



# Technical Assistance Consultant's Report

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## RETA 6137-REG: Corporate Governance Component

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For the Asian Development Bank

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**Asian Development Bank**

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## I. INTRODUCTION

1. In April 2004 the corporate governance component of TA 6137 REG commenced activities in Tajikistan and the Kyrgyz Republic. In November work began in Kazakhstan and Azerbaijan. The work was led by Henry N. Schiffman, International Corporate Governance Expert, who was ably assisted by local consultants Tahmina Nurova and Victoria Victorova in Tajikistan, Arslanbek Kenenbaev in the Kyrgyz Republic, and Amir Tussupkhanov in Kazakhstan and Azerbaijan.

2. The project undertook a comprehensive analysis of corporate governance and needs for its strengthening in Central Asia<sup>1</sup> focusing on four principal areas:

### A. The Legal Framework for Corporate Governance

3. Analysis of the legal framework to determine whether remedial legislation is appropriate to provide the proper enabling environment for corporate governance. Areas of consideration included: excessive responsibility of shareholders; definition of the basic role of board of directors;<sup>2</sup> coherence of accountability provisions; requirements for independent directors; obligatory committees of the board of directors; requirements for disclosure of information concerning a company; rules on related party transactions; and fiduciary duty for company officers.

### B. Corporate Governance Practices

4. Analysis of key corporate governance practices to determine whether practices differ from legal requirements. Whether significant departures from the Western model would be appropriate, was also considered, in light of local cultural and capacity factors, including enforcement, as described in item 3 below.

### C. Regulatory Activities

5. Consideration was given to current regulatory activity and to possibly more involvement by the regulatory authority—the agency responsible for securities in the case of public—for enforcement of corporate governance provisions. The laws assume that shareholders will enforce them but shareholders are generally passive, and even if they are active, they often have to use the courts that are often not competent in corporate matters or are subject to undue influence.

### D. Training in and Promotion of Good Corporate Governance.

6. Consideration was given to current promotion activities and needs for ongoing training, including public education in the benefits of good corporate governance and training of directors.

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<sup>1</sup> “Central Asia” refers to the four project countries: Azerbaijan, Kazakhstan, Kyrgyz Republic and Tajikistan.

<sup>2</sup> “Board of directors” in this report and means the upper tier board when there are two boards, often referred to elsewhere as the “supervisory” board as opposed to the lower level “management board.” A management board is referred to in this report as “management”

## II. EXECUTIVE SUMMARY

### A. Findings

7. The *legal framework* for corporate governance is weak and not enforced. In general, corporate governance rules in Central Asia are rudimentary but even basic rules are frequently violated in practice. Much of this is due the lack of knowledge by shareholders of their rights and general absence of the rule of law caused by a pervasive environment of corruption and impunity for beaches of the law resulting in part by inexperienced and/or corrupt judges so basic rules cannot be enforced even if there were attempts by shareholders to do so.

8. *Company practices*, in the absence of knowledge of, or requirements for, better ways of governance, at best follow the joint stock company law<sup>3</sup> yet the laws are deeply flawed with insufficient, incoherent, and inefficient provisions for governance. None of the important reforms in corporate governance begun in the West in the past four years have been generally adopted in law or practice. Many influential politicians and their friends are doing well under the existing system, including by abusive practices, and resist change. The companies that have good corporate governance practices are mainly those that have investments of foreign shareholders, particularly IFC and EBRD.

9. *Regulatory enforcement* of the joint stock company law or corporate governance rules of the securities law range from virtually none in Tajikistan to often excessive regulation in the Kyrgyz Republic. Regulatory agency staff is generally inexperienced and require training and there is a need for enforceable rules of ethics for these agencies.

10. *Promotional activities* for good corporate governance are predominantly limited to periodic and often short term donor initiatives rather than to established local institutions. Noteworthy exceptions are the five-year effort of the Corporate Development Center in the Kyrgyz Republic (2000-2005), ADB TA 3987 in Tajikistan and a very recent effort led by the Association of Financial Companies in Kazakhstan to develop a voluntary Code of Corporate Governance. In Azerbaijan a recent IFC project is the principal promotional activity although the Center for Economic Reform has a new plan to become active in this field. Currently there are no new or ongoing general promotional activities in Tajikistan.

### B. Recommendations

11. What can be done to seek to remedy this state of affairs? Basically five measures:

- (i) Repair or supplement the *legal framework* either by amending existing laws, that has proved politically very difficult, or adopting an alterative Standard Company Law;
- (ii) To enhance *company practices*, establish or increase public awareness through targeted campaigns so shareholders will be more knowledgeable of and assertive in their rights and should seek to elect capable and honest directors;
- (iii) For *regulatory* enforcement, rationalize the activities of regulatory authorities to focus on matters of significance and train staff to be capable and honest;
- (iv) *Promotional activities* should focus on providing training to company directors, especially independent directors, who are the key to good governance;

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<sup>3</sup> In Azerbaijan the relevant law is in the Civil Code.

- (v) Promote the practice of private arbitration for the resolution of corporate governance disputes as an alternative to litigation before the courts. Three of the four countries have recent laws on arbitration that could be utilized.

12. It is unlikely that sufficient reforms will be undertaken by governments on their own and will depend upon donor activities including conditionality in relation to donor-supported programs.

### **III. GENERAL OVERVIEW**

#### **A. The Challenge of Good Corporate Governance in Central Asia**

13. No rational prospective investor in the debt or equity of a company would part with their savings unless they have reasonable assurance that:

- (i) The governance of the company will be fair to investors
- (ii) The operations of the company will be efficient and profitable

14. Despite the fact that these two conditions are not met in the vast majority of cases in Central Asia, companies have received many investments. However, there is increasing realization of the need for the two conditions so the future may not bode well for aggregating investments of many investors in joint stock companies unless the situation changes markedly. The alternative may be to have mainly closely held companies that implies limits to the size and growth potential of companies.

15. For enterprises to currently achieve good corporate governance in Central Asia is very difficult for several reasons:

#### **1. Absence of the Rule of Law**

16. Even if the rules for corporate governance were appropriate to promote fair and efficient governance, which they are not, the fact that shareholders are generally passive in countries other than the Kyrgyz Republic and the courts are unreliable—often inexperienced, incompetent, or corrupt—means that shareholders cannot easily enforce the law even if they wanted to and hence rules will often not be followed by officers and directors of companies, even on basic matters such as providing notice of shareholders meetings and paying declared dividends. The securities commissions are often too inexperienced and under-resourced to be able to substitute for shareholders in enforcing the rules and corruption is also present in some agencies.

#### **2. Inappropriate Rules**

17. Company laws in most Central Asian countries are derived from the same model that provides for incoherent governance procedures and lacks provisions to protect of rights of shareholders and for effective company management. Instead, the law should provide for: a charter that provides for only basic matters; the right of shareholders to know the identity and holdings of other shareholders; an automatic annual meeting of shareholders; and the business judgment rule for director liability. At least for public companies, there should be one statutory board with independent directors (at least two to begin and a majority in 3-5 years) and committees of the board for audit, governance, and compensation.

18. As a result, recurring problems in basic matters include incoherent governance mechanisms, lack of adequate rules on transactions of a company with related parties and failures of companies to: register share ownership; notify shareholders of annual meetings; disclose to shareholders the identity of other shareholders; pay declared dividends; issue annual reports; or have required external audits. This problem has resulted in part from the fact that persons in Central Asia have had no experience with proper company rules so they lack the perspective to establish such rules.

### **3. Ineffective Shareholders**

19. As Warren Buffet has said, “Shareholders get the companies they deserve.” If shareholders are not vigilant, they cannot expect that the companies that they own will be well governed. There is an inherent conflict between the welfare of the managers and that of shareholders and shareholders must be assertive to protect their rights—especially by seeking to ensure that a skilled and honest board of directors is elected by shareholders.

