

### What is Corporate Governance?

Corporate Governance (CG) refers to the set of rules, practices, and processes that guide how a company shall be directed and controlled.<sup>1</sup> It is a system of checks and balances that ensures companies act to pursue their corporate objectives (e.g. creating shareholder values) and holds managers accountable for the results of companies' operations while ensuring that decisions are made in accordance with the corporate goals.

A strong corporate governance system empowers a company to operate in a more efficient, accountable, and sustainable way, while supporting the company's implementation of good environmental and social practices. To-date, many countries have established formal but non-mandatory corporate governance codes to define corporate standards and expectations.

### Why is Corporate Governance Important?

Sound CG builds trust, transparency, and accountability while fostering long-term capital investment and economic stability. It facilitates access to financing, drives innovation, and enhances productivity. By ensuring fair value sharing and protecting investor rights, CG facilitates market trust and long-term financing, while ultimately creating broader market access for clients and boosting economic growth and efficiency.

Assessing the effectiveness of CG system within a company provides investors with insight into the accountability mechanisms and decision-making processes that support all critical decisions affecting the allocation of capital and the likely delivery of long-term value. Strong governance allows a company to address key risks, including environmental and social issues, ensuring sustainable growth and performance.

On the other hand, a failure to manage CG risks often signals underlying governance weaknesses that hinder the company's ability to respond effectively to market challenges.<sup>2</sup>

Some of the risks often found in major CG scandals include:

### Key Corporate Governance Risks and Potential Mitigation Measures

**Imbalanced Board Composition:** Excessive power concentration on one board of director, or directors with similar skills, experience, age or gender that may form "groupthink" at the Board.

→ Mitigation measures: To increase diversity in the boardroom through diversity in professional backgrounds and experiences as well as gender, cultural and ethnic diversity. A more advanced measure is to appoint an independent, non-executive board chair.

**Lack of Effective Auditing:** Insufficient or non-independent auditing practices resulted in a failure to identify unethical business practices (e.g. tax evasion, conflict of interest).

→ Mitigation measures: Internal Audit Function to perform regular and timely oversight, and to report directly to the Board's Audit Committee (or equivalent). To appoint reputable and independent external auditors and enforce regular auditor rotation based on international best practices and local regulation requirements.

**The Agency Problem:** A conflict of interest where executives are given incentives to perform in their own interests, contrary to the interests of the owners, a widely recognized inevitable consequence of the separation of ownership and control.

→ Mitigation measures: To structure executive pay with a balanced compensation package that captures performance-linked remunerations alongside compensation that vests over the long term.

**Lack of Sustainability Reporting:** Companies may face reputational and transactional risks if the reporting lacks consistency or fail to provide a clear and accurate assessment of their environmental, social, and governance (ESG) performance.

→ Mitigation measures: To develop comprehensive, reliable sustainability / ESG reporting that is aligned with internationally established standards to ensure transparency and accountability.

## **ENRON SCANDAL (USA, 2001)**<sup>3</sup>

*Enron Corporation, founded in 1985, was one of the largest U.S. energy companies. In 2011, it was revealed that Enron fabricated its financial performance by hiding billions of dollars in debts from its off-balance-sheet special purpose vehicles (SPVs) and used dubious financial accounting practices. The company's collapse also led to the dismantling of Arthur Andersen, then one of the five largest accounting firms in the world, which conducted audits of Enron.*

*Following the scandal, the company's executives were convicted, and legislation such as the Sarbanes-Oxley Act was enacted to enhance CG, risk management, auditing, and financial reporting of public companies.*

*Some of the failures in CG that led to the scandal were:*

- *Weak oversight by non-executive directors.*
- *Violation of the code of conduct by the board of directors which enabled the CFO's use of off-balance-sheet structures.*
- *Limited disclosure of its special purpose vehicles (SPVs).*
- *Inadequate oversight of key business transactions, ineffective control of the code of conduct, and failure to manage external auditors, internal audits, and whistleblowers.*
- *Use of dubious accounting practices and fraudulent financial reporting.*
- *Overall, poor CG facilitated conflicts of interest and unethical behavior by the management.*

## **Strong Corporate Governance Attributes in a Company**

The *Corporate Governance Development Framework (CGDF)* developed the *CGDF CG Progression Matrix* to define the following six CG parameters as key components of CG best practices for a company's governance system:

### **1. Commitment to Corporate Governance:**

The company and its shareholders have demonstrated a commitment to implementing high-quality corporate governance, including the governance of key environmental and social policies and procedures, including:

- Dedicated CG officer
- Written code of ethics/conducts
- Basic governance documents
- Board committee on CG

- Understanding the business case for good CG

### **2. Structure and Functioning of the Board of Directors (BOD):**

The BOD is qualified and adequately structured to oversee the strategy, management, and performance of the company, including BOD's clearly defined:

