



The New Rules of the **Board Game:**

The Changing World of Corporate Governance and Its
Implications for Multilateral Development Institutions

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Executive Summary

This report reviews recent developments in corporate governance and considers their relevance to the governance of multilateral development institutions (MDIs).

Recent interest in corporate governance has been driven by a growing list of corporate scandals. Enron, Marconi, Polly Peck, Parmalat, Hollinger, Disney, Boeing and others are all companies where corporate activities, or the actions of some of their top executives, have given rise to serious concerns. The problems have to do with greed (excessive compensation of top executives, overly generous benefits), duplicity (failure to observe accepted standards of accounting, the disguising of transactions), conflict of interest (accounting firms in bed with client corporations, political payoffs to regulators or legislators) and corruption in various other forms.

These have raised questions about who is overseeing the affairs of corporations. This in turn has focused interest on a host of governance-related issues: the role of the board of directors, the independence of its membership from management, the functions of its committees (in particular, the audit committee), the responsibilities of the board chair, the chair's relationship to the chief executive, and the transparency and accuracy of financial reporting.

The scandals have attracted the interest of government ministries, the OECD, regulatory bodies, stock exchanges and other agencies. Responses have varied in different jurisdictions. America opted for detailed regulation, and passed the Sarbanes-Oxley Act which imposed many new requirements on corporations and their boards. In Britain a new *Companies Bill* is in the works. This is expected to complement a code of desired practices already promulgated by the London Stock Exchange.

The implications of these developments for MDIs and their boards are several. MDI staff need to be cognizant of the provisions of legislation such as Sarbanes-Oxley if they wish to issue paper on US financial markets. Executive directors of MDIs may wish to consider how their boards operate and what they deal with in light of developments in the private sector. For example: do MDI boards exercise a true governance function? What should be the qualifications of executive directors? Who should set the agenda for board meetings and chair them? Will the MDI's auditing arrangements stand up to outside scrutiny?

While developments in the private sector provide an interesting framework against which to consider governance in MDIs, adherence to private sector practices will not guarantee that sound governance exists in a particular MDI. Some business practices do not fit MDIs - there are important differences between MDIs and private corporations. Further, the discourse in business about governance has been limited – the current emphasis on corruption has masked more fundamental questions of legitimacy, ethics, accountability and corporate purpose. Some of these issues, as they relate to MDIs, are briefly discussed in this report. A set of governance principles developed by the UNDP (revised somewhat by the Institute On Governance) provides a broader frame of reference within which to consider the governance of organisations like MDIs that have public responsibilities and accountabilities.

Despite the limitations of business approaches, concerns over governance in the corporate world are certain to resonate in MDIs in many different ways. Governance is an issue that is here to stay. Improving governance practices both within MDIs and in the countries where they work will be critical to addressing the challenge of global poverty.

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The New Rules of the Board Game: The Changing World of Corporate Governance and Its Implications for Multilateral Development Institutions

1. Introduction

Why this report?

Britain's Department for International Development (DFID) channels a significant percentage of its development funds through multilateral development institutions (MDIs). It may raise this contribution in future, and it is thus concerned with how these organisations are governed. The International Division of DFID has a key role in this regard. Its Director's plan for 2003 states:

We will increasingly allocate our financial resources between multilateral agencies on the basis of a clearer vision of the overall system, the specific roles of individual agencies and evidence of effectiveness. We will increase the impact of key multilateral agencies ... by working to embed commitments to poverty reduction in the boards, management and staff... Working through a variety of approaches - corporate governance mechanisms, advocacy... alliances...and partnerships - we can secure change.¹

Terms of reference

In June 2003, the Division invited the Institute On Governance (IOG), an Ottawa-based think tank², to review recent developments in corporate governance and to consider their relevance to the governance of MDIs. A related objective was "to enhance the understanding of corporate governance within DFID" for the benefit of officials at representative missions, in headquarters, and field staff in country programs. The IOG was asked for a report on these questions, and also to develop a training program for officials concerned with MDI issues, whether based in London or in missions abroad.³

Overview of the report

This report begins by asking, why is governance attracting so much attention? It explores contemporary governance issues in the corporate sector. It considers the meaning of "good" governance and examines how "good" might be defined in different settings.

Next, it examines how governments and regulatory bodies have responded to public concerns about governance, with particular reference to the USA and the UK. It argues that a new vision or concept of the role of a board of directors is emerging, and it outlines the governance tasks that ought to preoccupy a board in a contemporary organisation.

¹ *International Division: Director's Delivery Plan, April 2003*, pp2-4.

² The Institute is a not-for-profit organisation with charitable status. Its mission is to explore, share and promote good governance, and to help governments, voluntary and private sector organisations and communities to apply this concept in practice, for the benefit of citizens and society.

³ The following program of work was carried out during this project: (1) interviews with DFID and some FCO staff in London, Delhi, New York, and Washington D.C. (2) review of literature on corporate governance and related topics in publications and on the internet (3) review of activities of different governments and regulatory agencies, (4) development of working background papers on several topics related to the theme of this project, (5) drafting of this report, (6) development of training materials for pilot course.

The report then considers to what extent recent developments in the private sector may have relevance for MDIs. It suggests that these developments contain useful insights for MDIs, while at the same time, arguing that MDIs are different from business corporations in important respects. It discusses some of the broader governance issues that should be of concern to MDIs. It concludes by stating that governance is here to stay – not a passing fad – and that our ability to get governance right will have a significant bearing on our ability to combat poverty around the world.

2. Why the interest in governance?

Governance has become a “hot” topic... The Secretary General of the United Nations, Kofi Annan, reflects a growing consensus when he states that “good governance is perhaps the single most important factor in eradicating poverty and promoting development”.⁴ Not surprisingly, governance as a term has progressed from obscurity to widespread usage, particularly in the last decade.⁵

Why this interest? Two reasons stand out. First, in recent years, a growing string of business scandals has occupied the front pages of newspapers in many countries. Governance practices are seen as a way to prevent abuse and keep corporations on track. Second, evidence indicates that sound governance practices are an important determinant of societal well being and economic growth.

Indeed, as the influence of the corporate sector becomes more pervasive and as the process of globalisation continues, large corporations are playing a dominant role in many local economies. Governance practices in the private sector may thus affect the lives of local citizens in a very direct way. In the view of the President of the World Bank, in future, “the proper governance of companies will become as crucial to the world economy as the proper governing of countries.”⁶

Corporate scandals are hardly new. History reveals numerous events such as Britain’s South Sea Bubble three hundred years ago that led to a mania of speculation followed by riots, bankruptcies, and suicides⁷, or the railway scandals in the United States in the 1800s. However, there is a widespread impression that today, these instances of greed or corruption - Enron, Marconi, UK pension funds, Bre-X, Polly Peck, World.com, the New York Stock Exchange, Parmalat, Hollinger and others - have increased in frequency and intensity.