#### **B. Cultural Factors**

The basic framework for corporate governance for joint stock companies in Central Asia as in the CIS and in most of the world is derived from English company law. As such it is a Western model. Given the state of corporate governance in Central Asia, some fifteen years into the transition to a market economy, the question arises as to whether local cultural factors should be taken more into consideration to develop a somewhat different model for corporate governance. The International Corporate Governance Expert put this question numerous times in workshops and to key actors in corporate governance in the course of the work. The only suggestion that appears to have promise to lead to better governance and to create more confidence by investors in companies is to have as the chairman of the board of directors or of an audit committee of the board a very well respected figure, in the village elder tradition. This would seem to have more resonance in Central Asia than it would in the West.

#### **C. Non Traditional Enforcement**

20. The only other somewhat different approach from the western model that suggested itself and that is recommended in this report, not related to cultural factors is enforcement of the joint stock company law by government regulators. This is due to the unreliability of the court system and passivity of shareholders because of broadly dispersed ownership largely as a result of voucher privatization. In the West, shareholders are the predominant enforcers of the company law.<sup>4</sup> Actual and potential transgressors know this and that courts are generally competent and honest and if the law is violated there will be a remedy. In Central Asia the law is often violated with impunity. In the West a governmental authority, usually a securities commission, enforces the securities law that has some important corporate governance requirements, but usually not the company law.

21. However, in only one of the four project countries is the securities regulatory authority generally considered to be objective in its enforcement, so reform in ethics is also a pre-requisite to regulatory authorities playing an important supportive role in corporate governance.

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<sup>4</sup> In the United States this is because of the vigilance of lawyers representing aggrieved shareholders.

#### **D. What are the Implications of Weak Corporate Governance?**

22. Unless companies are better governed, capital markets will remain weak and companies will not contribute to the economy to the extent that they might to improve living standards. However, only a small fraction of companies, usually the most economically significant companies, could expect to have access to the capital market. With increasing international competition, growth could be much less than otherwise expected. With more countries becoming members of the World Trade Organization, countries will face increasing competition from abroad that will have broad beneficial effects only if domestic companies can compete. These companies, too, should have increased opportunities to export goods and services but they must become larger and more efficient if they are to be able to compete effectively with foreign firms.

#### **E. What should be done?**

23. The establishment of the proper rule of law is a long term proposition. Adherence to proper ethical standards for company directors and management and regulators is required as is judicial reform—education, ethics, transparency and case management. Both are long-term efforts. However, proper rules for corporate governance and vigilant shareholders could provide a short cut to effective corporate governance for some companies that could be considered among the most important for the economy, even in the absence of enforcement capacity.

24. If shareholders elect competent and honest directors who themselves are vigilant and are obligated to conduct companies' affairs in accordance with proper rules under a company law, there will be little need to rely on external enforcement of the rules by courts or regulators. Thus, getting the company law right and training shareholders and directors is the easiest and quickest way to improve corporate governance with attendant benefits for company shareholders and the economy.

### **IV. ITEMS OF THE TERMS OF REFERENCE**

1. Comparison of the legal and regulatory frameworks<sup>5</sup> and promotional activities.  
See Tables 2, 3 and 4.
2. Effect of TA 3779 KGZ and TA 3987 TAJ  
See discussion under Appendix I for Kyrgyz Republic and Tajikistan.
3. Strategy to strengthen the legal and regulatory framework.  
See measures recommended in Executive Summary and Appendix VI.
4. Review and develop the concept of an institute of corporate directors drafted by CDC  
See Executive Summary, Appendix I under Kyrgyz Republic and Appendix VII
5. Strategy to promote corporate governance  
See promotional activities discussed for each country in Appendix I
6. Provide advice on promotional activities to local organizations promoting corporate governance in the countries covered  
See promotional activities discussion for Kazakhstan and Kyrgyz Republic<sup>6</sup>

<sup>5</sup> See [http://www.oecd.org/dataoecd/18/63/33970662.pdf\\_pp.76-109](http://www.oecd.org/dataoecd/18/63/33970662.pdf_pp.76-109) for a comparison of legal frameworks for corporate governance of Azerbaijan, Kazakhstan and the Kyrgyz Republic based on some 120 criteria.

<sup>6</sup> There are no such local organizations in Azerbaijan or Tajikistan

## COUNTRY-BY-COUNTRY FINDINGS AND RECOMMENDATIONS

### A. Azerbaijan

#### 1. Legislative Framework

1. **Finding:** The existing legislative framework that is contained in the Civil Code does not provide an adequate framework for corporate governance. It contains many inappropriate provisions and has major omissions.

2. **Recommendation:** The ill-conceived provisions in the law should be eliminated and important appropriate provisions should be added. Preferably, the provisions in the Civil Code should be repealed in favor of a law on joint stock companies that is more comprehensive and appropriate to have better prospects for the contribution of joint stock companies to Azeri economic development.<sup>1</sup> If the Civil Code is not appropriately amended or a new appropriate separate law is not enacted, the Standard Company Law should be offered as an alternative, to provide a proper legal framework for companies that wish to employ modern corporate governance and that provides for fairness to shareholders and efficiency in governance. ADB should support legislative reform since there is some momentum in this area based on this TA.

#### 2. Company Practices

3. **Finding:** With respect to rights of shareholders, they generally receive notice of shareholders' meetings, information on agenda items, and how they may participate and are provided detailed information concerning the matters submitted for shareholder approval. A shareholder cannot, however, obtain the names, addresses, and amount of shares owned by other shareholders. Shareholders are sometimes permitted to place items on the agenda of the annual general meeting of shareholders and are permitted to ask questions of directors and management. For some companies, shareholders are informed of material developments in the company's business through press releases or in announcements on the company's website.

4. With respect to composition and responsibilities of the board of directors, board members are generally elected individually, though for terms as long as five years. No boards have independent directors though all are non-executive. Board members generally do not demonstrate an obligation to obtain accurate, timely and relevant information on matters under their responsibility so they can make decisions on a fully informed basis. The chairman of the board of directors in very few companies decides the quantity and quality of information presented by management to the board. Only in a few companies does the board provide for the integrity of the company's accounting and financial reporting systems. This is generally left to management. Few companies have a code of ethics.

5. Regarding disclosure of information, only banks disclose more frequent than annual periodic reports of financial performance and condition. No company discloses the identity of either its largest shareholders or the amount of compensation of high level officials either individually or in the aggregate. Only one company interviewed discloses transactions or proposed transactions of the company with an insider.

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<sup>1</sup> Whether rules for joint stock companies are in the Civil Code or in a separate law is not a critical matter, but the law for joint stock companies in a transition economy should be subject to amendment from time to time and parliaments are usually reluctant to amend a civil code with frequency because it would open the code to other amendments and a civil code should be a more permanent statute.

6. **Recommendation:** Since practices are essentially based on the law for joint stock companies, the legal framework must be strengthened to require better corporate governance practices. Promotional activities for shareholder awareness and director training should also be undertaken to stimulate better practices.

### 3. Regulation

7. **Finding:** The Securities Commission supervises and regulates mainly for compliance with the securities law (contained in the Civil Code). While it also sometimes seeks to enforce compliance with the company law provisions in the Civil code, its work in this area is generally considered inadequate. The resource allocation is generally considered to be poor and the integrity of staff low. These are related matters. Instead of seeking to address more significant matters in company law enforcement, the Commission staff often prefers rent-seeking opportunities. The skill level of the staff should also be considerably strengthened.

8. **Recommendation:** Explicit authority for enforcing the company law provisions in the Civil Code should be given to the Commission. Training of staff and establishment of an enforceable ethics code would also be priorities. The Azeri legal framework is not supportive of good corporate governance so that must be strengthened, as recommended above, so there are proper basic rules to enforce.

