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Governance in Emerging Markets

Corporate governance reform has become an even more pressing issue in emerging markets, where demand for growth capital is the driving force. "Investors will pay more for a well-governed company, and the premium they are willing to pay goes up by quite a bit in developing countries," says Holly Gregory, a partner in the corporate governance group at the law firm Weil, Gotshal & Manges, who has organized corporate governance programs for the OECD, the World Bank, and the Global Corporate Governance Forum, among others. "What that says is that you will be rewarded if you embrace a best practice and then communicate this to the outside world."

Brazil has earned high marks for its recent steps in this direction. Despite resistance from many of the founding families that control the country's publicly traded companies, the government launched a sustained effort in the late 1990s to reform corporate governance practices.

Güler Manisali Darman, an international corporate governance expert based in Turkey and author of Corporate Governance Worldwide (ICC Books, 2004), cites Novo Mercado as an important step in the direction of reform. This is an exchange founded several years ago in Brazil for companies that voluntarily abide by governance practices and disclosure requirements over and above those that are required by Brazilian law.

Novo Mercado's requirements, which include the disclosure of insider trading by controlling shareholders or senior managers, all serve to increase transparency, says Manisali Darman. Companies on Novo Mercado also must report balance sheet information in accordance with U.S. Generally Accepted Accounting Principles (GAAP) or International Financial Reporting Standards (IFRS).

In order to encourage more companies to move in the direction of higher governance standards, Brazil has set up two intermediary listings, known as Levels 1 and 2. These consist of about three-dozen publicly traded companies listed on one of the so-called special segments of the Brazilian stock exchange. Some studies suggest that the shares of these firms have traded at values higher than those of the shares of Brazilian peers.

Foreign investors, lenders, and potential joint-venture partners may want to negotiate for governance concessions that approximate those required by one or more of Brazil's special exchanges or confine their activities only to companies listed on them. Other companies in the country still lag far behind on governance matters.

In Russia it may be too early to determine whether reforms have been substantive and effective enough to help companies compete globally for capital. Neil Getnick, a managing partner at New York City law firm Getnick & Getnick, has worked with the Russian Union of Industrialists and Entrepreneurs to increase awareness that, he says, "Raising standards will help companies gain access to capital, win preferred rates, get listed on foreign exchanges, and encourage joint ventures."

Yet there are cultural and historical obstacles in Russia that may take more time to overcome. "Whistle-blowers are viewed favorably in the United States," Getnick points out. "In Russia there's a very different history and set of connotations [associated with whistle-blowing], particularly from the Soviet period. You can't just impose U.S. mores on such a different culture."

Some governance experts have adopted a wait-and-see approach. "Corporate governance is still in its infancy here," says Kayal of Calvert. "[But] it's time for the country to deal with this issue more seriously."

Getnick believes that Russia's newer, entrepreneurial companies will take the lead in adopting international best governance practices. Indeed, this trend may replicate itself in one emerging nation after another. In developing countries, the growth-oriented companies may adopt global best practices more willingly and rapidly than the longer-established firms.

The challenges of corporate governance don't have easy answers. But with pressure for change coming from many directions—regulators, investors, and the global business community—one thing is clear: Despite the growing high-level attention devoted to better corporate governance, there remains much tactical work to do, such as aligning technology with increasing demands for transparency. Companies need to review their compliance architectures and strategies for enterprise content management as carefully as they look at who is sitting on their boards. Risks abound, but companies that can harmonize their internal processes, systems, and cultures with broader global governance imperatives will have the advantage.

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