Training for Reform

Protecting Minority Investors

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World Bank Group Flagship Report
16TH EDITION

World Bank Group
Development Economics | Global Indicators
Why does it matter?

What does it measure – and what does it not?

Methodology changes in the past 5 years

What are the main findings in DB19?

Good practices

Historical trends
Access to finance is the biggest obstacle for firms

Doing Business measures 2 of the 3 primary sources of finance.

Entrepreneurs

Doing Business indicators:
- Protecting Minority Investors
- Getting Credit
- Resolving Insolvency

Primary sources of finance:
- Family and friends
- Institutional investors
- Public equity
Trust and confidence increase liquidity, size of the market and access to finance

It only takes one scandal to undermine decades of regulation and deter investors…

THE PARMALAT SCANDAL
Trust and confidence increase liquidity, size of the market and access to finance

...or only one potential loophole.

**Germany Weighs Tighter Rules After Geely Takes Daimler Stake**

Merkel: No violations seen in Geely buy of Daimler stake

Geely’s purchase of a stake in Daimler, the owner of the Mercedes-Benz brand, has rekindled fears in Germany of its highly prized expertise falling into Chinese hands. Ralph Orlowski/Reuters
Stronger rules, requirements and protections foster trust and confidence

Stronger minority investor protection is associated with:

✓ **Higher market capitalization**

✓ **Higher entry level to capital markets**

**Market capitalization to GDP**

**Number of listed firms**


Note: Relationships remain significant when controlling for income per capita. Higher values on the strength of investor protection index indicate greater protection.
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How is the indicator constructed?

**Extent of disclosure index (0–10)**
- Review and approval requirements for related-party transactions
- Internal, immediate and periodic disclosure requirements for related-party transactions

**Extent of director liability index (0–10)**
- Minority shareholders’ ability to sue and hold interested directors liable for prejudicial related-party transactions
- Available legal remedies (damages, disgorgement of profits, fines, imprisonment, rescission of transactions)

**Ease of shareholder suits index (0–10)**
- Access to internal corporate documents
- Evidence obtainable during trial
- Allocation of legal expenses

**Extent of shareholder rights index (0–10)**
- Shareholders’ rights and role in major corporate decisions

**Extent of ownership and control index (0–10)**
- Governance safeguards protecting shareholders from undue board control and entrenchment

**Extent of corporate transparency index (0–10)**
- Corporate transparency on significant owners, executive compensation, annual meetings and audits
What is not measured?

<table>
<thead>
<tr>
<th>Protections for foreign direct investment (FDI)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Broad frameworks of rights for minority shareholders</td>
</tr>
<tr>
<td>Practical enforcement of laws</td>
</tr>
<tr>
<td>Fraud or violations of law</td>
</tr>
</tbody>
</table>
Extent of conflict of interest regulation

- Transaction priced above market-value;
- Clear conflict of interest, but possible business purpose;
- Legal requirements met, but not exceeded;
- The transaction is not fraudulent.
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Methodology changes in the Protecting Minority Investors indicators

• **Name:** the name was changed from “Protecting Investors” to “Protecting Minority Investors” to clarify what is measured by the indicator and what is not.

• **Doubled in scope:**
  
  ✓ The indicator went from a theoretical maximum of 30 points across 18 questions to 60 points across 48 questions.

  ✓ Three indices were added to measure protections in matters beyond conflicts of interest: extent of shareholder rights index, extent of ownership and control index and extent of corporate transparency index.

  ✓ The average of these three new indices forms the extent of shareholder governance index.

• **Expenses:** the ease of shareholder suits index was expanded to take into account the allocation of legal expenses.
Methodology changes in the Protecting Minority Investors indicators

In *Doing Business 2017* three questions were updated to address situations where legal systems in certain economies made these good practices legally impractical to achieve:

<table>
<thead>
<tr>
<th>COMPONENT</th>
<th>BEFORE</th>
<th>AFTER</th>
</tr>
</thead>
<tbody>
<tr>
<td>Extent of shareholder rights index</td>
<td>If Buyer is a limited company, must shareholders approve every time Buyer issues new shares?</td>
<td>If Buyer is a limited company, must all members consent to add a new member?</td>
</tr>
<tr>
<td>Extent of ownership and control index</td>
<td>If Buyer is a limited company, can shareholders remove members of the board of directors before their term?</td>
<td>If Buyer is a limited company, is there a mechanism to resolve management deadlock?</td>
</tr>
<tr>
<td>Extent of corporate transparency index</td>
<td>If Buyer is a limited company, must the notice of shareholder meeting be published 30 days in advance and contain sufficient information?</td>
<td>If Buyer is a limited company, must members meet once a year?</td>
</tr>
</tbody>
</table>
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Where are minority investors more protected in 2017/18?

