BIAC Comments

1. BIAC opening remarks

As noted by the OECD Corporate Governance Principles, any corporate governance framework should be developed with a view to its overall impact on the healthy functioning of our businesses and their relations to key stakeholders. Corporate governance principles are not goals in themselves, but rather should be developed with the ultimate objective of enabling business to grow and create sustainable value, while keeping in mind interests of key stakeholders as appropriate. A fundamental objective of sound corporate governance is to stimulate entrepreneurship and innovation, which requires access to and effective allocation of capital.

With this in mind, BIAC has developed a ‘thought starter’ (see attached), summarizing key business considerations in corporate governance, our comments on on-going key OECD activities, as well as pro-active business proposals for future OECD activities. The title is intentional: this is a BIAC ‘thought starter’ because it is meant to encourage even more new thinking at the OECD; for example, a significant section of the document includes proposals for new OECD activities. Moreover, the paper is a “living document”, which we will update on a regular basis.

2. Proposal for a business expert meeting

As mentioned at the last consultation, BIAC would like to reiterate its wish to become actively involved in the update of the OECD Corporate Governance Principles, which will be an overarching priority going forward. It is now timely and urgent to proceed with discussions on how the changes that have taken place over the last years should be reflected in the Principles to ensure that they remain relevant as an international reference document. At the same time, BIAC supports the OECD approach to analyze recent and on-going changes in the economy and specifically in capital markets to help define the policy objectives of the update.
BIAC therefore confirms its strong desire to become actively involved in discussion with the OECD Corporate Governance Committee and provide input all along the process to ensure that the revised Principles remain both a key international point of reference and feasible for business to implement in both OECD and non-OECD countries. In order to make a pro-active and timely contribution to the discussions, BIAC has started internal discussions on possible issues relevant to the update as well as key principles to be maintained. We look forward to continuing our close dialogue with the OECD and providing feedback throughout the process.

In order to provide first-hand practical input to the update of the Principles, BIAC would like to suggest organizing a meeting of high-level business representatives, including directors and chairmen from both member and major non-member economies, for an exchange of views early in the process. Such a meeting could take place back-to-back with the next consultation and could present views from these business leaders in three main areas: 1) how the Principles have been implemented in different countries; 2) how respective local conditions can inform the update; 3) how business experience in these countries can be reflected in the work on value creation and growth.

3. Competitive neutrality

Building on the discussions at the recent meeting of the OECD Working Party on State Ownership and Privatization Practices, BIAC appreciates that the OECD Corporate Governance Committee is reviewing and discussing ongoing work on competitive neutrality.

As BIAC mentioned during the March consultation with the Working Party on State Ownership and Privatization Practices, we continue to strongly support a robust, broad-based OECD work program on competitive neutrality, which should bring together contributions from corporate governance, competition, trade and investment. We congratulate the OECD for demonstrating leadership in the area of competitive neutrality, which is of crucial importance to business, and BIAC offers strong support for further work in this area. Building on the outcome of the OECD report “Competitive Neutrality: Maintaining a Level Playing Field between Public and Private Business”, which was published last year, BIAC appreciates the fact that the OECD has expanded its analysis by including non-member countries.

While it is critical to look at the nexus of competitive neutrality and SOEs going forward, it is important to have a solid conceptual and analytical framework to deal with the increasing instances where government owned/controlled/championed entities are competing directly with private entities. We all need ‘fair and transparent’ rules of the road. In understanding the role SOEs play, especially in emerging markets, transparency is one important tool. In the work going forward, we support activities that shed some light on current practices and which highlight sound leading practices.

BIAC would also like to highlight that the treatment of ‘public service obligations and how they are funded’ in commercial SOEs remains opaque in many countries, as does the manner in which many countries distinguish which SOEs are determined as commercial, non-commercial and
even strategic. Private enterprise requires this information in order to better understand the competitive environment. The OECD is well placed to provide a deeper and wider understanding of key challenges and opportunities, while fostering capacity building by sharing its analysis with emerging economies and engaging in a constructive dialogue with them.

4. Corporate Governance, value creation and growth

BIAC welcomes the initiative to connect corporate governance, value creation and growth and underlines that any corporate governance framework should be developed with a view to its impact on the overall economic performance of economies including capital markets. BIAC recognizes that corporate governance affects every step of the investment process, and that a functioning governance framework is essential to an effective equity market. That said, BIAC underlines that corporate governance principles are not goals in themselves, but rather should be developed with a view towards enabling business to take opportunities to grow and create sustainable value and jobs, which requires access to and effective allocation of capital.

