

Corporate Standards and Disclosure Around the World: What works?



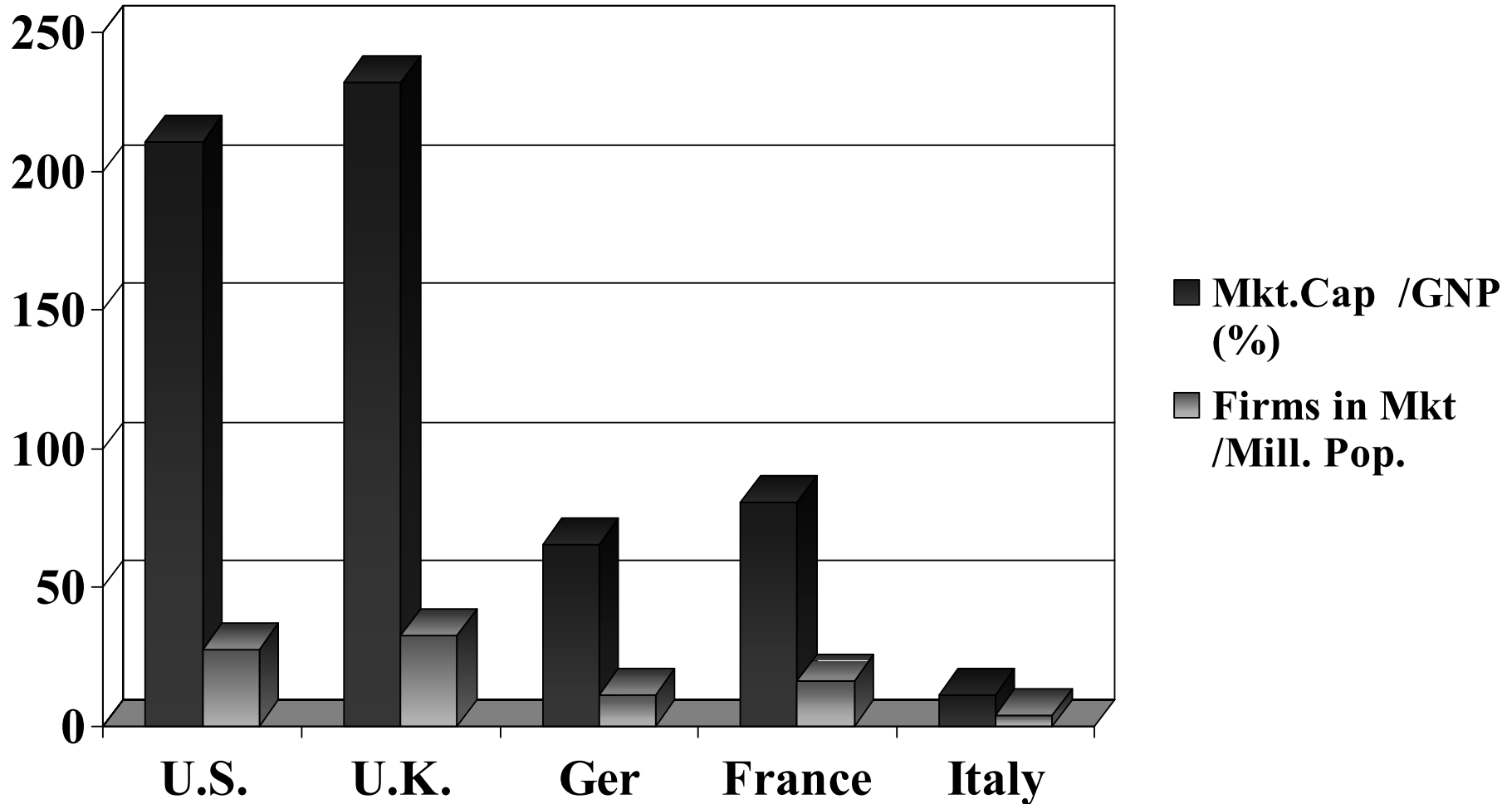
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September 20, 2002.

Why do some countries have broader and more valuable capital markets?



The Current Corporate Governance Crisis and The Role of Regulation

1. The Enron debacle and subsequent fallout hurt the image of America's boardroom practices, disclosure and accounting standards.
2. The impact of this crisis will be worldwide as standards will need to increase everywhere if money is to flow across borders.
3. The crisis calls for a better understanding of the role of regulation in securities markets, corporate practices and accounting standards.
4. We need to understand more about the mechanisms and channels through which corporate governance leads to better outcomes.
 - What are the virtues and problems of different accounting systems?
 - What is the role disclosure in general?
 - Who should be responsible for disclosure and the enforcement of conflicts of interest?
 - How should one go about increasing disclosure standards, particularly in the area of conflicts of interest around the world?

