here the work done by EcoDa leading up to the book launched today 'corporate governance guidance and principles for unlisted companies in Europe' can be a catalyst. I look forward to our debate and to learning from the corporate actors on the panel and in this room on some of the challenges.