

**“CORPORATE GOVERNANCE - CHALLENGES, OPPORTUNITIES AND RETURNS”**

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**Introduction**

First, may I say, on behalf of the Qatar Financial Centre and in particular the QFC Regulatory Authority for whom I work, that we are very pleased to have been invited to participate in this conference, and we would like to express our thanks to His Excellency the Minister of Finance and Acting Minister of Economy of Commerce for his patronage, and to the officials of the Ministry of Economy and Commerce for their organisation, of this important event.

Corporate governance is very important topic for the QFC. High standards of corporate governance are a key element of the vision of the QFC, and Qatar, being a leading location for international finance and business and attracting and facilitating the investment of capital into Qatar and the wider region.

The QFCRA's own Regulatory Objectives include

- the promotion of efficiency, transparency and integrity, and the promotion and maintenance of confidence
- Operating with a view to establishing and maintaining the QFC as a leading financial and business centre in the Middle East.

Good corporate governance is a key part of any regime which has confidence, integrity and efficiency as its bedrock and which is looking to attract and retain capital on a sustained long term basis.

For this reason, it is important that good corporate governance is not only driven by compliance or regulatory requirements, but very importantly is also seen as a means by which companies and economies can improve their performance, competitiveness and sustainability.

Various studies have been done of the role of corporate governance in improving company value and performance, and also endeavouring to quantify the resulting gains from improved corporate governance standards. I refer to some of the work done by McKinsey in this area. I cite as one example a September 2006 report noting a survey that institutional investors in emerging market economies would be willing to pay a premium of as much as 30 percent for companies with good corporate governance, and that companies can expect a 10 to 12 percent increase in market valuation by going from worst to best.

In short, good corporate governance should be seen as good for business.

It is also good for economies in various ways. For example in:

- providing the degree of confidence that is necessary for proper functioning of a market economy
- lowering the cost of capital, thereby underpinning growth
- more specifically , underpinning financial markets and contributing to financial institution soundness and financial system stability
- providing a basis whereby economies and business with good corporate governance can compete over economies and businesses with inferior standards.

In my remarks today (which I should note are personal and not necessarily the official views of the QFCRA), I will canvass

- the concept of corporate governance itself
- some of the roles and involvement of governments , regulators and market participants in this area
- some of the challenges faced by countries internationally in making changes.

I will conclude by venturing some suggestions on opportunities and returns in the present context.

### **The concept of corporate governance and what it can involve**

A vast amount has been written about corporate governance, what it is, and what good corporate governance should involve.

A very good starting point is of course the OECD Principles of Corporate Governance, discussed in detail in the earlier session of this conference. These are widely recognised benchmarks. In the financial sector context, they are one of the key sets of standards for sound financial systems as used by the Financial Stability Forum. They are used by the IMF and World Bank in their country assessments, and by other international bodies, such as IOSCO, in their standards setting.

The OECD Principles refer to corporate governance as involving a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.

The OECD principles focus on:

- ensuring the basis for an effective corporate governance framework
- the rights of shareholders and key ownership functions
- the equitable treatment of shareholders
- the role of other stakeholders including employees, creditors and counterparties.

Many other statements of principles, guidelines and codes have been written by regulators, self regulatory organisations, professional bodies, stock exchanges and other interest groups. Corporate governance is becoming associated with issues of corporate social responsibility but should not, in my view, be confused with that topic.