Today's Question:

The Role of Regulation on Disclosure and Corporate Standards

○ Regulation:

- It appears to be efficient from the enforcement viewpoint in many cases, and there are many successes.
- It also appears to fit more naturally with the civil law tradition.

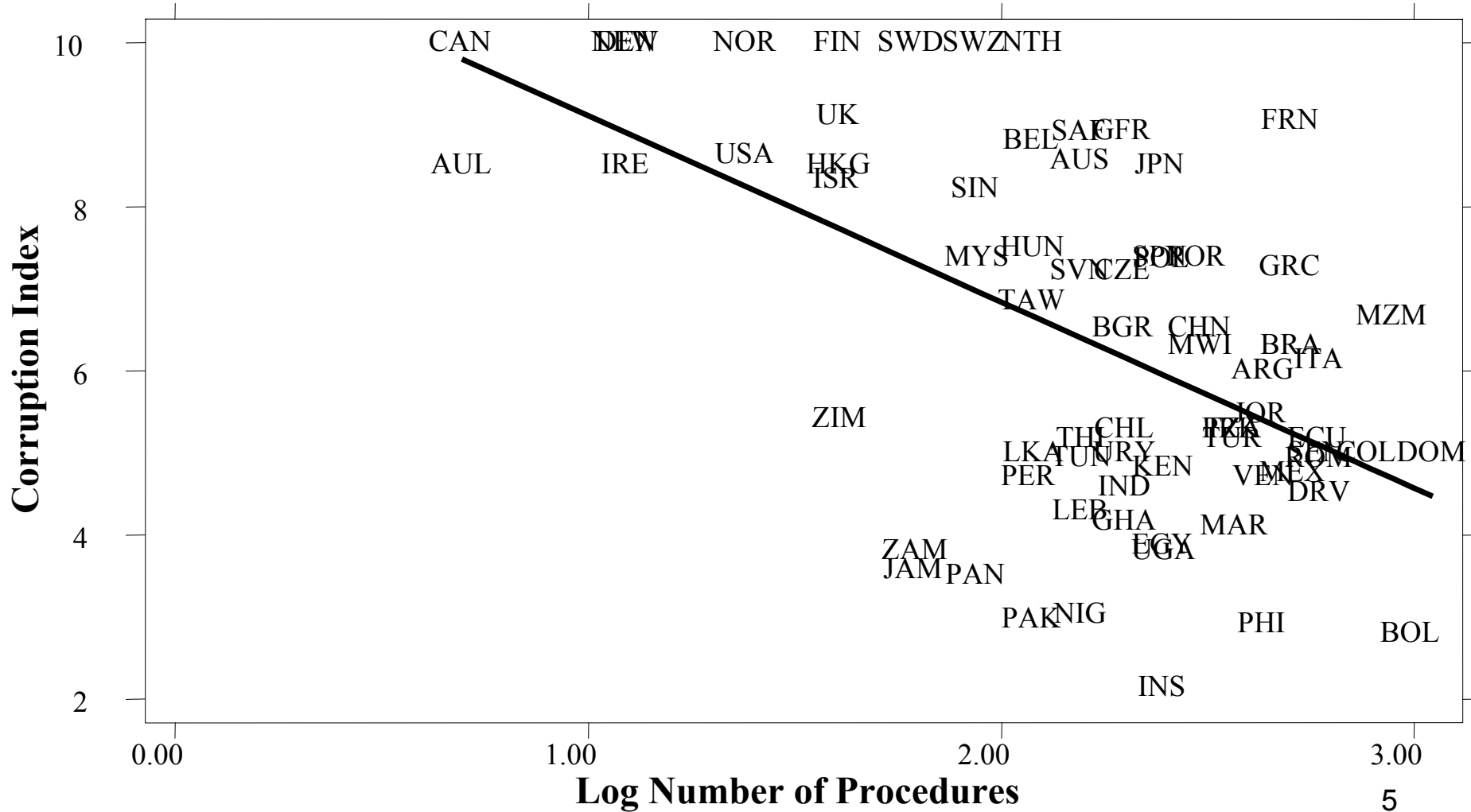
○ But...

- It has more serious problems of capture and political abuse.
- The evidence on regulatory performance is very poor, especially in developing countries. Stricter regulation is associated with:
 - ↑ Employment in the Informal Economy; and
 - ↑ Corruption.