### 4. Promotion

9. **Finding:** There is currently no local organization promoting good corporate governance. This TA prompted the Center for Economic Reform (CER) under the Ministry of Economic Development to develop a concept paper to expand its activities to corporate governance promotion and CER intends to seek funds from donors for this purpose. In January 2005 the IFC initiated a two-year program that will probably focus on analysis of company practices, public awareness, and training for company officers and directors.

10. **Recommendation:** Donor support should be provided to CER at a modest level so a local organization involved in promotion of good corporate governance will be established, provided that a division of labor with IFC is established so there will not be duplication of effort. IFC has substantial resources and CER should not work in essentially the same areas, since CER could not add much but rather CER should supplement IFC's efforts.

## B. Kazakhstan

### 1. Legislative Framework

11. **Finding:** While Kazakhstan has the best legal framework among the four project countries, there are still a number of important inappropriate provisions and omissions. A Code of Corporate Governance developed in February by a group of interested financial services companies and lawyers assumed recently quasi-legislative status because of its endorsement by the KASE. Compliance with the Code has been added to KASE listing requirements. All A listed companies have until 1 October 2005 to comply while B category companies until 1 October 2006. However, the Code is imprecise and contains some inappropriate provisions for corporate governance.

12. **Recommendation:** The Law on Joint Stock Companies should be considerably strengthened. Recent amendments before the Parliament were very insufficient. It appears that,

as in the Kyrgyz Republic and Tajikistan, vested interests would not permit a truly modern law that is fair to shareholders to be enacted because they are doing well under the current regime. Thus, a Standard Company Law would seem to be indicated for Kazakhstan. Support for this was expressed by the group that developed the Code and by the FSA lawyer responsible for joint stock company law reform. Explicit authority should also be granted for the FSA to enforce certain provisions of the Joint Stock Company Law.

## 2. Company practices

13. **Finding:** With respect to rights of shareholders, basic financial information is disclosed but not large shareholders, management compensation or material developments in their business. Shareholders identity is particularly opaque. There is no transparent process for nominating candidates for the board of directors.

14. The boards of directors often are not effective because most important matters are determined by principal shareholders. The board also frequently cannot influence the management. Unlike other countries in Central Asia, companies that are listed at the KASE must have thirty percent independent directors. However, there is no proper definition of "independent." The quality of work and integrity of independent directors is also questionable since there is a scarcity of qualified such persons for other than the largest companies and banks.

15. **Recommendation:** As in other project countries, the legal framework must be strengthened to induce companies to adopt better practices. Unlike the other countries, with the significance of the KASE for raising capital and enriching shareholders, KASE listing requirements could promote better corporate governance. But, as indicated above, the adoption by KASE of the flawed Code of Corporate Governance is not an auspicious start. KASE should be encouraged to lead in promoting good corporate governance. Training of directors is also an essential need.

16. There is an idea for a pilot project to select certain companies from those that volunteer to adopt enlightened corporate governance practices and provide training and documents to support the process. This idea deserves donor support if appropriate precise dimensions become clear.

## 3. Regulation

17. **Finding:** The FSA is responsible for supervision and regulation of the securities law but also supervises compliance with the Joint Stock Company Law by companies. For listed companies on the Kazakh Stock Exchange (about 45), FSA regularly reviews minutes of general shareholders meetings (GSM) and shareholder approval of major transactions. Usually FSA reviews companies' governance practices when additional securities issues have to be approved by FSA and when semi-annual reports are filed with FSA.

18. FSA allocates its resources more to supervision of public companies. FSA organizes routine inspections or can demand the provision of documents from companies. Usually the latter is prompted by a credible complaint concerning alleged illegal activities of a joint stock company. The FSA was established in 2004 (by separation from the National bank) and still has few qualified staff.

19. If the KASE listing rules were supportive and enforced, this could provide effective regulation of good corporate governance for listed companies. However, the KASE does not want enforcement responsibilities and expects this to be done by FSA.

20. **Recommendation:** FSA staff needs training and a better legal framework to enforce. FSA should focus its efforts on the larger public companies, defined as: (i) listed companies; (ii) companies with more than a specific large number of shareholders; and (iii) companies that have issued a specific relatively significant amount of securities.

#### 4. Promotion

21. **Finding:** As indicated in the Second Interim Report, there have been numerous short-term activities to support improvement of the legal regime and provide training in corporate governance. Very recently a more concentrated private sector initiative was launched to improve the legal framework. The IFC intends to establish a program for corporate governance in Kazakhstan if it receives external funding.

22. **Recommendation:** More sustained and consistent efforts to strengthen corporate governance are needed. The IFC may provide this. Donor support to strengthen the legislative framework, in which the IFC has been weak in Central Asia, would be very useful as well as to address immediately the flawed Code for Corporate Governance that has assumed such importance and should be fixed sooner than later.

### C. Kyrgyz Republic

#### 1. Legislative Framework

23. **Finding:** TA 3779 KGZ considerably improved the Law on Joint Stock Companies although there remain several areas of significance that need to be strengthened.<sup>2</sup> The amendments enacted in August 2004 to the law made a number of important changes. These include: shareholders may obtain information on the identity of other shareholders; shareholders activities are circumscribed (though the circle is still too large with respect to management prerogatives), and management must report to the board at least quarterly (though it should be specified that the chairman of the board determines what is to be reported).

24. **Recommendation:** If the new government and parliament is inclined, a new joint stock company law should be enacted. The existing law is on the neo-Soviet model and it may be an optimal time for a break with the past. If the politics are such that a new law does not seem to be feasible, and past evidence is that it is not, the alternative Standard Company law should be advocated.<sup>3</sup>

#### 2. Company Practices

25. **Finding:** There is substantial compliance with proper rules and procedures to secure the rights of shareholders like providing notice of annual meetings and permitting shareholders to submit candidates for election to the board of directors and to add items to the agenda of the annual shareholders' meeting. The responsibilities of the board of directors are less well

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<sup>2</sup> See Attachment V to the Interim Report.

<sup>3</sup> At the Regional Workshop in Bishkek in November, the Vice-Chairwoman of the Court of Arbitration, formerly a highly respected lawyer in the private sector, said, "If there were such a law, the parliament would enact it in two days." Other Kyrgyz participants supported this sentiment.

executed in matters such as obtaining quality information from management and establishing committees of the board. The weakest area is in disclosure of information concerning a company—significant events affecting the company, more frequent than annual financial reporting, and disclosure of compensation policy and aggregate executive compensation.

26. **Recommendation:** The recommendations in this part of the report for legislative reform and for promotional activities and in Appendix V that provide for public awareness programs and training of directors would be the most effective way to improve company practices in corporate governance. If the SCSM refines and strengthens its regulatory enforcement in a proper way, it may have a demonstration effect and deter corporate misconduct.

### 3. Regulation

27. **Finding:** The SCSM is at a cross roads with a largely new senior staff at a time of broad reform in the Republic. Proposals are before parliament for a new securities law that contains the main provisions for corporate governance regulatory enforcement and for a new internal structure of the SCSM. The outcome of these remains to be seen.

28. **Recommendation:** The SCSM staff needs extensive training and direction to use its resources more efficiently, solely in the interest of protecting the interests of investors and the orderly conduct of the securities market. If the new legislative framework is not supportive, efforts should be undertaken to amend it.

### 4. Promotion

29. **Finding:** TA 3779 KGZ supported the Corporate Development Center that was very active in providing an impetus for good corporate governance. The CDC's activities included a campaign of public awareness of the needs and procedures for good corporate governance, providing training to shareholders and directors, publishing a monthly newsletter on corporate governance issues, and advocating legislative reform.

30. The CDC conceived of the establishment of an Institute of Corporate Directors. The idea was to have a new institution to focus on public awareness, research and training of directors. The scope was intended to reach both private companies and state-owned enterprises where governance was perceived to be in great need of strengthening.