- Roles and responsibilities
- Composition and structure, including board committees
- Procedures and practices of meetings
- Role of corporate secretary
- Independence and skills
- Remuneration and evaluation

### **3. Control Environment and Processes:**

The company's internal control system, internal audit function, risk management system, and compliance function are adequate to ensure sound stewardship of the company's assets, effectiveness of operations, accuracy in reporting, and compliance with policies, procedures, laws, and regulations. Its key components should include:

- Internal Audit function, independent, reporting to Board Audit Committee
- Internal control systems
- Risk management
- Compliance function

### **4. Disclosure and Transparency:**

The company's financial and non-financial disclosures are a relevant, faithful, and timely representation of material events to shareholders and other stakeholders, including:

- Financial and non-financial reporting,
- External audit practices and reports
- Disclosed shareholders agreements
- Disclosure of major events
- Sustainability Report/ESG Report

### **5. Ownership and Shareholders' Rights:**

The company's minority shareholders' rights are protected and all stakeholders are treated equitably manifested in:

- Shareholders' meetings and share voting
- Representation and fair treatment of shareholders

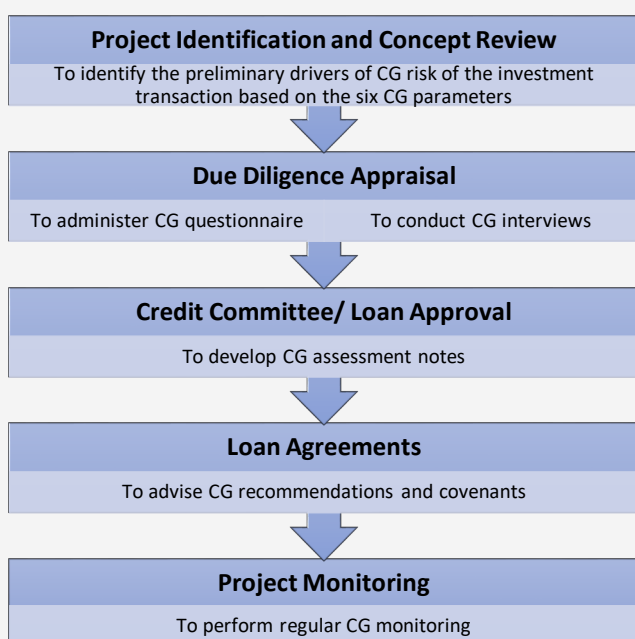
- Access to information, annual report or other regular reporting to all shareholders
- Related Party Transactions (RPTs) policies and disclosures

## 6. Governance of Stakeholder Engagement:

The company's governance of stakeholder engagement is adequate, particularly oversight over stakeholder mapping, stakeholder engagement policy and grievance mechanisms.

## Assessing Corporate Governance Risks in Infrastructure Projects

CG risk assessments are integrated across the lifecycle of investment transactions in infrastructure projects.



### 1. Developing Tailored CG Questionnaire

Based on the client's ownership type and the modality of infrastructure project, investors may apply relevant CG progression matrix and develop tailored CG questionnaire to request CG information to form a better understanding of the client's CG policies, processes and implementations.

- IFC developed specific CG tools, including progression matrix and list of documents and information to request, for six different kinds of companies: listed companies; family or founder-owned businesses; financial institutions; state-owned enterprises (SOEs); funds; small and medium enterprises (SMEs).
- For infrastructure projects involving SPV as the loan borrower and operating body, investors may refer to the *Greenfield and Project Finance Corporate Governance*

*Assessment Tool* launched by CGDF in 2024, to address specific governance risks during construction and pre-operational phases of a greenfield or project finance transaction.

### 2. Conducting CG Interviews

CG interviews are directed at individuals with the central role in governance, senior management, and staff with CG support roles. Building on the preliminary research and client's responses to the CG questionnaires, CG interviews will further analyze the client's CG philosophy and practices.

Individuals to interview include but are not limited to representatives of controlling shareholders, chairperson and members of the Board of Directors (including independent Board members), Chief Executive Officer, Chief Financial Officer, general counsel, corporate secretary, Chief of the Internal Audit function, independent external auditors and minority shareholders.

### 3. CG Assessment Notes and Recommendations

While there is no fixed structure defined for a CG assessment note, it typically contains material descriptions on the client's CG framework and practices, identified red flags in CG risks, as well as associated mitigants proposed.

Any resolvable gaps identified in the client's CG structure and practices may be addressed either in the form of CG covenants to be included in the Loan Agreement, or as non-binding value-added CG enhancement recommendations to be further communicated to the client.

## Commonly Used Corporate Governance Approaches and Metrics

By way of background, the *Organization for Economic Co-operation and Development (OECD) Principles of Corporate Governance*<sup>4</sup> was the first initiative by an inter-governmental organization in 1999 to develop a set of standards and guidelines on good CG structures. The principles help policymakers evaluate and improve the regulatory and institutional framework related to CG, while offering practical guidance for implementation at the corporate level.