It is also important the subject of corporate governance does not turn into fashionable business-speak or a concept devoid of meaningful application. The HIH Insurance Group collapse in Australia in 2001 was the largest corporate failure in Australia. The deficiency is still estimated as being between 3.6 and 5 billion Australian dollars. A Royal Commission was established to inquiry into the collapse. In his Report, the Royal Commissioner, Justice Owen said this:

*'I am becoming less and less comfortable with the phrase "corporate governance" - not because of its content but because it has been so widely used that it may become meaningless. There is a danger it will*

*be recited as a mantra, without regard to its real import. If that happens, the tendency will be for those who have to pay regard to it to develop a 'tick the box mentality'. The attitude might be, 'Yes, we have a state – of the art corporate governance model; yes it is committed to writing; and, yes, the company secretary has checked that each item is in place and has included a statement to that effect in the annual report. Therefore there could be no problem in the corporation.'*

*Corporate governance – as properly understood – describes the framework of rules, relationships, systems and processes within which and by which authority is exercised and controlled in corporations. Understood in this way, the expression 'corporate governance' embraces not only the models or systems themselves but also the practices by which that exercise and control of authority is in fact effected.'*

As well as being wise words generally, Justice Owen is reiterating the importance of focusing not only on the models or systems themselves, but also the practices by which that exercise and control of authority is in fact effected.

Good corporate governance can also be defined by looking at the opposite – and some of the catastrophic failures, such as Enron, Palarmat, Barings, HIH, many of which happened very quickly, and involved companies which ostensibly appeared to be doing very well.

But we do not need to look only at the spectacular collapses -we also see examples of bad governance in the every day failure of firms, the everyday reluctance of particular investors to invest in particular markets, and in the regular cycle of market downturns where some participants survive, but others do not, or where confidence overall takes a severe battering.

### **Involvement of governments, regulators and market participants**

A key feature of developments in corporate governance in recent years is the involvement of various players – it is not being left to one group alone, nor can it be.

Governments have a major role, including in

- providing the overall legal and regulatory regime with appropriate incentives and sanctions for good corporate governance; and robust and independent and regulatory and judicial structures, with appropriate enforcement mechanisms
- addressing the critical interface of corporate governance with company, securities, insolvency and criminal law; and
- having appropriate mechanisms to address market crises or failures.

International bodies and agencies are playing a key role. International bodies such as Basel, IAIS, IOSCO, OECD, ADB and the IMF/World Bank (including, in the case of the latter, for their FSAP processes) have a major interest in good corporate governance standards. In many cases those bodies are issuing standards themselves, or monitoring firms and regimes against particular corporate governance benchmarks.

Market regulators have a key role, including

- in relation to issuers of securities, and oversight of exchanges
  - disclosure requirements
  - listing rules requirements
  - monitoring and enforcement
- in viewing corporate governance as a criteria for authorisation
- in developing relevant and appropriate rules for market sectors (for example, in respect of banks or insurers supervised by those regulators).

Rating agencies have a key role, in that corporate governance is relevant to both their country and issuer assessments, which directly flow through to pricing of the paper of those sovereigns and those firms.

The market itself has a key role, for example in relation to listing requirements, professional associations and, very importantly, the approach that companies and other entities take to their own corporate governance.

In short, the topic of improving corporate governance can not be ignored – it is here to stay, and like any change the option is either for us to manage that change or else let the change manage us.

And as with all changes, there are challenges, opportunities and returns.

### **Challenges**

I will comment briefly on some of the challenges which various countries have encountered in their efforts to improve corporate governance practices.

First, I mention the challenge of existing practices themselves. I have touched on these already. The following are some examples:

- failure by the boards of direction to understand the risks their firm is taking
- conflicts of interest and a lack of “independent” (and even more importantly , independently minded) Board members or senior executives
- boards entering into, or allowing, transactions that benefited a few at the expense of the many
- weak or non-existent internal controls , or controls which appeared to be adequate on paper, but which were not implemented in practice
- internal and external audit failure, either through negligence or incompetence, or through aiding and abetting fraudulent or inappropriate behaviour
- transactions, and organisational structures, designed to reduce transparency and prevent market participants and regulators from gaining a genuine picture of the firm’s condition
- and perhaps most importantly, a corporate culture which fosters unethical behaviour and in particular discourages difficult questions from being asked.

