CREATING A SUSTAINABLE CORPORATE ENVIRONMENT

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The U.S. Agency for International Development (USAID), working with the Center for International Private Enterprise (CIPE), a private sector partner, has been helping countries establish the foundation for ethically managed businesses and to improve the transparency of existing corporate structures. Combining international expertise with local knowledge, USAID and CIPE have guided market participants through corporate governance development and facilitated local solutions based on international principles.

Photo above: A conference on the Asian financial crisis sponsored by the Center for International Private Enterprise (CIPE), which promotes democratic and market-oriented reform by working directly with the private sector in developing and emerging markets. (Courtesy of CIPE.)

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Corporate governance is becoming increasingly central to global development strategies. The spread of market principles to previously closed economies has spawned a new generation of entrepreneurs and investors worldwide, as well as new responsibilities for the U.S. Agency for International Development. If countries are to successfully use the private sector as an engine of economic growth, they need to create environments that nurture competitive, profitable, and ethically managed businesses.

Shortly after the call for rapid economic decentralization in countries such as Russia and Ukraine, as well as all of Central and Eastern Europe, USAID partnered with the Center for International Private Enterprise (CIPE) on issues of corporate governance. An affiliate of the U.S. Chamber of Commerce, CIPE promotes democratic and market-oriented economic reform by working directly with the private sector in developing and emerging markets. CIPE's institutional approach to corporate governance has been to combine international expertise with local knowledge to build mechanisms to improve self-governance in firms.

Although the practice of good corporate governance was once seen as the exclusive domain of companies in the advanced industrialized economies, today the value of corporate governance for the functioning of markets has been recognized by U.S. government agencies and international and nongovernmental organizations (NGOs). The Organization for Economic Cooperation and Development (OECD) is another leader in international standard setting, comprising 30 member countries sharing a commitment to democratic government and market economies. The OECD has active relationships with some 70 nonmember countries, NGOs, and civil society, and it has a global agenda that includes corporate governance principles. The fact that the OECD just endorsed a new set of corporate principles in 2004 is proof that corporate transparency is an issue for corporate sustainability.

Corporate Governance in Transition Economies

USAID technical assistance programs in corporate governance are rooted in the transformation of the former Soviet Union and countries of Central and Eastern Europe from centralized communist economies to a system of decentralized ownership. The collapse of communism in Europe at the end of the 1980s set off a wave of privatization efforts designed to transfer ownership of state-owned industries from the government to the general population. Although the emphasis of this process fell on the question of ownership, the long-term issue of governance required the establishment of new rules and the education of local stakeholders—stockholders, new company directors, management, and the general public—in order for privatization to contribute to a healthy economy. Values of transparency, responsibility, accountability, and fairness in the governance of companies had to replace old practices of cronyism, favoritism, and backdoor deals. In systems known for weak enforcement, the priority of effective self-regulation became paramount.

With the stability of the new democratic regimes riding on their ability to deliver economic results, USAID renewed its support of corporate governance development as part of its economic assistance programs in Central and Eastern Europe and the former Soviet Union.

Meeting Global Challenges

USAID is prepared to scale up corporate governance activities in both emerging-market economies and developing countries worldwide. New development challenges related to global competitiveness, the Group of Eight (G8) business climate initiative, and trade promotion all stand to benefit from high ethical standards of financial reporting and fiduciary oversight of shareholder rights.

CIPE's and USAID's joint approach to corporate governance reform recognizes that each region has unique problems. Many African countries have delayed important economic reforms to address political crises and have tackled corporate governance only in the past 10 years. Public awareness of the issues and the need to develop trust between the public and private sectors are still formidable challenges for any corporate governance initiative in Africa. In the future we hope to move from dialogue to actionable programs of corporate governance throughout Africa.

In Latin America, a focus on enforcement and family-run businesses is a key element of corporate governance programs. There, a strong entrepreneurial class and small- and medium-enterprise structure often limit any USAID role to coordination. In Latin America, policy makers exhibit a hands-on approach to corporate governance that enables assistance programs to focus largely on public awareness and outreach.

Building support for democratic transitions in the Middle East is multifaceted, and corporate governance can play a key role in separating the state from the private sector. Greater awareness of corporate governance and its role in helping countries attract investment and gain competitiveness is evident in many countries in the region.

In Asia, commercial reform and business development often absorb the bulk of scarce USAID resources. In India, which leads in this area, local efforts to improve corporate governance following the financial crisis of 1997 have also been successful in delivering solutions, as evidenced by the work of the Association of Development Financing Institutions in Asia and the Pacific (ADFIAP), which is working with lending institutions to educate them on how corporate governance practices—or the lack thereof—affect credit risk.

For the Europe and Eurasia region, CIPE and USAID have sought to shift responsibility for companies from the state to the entrepreneurial class and, where no entrepreneurial class exists, to create public awareness and investors' associations to represent stakeholder interests.