○ Do we want to promote shareholder litigation or increase powers to the regulator?

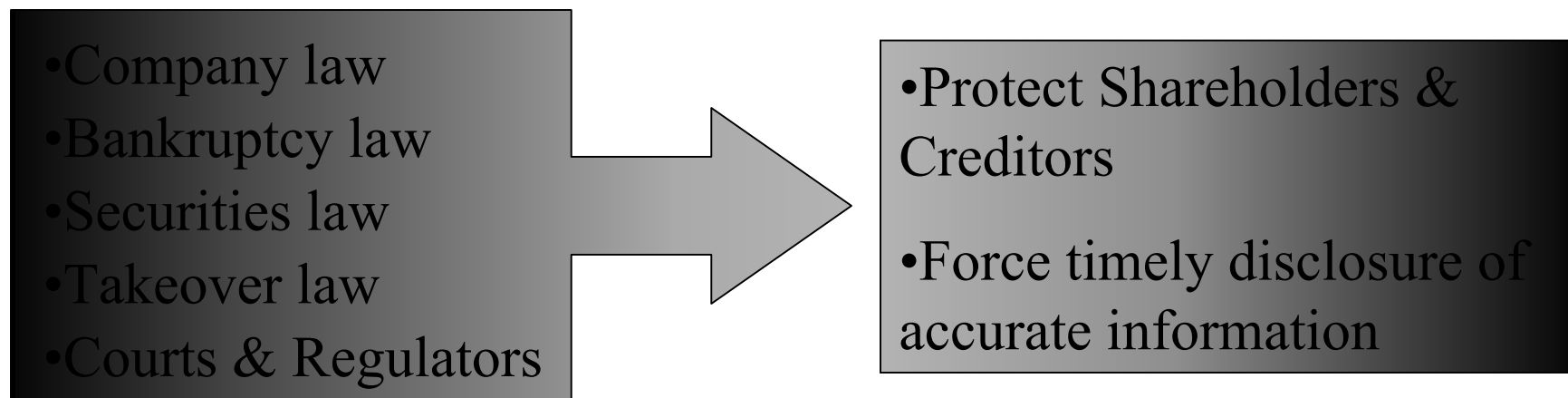
○ Are there any instances where regulation has worked?

Corruption & Regulation of Entry



The Legal Approach to Corporate Governance

- The *law* and its *enforcement* are key mechanisms of investor protection.
- When investors finance firms, they receive rights or powers in exchange. Without an ability to *enforce* rights, investors might end up with nothing.



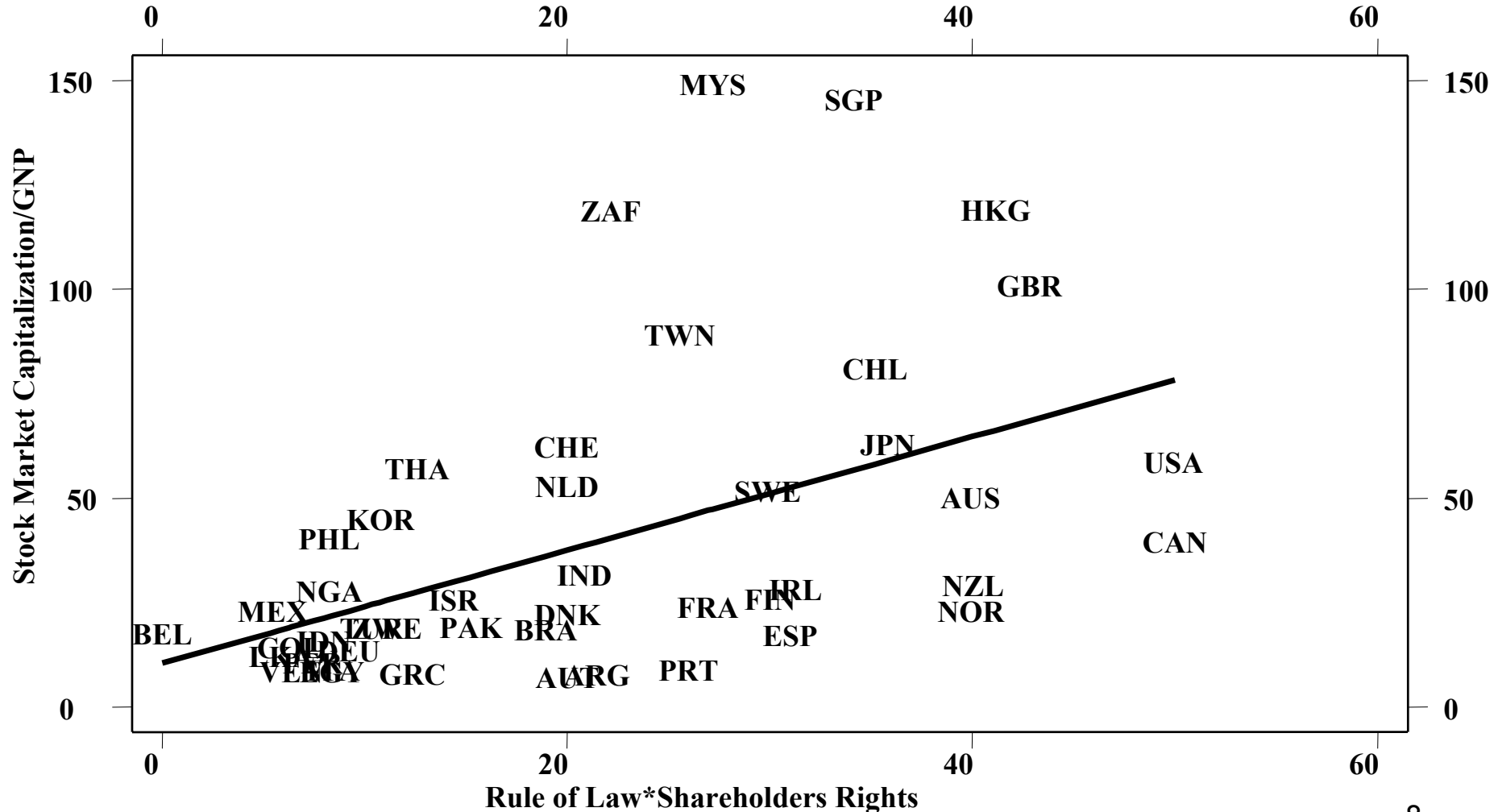
- **Implication: Strong investor protection leads to deeper financial markets & better financing terms for firms.**