Based on the OECD principles, *International Finance Corporation (IFC)*, a member of the World Bank Group, developed the *IFC's CG Methodology* in 2003, an approach to evaluate and improve the corporate governance of a company to identify, reduce, and manage risk.

Based on the IFC's Corporate Governance Methodology, the **Corporate Governance Development Framework (CGDF)** was established in 2011 to provide Multi-lateral Development Banks (MDBs) and Development Finance Institutions (DFIs) a common approach to work with the private sector on the CG due diligence, in order to evaluate and enhance governance system in their investee companies.

To date, CGDF has been adopted by 33 DFIs, and covers emerging markets around the world, including Africa, Latin America, the Caribbean, Asia, the Middle East, North Africa, Europe and Central Asia, with total assets of more than \$940 billion.<sup>5</sup> The framework is actively adopted and updated through extensive collaboration among the *DFI Corporate Governance Working Group*, which consists of representatives of several leading international MDBs and DFIs.

**The International Corporate Governance Network (ICGN)** is an investor-led organization established in the UK to advance effective CG standards and investor stewardship around the world. ICGN developed three key guidance documents for investors, including the *Global Governance Principles, the Global Stewardship Principles and the Model Mandates*. These principles highlight the primary standards for well-governed companies and governance framework for investors to fulfill their fiduciary duties on behalf of clients and beneficiaries.

The **Asian Corporate Governance Association (ACGA) CG Watch Reports**<sup>6</sup> provide in-depth evaluations of CG performance for 12 markets in the APAC region, including China, India and other major markets. This independent, non-profit organisation advocates for a dynamic governance rulebook, regularly updated to align with international standards, and encourages companies to see governance as a competitive

advantage rather than a mere compliance or marketing task and urges institutional investors to focus on long-term governance and ESG integration, executing independent audit regulators and media, and supporting a diverse civil society.

## Other Useful Tools and Resources

### Corporate Governance Progression Matrix

<https://cgdevelopmentframework.com/dfi-cg-progression-matrix-final-formatted-dec-2024/>

By: Corporate Governance Development Framework (CGDF)	Based on the IFC's Corporate Governance Methodology, the Corporate Governance Development Framework provides signatory institutions a common approach to evaluating and enhancing governance practices in their investee companies.
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### OECD Guidelines on Corporate Governance of State-Owned Enterprises

[https://www.oecd.org/en/publications/oecd-guidelines-on-corporate-governance-of-state-owned-enterprises-2024\\_18a24f43-en.html](https://www.oecd.org/en/publications/oecd-guidelines-on-corporate-governance-of-state-owned-enterprises-2024_18a24f43-en.html)

By: OECD	OECD revised the guidelines in 2024 to capture the latest developments in standards and best practices around sustainability, transparency, board independence, stakeholder engagement and risk management.
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### IFC Climate Governance: Progression Matrix & Tip Sheet (2023)

<https://www.ifc.org/en/insights-reports/2023/publications-climate-governance-matrix-tip-sheet>

By: IFC	This matrix and tip sheet outlines practices to assist boards in identifying and overseeing climate-related risks and opportunities in projects.
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### NDB Corporate Governance Due Diligence Questionnaire for Projects

<https://www.ndb.int/wp-content/uploads/2024/04/NDB-CG-QuestionnaireEN-April-2024.docx>

By: New Development Bank (NDB)	A standard CG due diligence questionnaire for NDB's prospective clients to highlight their CG policies, standards and practices.
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#### References:

<sup>1</sup> Corporate Governance Institute. "<https://www.thecorporategovernanceinstitute.com/insights/lexicon/what-is-corporate-governance/>"

<sup>2</sup> OECD (2023). OECD Principles of Corporate Governance. <https://doi.org/10.1787/9789264173705-en>

<sup>3</sup> World Bank. The Enron Crisis: Some Lessons for Transition Economies.

<https://documents1.worldbank.org/curated/zh/271261468115157624/>

<sup>4</sup> OECD (2023). OECD Corporate Governance Factbook 2023. [https://www.oecd.org/en/publications/oecd-corporate-governance-factbook-2023\\_6d912314-en.html](https://www.oecd.org/en/publications/oecd-corporate-governance-factbook-2023_6d912314-en.html)

<sup>5</sup> Data sourced from the Corporate Governance Development Framework. Available at: <https://cgdevelopmentframework.com/>

<sup>6</sup> Asian Corporate Governance Association. The CG Watch Reports. <https://www.acga-asia.org/cgwatch.php>

The New Development Bank is a multilateral development bank established by Brazil, Russia, India, China and South Africa with the purpose of mobilising resources for infrastructure and sustainable development projects in emerging markets and developing countries.

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NDB Sustainability