31. The proposal was never realized, perhaps due in part to the lack of human resources to pursue the concept. However, apparently it would have had to rely solely on initial donor support. There was not sufficient private sector interest in supporting an ICD from inception. The private sector support would have come in the form of user-funded activities.

32. The Institute of Corporate Governance and Development was founded in 2005 by consultants on corporate governance. The main goals of the Institute are promotion of corporate governance, training boards of directors, and improvement of the legislation on corporate governance. Also in 2005 shareholders who have investments in many companies founded the Organization on Protection of Shareholders' Rights. This organization is to protect rights of minority shareholders and advocate for corresponding reforms in the legislation.

33. **Recommendation:** The new regime at the SCSM should support promotion of private sector initiatives underway by the stock exchange, the Institute of Corporate Governance and

Development and the Organization on Protection of Shareholders Rights should supplement gaps in coverage.

## **D. Tajikistan**

### **1. Legislative Framework**

34. **Finding:** The existing legislative framework of the Republic of Tajikistan does not provide an adequate framework for corporate governance. An improved but still deeply flawed law is pending in parliament that is based on the laws of CIS countries. The prospects for proper governance are also impaired by the lack of an appropriate law for the regulation of securities issuance and trading, the absence of an organized securities market, a weak economy in the Republic, and corruption.

35. **Recommendation:** The draft Law on Joint Stock Companies that is pending before parliament should be strengthened to remedy especially the weakness noted in Appendix III; however, if the draft is the maximum that, as has been reported, is politically realistic, for a joint stock company law, the Standard Company Law should be offered as an alternative, not a substitute, to provide a proper legal framework for companies that wish to employ modern corporate governance that provides for fairness to shareholders and efficiency in governance.

### **2. Company practices**

36. **Finding:** In company practices, the most developed areas, but only for companies with relatively few shareholders, are notification to shareholders about the annual meeting; and allowing shareholders to place items on the annual meeting agenda and to ask questions of directors and management. Nominees for the board of directors are elected individually. Few companies provide shareholders with information on material developments in the company or even general information like the identity of major shareholders or management compensation.

37. **Recommendation:** The recommendations in this part of the report for legislative reform and for promotional activities and in Appendix V that provide for public awareness programs and training of directors would be the most effective way to improve company practices in corporate governance.

### **3. Regulation**

38. **Finding:** There is currently virtually no regulatory enforcement of the Joint Stock Company Law. If a company does not follow some rules of law, for example, does not publish annual financial statements or call the annual shareholders meeting, there is no government body which can play an enforcement role and the shareholders are generally passive.

39. **Recommendation:** The new joint stock company law should provide for enforcement of basic corporate governance requirements by a new independent commission. This will require considerable resources including extensive training of regulators. The existing MOF Agency for Securities and Foreign Investment is not equipped for this task and is not independent.

#### 4. Promotion

40. **Finding:** The first time that any significant promotion of good corporate governance was undertaken in Tajikistan was in mid-2003 by ADB, TA 3987 TAJ, Strengthening Corporate and Financial Governance Reforms. Undoubtedly much public awareness was established but it is hard to discern concrete results. In the context of the development of a new draft Law on Joint Stock Companies, USAID held seminars and headed a drafting group for the draft law that undoubtedly imparted more knowledge of good corporate governance practices. There is currently no local organization that could serve as the basis, including the chamber of commerce.

41. **Recommendation:** A donor organization, following enactment of a strengthened company law, should and probably will establish a public awareness campaign and provide training to directors. A proposal like that of the Kyrgyz CDC for an Institute of Corporate Directors would probably have only a slight prospect for success, since it depends upon some substantial local financial support from companies, to attract donor funds, and it is probably too early in Tajikistan for this, because there are so few joint stock companies of significance or wealth. One or more donors should develop a local promotional institution from inception in a few years time.

## SUMMARY OF CORPORATE GOVERNANCE BY COUNTRY

**Table A2.1: Azerbaijan Corporate Governance Assessment  
Classification of Companies<sup>a</sup>**

Rights of shareholders		Substantial Achievement	Moderate Achievement	Little or no Achievement
	Shareholders participation in annual general meeting <sup>1</sup>	F	M	
	Disclosure of extraordinary events		F	M
Composition/ responsibilities of board				
	Independent <sup>2</sup> or non-executive directors	M		
	Establishing company strategy	F	M	
	Establishing compensation policy and replace managers	M		F
	Monitor conflict of interests			M
	Oversee the process of Information disclosure			A
	Code of Ethics		F	M
Disclosure of information				
	Disclosure of major shareholders			A
	Disclosure of officer compensation			A
	Disclose of material factors in securities issues		F	M
	Disclosure of proposed insider transactions	F		M

<sup>a</sup> Legend: A=all companies; M=most companies; F=few companies

<sup>1</sup> Shareholders notification about AGM, contribution to the agenda and right to ask questions on any subject.

<sup>2</sup> No companies have independent directors in the sense of persons not related to management or to principal shareholders of the company by marriage, consanguinity to the second degree, employment, or business interest.

**Table A2.2: Kazakhstan Corporate Governance Assessment  
Classification of Companies<sup>a</sup>**

<b>Rights of shareholders</b>		<b>Substantial Achievement</b>	<b>Moderate Achievement</b>	<b>Little or no Achievement</b>
	Shareholders participation in AGM <sup>3</sup>		A	
	Disclosure of extraordinary events	M	F	F
<b>Composition/ responsibilities of board</b>				
	Independent <sup>4</sup> or non-executive directors	F	F	M
	Establishing company strategy	M	F	
	Establishing compensation policy and replace managers		M	F
	Monitor conflict of Interests	F	M	F
	Oversee the process of Information disclosure		F	M
	Code of Ethics <sup>5</sup>		F	M
<b>Disclosure of information</b>				
	Disclosure of shareholders			A
	Disclosure of officer compensation			A
	Disclosure in prospectuses of material factors		F	M
	Disclosure of proposed insider transactions		F	M

<sup>a</sup> Legend: A=all companies; M=most companies; F=few companies

<sup>1</sup> Shareholders notification about AGM, contribution to the agenda and right to ask questions on any subject.

<sup>2</sup> Independent means not related to management or to principal shareholders of the company by marriage, consanguinity to the second degree, employment, or business interest. No companies have independent directors in this sense.

<sup>3</sup> A comprehensive code to prohibit exploitation of conflicts of interest by employees and officers of the company with enforcement provisions.

<sup>3</sup> Shareholders notification about AGM, contribution to the agenda and right to ask questions on any subject.

<sup>4</sup> No companies have independent directors in the sense of persons not related to management or to principal shareholders of the company by marriage, consanguinity to the second degree, employment, or business interest.

<sup>5</sup> As I indicated in my comments above some companies accept internal documents (Provisions) which prohibit on exploitation of conflicts of interest by employees and officers, which contain some moments of the standard Code of Ethic. Thus, most companies accept Provisions and few companies (usually financial institutions) accept Code of Ethics.

**Table A2.3: Kyrgyz Republic Corporate Governance Assessment  
Classification of Companies <sup>a</sup>**

<b>Rights of shareholders</b>		<b>Substantial Achievement</b>	<b>Moderate Achievement</b>	<b>Little or no Achievement</b>
	Shareholders' participation in AGM <sup>6</sup>	A		
	Right to ask questions on any subject	M		F
	Provision of information regarding shareholders' meeting agenda, including information on candidates	M	F	
	Disclosure of extraordinary events		F	M
<b>Composition/ responsibilities of board</b>				
	Independent <sup>7</sup> or non-executive Directors	M		
	Establish company strategy	A		
	Establish compensation policy and replace managers	M		F
	Monitor conflicts of Interest		M	
	Oversee the process of information disclosure		F	M
	Establish internal audit and independent external audit systems		M	F
<b>Disclosure of information</b>				
	Disclose of information through press-releases and web-site <sup>3</sup>		F	M
	Disclosure of shareholders		F	M
	Disclosure of officer compensation			A
	Disclosure in prospectuses of material risk factors		F	M
	Information disclosure on related party transactions		F	M
	Compliance of information disclosure with business and financial accounting standards		M	F

<sup>a</sup> Legend: A=all companies; M=most companies; F=few companies

<sup>6</sup> Shareholders notification about AGM, contribution to the agenda.