Of the contemporary scandals, Enron has the dubious honour of having the highest profile. The story is remarkable. A firm that only began operations in 1985 managed, by 2003, to register losses in the range of \$US 4 *billion*. Its collapse led in turn to the implosion of one of the world's largest and best-reputed accounting firms, Arthur Andersen, the first ever to be charged with a US felony. Enron's connections involved individuals at the top of the American government, including a member of the Bush Cabinet and the President himself. Public officials involved in regulatory functions personally benefited from campaign contributions from the corporation, apparently oblivious to their conflict of interest.⁸ As stories such as Enron pervade the business press, there is a growing realisation that in many

⁴ Annan, www.unu/p&g/wgs/. Similar themes are found in the “New Partnership for Africa’s Development (NEPAD)”, the UN Millennium Declaration and many of the declarations and plans resulting from the World Summit on Sustainable Development (WSSD).

⁵ *Principles for Good Governance in the 21st Century*, Graham, John, Bruce Amos and Tim Plumptre, Institute On Governance, Ottawa, 2003. www.iog.ca/publications/policy_briefs.

⁶ Statement attributed to Jim Wolfensohn, King Report on Corporate Governance, South African Institute of Directors, March 2002.

⁷ Churchill, Winston S., *A History of the English Speaking Peoples*, vol. 3, (Cassell & Co., 1957), 92-3.

⁸ Blahuta, Jason, Case Study 1: Enron (US), unpublished research paper, Institute On Governance, 2003.

cases, an alert board could - and should - have averted the scandal. Where was the board when these scandals were brewing? Were they aware of their governance responsibilities?

Interest in sound governance is growing not only because of scandals, but also because of a growing body of evidence linking governance and corporate performance. This comes from many countries. For example, a study recently published in the USA found that investors will pay a premium to invest in well-governed firms.⁹ An article in the McKinsey Quarterly¹⁰ reports on a new stock exchange in Italy. Companies listed on this "STAR" exchange follow a strict set of governance requirements. They are said to outperform companies listed on the main board, and this in turn has a positive impact on their market value. An Australian study examined the relationship between board demographics and corporate performance and concluded that there is a positive relationship between board make-up and firm value.¹¹ A paper from South Africa¹² claimed that the collapse of a local airline, Sun Air, was the result of poor corporate governance. The lead editorial in a major Canadian newspaper in September 2003 asserted, "Corporate bosses who fail to take the reform drive seriously in the mistaken belief that it's a passing fad...will find some of their biggest shareholders voting with their feet. And that should be a bigger concern than the cost of changing their practices."¹³

The scandals in the private sector have given rise to concerns on several fronts. First, as the Enron case illustrates, questions have arisen with respect to accounting practices. Were appropriate practices and standards being followed? Was there adequate transparency in financial reporting? A related concern, also illustrated by Enron, has been conflict of interest. Enron's auditors were reportedly earning millions of dollars from consulting fees, thus they had a vested interest in muffling any criticism from management that could have imperiled these revenues. There were also questions about the conduct of public officials who had important oversight or regulatory responsibilities vis-à-vis Enron but who were also recipients of the company's largesse.

A somewhat related issue that has preoccupied investors has been that of executive compensation. Many corporate executives receive enormous revenues in the form of salary, stock options, bonuses, travel allowances, benefits, pensions and the like. Some also have been recipients of generous loans from their corporation, often with very flexible and generous repayment provisions. Often, the size of executives' payouts has seemed to bear little correlation to the financial fortunes of the companies for which the executives were responsible. Gold-plated compensation has persisted even when the corporation was losing money. And quite apart from the question of corporate performance, in some instances, compensation has been so vast that it was repugnant to many observers on moral grounds. How could *anyone* warrant income on such a scale, particularly in light of the impoverished conditions of so many millions of people in developing countries?

In turn, concerns such as these began to raise questions about how decisions were taken, who had power, how oversight was exercised and by whom. In theory, the board of directors was supposed to represent the interests of shareholders, and perhaps, of other stakeholders with an interest in the conduct of the corporation. Were they playing this role? Similarly, government ministries and agencies

⁹ Coombes, Paul and Watson, Mark, (2000), "Three Surveys on Corporate Governance", in *The McKinsey Quarterly*, 2000 Number 4..

¹⁰ "A Market For the Well Governed", in *The McKinsey Quarterly*, Number 3, 2002.

¹¹ Kiel, Geoffrey, (2002), "Board Composition and Corporate Performance: how the Australian experience informs contrasting theories of corporate governance", paper presented to the 5th International Conference on Corporate Governance and Direction, Henley, 8-10 October 2002; published in *Corporate Governance: An International Review*, 11:3, pp. 189-203; 2003.

¹² Roodt, Anton, (2001), "Corporate Governance As Investment Imperative: An African Perspective", paper presented to the Annual African Investment Conference and Exhibition, Stellenbach, 24 August 2001.

¹³ *Globe and Mail*, September 24, 2003.

such as stock exchanges, securities commissions or auditors were seen to be part of the apparatus to protect the public interest and prevent fraud. Were they equipped to do their job? How effective were these organisations?

3. Corporate governance: architecture and issues

To understand corporate governance, it is useful to grasp some basics as to what governance is, and how it is supposed to work in a business context.

Governance defined

Governance is essentially about taking big decisions. At a general level, it may be defined as the process whereby organisations or societies take decisions about matters of importance. Governance is sometimes defined as the art of *steering* an organisation. A more elaborate version sees governance as the process whereby leaders are selected, powers are conferred, strategic directions are set, key relationships are maintained, organisational health is safeguarded, performance is monitored and account is rendered. This process takes place in many settings: - in communities, governments, businesses (corporate governance), non profits, and also in less structured situations, such as alliances, partnerships, global mechanisms for cooperation or problem-solving.

In the 1990s, the Organisation for Economic Cooperation and Development (OECD) established a Task Force to look into questions of corporate governance. This Task Force reported in 1999, defining corporate governance as follows:

Corporate governance ... involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and shareholders and should facilitate effective monitoring, thereby encouraging firms to use resources more efficiently.¹⁴

Governance: essential elements and critical issues

Governance arrangements in the private sector center around principal-agent relationships. Shareholders (principals) who invest in a company elect a board of directors (agents) to represent their interests. In turn, these directors are expected to ensure that the management of the corporation behaves responsibly, and that executives carry out their duties in a way that will result in appropriate rewards to shareholders.

Reduced in this way to its theoretical essentials, governance may appear to be quite a simple proposition. In practice, however, it is a complex affair. It raises questions about which there may be legitimate, and deeply held, differences of view. For example:

- How should directors be elected?
- What are their responsibilities – individually and collectively?

¹⁴ OECD Principles of Corporate Governance, (April 1999), <http://www.worldbank.org/html/fpd/privatesector/cg/docs/oecd-principles.pdf>. At time of writing, the OECD was engaged in updating this set of principles. A revised formulation is expected in mid-2004.