Benefits Emerge, But Gradually

Despite the importance of corporate governance practices to financial market stability, investment promotion, competitiveness, and the economic growth of

COMING TO THE MARKET: THE RUSSIAN INSTITUTE OF DIRECTORS

Following the collapse of the Russian banking sector in 1998, Russian companies faced a new business reality: The days of "Wild East capitalism" were drawing to a close. The fragility of Russia's investment environment would no longer tolerate the shareholder abuse and asset stripping that characterized Russian corporate behavior throughout the first half of the 1990s. Publicly traded Russian stocks were vastly undervalued, and majority shareholders had the necessary market impetus to improve governance and performance.

Seeking to improve investor confidence and boost share values, leading members of Russia's business community publicly committed themselves to higher standards of corporate governance. A voluntary code of corporate governance was created with the assistance of the European Bank for Reconstruction and Development; a USAID/CIPE grant supported the establishment of the new Russian Institute of Directors (RID).

The RID grew out of a CIPE grant to the Institute for Stock Market and Management (ISMM) to conduct corporate governance training for Russian senior managers and corporate directors. The initial training modules were well received by the business community. Firms quickly saw the value of creating an independent group that would provide ongoing training to companies and their boards, as well as assist in better defining accepted corporate governance standards and practices. Built through the joint sponsorship of leading Russian companies (which serve as its members), the Russian Federal Securities Commission, and USAID/CIPE, the RID has evolved into a full-service directors institute.

Today, the RID offers a variety of corporate governance services to its members, including training for directors and company secretaries, maintenance of a data bank of qualified directors, and stewardship of a new public-private initiative on improving corporate governance.

emerging markets, the benefits of corporate governance are realized gradually. In Russia and Ukraine, 10 years of USAID project activities in institutional development; training of company managers, employees, and policy makers; and technical assistance have resulted in concrete actions by financial market institutions and policy makers to harmonize domestic practices with global accounting, banking, and capital market standards.

The latest generation of development activities in such areas as competitiveness, pension reform, trade, poverty reduction, and anti-corruption practices requires corporate governance assistance to ensure that enterprises act responsibly in their quest for profits. The presence of large informal sectors in the developing world also makes the application of corporate governance practices difficult. Thus, USAID's development experience indicates that no single development sector should be pursued in isolation. Rather, corporate governance is one of many forms of assistance that seek to cross-fertilize and make the best use of resources for economic growth and poverty reduction.

THE FIVE STAGES OF LOCAL INITIATIVE

The experience of USAID and CIPE has demonstrated that business communities pass through five stages in the adoption of stronger corporate governance practices.

- **Raising Awareness:** One of the challenges that CIPE and USAID have faced in several countries, notably in the Middle East, is that the concept of corporate governance did not exist in the local language. Therefore, discussions first focused on defining the term and trying to apply it to the local context.

Initial efforts also focused on getting the business community and governments to realize the benefits of corporate governance. ADFIAP began its efforts to raise corporate governance practices among its own member banks. It is now working with its members to educate them on how the corporate governance practices of companies should be assessed when making loan decisions because they directly contribute to credit risk. Consequently, many Asian companies are now becoming aware of how corporate governance factors into their bottom line.

- **Developing National Codes:** Once awareness rises in a country's business community, the process of identifying local business norms that pose compliance issues can begin. Often, the development of national codes begins with the OECD Principles of Corporate Governance as a foundation. Building upon such a foundation, countries can develop their own codes that address the local realities of doing business and adhere to international standards by bringing together champion reformers from host countries representing nongovernmental organizations,

CREATING THE LANGUAGE OF REFORM:
THE EGYPTIAN CENTER FOR ECONOMIC STUDIES

As early as 1999, Egyptian private sector leaders were aware of the need to address corporate governance as a key to the modernization of Egyptian firms. With support from CIPE, the Egyptian Center for Economic Studies (ECES) and the Federation of Egyptian Industries introduced the concept to the Arab world, building the vocabulary of corporate governance and promoting its acceptance.

For several years, ECES had conducted a series of studies on corporate governance in Egypt. In 2001, with support from CIPE, the Egyptian Capital Market Association (ECMA) and the Cairo and Alexandria Stock Exchange intensified the debate over corporate governance, holding a major conference for more than 500 of Egypt's market practitioners. Conference participants, including Egypt's minister of foreign trade, Youssef Boutros-Ghali, observed that corporate governance as a concept was new to the Arab world and called for its "Arabization" (http://www.cipe.org/publications/fs/articles/article2728.htm).

With CIPE support, ECES, in cooperation with Egypt's main business and finance associations, convened a workshop series explaining key corporate governance concepts and how international trends affect the Egyptian business community. The workshops ignited a wide-ranging debate within the media and the business community. Prompted by Minister Boutros-Ghali, the Arab Linguists Council declared "al-hawkma ash-sharikatiya" as the most appropriate Arabic term for corporate governance.

In 2002, CIPE supported ECES's business-level survey of the corporate governance environment in Egypt. The survey was unveiled at a conference calling for the development of an institute of directors in Egypt to speed corporate governance reform and train the business community on current practice and principles. Today, the Egyptian Institute of Directors, with a board representing mostly private sector associations, is developing a comprehensive training program for board members.

corporate governance institutes, academia, the media, and businesses.