<table>
<thead>
<tr>
<th>Top ten performers</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Kazakhstan</td>
<td>85.00</td>
</tr>
<tr>
<td>2. Azerbaijan</td>
<td>81.67</td>
</tr>
<tr>
<td>2. Djibouti</td>
<td>81.67</td>
</tr>
<tr>
<td>2. Georgia</td>
<td>81.67</td>
</tr>
<tr>
<td>2. Malaysia</td>
<td>81.67</td>
</tr>
<tr>
<td>2. New Zealand</td>
<td>81.67</td>
</tr>
<tr>
<td>7. India</td>
<td>80.00</td>
</tr>
<tr>
<td>7. Macedonia, FYR</td>
<td>80.00</td>
</tr>
<tr>
<td>7. Saudi Arabia</td>
<td>80.00</td>
</tr>
<tr>
<td>7. Singapore</td>
<td>80.00</td>
</tr>
</tbody>
</table>

Where are minority investors more protected in 2017/18?

<table>
<thead>
<tr>
<th>Top ten improvers</th>
<th>DB2019 score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Afghanistan</td>
<td>71.67</td>
</tr>
<tr>
<td>Djibouti</td>
<td>81.67</td>
</tr>
<tr>
<td>Kenya</td>
<td>78.33</td>
</tr>
<tr>
<td>Bahrain</td>
<td>66.67</td>
</tr>
<tr>
<td>Sudan</td>
<td>35.00</td>
</tr>
<tr>
<td>Jordan</td>
<td>46.67</td>
</tr>
<tr>
<td>Armenia</td>
<td>63.33</td>
</tr>
<tr>
<td>Azerbaijan</td>
<td>81.67</td>
</tr>
<tr>
<td>China</td>
<td>60.00</td>
</tr>
<tr>
<td>Dominican Republic</td>
<td>56.67</td>
</tr>
</tbody>
</table>

23 economies strengthened minority investor protection in 2017/2018

Afghanistan
Armenia
Azerbaijan
Bahrain
China
Cyprus
Djibouti
Dominican Republic
Egypt, Arab Rep.
Jordan
Kenya
Kuwait
Kyrgyz Republic
Lithuania
Mauritius
Papua New Guinea
Philippines
Saudi Arabia
Sudan
Taiwan, China
Tunisia
Ukraine
Uzbekistan

### Feature

**Expanded shareholders’ role in company management**

Afghanistan; Armenia; Azerbaijan; Bahrain; China; Cyprus; Djibouti; Dominican Republic; Egypt, Arab Rep.; Jordan; Kenya; Kuwait; Kyrgyz Republic; Lithuania; Mauritius; Papua New Guinea; Philippines; Saudi Arabia; Sudan; Taiwan, China; Tunisia; Uzbekistan

**Some highlights**

The Philippines issued new rules for companies listed on its stock exchange. Shareholders can now approve the appointment and dismissal of the auditor and companies must establish an audit committee composed exclusively of board members.

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**Increased disclosure requirements for related-party transactions**

Afghanistan; Armenia; Bahrain; Cyprus; Djibouti; Kenya; Kuwait; Tunisia; Ukraine

In Tunisia, an amendment to capital market rules requires that companies promptly make public information on interested party transactions and conflicts of interest.

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**Enhanced access to information in shareholder actions**

Afghanistan; Bahrain; China; Djibouti; Jordan; Sudan

Djibouti introduced major changes to its Code of Commerce. Among the changes, any information relevant to the subject matter of the claim must now be made available to shareholders when they bring a lawsuit.

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**Increased director liability**

Djibouti; Kenya; Saudi Arabia

Kenya enacted the Companies Amendment Act 2017, which holds directors liable for transactions with interested parties valued at 10% or more of a company’s assets and that cause damages to the company. Directors involved in prejudicial transactions are now required to pay damages, disgorge profits and may be disqualified from holding similar office for up to five years.

Europe and Central Asia offers stronger protections overall while OECD high-income is stronger against conflicts of interests.

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What are some **good practices** that help protect minority investors?

### Global good practices

- Ensuring transparency in related-party transactions
- Involving disinterested shareholders in the approval of related-party transactions
- Holding directors accountable for their actions
- Facilitating access to corporate documents
- Increasing shareholder rights and role in corporate decisions
- Clarifying ownership and control structures
- Requiring greater corporate transparency
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OECD high-income economies historically offered the strongest protection but are now surpassed by Europe and Central Asia.

Score on the protecting minority investors indicator (0-100)

Source: Doing Business database.
THANK YOU!

www.doingbusiness.org