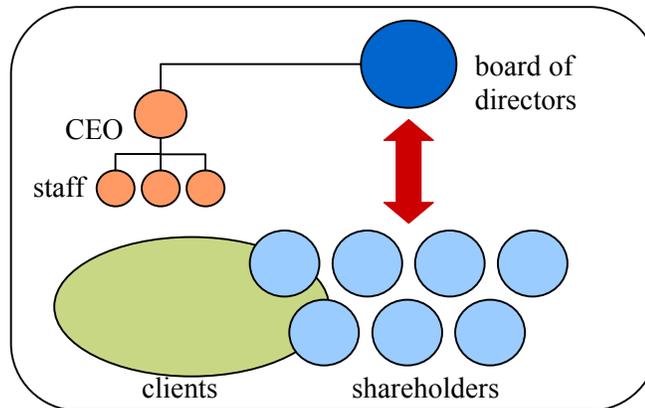


Diagram (1) - Governance at a Company

- Should directors also be members of management? What proportion should be independent or ‘outside’ the management cadre?
- What is the definition of an ‘independent’ director?
- Are directors accountable solely to shareholders, or is there a broader accountability, for example, to communities within which the corporation operates? Or to the public at large, for example, on environmental matters?
- Who should chair meetings of the board? Who should set the agenda?
- Is it appropriate for the staff CEO to function also as the chair of the board?
- What is the role of the audit committee?
- What information related to corporate finances and performance should be made public? Where should the line be drawn between transparency and the protection of strategic intelligence?

The literature of corporate governance is now full of debate on issues of this kind. The broad concept of how governance in a company is supposed to work is typically set forth in framework legislation (such as a corporations or companies act). It is further defined in documents of incorporation that accord the company its legal persona, and in the corporation’s bylaws. Some companies complement these bylaws with their own governance policies that may address such questions as the role of directors, the terms of reference of committees of the board, or the nominations process. Conferences, seminars, workshops, and academic courses about sound governance are becoming increasingly common.

4. Good governance: basic principles

The OECD Task Force stated that “there is no single model of good corporate governance.” However, it did propose a set of principles to provide guidance on sound practices and a framework for assessing the state of governance. These principles address such issues as the rights of shareholders, the role of *stakeholders* (in contrast to *shareholders*), what kinds of information should be disclosed (transparency), and the responsibilities of the board of directors.

To remain competitive in a changing world, corporations must innovate and adapt their corporate governance practices so that they can meet new demands and grasp new opportunities. Similarly, governments have an important responsibility for shaping an effective regulatory framework that

provides for sufficient flexibility to allow markets to function effectively and to respond to expectations of shareholders and other stakeholders.

The OECD principles reflect input from officials concerned with governance in many member countries, and they are a helpful guide. However, they are particularly directed at the world of commerce, and are somewhat less useful with respect to governance in other kinds of organisations, such non-profits, charities, government agencies, governments themselves or global governance.

Whereas businesses tend to focus primarily on how to enhance rewards to shareholders, these other kinds of organisations are usually concerned with wider issues: how to address societal problems or reconcile the views of competing constituencies, how to set policies that reflect the overall public interest. For these organisations, governance tends to be even more complicated than in business because of the intractable nature of many public sector issues. For example, in public sector organisations, different views may exist as to what constitutes “success”. Similarly there is often difficulty in measuring performance. There are often powerful differences of view as to what lies at the root of social or economic problems. Underlying these may be important differences of values or culture.

The United Nations Development Program (UNDP) has articulated another set of principles of good governance that are somewhat better suited to public organisations than the OECD version. These are rooted in documents approved by governments from many parts of the world, notably, the Universal Declaration of Human Rights. A somewhat simplified version of the UNDP principles has been developed by the Institute On Governance (see Appendix A for details).

According to this approach, good governance exists where those in positions of power are perceived to have acquired this power *legitimately*, and there is appropriate *voice* accorded to those whose interests are affected by decisions. Further, the exercise of power results in a sense of overall *direction* that serves as a guide to action. *Performance* is a third criterion: governance should result in performance that is responsive to the interests of citizens or stakeholders.

In addition, good governance requires *accountability* between those in positions of power (agents) and those whose interests they are supposed to be serving (principals). Accountability cannot be effective unless there is transparency and openness in the conduct of the organisation’s work. Finally, governance should be *fair*, which implies conformity to the rule of law and principles of equity.

This approach encompasses the principles contained in the OECD statement, but it goes further. In concert with the OECD principles, it can provide a valuable framework for assessing approaches to governance in different settings¹⁵ – for example, for governments themselves, as well as for pan-governmental organisations and also for multilateral development institutions and related entities, such as the new “Multisectoral Global Funds”(MGFs) now being established.¹⁶

¹⁵ For example, this set of principles was adopted by an International Congress on Protected Areas in 2003 as a framework for determining what constituted “good governance”. Protected Areas can be governed in many different ways: e.g. by governments, Aboriginal peoples, non-profit organisations, state owned agencies, communities or private corporations.

¹⁶ MGFs “are emerging as an increasingly popular and important mechanism for the mobilization and distribution of new international revenues. Several ... have annual disbursements that are as large or exceed the core budgets of the largest UN agencies.... Yet comparatively little is known about the way MGFs operate....” There are also considerable uncertainties as to the kinds of governance arrangements that should be put in place for these entities. See Heimans, Jeremy J., “Multisectoral Global Funds as instruments for financing spending on global priorities.”, ST/ESA/2002/DP.24, DESA Discussion Paper No. 24, United Nations, September 2002.

5. How governments and regulators have responded

Much of the burden of improving governance falls directly upon individual corporations. However, it is questionable how much change would have occurred if the task of improvement had been left entirely in the hands of the free market. Certainly until the Enron scandal broke, it appeared that many businesses viewed corporate governance as a distraction from the ‘real’ business of the company. Absent a more stringent regulatory environment, this attitude may well have persisted post-Enron.

However, around the world, government ministries and agencies with regulatory responsibilities related to business have been taking a hard look at their policies. Different countries have adopted different approaches in light of their circumstances, culture and legislative traditions; but there has been significant movement in many jurisdictions. The push for reform has affected not only the business sector, but also other sectors and institutions, including international organisations, charities and non-profit organisations. In the next section, we consider how corporate governance has been dealt with in two jurisdictions: the USA and the UK.

The USA

As one might expect in light of the importance of US financial markets, the regulatory changes with the widest global impact are those in America. Not long after the Enron fiasco, Congress passed the Sarbanes-Oxley Act (“SOX”) of 2002. In addition, the New York Stock Exchange, the NASDAQ and the Securities and Exchange Commission have all been weighing in with new requirements. This process is ongoing. Simply keeping up with this fast-changing regulatory context occupies legions of corporate lawyers, both inside and outside the USA¹⁷. This is because any corporations and organisations that do business on American financial markets, (including multilateral institutions such as the IMF, the World Bank and regional development banks) have all had to take account of these provisions, no matter where they are located.¹⁸

The implications for business conduct have been substantial. Significant new requirements for reporting ownership-related information were imposed. Provisions related to a code of ethics for senior financial officers were also under review. Personal loans to corporate executives were banned, and more stringent requirements imposed with respect to business expense payments and the use of stock options. New rules were formulated with respect to the composition of corporate boards of directors, calling for a higher proportion of “independent” directors and imposing tighter definitions of what “independent” means.

Similarly, more stringent requirements were imposed with respect to the membership of the audit committee, its mandate and the capabilities of its members. Independent directors were called upon to assume a more explicit role in the determination of executive compensation. Companies were enjoined to disclose their corporate governance guidelines, and to adopt explicit codes of business conduct. This information should be posted on the company’s web site.