<sup>7</sup> No companies have independent directors in the sense of persons not related to management or to principal shareholders of the company by marriage, consanguinity to the second degree, employment, or business interest.

<sup>3</sup> Company reports, corporate governance structure, information on company managers

**Table A2.4: Tajikistan Corporate Governance Assessment  
Classification of Companies<sup>a</sup>**

<b>Rights of shareholders</b>		<b>Substantial Achievement</b>	<b>Moderate Achievement</b>	<b>Little or no Achievement</b>
	Shareholders participation in annual general meeting <sup>8</sup>	F	F	M
	Disclosure of extraordinary events		F	M
<b>Composition/ responsibilities of board</b>				
	Independent <sup>9</sup> or non-executive directors	M		
	Establishing company strategy	A		
	Establishing compensation policy and replace managers	M		F
	Monitor conflict of Interests			M
	Oversee the process of Information disclosure		F	M
	Code of Ethics		F	M
<b>Disclosure of information</b>				
	Disclosure of major shareholders			A
	Disclosure of officer compensation			A
	Disclose of material factors in securities issues		F	M
	Disclosure of proposed insider transactions	F		M

<sup>a</sup> Legend: A=all companies; M=most companies; F=few companies

<sup>8</sup> Shareholders notification about AGM, contribution to the agenda and right to ask questions on any subject.

<sup>9</sup> No companies have independent directors in the sense of persons not related to management or to principal shareholders of the company by marriage, consanguinity to the second degree, employment, or business interest.

**Table A3: Comparison of Legal Framework<sup>1</sup> Key Corporate Governance Provisions**

<b>Rights of shareholders</b>		<b>Azerbaijan</b>	<b>Kazakhstan</b>	<b>Kyrgyz Republic</b>	<b>Tajikistan<sup>2</sup></b>
	Shareholders participation in annual general meeting <sup>3</sup>	P	P	P	P
	Disclosure of other shareholders and holdings	Y	N	P	N
	Annual election of directors for one year term	N	N	Y	Y
	Vote on fundamental matters affecting company <sup>4</sup>	Y	Y	Y	Y
	Shareholders decisions on matters that should be management prerogatives <sup>5</sup>	Y	Y	Y	N
	Right of shareholders to redeem shares at will <sup>6</sup>	Y	P	Y	Y
<b>Board composition/ responsibilities</b>					
	Proper definition of role of board <sup>7</sup>	N	N	P	N
	Requirement for independent <sup>8</sup> directors	N	P <sup>9</sup>	N	N
	Obligatory committees of the board for audit, governance, and compensation	N	N	N	N
	Duty of chairman to obtain adequate qualitative and quantitative information from management	N	N	N	N
	Separation of positions of CEO and board chairman	Y	Y	Y	Y
<b>Disclosure of information</b>					
	Disclosure of major Shareholders	N	N	N	N
	Disclosure of higher level officers' compensation <sup>10</sup>	N	N	N	N
	Contemporaneous disclosure of extraordinary events	P	P	N	N

<sup>1</sup> The Law on Joint Stock Companies in Kazakhstan, Kyrgyz Republic and Tajikistan. The Civil Code in Azerbaijan. The securities laws are also considered for corporate governance provisions.

<sup>2</sup> For Tajikistan the draft Law on Joint Stock Companies that is likely to soon be enacted is analyzed.

<sup>3</sup> Shareholders notification about AGM, contribution to the agenda and right to nominate directors and ask questions on any subject.

<sup>4</sup> Merger, acquisition, dissolution, capital increase, charter amendment

<sup>5</sup> Y is undesirable.

<sup>6</sup> Y is undesirable.

<sup>7</sup> Definition: Establish policies for the operations of the company and oversee their implementation.

<sup>8</sup> Independent directors means persons not related to management or to principal shareholders of the company by marriage, consanguinity to the second degree, employment, or business interest.

<sup>9</sup> Public companies must have thirty percent but not more than fifty percent independent directors but the definition of "independent" is not clear.

<sup>10</sup> Individually or in the aggregate

<b>Rights of shareholders</b>		<b>Azerbaijan</b>	<b>Kazakhstan</b>	<b>Kyrgyz Republic</b>	<b>Tajikistan<sup>2</sup></b>
	Disclosure of insider transactions	N	P	P	Y
	More frequent than annual financial statements disclosure <sup>11</sup>	N	P	P	N
<b>Other</b>	Rules against abusive in insider transactions	P	P	Y	Y
	Charter may not change statutory rights, duties	N	N	N	N
	Annual external independent audit	N	Y	P	P

Legend: Y=yes P=partial (insufficient provisions for proper governance) N=no

<sup>11</sup> Other than for companies subject to securities law reporting that generally requires quarterly filings of financials.

**Table A4: Comparison of Regulatory Regimes**

	<b>AZE</b>	<b>KAZ</b>	<b>KGZ</b>	<b>TAJ</b>
Broad authority for a government agency to enforce joint stock company law <sup>1</sup>	N	N	N	N
Enforcement of some corporate governance rules in practice	Y	Y	Y	NA <sup>2</sup>
Resource allocation <sup>3</sup>	P	F	P	NA
Staff skill level <sup>4</sup>	L	M	L	NA
Integrity <sup>5</sup>	L	H	L	NA
Code of conduct for staff specific to the agency	N	N	N	NA

## Legend:

N=no

Y=yes

G=good

F=fair

P=poor

H=high

M=moderate

L=low

<sup>1</sup> The law that governs the organization and governance of joint stock companies as distinguished from the law governing the issuance and trading of securities.

<sup>2</sup> NA means not applicable as there is no regulatory function in Tajikistan for corporate governance.

<sup>3</sup> Market perception.

<sup>4</sup> Market perception.

<sup>5</sup> Market perception.

**Table A5: Comparison of Promotional Activities**

	<b>AZE</b>	<b>KAZ</b>	<b>KGZ</b>	<b>TAJ</b>
Locally staffed entity primarily devoted to corporate governance promotion	<b>N</b>	<b>N</b>	<b>N<sup>1</sup></b>	<b>N</b>
Government entity partially devoted to promotion			<b>Y</b>	<b>N</b>
Promotion predominantly by donors	<b>Y</b>	<b>Y</b>	<b>Y</b>	<b>Y</b>
Recent initiatives for public or private entity solely for promo	<b>Y</b>		<b>Y</b>	<b>N</b>
Level of knowledge of corporate governance of shareholders	<b>L</b>	<b>L</b>	<b>M</b>	<b>L</b>
Level of knowledge of corporate governance of company directors	<b>L</b>	<b>L</b>	<b>L</b>	<b>L</b>

Legend:

N=no

Y=yes

H=high

M=moderate

L=low

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<sup>1</sup> The Corporate Development Center that was such an agency ceased operations in January 2005 after five years of activity.

Table A6: Summary of Recommendations

		AZE	KAZ	KGZ	TAJ
<b>Legal Framework</b>					
	Amend law	\ <sup>1</sup>	\		
	New JSC law	\			\
	Adopt Standard Company Law		\	\	
	Strengthen regulatory powers	\	\	\	\
<b>Company Practices</b>					
	Strengthen legal framework	\	\	\	\
	Educate shareholders	\	\	\	\
	Train directors	\	\	\	\
<b>Regulation</b>					
	Train staff	\	\	\	<sup>2</sup>
	Rationalize activities	\	\	\	
	Code of conduct for agency	\	\	\	
<b>Promotion of Corporate Governance</b>					
	Create local promotional entity <sup>3</sup>	\	\		
	Educate shareholders	\	\	\	\
	Train directors	\	\	\	\

<sup>1</sup> Provide for minimal general provisions in the Civil Code supplemented by a modern company law.