The Current Corporate Governance Crisis and The Role of Regulation

○ Dimensions of importance:

1. Accounting standards;
2. Independence of securities regulator (budgetary autonomy; dismissal rules)
3. Rule making powers of the regulator, legislative branch, executive branch and the stock exchanges;
4. Administrative enforcement (powers to issue subpoenas, give orders to issuers, stop IPOs, remove licenses, impose administrative civil penalties);
5. Requirements of independence of institutions undertaking settlement and custody arrangements;
6. Disclosure requirements (financial & ownership information, role of accounting standards, responsibility for omissions);
7. Disclosure of Conflicts of Interest

Poor Investor Protection → Shallower Financial Markets

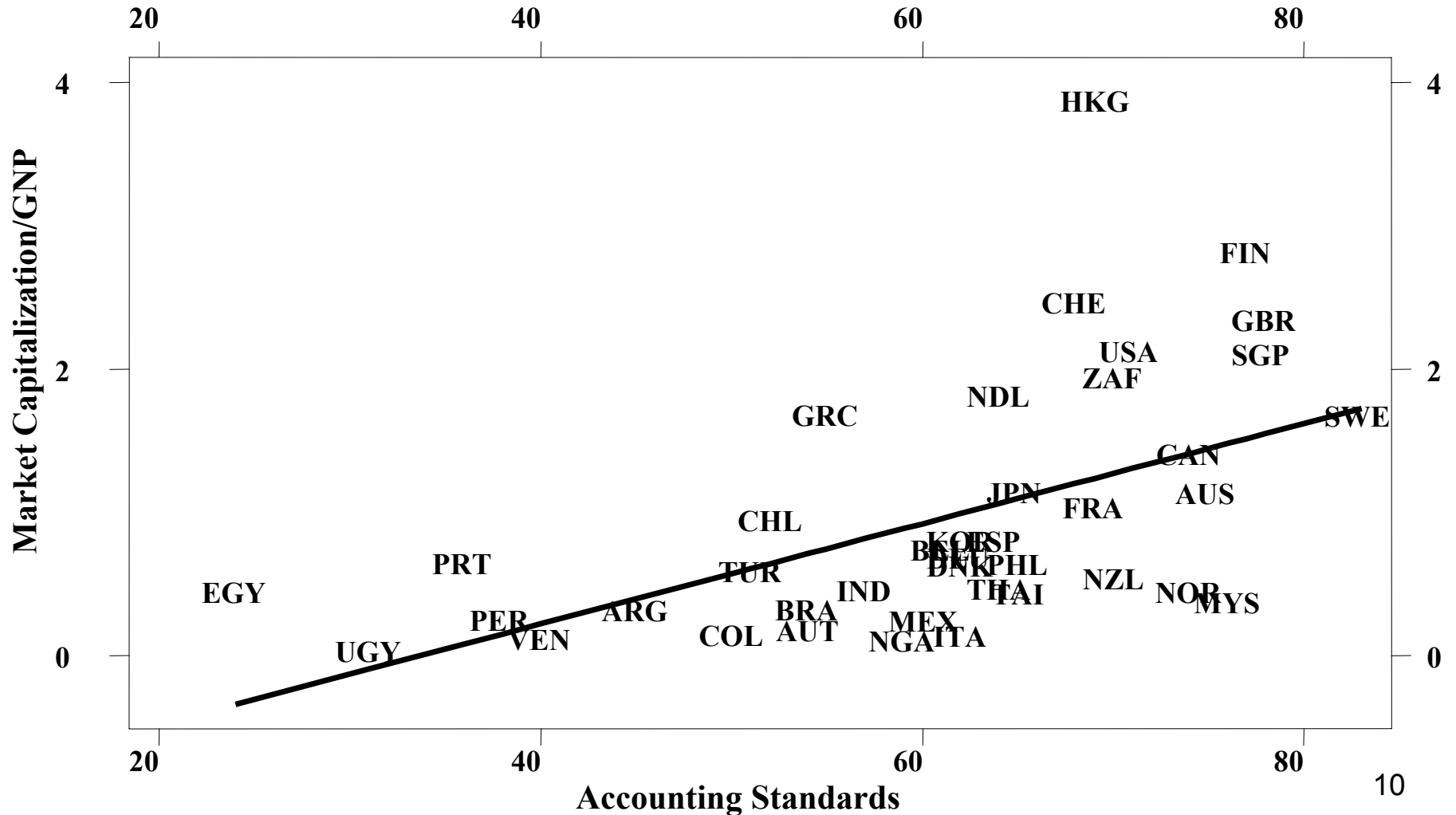


Poor Investor Protection → Deeper Financial Crises

**Stock Market Declines in Emerging Markets
after Asia's '97-98 Crisis**



Poor Accounting Standards → Shallower Financial Markets



Better Disclosure and Regulation → More Developed Capital Markets

| Increase in: | Market Capitalization/GDP | Companies / Mill. Pop. | IPO / Mill. Pop. |
|------------------------------|------------------------------|---------------------------|---------------------|
| Director's Compensation | 29% | 4.11 | 0.62 |
| Ownership Structure | 23% | 6.98 | 0.56 |
| Directors' Shareownership | 20% | 14.02 | 0.99 |
| Related Parties Transactions | 23% | 4.52 | 0.89 |

Better Disclosure and Regulation → More Developed Capital Markets

| Increase in: | Market Capitalization/GDP | Companies / Mill. Pop. | IPO / Mill. Pop. |
|---|------------------------------|---------------------------|---------------------|