Further, new regulations were either proposed or enacted with respect to various internal control procedures and to the nature and timeliness of financial reporting. Specific new requirements concerning “off-balance sheet” transactions (of the kind used by Enron) were enacted.

¹⁷ Firms with significant corporate law practices have been called upon to ensure that their clients are in compliance with these new requirements, and many have produced extensive briefs on the implications of the changes. See, for example, http://www.lockeliddell.com/newsevents/files/Corporate_Governance_Alert.pdf#zoom=100.

¹⁸ See, for example, the IBRD / IFC joint review of SOX: SecM2003-043 8, IFC/SecM2003-0060 October 1, 2003.

These developments have not been without controversy. Despite a general consensus that business practices need cleaning up, some believe the new US regulatory environment was imposed with insufficient forethought. Questions have been raised as to whether the rules will result in desired outcomes. The American Association of Bank Directors, for example, wrote an open letter to the NYSE to register concerns over the new definition of director independence. Other concerns voiced with respect to SOX include the following:

- Small companies may now avoid going public because it is too expensive to comply with SOX.
- The act places an unreasonable burden of responsibility on board members.
- SOX relies heavily on criminal sanctions to produce desired behaviour. But criminalisation of white collar crimes has had mixed results – is it the best deterrent?
- SOX may make it too hard to form and run a company, which will be detrimental to the economy.
- With its emphasis on detailed rules, SOX will simply encourage companies to meet the letter of the law but then they will search for new loopholes – which they will inevitably find. Detailed rule-making does not work unless appropriate *values* are at play – this should be the real focus of reform.

What about outcomes? *The Economist* in December 2003 reviewed recent developments at two major US corporations, Disney and Boeing. It concluded by expressing doubt as to “the efficacy of rules-based solutions alone for the boardroom.” Similarly, it argued, even “good governance and a tough, independent board do not guarantee good corporate behaviour.”¹⁹ *The Economist*’s analysis illustrates how complex the challenge of improving business behaviour can be, and how, for any organisation, achieving the goal of sound governance is likely to be an ongoing journey rather than a single voyage.

Developments in the UK

The wave of corporate governance reform has also been sweeping the United Kingdom. In the British tradition, the UK has not adopted the American rules-based approach, and has opted for more reliance on principle.

As in the US, developments in Britain in the 1990s were driven in part by a series of high profile scandals.²⁰ Among these was the looting of pension funds by Robert Maxwell at the Mirror Group in the early 1990s. It was found that a large amount of Mirror Group pension fund money was being invested in companies in which Maxwell had an interest: it was estimated that some £458 million were missing from various Maxwell pension funds.²¹ As in the case of Enron, a major accounting firm – in this case Coopers and Lybrand (now part of PriceWaterhouse Coopers), was implicated. It was found to have become “too close [to the company] to see what was going on” and it eventually admitted 59 errors of judgement. Another scandal involved businessman Asil Nadir, who had diverse interests within his Polly Peck empire. He fled the UK in 1993 for northern Cyprus to avoid charges of theft.

In light of these kinds of scandals, several high-profile committees were established to examine corporate governance. The “Cadbury Report” reviewed financial aspects of corporate governance and

¹⁹ *The Economist*, “A tale of two boards”, December 6, 2003, 13-14.

²⁰ M. MacLean, (1999) ‘Corporate Governance in France and the UK: Long-Term Perspectives on Contemporary Institutional Arrangements’ *Business History* 4(1), 88-116 quoted in James Kirkbride and Steve Letza (2003)

²¹ Prem Sikka, ‘Maxwell Auditors and Self-Regulation: The Verdict’, *University of Essex*
<http://visar.csustain.edu/aaba/auditmaxwell.htm>

produced a widely cited “*Code of Best Practice*”.²² This report in particular was seen as a landmark in UK thinking about governance issues, particularly on the roles, responsibilities and linkages of executive and non-executive directors, auditors, shareholders and boards of directors. The 1995 Greenbury Report on directors’ remuneration stressed accountability, transparency and the need to link rewards to performance. Its recommendations were incorporated into *the London Stock Exchange Combined Code*.²³

The Hampel Committee was established to review the implementation of Cadbury and Greenbury findings.²⁴ Two further reports – the Turnbull Report and the Higgs Report – were undertaken under the auspices of the Department of Trade and Industry to examine what changes were necessary to regulatory regimes of audit and corporate governance.²⁵ The debate in the UK has centered on the same issues as in the U.S.: concern about corporate fraud, the abuse of managerial power and social irresponsibility.²⁶

An important development was the publication in 1998 of *the London Stock Exchange Combined Code*. Companies listed on that exchange are now required to state in their annual reports the extent to which they have complied with each of the Code’s provisions and over what time scale. Noncompliance must be explained, although the structure and content is left up to the companies. Many public bodies also see value in the Code for themselves and are implementing its provisions.

In a recent article, Sir Adrian Cadbury asked what the impact of these codes and this committee work has been on the governance agenda and on the balance of corporate power. He argued that they have been followed quite quickly. For example, the UK Cadbury Committee’s “*Code of Best Practice*” (which was the bedrock for the London Stock Exchange’s code) recommended that there should be an agreed procedure for directors to obtain independent professional advice. Cadbury reported that while a few leading firms had such a procedure in place at the time the Code came out, two years later the vast majority of the top 1550 companies listed on the London Stock Exchange had implemented that recommendation.²⁷

Another area where change occurred during the 1990s was with respect to the relationship between the chair of a board and the chief executive of the corporation. The Cadbury report recommended that these roles should be split. It would appear that there has been movement on this front as well.²⁸ In general, in the UK, it seems to be more widely believed that to maintain a proper balance of

²² The 1995 report of the Cadbury Committee (the Committee on Financial Aspects of Corporate Governance, chaired by Sir Adrian Cadbury), is available at <www.ecgi.org>.

²³ The Greenbury Committee’s 1995 *Directors’ Remuneration Report* is available at <www.ecgi.org>.

²⁴ The Hampel Committee’s 1998 *Committee on Corporate Governance – Final Report* is available at <www.ecgi.org>

²⁵ The Higgs Report (*Review of the role and effectiveness of non-executive directors*: January 2003) is available at <www.dti.gov.uk> and the Smith Report (*Audit Committees: Combined Code Guidance*: January 2003) is available at <www.frc.org.uk>.

²⁶ James Kirkbride and Steve Letza (2003) ‘Establishing the Boundaries of Regulation in Corporate Governance: Is the UK Moving Toward a Process of Collibration?’ *Business and Society Review* 108:4, p. 463.

²⁷ Cadbury, *The Corporate Governance Agenda*, p. 11.