In the Middle East and North Africa, supported by the Middle East Partnership Initiative (MEPI), CIPE is working with groups to develop their own standards—standards that reflect the realities of economic dominance of state-owned enterprises, the prevalence of family firms, and a unique banking system.

Russia put its corporate governance law in place several years ago after private sector groups identified a common set of standards and took them to the government. Russia is now focused on the later stages of corporate governance implementation—compliance and training.

• **Monitoring Implementation:** Once a national code of corporate governance is formally adopted, company adherence must be clarified.

In the West, stock markets have traditionally been the gatekeepers of corporate governance through listing requirements. That approach is often insufficient outside the western industrialized economies. Elsewhere, stock exchanges, where they exist, do not encompass a significant share of economic activities. Parallel to the development of stock markets is the development of government institutions to monitor the securities industry.

Business associations can play an important role in policing their own members. Those outside the business community also have a stake in the benefits of corporate governance, and so other groups must also become involved in monitoring the process. The press also has a watchdog responsibility.

• **Training for New Responsibilities:** Once a framework for corporate governance has been established, new responsibilities fall to business executives, corporate directors, corporate secretaries, and the like. The business community must educate these players on their roles.

For example, after the passage of Russia's corporate governance law, the Russian Institute of Directors (RID) conducted an extensive series of training sessions across the country for corporate officers. This required the development of original course materials, as well as translations of suitable material from other countries, and it involved the challenge of imparting not just information but also a sense of responsibility and a new code of ethics.

• **Institutionalizing Corporate Governance:** The final stage of a nation's corporate governance development

IMPROVING COMPETITIVENESS: CONFECÁMARAS IN COLOMBIA

Knowledge about best practices in corporate governance is often limited in developing countries. In Latin America, this lack of awareness holds countries back from being truly competitive globally or being able to take full advantage of free trade initiatives that are being negotiated throughout the region. CIPE began working with the Colombian Confederation of Chambers of Commerce (Confecámaras) in 2002 to strengthen corporate governance, with the aim of increasing investor confidence in the country and building stronger capital markets.

Confecámaras launched its corporate governance program with a survey of current practices and knowledge of best practices within the private sector. The results were published in a leading business magazine, *Dinero*, instantly raising public awareness of how much needed to be done for Colombia to catch up to international standards. The program then established a three-pronged strategy: developing a national standard for best practices within the private sector, advocating for changes in laws and regulations to improve corporate governance, and training journalists to effectively report on the process.

Confecámaras participated in OECD roundtable discussions within the region to establish a regional standard of best practices, while simultaneously working with the Colombian business community through a series of white papers and public forums. The result has been a measurable increase in the number of companies seeking out advice and applying these new standards to their business operations. CIPE and Confecámaras are using the success of this program to generate interest in strengthening corporate governance in the private sectors of neighboring countries.

The Confecámaras press training program recognizes the important watchdog responsibility of the media. The complexities of corporate governance make it a difficult subject to report on, even before considering the difficulty in obtaining reliable information. The Confecámaras program thus provides specialized training for journalists on how to report knowledgeably on economic issues in general and corporate governance in particular.

comes when the business community accepts it as a normal and beneficial part of doing business and when the institutions that support compliance are solidly in place. Those institutions include private sector initiatives such as national institutes of directors to provide ongoing professional enrichment, as well as governmental institutions such as a judicial system that adjudicates conflicts fairly.

In Russia, USAID supported the creation of RID under the direction of Igor Belikov, a leader in the mobilization of the Russian business sector to develop its corporate governance law. Similarly, an Institute of Directors in Turkey has made a good start.

Looking Ahead

The link between corporate governance and economic development is likely to become stronger as governments and businesses deal with the fallout from the Enron, WorldCom, and Parmalat scandals. Although corporate governance reform is costly for both domestic and international firms, it ensures sustainability in the long run and opens the door to the economic growth necessary for eradicating poverty. Moreover, a healthy business climate reduces risk and enables countries to join groups such as the World Trade Organization and the European Union. Alternatively, corporate governance may result in higher investment ratings.

USAID and CIPE are designing corporate governance activities to address the broader spectrum of corporate governance issues. Such activities are necessary to long-term corporate viability, profitability, and sustainability in developing countries. Corporate governance also is a first step in building the capacity of the private sector for leadership not only in economic matters, but also in social and political development. The process used by USAID and CIPE imparts consensus-building, communications, and advocacy skills that the business community can employ elsewhere. As companies face increasingly frequent calls for “corporate social responsibility,” the more sustainable alternative is a pattern of corporate citizenship in which the private sector proactively works to find solutions to common problems.

While it is true that companies may need to cut costs to raise their global competitiveness, investment in corporate governance is proving to be the necessary foundation for businesses that inspire confidence among investors, employees, and managers, and for practices that lead to sustained economic growth. ■