<sup>2</sup> There is no regulatory authority for corporate governance at present in Tajikistan. One should be created.

<sup>3</sup> Local training entities and new promotional foci exist in the Kyrgyz Republic. In the absence of a local entity devoted to promotion because of lack of feasibility (Tajikistan), promotion would be by donors.

KYRGYZ REPUBLIC  
INSTITUTE OF CORPORATE DIRECTORS  
A PROPOSAL FOR FUNDING

SUBMITTED TO \_\_\_\_\_

ON \_\_\_\_\_

BISHKEK, OCTOBER 2004

***ICD Mission Statement:***  
***To Promote Integrity, Competence, and Commitment***  
***in Kyrgyz Corporate Governance***

## **I. INTRODUCTION**

1. The independence of the Kyrgyz Republic in 1991 has involved comprehensive and significant reforms that have affected all aspects of social, economic, and political life. One of the major steps was the transition from a planned to a market economy. This has led to the need for processes to channel the energies of stakeholders to productive uses. In the light of these developments, the Government of the Kyrgyz Republic has committed itself to important reforms in corporate governance through practical policies and procedures in finance, commerce and industry.

2. Understandably, undertaking various reforms in corporate governance revealed numerous weaknesses that require further reforms in institutional policy and private initiative.

3. The initiatives described in this Proposal (TP) are oriented towards:

- (i) enhancing the attractiveness for investment in the enterprise sector;
- (ii) increasing the confidence of domestic and foreign investors;
- (iii) strengthening of corporate governance policies, practices and rules.

4. This TP is written for a wide range of potential donors who are interested in further promotion of corporate governance and overall economic growth of the Kyrgyz Republic. TP seeks funding from various local stakeholders, sponsors and bilateral development agencies and international institutions. There is, of course, scope for modifying the proposal if interested donors so desire.

## **II. BACKGROUND**

5. In 1997, the Asian Development Bank (ADB) at the request of the Government of the Kyrgyz Republic initiated a pilot project, the first of its kind for this institution in former CIS countries, to develop corporate governance through a "Corporate Governance Capacity Building Program". Building on gained experience, a second phase of "Corporate Governance and Enterprise Reform" was initiated. Not only was it responsive to meet the requirements of the economy, but it also increased the overall capacity and awareness of companies and investors in corporate governance. It allowed for the introduction and development of many international best corporate governance practices. These, by and large, include: (i) development of corporate governance, accounting, and bankruptcy legislation; (ii) corporate governance capacity building through establishment of the Corporate Development Center (CDC), the ADB Implementing Agency; (iii) development of technical assistance for institutional mechanisms and for enforcing regulations of joint-stock companies (JSC) (information disclosure; publication of information about JSC's in mass media and web sites; legal and corporate advisory services to shareholders; training in capital markets operations); (iv) implementation of wide-scale public awareness and information programs on corporate governance issues, including monthly publication of "Korporativniy Vestnik" (Corporate Herald) and maintenance of a website; and (v) implementation of training programs for managers on corporate governance procedures, shareholder meetings, and transparency in JSC

management. Nonetheless, more practical steps are required in capital markets and the enterprise sector to foster enhanced practices in corporate governance.

6. The more tangible achievements of the CDC are in drafting and publication of (i) JSC Charter Model, according to best international standards, particularly OECD; (ii) Handbook on Corporate Governance in the Kyrgyz Republic; (iii) Revised Instructions on Bankruptcy; (iv) amendments into the Laws on Economic Partnerships and Companies, On Bankruptcy, Civil Code, JSC, Collateral, Mortgage, and Accounting.

### **III. RATIONALE**

7. Corporate governance has become an important focus worldwide. Companies play a vital role in fostering overall economic development and social progress; especially in transition economies-- it facilitates providing employment, public and private services, goods and infrastructure. The efficiency, transparency, and accountability of joint stock companies are now a matter of both public and private concern. Hence, corporate governance has become one of the key issues in the global agenda.

8. Reforms in governance can no longer be viewed as a national or local issue for any company: globalization has brought the need for international coordination of efforts to ensure that developing and transition country growth is promoted and shared in bringing prosperity to the many, rather than the few.

9. Good corporate governance is important for competitiveness. In an increasingly globalised economy, firms need to tap domestic and international capital markets for investment. Investors have a choice, and the quality of corporate governance is increasingly becoming a criterion for investment. Expanding and deepening the capital pool for developing and transition economies requires conformity to good corporate governance standards.

10. There is a complex interplay of factors which contribute to a functioning corporate governance system: there are factors internal to the firm such as the board of directors, providers of capital, shareholders, and management; likewise there are factors external to the corporation which ensures effective governance: law and regulation, competitive markets, the media and accounting rules for accounting and reporting. Governance failures or weaknesses can reflect deficiencies of both.

11. The precise precepts for corporate governance are still a matter for debate. It is an emerging discipline, on which little to date has been written from the perspective of developing and transition economies. Nevertheless, much focus should be placed on designing such a scheme which would build on the already ongoing initiatives under the Asian Development Bank's Corporate Governance and Enterprise Reform Program II. The tools and expertise developed could contribute to the furthering of reforms. Moreover, the positive experience may lead to sharing with other economies that have the Soviet heritage.

12. The role of public policy is to provide firms with the incentives and discipline to minimize the divergence between private and social returns, and to protect the interests of stakeholders.

13. In the light of the above rationale, it is imperative to support an institution which has national importance in promoting corporate governance. The proposed Institute of Corporate Directors would play a role of champion of a non-governmental nature to direct significant efforts for practical promotion of good corporate governance.

#### **IV. GOALS AND OBJECTIVES**

14. Exchange of information, experience, and practices will allow the lessons of success and failure to be shared. Pooled knowledge, expertise, and contacts will build a resource to which each party contributes and from which each benefits in return.

15. Coordination between the many organizations engaged in governance will lead to more effective use of resources and marshalling of efforts nationwide. As governance is a complex, multifaceted process, so too must be the assistance efforts to address the many aspects of internal and external factors that are needed for efficient systems. In this, the roles of the public sector and private sector--capital providers and other stakeholders--need to be fully addressed.

16. A critical task for the ICD is to assist companies to identify priority areas and help implement these in a consistent and sustained basis through leverage of resources and expertise.

##### **A. Transition of Public Function of Promoting Corporate Governance to the Private Sector**

17. Unlike some other countries, Kyrgyzstan has a poorly developed self-regulating tradition. This, in turn, has adverse implications for corporate governance, as a whole, for the state being slower than the private sector in reacting to trends and achievements in the corporate sector. Appealing to courts for protection in cases of infringed corporate rights is constrained by a complex procedure of dispute resolution by the state courts and lack of financial means of most shareholders to afford qualified legal assistance.

18. In line with the desire of the state to implement a corporate reform agenda, there is need for separating the present Corporate Development Center (CDC) from government affiliation and transform it into a private body. This is consistent with a requirement under the Corporate Governance and Enterprise Reform Program II, where CDC has to be separated from the state into a private entity with a viable corporate governance development strategy.

19. The anticipated outcome will ensure establishment of an institute uniting companies, without public influence, and supporting international corporate governance standards.