²⁸ “There is a key difference here between the UK CE and the US CEO. In America, the CEO is more often like a combined UK Chair and CE role, whereas the UK Chief Executive has a Chair (usually non-executive/outside/part-time) to whom s/he is accountable.” A. Pye (2001) ‘A Study in Studying Corporate Boards Over Time: Looking Backwards to Move Forwards’ *British Journal of Management* 12: p. 36.

power, the two roles should be held by separate individuals. This is reportedly the case in more than 70 percent of UK public companies, but in only about 20 percent of US companies.²⁹

As in the case of the US, keeping on top of current developments in the UK is not easy. After a decade of reports and studies, the government began to take a closer look at the British regulatory framework. It initiated a series of reviews, primarily under the auspices of the Department of Trade and Industry (DTI), to examine what changes should be made.³⁰ The House of Commons Treasury Committee also undertook its own inquiry, to which the government responded. In the wake of all this study, Patricia Hewitt, the Trade and Industry Secretary, stated in Parliament that there was no need for the UK to rush into a US-style *Sarbanes-Oxley Act*. It was suggested that UK audit and accounting practices were more robust than those in the USA.

Nonetheless, the British Government did launch a review of UK company law. In July 2001, the Reviewing Steering Group delivered its final report, following which, in July 2002, Secretary Hewitt released a White Paper called “Modernizing Company Law”. This set out the government’s proposals for reform, including:

- new transparency provisions
- reforms to auditing and reporting
- using small companies as the basis of company law
- modernizing and simplifying decision-making
- roles and duties of directors more clearly defined
- the creation of a new type of corporate vehicle, the Community Interest Company, to promote social enterprise
- establishment of a statutory Operating and Financial Review (OFR) for large companies.³¹

A year later, Secretary Hewitt announced plans for a new *Companies Bill* designed to implement changes to the law and restore investor confidence.

In some areas, however, considerable uncertainty persists.³² It remains to be seen how these issues and proposals will play out in the next few years.

6. The role of the board

Early views of the board's role

At the heart of much of the debate about corporate governance is the role of the board. What should it do, and how should it be equipped to play this role? For many years, in the private sector, boards were seen more or less as male clubs. Their function appears to have been social as much as business-related: periodic meetings in comfortable surroundings where colleagues and business associates discussed issues of interest and approved the plans of senior management. Board members were well remunerated for the performance of fairly perfunctory responsibilities and were selected on the basis of established connections and similarity of outlook and values.

²⁹ Hugh Parker, ‘The Chairman/CEO Separation: One View’ *Corporate Governance II*, www.thecorporatelibrary.com/cgii/CGD06.htm

³⁰ Ian Dewing and Peter Russell (2003) ‘Post-Enron developments in UK audit and corporate governance regulation’ *Journal of Finance Regulation and Compliance* 11:4, p. 309.

³¹ See <http://www.dti.gov.uk/companiesbill/whitepaper.htm>

³² For example, non-executive directors are currently not yet defined in law. As a result, there is both confusion and disagreement about what their role really is, or ought to be. Likewise, questions remain about how to deal with management fraud and whether this requires checks and balances outside the executive to prevent it.

An emerging role

Scandals – not only landmark ones such as Enron, but a continuing procession of new ones in many countries (Britain, the US, Australia, Italy, Canada, and others) - disturbed this equilibrium. Board members began to become uncomfortably aware of their stewardship responsibilities and of their personal liabilities as directors. In the non profit sector, as more demands were placed on voluntary organisations and as fund-raising needs became more pressing in the wake of government cut-backs, both executive directors and board members began to wonder how to make governance more effective. Both staff and board noted that often, boards did not seem to add much value to the organisation. Executive directors sought ways to disentangle board work from staff work. They also looked for a rationale to prevent board members from trying to micro-manage the work of paid staff. Was there in fact a meaningful role for the board; if so, what was it, and how should it be discharged?

These concerns have led to the emergence of a role for board of directors - a governance role - that is both more substantive and more clearly defined than in the past, and somewhat distinct from the role of staff. The process of refining the role and composition of boards has affected all sectors of society – businesses, non-profit organisations, charitable trusts, government agencies, public corporations, international organisations, multinational corporations – alike. Our focus in the next section will be on the private or corporate sector in particular.

The tasks of governance

What are the tasks associated with governance and who should carry them out? There are many versions of governance responsibilities, promulgated by organisations such as the OECD, stock exchanges, regulatory agencies, government treasury departments, consultants, academics and others. Different versions emphasize some functions more than others. However all fall within the broad realm of stewardship, direction and oversight. This version draws on various sources.³³

- 1) *Developing and maintaining a longer term vision.* Most observers agree that a well-governed organisation whether in the private, quasi-governmental or non profit world, benefits from a sense of direction that defines where the organisation wishes to go over the longer term. Sound governance would suggest the need for a defined process or discipline for developing such a vision and updating it periodically.
- 2) *Ensuring the prevalence of high ethical standards.* Strong organisational values lie at the root of sound governance. Boards are sometimes described as the custodians of these values;³⁴ certainly those values will be reflected in what has sometimes been described as the single most important responsibility of the corporate board, namely, the appointment and evaluation of the top staff person (chief executive, managing director, CEO, etc.) In practice, this individual may have as much or even more impact on organisational values than the board; nonetheless, through its policies and hiring practices the board can play a key role in this area.

³³ This list reflects a private sector orientation. In the case of a public sector, or quasi-public sector board, corporate entities may well have a public policy role that they are expected to discharge. Thus *meeting public policy objectives* would have to be added to this list as a central governance responsibility. (This may also be true in the case of certain non profit organisations, particularly if they receive directed financing from government.)

³⁴ According to proposed revisions of the OECD principles under consideration at time of writing, “The board has a key role in setting the ethical tone of a company, not only by its own actions, but also in appointing and overseeing key executives and consequently the management in general.” (*Annotations to the OECD Principles of Corporate Governance, section V – C*). Also cited in this connection are the rights of stakeholders, including employees, to freely communicate concerns they may have about illegal or unethical practices to the company.

The organisation's values and beliefs will shape the conduct of all important business activities. Governance-related values might include, for example, attitudes about transparency and openness, the role of stakeholders, public consultation, how staff should be treated, how managers should behave, what trust should be accorded to suppliers or clients, conformity with regulatory or legal requirements, or, in the non-profit sector, the role of volunteers. Values relate closely to basic principles of good governance, about which we shall say more below.

- 3) *Ensuring effective performance through sound information.* Both boards and senior management should have at their disposal sound information related to the strategic aspects of performance. Boards need to be involved in defining their own information needs - it is not enough to leave this job entirely in the hands of management.

Particularly for public sector organisations, determining what constitutes effective performance can be a conceptual challenge. Activities need to be distinguished from results or outcomes. Causal relationships need to be explored. Intangibles need to be measured, perhaps through proxies of some kind. The discipline of results-based management (RBM) and the application of these concepts to multilateral organisations (the multilateral effectiveness framework, or MEFF being developed by DFID and other aid agencies) are examples of this type of work.³⁵

Good information on performance should also allow the board to know whether or not its policies and directives have been implemented.

- 4) *Ensuring financial and organisational health.* Both the finances and the organisation itself need to be in good condition. Financial stewardship is sometimes interpreted as making sure funds are properly spent and accounts properly maintained. While these aspects of financial oversight are important, this perspective overlooks the important responsibility of ensuring that future revenue needs are provided for. This is - or should be - the principal preoccupation of most boards in the voluntary sector.