In view of the withdrawal of more and more companies from the major public capital markets over recent years, the question remains how companies can be assured of continued access to sufficient capital to grow and drive growth in both innovation and employment. The findings of the OECD Value Creation Project can make an important contribution by informing both policy makers and business of the key changes in equity markets. It can also contribute to shedding further light on the ability of equity markets to serve the long-term needs of the real economy and the role of effective corporate governance to help channel savings to companies that need capital for innovation, job creation and growth. The project will be particularly important in providing fact-based analysis on global trends and the changes we have been experiencing, which will be indispensable to informing discussions on the forthcoming update of the Principles.

Based on the findings of the initial report on Corporate Governance in Current Equity Markets, BIAC supports the proposed next steps for future empirical and analytical work within the Value Creation Project as described on page 5 of the background document (DAF/CA/CG(2012)10/FINAL). In particular, we support further investigation in the following areas, and again offer support from the business community to help the Corporate Governance Committee in its work:

- Further analysis of how changes in reporting requirements and market structures influence the incentives of investors and companies to enter or exit public equity markets. In this regard, BIAC urges the OECD to consider the unique needs of SMEs and encourage their access to risk capital.

- Analysis of how business models and ownership strategies of different categories of institutional investors influence their incentives and ability to carry out their corporate governance responsibilities. We understand that the OECD plans to create a taxonomy of current investors and their respective approaches to corporate engagement. BIAC, together with the investor members of its Corporate Governance Task Force, stands ready to assist the OECD with its work in this area.
• Analysis of how differences in ownership and control affect the quality of corporate governance, with a particular focus on the dynamics of controlled companies.

• Description and analysis of corporate governance in emerging markets.

BIAC continues to support efforts to identify public or private incentives for owners to better monitor their investments. To some extent, recent trends in portfolio diversification that make it difficult to monitor all investments closely may be too late to reverse, but there are lessons no doubt to be learned from jurisdictions that have introduced stewardship codes, changes in tax policy, or other mechanisms to enhance monitoring. It is in this context that we applaud the OECD’s sensitivity to the complicated and varying structures and motivations of institutional investors. BIAC encourages additional thinking about shareholder monitoring and the incentives in place and governance at shareholders themselves that might support such monitoring.

BIAC concurs with the OECD’s findings that encouraging stewardship codes is a positive start, but alone will not necessarily encourage the degree of institutional investor activism desired, since one could meet fiduciary obligations without engaging in corporate governance activities, with limited monitoring and engagement with investee companies, and perhaps even without voting the shares of portfolio companies. In view of the increasingly complex landscape of institutional investors and the lengthened investment chain, we look forward to being involved in discussions with the Corporate Governance Committee to find creative and appropriate solutions for encouraging investor engagement and addressing the challenges highlighted in the Kay Review (DAF/CA/CG/RD(2013)1), which raises a number of important questions about both the short-termism in our equity markets and the oversight role of investors. We recognize that we need to have a better understanding of the impact of long-termism and short-termism on the state of market developments and support further analysis in this area. Work carried out in other organizations, such as at the EU level (Green Paper – Long-term Financing of the European Economy), should be considered.

Given shifts in some equity markets in favor of controlling ownership structures, BIAC supports greater research into governance improvements at controlled companies, both in emerging economies and in OECD-countries, recognizing the different potentials and risks of dispersed and controlled ownership structures. Such research may consider if control impacts corporate governance in different ways in developed and emerging markets. In view of the various and unique factors at play, BIAC agrees with the premise of the Karl Hofstetter paper (DAF/CA/CG(2013)2) which emphasizes that one size does not fit all when it comes to corporate governance and controlled companies. We agree with Mr. Hofstetter's conclusion that “equal treatment requires that unequal structures be treated unequally.” Therefore, when it comes to devising the most appropriate corporate governance principles for controlled ownership structures, regulatory flexibility and differentiated rules are essential to allow controlled companies the latitude needed to choose the appropriate corporate governance structures which best address their individual shareholder (including minority shareholders) and other stakeholder needs. We encourage the OECD to consider the different challenges raised by the Hofstetter paper as it weighs how to best improve corporate governance of controlled companies.
BIAC also welcomes the scoping paper on corporate governance in emerging markets (DAF/CA/CG(2013)3) and the OECD’s proposal to complement on-going work within the value creation project. We support further empirical and analytical work focused on a detailed description of equity market structures and trading practices, ownership structure of listed companies and current corporate governance arrangements in emerging economies. In view of the importance to reflect a global shift in investment and wealth, such a report could provide an important input to the update of the Principles. BIAC supports the creation of a dedicated expert group on corporate governance in emerging markets and would be pleased to be involved in these discussions.