##### **B. Activities of the Institute of Corporate Directors**

20. The main activities of the ICD are outlined below:

- (i) Training
  - (a) Company directors in corporate governance
    - i. Conduct of annual meetings
    - ii. Activities of committees of the board: audit, compensation, governance
    - iii. Shareholder and community relations: corporate disclosure and communications
    - iv. Corporate secretary functions
    - v. Selected issues; e.g., dividend policy, resolution of corporate disputes

- (b) Independent directors—boot camp
  - (c) Staff of the State Committee on the Securities Market (SCSM), the securities regulatory authority, (when they have no equivalent training)
- (ii) Research
    - (a) Surveys of impediments to good corporate governance
    - (b) Analysis of successful practices of companies in governance, shareholder relations
    - (c) Development of a model code of ethics for company officers and directors
    - (d) Development of a handbook for company directors
  - (iii) Public awareness/education
    - (a) Publishing results of research—surveys, studies—lessons learned
    - (b) Posting on the Website PowerPoints of training sessions
    - (c) Publishing model code of ethics and handbook for company directors
    - (d) ICD publication 8x/yr including re-prints of articles from the world press and foreign academic and professional journals on relevant corporate governance topics
    - (e) ICD Website—corporate governance documents
      - i. Legislation
      - ii. Model documents—proxy materials; annual reports; reports of committees of the board on audit, compensation, governance

## **V. KEY AREAS OF ICD FOCUS**

### **A. Enhancing Corporate Governance through Addition of Independent Directors on Boards of Directors, including those of State-owned Enterprises**

#### **1. Effective Management of Corporate Rights by the State**

21. The state constitutes the biggest corporate investor in the country. However, effectiveness of corporate governance remains low. Shortcomings are seen in lack of proper public management policy which would incorporate: (i) attraction of highly qualified persons into management of companies with state capital; (ii) establishment of effective corporate governance system in companies where all the interests of stakeholders are honored.

22. The State Enterprises Cadre Commission (the “Commission”) is the system through which the state manages its holdings in joint stock companies. Although the Commission was formed in 1995, it began to select representatives for the managing boards of joint stock companies only in 2001. The state, through the State Property Fund (the “SPF”), holds shares in approximately 200 enterprises. These holdings range from a few percentage points up to one hundred percent ownership. The primary method of management is through nomination of directors of the enterprises. In those cases where the State owns more than 50% of the shares of the enterprise, it nominates all of the company’s directors and where there is more than 10%, one representative. Where the SPF owns a minority of the shares, it often nominates the number of directors proportionate to its shareholdings, and its nominees generally are elected.

23. The procedure for selection and nomination of enterprise directors is managed through the Commission except for approximately 15 strategic enterprises wholly owned by the state whose directors are appointed by the Presidency. Training of candidates, raising their qualifications and monitoring performance of directors currently have deficiencies which need to be addressed.

24. The low skill level of candidates is at the same time one of the most pressing problems and one of the great opportunities in the process. Since the Kyrgyz Republic does not have long experience with capitalism, there is a shortage of skilled managers and directors. Many of the current nominees are government employees.<sup>39</sup> If such a corps of skilled people is to develop, they must be trained.

25. This will be carried out under the ICD Training component. The ICD will use the existing curriculum and instructors for training directors and potential directors. Successful completion of a substantial corporate training course, leading to a certification, should be a requirement for being nominated to a directorship. The course would cover such topics as a director's duties to shareholders including minority shareholders, the duty of loyalty and the duty to gather sufficient information to make informed decisions. Ongoing training should be a requirement for re-nomination.

26. No system exists for evaluating the performance of individual directors. In addition, outstanding performance is not rewarded and the regular compensation of directors is quite low. An evaluation procedure should be instituted for assessing the performance of individual directors. This should include self-evaluation forms, completion of evaluation forms by fellow directors, and also such objective criteria as attendance at meetings and committee meetings and improvement in the profitability of the company. There should be established a system of incentive–reward within each company.

## **B. Promoting Transparency**

27. Information on the activities of companies is of interest for a large number of investors. As of January 1, 2002 there were 400,000 individual shareholders in more than 1400 companies in the Kyrgyz Republic. A fundamental requirement for a sound and viable corporate sector is comprehensive disclosure of corporate information. This will help investors and other stakeholders to make decisions with regard to companies participating in the capital market. This information will be published by ICD both in the bi-monthly publication and on the Website on a user fee basis.

28. Model documents will also be published—an annual company report and company by-laws.

## **C. Training Programs**

29. This component of ICD activity will be critical for it provides for capacity building and human resource development applicable to all other areas of ICD involvement. It will serve as a multifaceted center with training in:

- (i) training of directors and officials of companies on corporate governance, corporate strategy issues, management, enterprise restructuring, attraction of foreign direct investments, information disclosure;
- (ii) development and printing of methodological materials, including a handbook on corporate governance practices, code of ethics, best practice case studies;
- (iii) training of assessors on relevant areas of expertise necessary for undertaking a self-assessment rating of their own enterprises;
- (iv) training courses for executive representatives and candidates into SOE management bodies where there will be required testing;

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<sup>39</sup> The recently amended Law on Joint Stock Companies prohibits this practice.

- (v) ICT training programs for modern electronic corporate governance (e-CG) methods and tools.

30. The necessary methodological guidebooks and manuals will be developed in consultation with a corps of professional trainers from overseas. This segment of the Training Program will require supplemental assistance from donor institutions.

#### **D. Public Awareness Programs (PAP)**

31. PAP is connected with each component of ICD operations. The awareness campaign will provide outreach to the public which will enhance the impact of certain components. Moreover, the country needs a medium to bring attention to corporate governance developments nationwide.

32. The effective operation of PAP will emanate from each activity where ICD renders its services. The PAP will also use its own prime channels of information as the "Corporate Herald" newspaper (both electronic and print versions) and ICD web page. These media will be used for disseminating information on all relevant corporate governance issues.

33. This component will also conduct thematic round tables and seminars to target audiences in the Kyrgyz Republic where there is major corporate concentration and investment. It is intended to counter the problem of lack of awareness among the citizens who have shares who are inactive due to ignorance of corporate affairs and remoteness of their residence location. Considering that some significant amount of savings is located in outlying regions, it is necessary to attract participation in a range of business initiatives.

## ILLUSTRATIVE CASES OF PRACTICE AND PROMOTION OF CORPORATE GOVERNANCE

### I. KAZAKHSTAN

#### A. Case No. 1: Shareholders' Rights

1. “TransBuildBridge” company specializes in construction of bridges. This company has highly qualified personnel. There are about 480 shareholders in “TransBuildBridge,” 5% of them are preferred shareholders with a permanent dividend (5 KZT for 1 share).

2. In August 2003 a few preferred shareholders filed a claim in court asking for payment of dividends for the period of 2001-2003. The court decided that the company must pay in full dividends and a fine for illegal using of other’s money. Court representatives send a copy of the decision to FSA, with a request to take this company under supervisory control. This case provides a result for court practice, but enforcement of the court decision took over eight months. However, requesting the FSA to enforce a court decision is questionable.

#### B. Case No. 2: Shareholders’ Rights

3. A new shareholder of 20% shares in TransBuildBridge the company requested the General Director to provide it with financial documents, board of directors’ minutes, and the minutes of the general shareholders meeting. The General Director owns almost 60% of the shares and is a member of the board of directors. The General Director replied that the documents will be provided within thirty days (in accordance with Law on Joint Stock Companies). However, after thirty days the General Director did not comply.

4. It appears that the General Director tried to falsify financial documents during this thirty day period. The new shareholder applied to the board of directors, which has five members (General Director is one of them). But the Board of Directors also ignored the shareholder.

5. The new shareholder (possessing the rights of principal shareholder) applied to the Board of Directors with a request to hold an extraordinary General Shareholders Meeting. But the Board of Directors also ignored this request. The shareholder filed with the court two claims, to:

- (i) Obtain the financial documents;
- (ii) Convene an extraordinary General Shareholders Meeting with the agenda of re-election of the Board of Directors.

6. After eight months, the court took a positive decision on both claims. The shareholder was provided with all financial documents. In the process of verification of documents, the shareholder discovered violations and in the next General Shareholders Meeting the new shareholder elected two members to the Board of Directors.

7. This case is also positive for court practice. However, in general the majority of judges, tax and police officers have a little knowledge of corporate governance.