Stewardship also implies a responsibility to ensure, at a 'macro' level, that the organisation is well run, that sound organisational values prevail, and that staff are well motivated. Historically, some staff executives took the view that these issues were outside the purview of the board. More recently, recognizing the correlation between sound human resource management practices and corporate performance, many boards have taken a more active interest in these dimensions of stewardship.

- 5) *Ensuring sound relationships.* Organisations depend on a web of key relationships to perform. These will typically include customers, investors, partners, regulators, and suppliers in the private sector; and in the non profit sector, members, stakeholders, volunteers, community groups, clients, and others. Sound governance demands that these important relationships be in good shape. Board and staff often share this responsibility. The OECD principles make a point of underlining the legitimacy and importance of *stakeholders* as well as *shareholders*.

- 6) *Managing risk.* Recent concerns about corporate scandals, combined with the growing range of risks facing the modern organisation in a complex society, have raised the profile of this function in many corporations. Risk management is seen as "central to effective governance" in many organisations today. It has been defined as "identifying, assessing, measuring, mitigating, communicating, and monitoring"³⁶ important developments that may have an uncertain outcome.

³⁵ "An effective partnership between board and management means that ... boards must *realistically* define what they want, when, and in what form. Management needs to be proactive in getting the board the information it needs and keeping the dialogue going." Campbell & Hushagen, p.7)

³⁶ *Risk Management Tool and Guide for Cooperatives and Credit Unions*, Brown, Debra L., and David A.H. Brown, Canadian Cooperative Association, July 2003.

Such developments may encompass not only financial risks but others, such as human resource management risks, risks arising from changes in government policy or legislation, competition, and others.³⁷

7) *Rendering account.* One of the main governance responsibilities is to ensure that account for performance is well rendered by agents to principals. Rendering account can be interpreted narrowly, for instance, simply as the publication of financial reports as required by law. However, a corporation committed to the principle of transparency will have a more open and proactive approach to its accountability responsibilities. "Rendering account" can have implications for what kinds of information are collected, what corporate documents are made public, the design of the website, the outreach activities of the corporation's board and staff, the level of detail provided in reports, as well as what policies and practices are adopted vis-à-vis public consultation.

This responsibility also requires a corporation to consider where its major accountability relationships lie, and how to maintain them well.

8) *Ensuring the soundness of the governance system.* In the past, it was sometimes unclear in corporations just who was responsible for governance-related policies. Recent concerns have now made it apparent that monitoring contemporary developments in governance and updating the state of a corporation's own system are key governance tasks. Some corporations have appointed a committee of the board to take on this responsibility. Others have linked this task to the role of the nominating committee of the board, while still others have set up specialised governance departments at the staff level.

New policies and practices for boards

As governance tasks have become more clearly defined, many boards have adopted new measures to try to make their work more efficient, and to establish a clearer separation between the responsibilities of governance and the role of management. The following are examples of such measures:

- Role descriptions for boards that are distinct from staff responsibilities.
- Private board meetings where staff do not attend, allowing for more open discussion.
- New rules, as noted above, requiring that a certain proportion of directors be "independent" or outside the corporation, to ensure more objective judgement is brought to bear on key governance and accounting issues.
- Agendas for board meetings that are set by the chair or an executive committee composed of board members, in lieu of agendas developed by staff and meetings run according to staff priorities.
- Explicit authority for boards to retain independent outside advice if necessary.
- Better preparation for board meetings; shorter, more focused background documentation distributed in a timely manner.
- More careful definition of the qualifications and appointment processes for board members, and more priority to the orientation and training of new board members.
- Procedures for the routine evaluation of board performance, and sometimes, for evaluation of the performance of individual board members.
- Better management of board meetings, more effective chairmanship and tighter time management.

³⁷ DFID officials concerned with MDIs may wish to ensure they are familiar with DFID policies related to risk as set forth in "Managing Fiduciary Risk When Providing Direct Budget Support" (March 2002) and with the DFID "Risk Management Policy Framework" (November 2002).

- Clarification of the terms of reference of committees of the board, differentiation between standing committees and task forces with more focussed, time-bounded mandates.

Board-staff relations

An issue that many boards have found troublesome is where the border between board and staff responsibilities related to governance should be drawn. At one extreme is the view that governance is the unique province of the board, and that the board should focus solely on "ends" and on the formulation of governance policies. The role of staff is to deal with "means" or implementation. According to this view, very clear lines of demarcation must be set between board and staff work.³⁸

Others, including this writer, have serious reservations about this approach. "Does a one-size-fits-all approach to corporate governance make sense? ... We think the answer is probably not."³⁹ Governance is not a role conferred uniquely upon the board. Rather, sound governance requires a partnership between board and staff. Most boards cannot function effectively without staff support, and a number of the tasks described above will of necessity implicate staff. As new issues and new governance-related demands arise, it is important that the border between board and staff be watched with care so that priorities are met, areas of controversy reviewed (in all likelihood, between the senior staff executive and the board chair), and harmony maintained.

[E]ffective organisations depend on an effective partnership between governance and management, which in turn depends on clarity and differentiation of roles and functions between the two. The challenge ... is in finding the right balance where board members are actively and usefully engaged but never moving into the area of duplicating or even micro-managing the work of the managers.... [T]he board and management must both break out of traditional habits - habits that have management obscuring issues for the board, and the board delving into operational matters....⁴⁰

7. Corporate Governance and MDIs

To what extent do these developments and ideas related to board governance relate to multilateral development institutions? In exploring this question, it is important to take account of the fact that MDIs are hardly a homogenous collection of organisations. The UN agencies alone – ranging from the Secretariat through the UNHCR, UNIDO, ICAO, WFP, WHO, UNICEF, UNDP, UNEP and others – are very diverse in themselves. Further, they are part of a large, complex family that is difficult to understand without the benefit of extensive exposure to its workings and the political context within which they function.

Moreover, the international financial institutions (IFIs), including the World Bank Group (which comprises a group of organisations that are technically UN Specialized Agencies, though this is often

³⁸ The most vigorous proponent of this view is consultant and author, John Carver, whose model-based approach to board governance has been widely promoted, particularly in North America. Carver argues that his is the only conceptually coherent, universally valid theory of board governance.

Carver, John, *Boards that Make a Difference*, (2nd ed.), Jossey-Bass, 1997.

³⁹ Conger, Jay, Edward E. Lawler III, and David L. Finegold, *Corporate Boards - New Strategies for Adding Value at the Top*, Jossey-Bass, 2001, p.165. See also the OECD Principles: "There is no single model of good corporate governance."

⁴⁰ *Issues, Concerns and Best Practices in Governance in the Non-Governmental, Public and Corporate and Intergovernmental Sectors*, Campbell P. and J. Hushagen, (Working document for World Food Program), January, 2000, 2-4.

forgotten), the Asian Development Bank, the Caribbean Development Bank, the European Bank for Reconstruction and Development, the Inter-American Development Bank and the African Development Bank, likewise comprise a very diverse group of organisations. Although there is a superficial similarity, just below the surface one finds different memberships, purposes, corporate cultures and traditions, kinds of staff, financial arrangements and constitutions⁴¹. For these reasons, one must be careful about generalizations related to the governance of these organisations.