Second, there are often attitudes which are impediments to change, for example:

- “short term” thinking - in particular by companies that might only be surviving for the moment because of a continuation of poor corporate governance within that entity or the market in which that entity

operates; in other words where higher standards could put them out of business

- a culture that sees a company as proprietary to one or more directors or shareholders, with minorities, the public, other stakeholders, simply being ‘along for the ride”
- a feeling that the system “warts and all” is working, and that there is no real pressure to change
- a feeling that there is a lack of a sound legal, judicial and regulatory structure providing sufficient incentives and disciplines for good corporate governance even if there is a will within particular firms to change. Such lack also means that companies with, or aspiring to, good corporate governance may view them at a competitive disadvantage in the particular market.
- a lack of commitment and leadership driving change at political, regulatory, and Board and executive levels.

A third challenge is impediments arising because of the nature of a particular sector. A very good example of this worldwide is the state-owned enterprise sector, which in many countries is severely underperforming. Much of that underperformance can be attributed to poor corporate governance, with specific issues relating to their position in the public sector. Examples of difficulties include:

- § conflicting objectives , commercial and non-commercial
- § lack of independence of Boards
- § not appointing suitably qualified or independent thinking directors with relevant business skills
- § political interference at Board level
- § exemptions or differential treatment of SOEs from requirements applicable to other companies e.g. financial reporting standards and disclosure obligations
- § different and insufficient monitoring regimes by shareholders
- § different attitudes of governments as shareholder e.g. on their appetite for risk, capital allocations and expected returns
- § conflicting roles of government itself

Those difficulties are all examples of difficulties in corporate governance, but need to be addressed by specific public sector reforms and measures to address the particular circumstances of SOEs.

## Implementation

In my view, all of these challenges can be overcome if there is a sufficient will and an appropriate approach and programme for implementation. Like the topic of SOE's, the topic of implementation of a programme for improving corporate governance is a major one in itself. In my comments today I make three observations:

- it is very important to have an integrated approach to any corporate governance reforms. Laws themselves, for example, are insufficient without also a will and culture at senior government and business levels to have them work. Conversely statements of aspiration and good intent are insufficient without strong and robust legal, regulatory and enforcement structures
- it is also very important to recognise that a 'one size fits all' approach does not work. The US model for example is highly prescriptive and rules based; the UK/European model is more principles based; there are hybrids e.g. the 'comply or explain why not' approach
- in particular it is important to recognise the cultural, legal and structural issues existing in different countries. There needs to be a programme which will achieve the objective of improved corporate governance, but by recognising and addressing those differences. For example, some countries have a high percentage of major companies with a dominant or family shareholding, other countries have a very wide spread of shareholders. Some countries have a history, and widespread practice, of using litigation to address disputes, in other countries litigation is not at all common, with disputes frequently being settled privately. Some jurisdictions have by now a well understood and accepted approach to public disclosure of information; in others it is the reverse. Some jurisdictions have a culture of free and vigorous debate between superiors and subordinates – others do not. To be effective, any corporate governance reforms must recognise the circumstances of the particular country and determine how best to address them.

## Opportunities and returns

In relation to opportunities here, I note Qatar is favoured by:

- a commitment at highest governmental levels to best international practice already demonstrated in the case of the financial and securities markets by the Qatar Financial Centre , and also in announcements regarding the Qatar Financial Markets Authority
- substantial development of robust regulatory structures and the rule of law
- a strong sustainable economy with an ability therefore to make changes for long term gain
- a willingness to embrace change at governmental and business levels.

The potential returns from good corporate governance include:

- an increased willingness of quality investors to invest in diverse sectors of the economy on a sustained basis
- improved company and market performance
- enhanced soundness of the financial system and financial markets
- long term benefits to the economy, and its comparative advantage

Continuing development of good corporate governance can capitalise on and leverage the unique opportunities, developments and leadership which Qatar has, and is already demonstrating, in the region and internationally.

Michael Webb