The OECD could provide value in analyzing the risks and opportunities related to corporate governance arrangements in these fast growing economies. As noted in the scoping paper, BIAC also encourages the OECD to continue to recognize and address the substantial existing barriers to cross-border shareholder voting. Removing these barriers should improve continuing dialogue between companies and investors. Given the significant increase in capital raised by companies from non-OECD countries, BIAC strongly supports the OECD’s focus on corporate governance in emerging markets and hopes that we allow the emerging market experiences to inform discussions on the forthcoming update of the Principles.

Thanks to its focus on value creation and growth, this project could also make a contribution to the OECD horizontal project on New Approaches to Economic Challenges.

5. Thematic peer review of risk management and corporate governance

There is currently a very little reference to risk in the OECD Principles. BIAC supports efforts to improve sound risk governance, both in terms of board-level direction and management oversight of risk-taking as a core element of effective corporate governance and as a complement to long-term sustainability of business growth and value. Risk governance includes the balance between risk and reward, bearing in mind that boards must direct and oversee risk-taking by senior management. While BIAC agrees that direction and oversight of risk taking is important, BIAC also underlines the importance of adequate risk management and internal control to enable business to set and achieve their objectives. BIAC therefore applauds the OECD’s recognition of the fundamental role of risk-taking which is crucial for business to succeed.

BIAC strongly believes that there is no one-size-fits-all solution to effective risk governance and advocates flexibility in risk governance guidelines with respect to risk management and internal control. Direction and oversight of risk-taking is one of the most urgent tasks facing business in the wake of the financial crisis, and there are few areas of consensus emerging about how boards of directors should do this most effectively.

In this regard, BIAC feels that the nature of existing risk governance standards is appropriate. The specific identification and management of risk should take place at the company level. Risk governance standards ought to be general in order to allow companies the flexibility to implement risk governance practices appropriately tailored to their unique and varied needs based upon,
among other things, their size, stage of development, ownership, structure, industry, culture, and geographical factors. We call upon national regulators to resist the urge to over-prescribe risk management and internal control regulations, especially in the non-financial sector. Over-prescription may lead to a false sense of security and will not meet the complexities of today’s risk environment, nor the specific risk situation of individual companies. We observe that in the wake of the financial crisis, there has been a tendency for increased regulation regarding risk management and internal control in the financial sector. However, we agree with the OECD’s position that “risk governance rules and practices appropriate for financial institutions may not be directly applicable to non-financial institutions.”

We note the recent and important study by the Financial Stability Board (FSB) and its very specific and comprehensive guidelines for risk management. However, in view of the fact that the FSB study was specific to financial institutions, we urge the OECD to consider the study as only one of many inputs as it updates the Principles. Specific operational risk governance standards and principles (e.g., whether companies should create separate risk committees of the board or establish a CRO function, how the collective skills and qualifications of the board members should be assessed, and the precise methods by which companies govern their risk) should be left to individual companies and their boards. In this regard we strongly support the important role of the Principles and this OECD peer review in providing overarching risk governance guidance to listed companies around the world. The “apply or explain” approach is particularly useful and appropriate in regards to risk oversight disclosure.

We recommend that the OECD further explore risk governance best practices of listed companies in the non-financial sector for in-depth investigation in the second stage of the review. The OECD can make a significant contribution by highlighting these best practices on both a national and enterprise level to encourage appropriate regulatory reform and evolution of sound risk governance culture. While there has been a lot of research of risk practices in banks and financial institutions, far less research has been carried out on non-financial companies. The OECD could help increase our understanding in this area: for example in exploring how boards provide direction and risk oversight, how remuneration and other incentives affect risk-taking, and how boards can gain a better view in cases where management’s approach to risk-taking changes.

Due attention should be given to the role of investors in articulating what they see as appropriate risk governance within companies they own and/or manage. Companies need to have a clear understanding of the wishes of their owners in this regard. BIAC therefore encourages the OECD to examine the role of investors in this area. It remains to be seen how investors can be encouraged to use enhanced disclosure about risk management to better seek accountability or pursue private enforcement.

We look forward to working with the Corporate Governance Committee and offering our thoughts and suggestions of how to shape the guidance offered by the Principles to listed companies in the area of risk governance. We support more specific elaborations about risk management best practices in the annotations to the Principles.