Differences between private sector corporations and MDIs

Furthermore, these institutions are different in important ways from private sector corporations. At a very broad level, their institutional structure differs significantly from that of a private corporation. Below, in diagram (2), we outline in schematic form the organisation of the World Bank.

When this is compared with the conventional corporate structure outlined in diagram (1) above, some important differences emerge – for example:

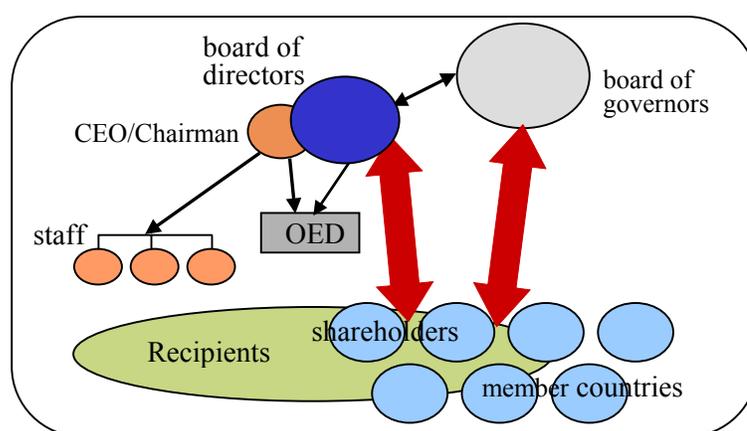


Diagram (2) – Governance at the World Bank

- The Board is chaired by the CEO, a member of staff
- The Executive Board, or board of directors, is subordinate to the Board of Governors
- Both the Board of Governors and the Board of Directors are accountable to the shareholders, but these are governments, not institutions or individuals
- Unlike the world of business, where shareholders of a given corporation tend to have similar interests, the shareholders of the Bank have very diverse values and objectives
- Unlike the board of a business corporation, the board of the Bank is in more or less permanent session
- Directors at the Bank have weighted votes, unlike directors of business corporations who typically all have an equal voice in decision-making.
- Directors of business corporations are increasingly selected to fill particular needs of the corporation in terms of expertise, contacts, or professional knowledge. Directors of the Bank are selected by member countries on the basis of criteria that may be entirely different.

⁴¹ See for example the undated DFID International Division document, “MDB Governance Best Practices” which compares governance arrangements at the European Investment Bank, the European Bank for Reconstruction and Development, the Inter-American Development Bank, the African and Asian Development Banks.

The new approaches to governance being adopted in the private sector provide a framework against which to consider governance arrangements in multilateral development institutions. Comparisons may raise some useful questions to be asked in relation to MDIs. At the same time, the limitations of the corporate perspective should also be taken into account.

Limitations of the corporate perspective

DFID's intention is to ensure that the funds it allocates to MDIs are used effectively for poverty reduction purposes. Most discourse in the private sector has been concerned with issues of financial propriety and the elimination of greed and corruption. These concerns certainly need to be taken into account in consideration of governance at MDIs, but good governance is about more than this. Corporate governance principles do not of themselves provide a sufficient frame of reference for considering what policies should be adopted vis-à-vis the governance of MDIs.

For example, noticeably absent from most current debate about corporate governance are questions about the broader purposes of private corporations. Commentators have yet to see the connection between the goal of good governance and the literature on corporate social responsibility (CSR). CSR seeks to enlarge the objectives of private companies beyond profit making to include sustainable development and the need to address the social, economic and environmental impact of their operations (the triple bottom line approach encouraged by the European Union). It raises profound issues with respect to the accountability of corporations, as well as considerations of equity, effectiveness and responsiveness – the kinds of issues highlighted in the “good governance” principles outlined in Appendix B to this report.

“Good governance” at MDIs

Governance issues at the UN

There is ongoing international debate about what constitutes “good governance” in MDIs. At the United Nations, most of the criticism revolves around performance, legitimacy and voice.⁴² Critics say the UN is inefficient, too bureaucratic and too costly. These criticisms have led to the withholding of membership dues and, in the past, intense pressures for changes in top-level leadership. The UN spends about \$12 billion annually. At the end of 2001, arrears to the regular UN budget and peacekeeping totalled \$2.1 billion. (Some 38 percent of arrears (\$690.9 million) were outstanding contributions by the United States.) Arrears severely restrict the effectiveness of UN operations.

As for voice and legitimacy, the “one country, one vote” system is supposed to make the UN a completely democratic institution. However, some member states clearly have more sway than others. The United States, because of its veto power on the Security Council, financial contributions, and military might can subvert the multilateral intentions of the UN. Critics of the Security Council say it needs to be completely restructured, arguing that the five permanent members⁴³ have too much influence, while others have too little or none.

Civil society actors feel they are not heard or taken seriously by governments and the UN Secretariat. They want the UN to be more active in providing funding, training and information for southern NGOs to participate effectively in the UN's work. Civil society organisations want access to

⁴² Melles, Brenda, “Key Governance Issues at the United Nations”, Briefing Note, Institute On Governance, August 2003.

⁴³ China, France, Russia, UK, and the US

The New Rules of the Board Game, Tim Plumptre, Institute On Governance, Ottawa, 2004.

the General Assembly and the Security Council. On the other hand, some member states question the legitimacy, representativeness, sources of funding, “hidden agendas” and tactics of civil society organisations and resist increasing their participation. UN Summits are seen by some as a kind of ‘medieval fair’, where all causes set up their stalls. There is fear that increasing participation might overwhelm the system and pose security challenges. Some governments see civil society participants as predominantly pushing for a “northern cultural view”.

Another contested issue is leadership. Leadership selection is not a truly democratic process. The Secretary-General is appointed by the General Assembly on the recommendation of the Security Council. The Secretary-General's selection is therefore subject to the veto of any of the five permanent members of the Council.⁴⁴

Governance Issues at the World Bank

As noted above, development banks differ in important respects, and governance issues that might top the agenda at, say, the IADB, would not necessarily have such priority at the ADB or the World Bank. However, to illustrate how governance issues raise wider concerns at MDIs than they do in the corporate world, a brief review of concerns vis-à-vis the World Bank may be helpful.

Much of the critique of the World Bank centers around how it formulates and applies its policies, including their social and economic impact. Criticism is often focussed on:

- the perception that the Bank forces its agenda on developing countries;
- the attachment of loan conditionalities based on the “Washington Consensus” of neo-liberalization without due regard for individual circumstances of borrowers and with sometimes disastrous economic, social and environmental impact;
- the types of projects that are funded (specifically, large infrastructural projects) and their impact on environment and people living in the project area;
- the championing of the private sector and its potential to undermine the role of the state as the primary provider of essential goods and services such as health care and education;
- the role of the World Bank in shaping the development discourse through its highly regarded research, training and publishing, which may undermine or eliminate alternative perspectives.

