

CORPORATE GOVERNANCE, SOE REFORMS AND FINANCIAL INSTRUMENTS – LEGAL ASPECTS

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CONCEPT OF A CORPORATION

- LEGAL PERSONALITY
- LIMITED LIABILITY
- TRANSFERABLE SHARES
- DELEGATED MANAGEMENT
- INVESTOR OWNERSHIP

PRINCIPAL FUNCTIONS OF CORPORATE LAW

- Provide business enterprise with a legal form with the five attributes
- Lower the cost of conducting business
- Provide a generally accepted legal core on the operation of a corporation
- By facilitating the “bundle of contracts” to take care of the ongoing relationships and cost of running a corporate entity
- Provide a basis for governance of corporation – rights, obligations, options of each participants

THE AGENCY PROBLEM

- The core of corporate governance – caused by conflict (misalignment of interests) between:
- MANAGERS AND SHAREHOLDERS
- CONTROLLING AND NON-CONTROLLING SHAREHOLDERS
- SHAREHOLDERS AND OTHER CONTRACTUAL COUNTERPARTS

How are these managed?

APPROPRIATE GOAL OF A CORPORATE FORM

- Advance aggregate welfare of all who are affected by its actions – shareholders, employees, suppliers, customers, and third parties
- Reducing cost of contracting among contractual constituencies
- Addressing externalities by regulatory constraints
- Narrow view – maximize financial returns for shareholders (but implicit in it is the understanding that maximization over a period of time is possible only through collaboration with broader stakeholders)

SOEs AND HOW THEY ARE UNIQUE

- Government involvement in certain sectors has survived waves of privatizations; listed SOEs account for over 10% of market cap; very significant presence in all major emerging economies
- Economic rationale – potential for market failure (although governments can fail too!)
- Between efficiency and cost of regulation – SOEs with some market participation have emerged as a more acceptable model
- Reduces the cost of regulation (because Government sits on the Board)
- Serves a public good and enhances efficiency

THE AGENCY PROBLEM IN SOEs

- No incentive for management competence – because there are no private owners
- Capture by rent-seeking special interest groups
- Listing in stock exchanges – takes care of the conflicts substantially
- Market price as a disciplining factor
- Bond issues (and even bank credit) have a significant positive impact (although problem of “implicit guarantee” persists)
- A major problem of corporate governance in Asia – heavy presence of state ownership

SOEs and INFRASTRUCTURE GOVERNANCE

- Context - how SOEs take decisions on major infrastructure projects
- Well planned and prepared projects as an attribute of infrastructure governance
- Affordability is governance matter
- Need for good governance of PPP initiatives - what does it entail?
- Use of project financing as a governance enhancer (presence of investors, lenders, credit rating agencies and others)

ADB's ENGAGEMENT WITH SOEs

- On a case by case basis

SOEs can be of different categories –

- Running at a loss (surviving on government subsidy) – providing an important service but no access to private capital – sovereign loans including policy loans
- SOEs adopting “user pays” model – may be pursuing greater independence from sovereign – sovereign and non-sovereign loans
- SOEs operating fully on commercial basis – non-sovereign loans

CREDIT ENHANCEMENT OF PROJECT BONDS

- In partnership with IIFCL India
- A guarantee facility to provide back-stop to IIFCL
- IIFCL provided first loss guarantee for a portion of the bond issues – resulting in better credit rating, better coupon rate and more interest among underwriters/investors
- Innovative and resource intensive
- Enhancing a market for the product
- Production of model documents for similar transactions

SOVEREIGN/NON-SOVEREIGN BLEND LOAN

- Green Energy Corridor and Grid Strengthening Project (2015)
- Financing transmission and distribution assets
- Sovereign and non-sovereign loan in one package (50/50)
- The transaction arguably provides the best of both worlds
- Longer tenor and availability period (of sovereign), and financial due diligence and rigor (of non-sovereign)
- Public sector procurement rules coupled with private sector portfolio management

WHAT WORKS IN SOE REFORM?

- Rewriting the rules and procedures of an SOE – on the role of government, minority shareholders and stakeholders, statement of objectives, transparency and disclosure
- A transaction by transaction approach – pushing the envelop and introducing market discipline
- Addressing the elephant in the room – i.e., the role of the dominant (or only) shareholder

THANK YOU