| <i>Orders to rectify non compliance, institute changes and/or refund investors:</i> | | | |
| Directors of the Firms | 19% | 17.43 | 1.07 |
| Distributors of Newly-listed Securities | 24% | 13.14 | 1.28 |
| Auditors of the Prospectus | 22% | 20.49 | 1.36 |

Better Disclosure and Regulation → More Developed Capital Markets

| Increase in: | Market Capitalization/GDP | Companies / Mill. Pop. | IPO / Mill. Pop. |
|--|------------------------------|---------------------------|---------------------|
| <i>Civil liability for content and omissions in prospectus</i> | | | |
| Distributor | 17% | 10.87 | 0.94 |
| Controlling Shareholders | 23% | 5.88 | 0.35 |
| <i>Difficulty of recovering / burden of proof against:</i> | | | |
| Directors of the Firms | 16% | 2.80 | 0.11 |
| Underwriter of the IPO | 16% | 5.94 | 0.41 |
| Accountants / Auditors | 18% | 3.77 | 0.16 |

Conclusion

- Empirically, strong regulation on corporate standards disclosure and accounting is associated with more effective corporate governance which leads to more valuable and broad financial markets.
- The impact of the US Corporate Governance crisis will be felt worldwide as standards will need to increase everywhere if money is to flow across borders.
- The crisis calls for a better understanding of the role of regulation in securities markets, corporate practices, disclosure and accounting standards.
- **Implications:**
 - Corporations in high-corruption, low-disclosure and poor-regulation environments have to work harder to raise capital and need to be more creative.
 - Corporate Governance reform has large payoffs for firms, investors and countries.