The World Bank also falls prey to criticisms on its own governance – especially ironic given the Bank’s strong commitment to governance-related programs in the countries in which it works.⁴⁵

As in the case of the UN, concerns about the Bank’s governance relate to both voice and legitimacy. Rich country Executive Directors control over 60 percent of the votes. The combined total of developing country votes is 39 percent. Low and middle-income countries as a group comprise 84 percent of the world’s population, yet they have only 30 percent of IFI votes, and less than half the seats on the executive boards of these organisations.⁴⁶

⁴⁴ For example, the US exerted intense pressure – both through public statements and through withholding membership dues - for former Secretary-General Boutros Boutros-Ghali to step down because the US felt he did not adequately support US proposals for UN reform.

⁴⁵ In FY 2002, for example, 24 percent of IBRD lending and 19 percent of IDA lending went to projects themed “public sector governance”.

⁴⁶ Options for Democratizing the World Bank and IMF. February 2003. Christian Aid.

www.christian-aid-org.uk/indepth/0303options/options.pdf

The structure of the 24-member Executive Board does not favour the participation of the countries whose populations are most in need of Bank assistance. Seats and votes are allocated to countries according to economic size or historical significance. The 46 sub-Saharan African countries have two Executive Directors to represent them on the Bank Board, while the five largest vote holder countries have a single Executive Director each (the US, UK, Japan, Germany and France). The offices and the Directors representing poorer countries are overstretched and have limited access to the expertise they need.

Selection of the leaders of the World Bank and IMF is non-transparent, and limits applications on the grounds of nationality. An unwritten convention means that the European countries nominate the IMF Managing Director while the USA nominates the World Bank President and the IMF Deputy Director.⁴⁷ Other criticisms of the Bank have, for example, questioned whether the goal of poverty alleviation is best achieved by its lending for social sectors, and whether in their quest for a well-endowed IDA, developing countries may not be sacrificing their larger interests in the global system⁴⁸

8. Conclusion: the quest for good governance

In the world of international development, where discourse and thinking have been dominated by economics for years, the importance of institutional factors is finally being recognized. The advent of governance draws our attention to how the big decisions get taken and to the classic governance questions: who has power, whose values are at play, how is direction set, who has voice, how are leaders held to account, what are the checks and balances on the exercise of power, how is accountability made real.

Governance is not a fad. It is here to stay. As Sir Adrian Cadbury stated in the Preface to his book on *Corporate Governance and Chairmanship*, “The central issues of governance ... know no boundaries and are universally relevant.” Our ability to ‘get governance right’, with all the complex questions of judgement that are involved in this quest, will have a powerful impact on our capacity to build well-performing corporations, to establish responsive institutions and – most important – to eliminate the scourge of poverty around the world.

⁴⁷ “Apart from the practice of the executive boards appointing IFI leaders, neither the World Bank nor the IMF has formal selection procedures... Not only are non-European and non-US members unable to nominate candidates, there is no opportunity for them to make a selection between nominated candidates, since a list of nominations is not presented.” (Options for... 2003, 5). Critics argue that selection should be open to all qualified candidates, regardless of nationality, with clear criteria and timelines for selection. Saul, Graham. 2003. Transparency and Accountability in International Financial Institutions. Bank Information Centre.

www.bicusa.org/publications/IFI_Transparency_Chptr.pdf

⁴⁸ See Kapur, Devesh, “Do as I say and not as I do”, a critique of G-7 proposals for “reforming” the World Bank, Department of Government, Harvard University. Kapur argues that the locus of policy-making has effectively shifted from the IBRD’s Executive Board to the IDA Deputies (the representatives of donor countries). This paper contains a useful appendix summarizing reform proposals for development banks from a variety of sources.

The New Rules of the Board Game, Tim Plumptre, Institute On Governance, Ottawa, 2004.

Appendix A: Principles of Good Governance Based on the UNDP Framework

<i>Principles of Good Governance</i> <i>(Derived by the Institute On Governance, 2003)</i>	
Five Good Governance Principles	UNDP Principles and related UNDP text on which they are based
1. Legitimacy and Voice	<p>Participation – all men and women should have a voice in decision-making, either directly or through legitimate intermediate institutions that represent their intention. Such broad participation is built on freedom of association and speech, as well as capacities to participate constructively.</p> <p>Consensus orientation – good governance mediates differing interests to reach a broad consensus on what is in the best interest of the group and, where possible, on policies and procedures.</p>
2. Direction	<p>Strategic vision – leaders and the public have a broad and long-term perspective on good governance and human development, along with a sense of what is needed for such development. There is also an understanding of the historical, cultural and social complexities in which that perspective is grounded.</p>
3. Performance	<p>Responsiveness – institutions and processes try to serve all stakeholders.</p> <p>Effectiveness and efficiency – processes and institutions produce results that meet needs while making the best use of resources.</p>
4. Accountability	<p>Accountability – decision-makers in government, the private sector and civil society organisations are accountable to the public, as well as to institutional stakeholders. This accountability differs depending on the organisations and whether the decision is internal or external.</p> <p>Transparency – transparency is built on the free flow of information. Processes, institutions and information are directly accessible to those concerned with them, and enough information is provided to understand and monitor them.</p>
5. Fairness	<p>Equity – all men and women have opportunities to improve or maintain their well-being.</p> <p>Rule of Law – legal frameworks should be fair and enforced impartially, particularly the laws on human rights.</p>

Appendix B: Comparing Governance in Business with Development Banks

The table below compares conventional business corporations with development banks. The differences would be even more pronounced were UN agencies to be included in the table.

EXAMPLES OF DIFFERENCES IN GOVERNANCE BETWEEN BUSINESS CORPORATIONS AND DEVELOPMENT BANKS		
	<i>Business corporations</i>	<i>Development Banks</i>
Mission	Maximize profits and shareholder returns	Reduce poverty in less developed countries
Nature of governance concerns	To ensure sound operation of the business enterprise and effective relationships with capital markets.	Tripartite interest: (a) sound operation of the institutions (b) effective relationships with capital markets (c) to effect improvements in governance practices in multiple settings in developing countries.
Directors' meetings	Meet from time to time	In permanent session, resident status
Directors' status	No specific representative function, usually chosen for their competencies, relationships or other strengths.	Appointed by member countries, many directors may have no board experience or special competencies related to institutional needs, must represent interests of one or more member countries.
Voting	One person, one vote	Weighted voting according to member country's capital contribution, may be explicitly or implicitly recognised.
Status of board of directors	Top decision-making body	Board of Directors is subordinate to Governing Council comprising ministers from member countries. Top executives of Banks may have personal connections with Governors that can trump board members.
Role of chair	May be independent of the CEO, separate individual.	Board meetings chaired by bank president in case of IFIs, a member of staff.
Directors' interests	Generally, no interest in a permanent relationship with the corporation.	Many directors from developing countries may be interested in moving into remunerative staff positions paid in hard currency. Directors from donor countries may be moving on to entirely unrelated next posting.
Relationship to capital markets	Corporation stands on its own feet based on its financial performance.	Relationships tempered by knowledge that bonds of MDIs are usually backed by large donor governments.
Board agenda	Consists primarily of periodic issues related to corporate strategy and performance.	A complex ongoing diet of financial, political, policy and other development-related questions.
Exposure of board members	Significant personal liability could flow from errors of judgement or poor governance.	No significant personal risks associated with board membership.