#### C. Case No. 3: Major Transactions—Joint Stock Company Law

8. One big metallurgical company concluded a lot of major transactions. Accordingly to legislation, the Board of Directors must decide on major transactions. Afterwards, this decision should be approved by the General Shareholders Meeting. The process of concluding major

transactions takes approximately 35-40 days. The General Shareholders Meeting did not approve the decisions on concluding the major transactions, thereby violating the law.

9. After four years, two shareholders filed a claim with the Ust-Kamenogorsk city court to cancel such major transactions (selling a foundry for US\$ 568,000 to a Chinese company "Ban Hui." Estimation of company assets were US\$ 2,250,000.

10. The court refused to accept the claim because the period in which such transaction can be cancelled had expired (accordingly to the Civil Code, the period is 3 years). This case shows that rules indicated in the company law on procedure for approval of major transactions are unrealistic in relation to commercial needs.

#### **D. Case No. 4: Fraudulent Financial Statements**

11. An agricultural company (main activity: growing grain, corn, cereals) with five branches in Central and North Kazakhstan in 2003 published its annual financial report on its website. Two months later, this company issued additional shares that were bought by one Kazakh individual investor. After he became a shareholder, he recognized that the annual financial report did not reflect the real financial situation of the company. Moreover, in 2004 the company incurred losses, due to low harvest. The new shareholder (owner of 15% shares) filed a claim for damages caused by false information on the financial situation of the company, which was published on their website. The court decided to award damages to the new shareholder. The state prosecutor also proceeded against the management of the company, the General Director and chief accountant paid fines for their criminal activities.

12. This case shows the problem that state authorities do not check the information posted on companies' websites. Nowadays, it is common for a company to post information about annual and quarterly financial reports and governance structure of the company on their websites. The majority of foreign investors are first acquainted with information about companies on their websites. The FSA should exercise more control on information which is published on websites.

#### **E. Case No. 5: Shareholders' Rights--Judicial Incompetence**

13. One mining company "Syrymbet" (hereinafter "Company") was established in 1993 by the merger of two companies. The Company issued 3940 shares, 986 preferred shares and one "golden share" ("golden share" gives the right of veto on decisions of the general shareholders meeting, Board of Directors and management on issues defined in the Articles of Association (Article 13 the company Law)). Shares were sold to 15 shareholders. In 1999 shareholders were divided on the decision of the company to acquire an industrial complex. The general shareholders meeting could not approve a decision on such question without approval of the "golden share" owner. Later the general shareholders meeting decided to abolish the "golden share" due to the exclusive right of the general shareholders meeting to found and abolish the "golden share" (Article 36 of the company Law).

14. The owner of the "golden share" brought an action in court to cancel the decision of the general shareholders meeting referring because a "golden share" gives the right of veto on decisions of the general shareholders meeting, including a right to veto a decision of the general shareholders meeting to abolish the "golden share."

15. The court ruled in favor of the shareholder, considering that the decision of the general shareholders meeting contradicted the Articles of Association of the Company. However, the court

did not consider that the Law has the priority over the Articles of Association, and therefore the general shareholders meeting could abolish the “golden share”.

16. This case shows the incompetence of courts in corporate law. There is a need to improve professional knowledge of judges.

## II. KYRGYZ REPUBLIC

### A. Case No. 1: Promotion of Corporate Governance--Corporate Development Center

17. The Corporate Development Center was founded in 1999. It was to assist in introducing of best practices of corporate governance in joint stock companies of the Kyrgyz Republic. The CDC was financed by the Asian Development Bank and coordinated the performance of actions on corporate governance agreed with ADB by the Government of the Kyrgyz Republic. The CDC acted under the Government of the Republic for a long period of time and had high status.

18. In the framework of training and promotion of corporate governance CDC accomplished the following:

- (i) more than 150 seminars on corporate management, where about 2500 people studied management, marketing and finance;
- (ii) 58 television programs, including “the ABCs of corporate governance” and 17 radio programs dedicated to corporate governance;
- (iii) more than 20 round tables and conferences on corporate governance;
- (iv) until the end of 2003, the “Corporate Bulletin” newspaper was published monthly and distributed among shareholders and officials of joint stock companies. This newspaper included annual reports, and commentary on corporate legislation and bankruptcy;
- (v) web-sites of 16 joint stock companies were developed;
- (vi) consultation on legislation that regulated corporate relationships, bankruptcy procedures to more than 2500 shareholders. Some shareholders were assisted in preparation of petitions to courts and other state organs on the issues of protection of rights.

### B. Case No. 2: Board Members of Joint Stock Companies with State Investments

19. In 2003 in the Kyrgyz Republic the new Law on Joint Stock Companies came into force. It prohibited government officials from being elected to executive organs of joint stock companies. In that case the inter-departmental commission on planning of managerial staff under the Fund of State Property that recruited private sector representatives was founded.

20. This Commission administers an examination among people interested in vacancies in Boards of Directors or Revision Committees in joint stock companies with a state share in capital and also interviews candidates. Based on the results of candidate selection tests, some are recommended by the Commission to executive organs on behalf of the government, others are taken to the reserve of managerial staff.

21. In such process, the members of executive organs of some 70 companies are selected. They are called representatives of government in joint stock companies. After being elected by the general shareholders meeting, government representatives sign an agreement with the Fund of State Property. In this agreement duties of government representatives – notification of significant events of companies, information on current situation, etc. – are required. The agreement also sets

forth the duty to coordinate some decisions with the Fund. In this way, the Fund intervenes in the governance process by influencing directly decisions of the board of state-owned companies.

22. After finishing a term of office, the government representatives submit reports on their work to the Commission. Based on the report and recommendations of the Fund, the Commission decides whether to nominate a candidate for next period, or to nominate other person. The government representatives are to receive remuneration. However, sometimes such remuneration is not paid and work of the representative is rather ineffective.

### **C. Case No. 3. Training in Promoting Corporate Governance**

23. In Kyrgyz Republic there are three training centers that promote corporate governance: training center under Fund of state property (FSP), training center under Kyrgyz Stock Exchange (KSE), training center under of State Commission on Securities Market (SCSM). Training center under the FSP assists the Commission in managerial staff development and training of government representatives in joint stock companies. Training centers of the SCSM and the KSE provide compulsory training of specialists who plan to get a license from the SCSM for conducting professional activities in the stock market. Also, the training center under the KSE provides training of university students.

24. All these centers are self-financed by providing training courses for a fee. It should be mentioned that some stock market professional participants provide free seminars on corporate governance for joint stock companies for marketing.

### **D. Case No. 4: Special Legislation for Banks on Corporate Governance**

25. In Kyrgyz Republic, as in all countries of Central Asia, many joint stock companies were founded as a result of privatization of state enterprises. Many of these enterprises are far from practicing high standards of corporate governance and they are against appropriate legislation in this field. Thus, in the Republic's parliament it is rather difficult to adopt progressive changes in the Law on Joint Stock Companies that would improve corporate governance.

26. The National Bank of Kyrgyz Republic, working for improvement of corporate governance in commercial banks, initiated setting of standards on corporate governance in the Law on Banks and Banking. The standards of this special law are set higher than standards of the general Law on Joint Stock Companies. Therefore, in Kyrgyz Republic there is rather different system of corporate governance for banks than for other joint stock companies, including compulsory cumulative voting for Board of Directors election, requirements of independent directors.

## **III. TAJIKISTAN**

### **A. Case No. 1: EBRD/TSOB<sup>40</sup> Rights of Shareholders; Disclosure of Information**

27. In November 2000 EBRD made an equity investment in the Tajik commercial bank "Tojiksodirotkonk" (TSOB). After two years TSOB issued free shares to one of the shareholders. TSOB did not inform other shareholders. As a result of this TSOB action, the EBRD equity declined from 19.4% to 8.3%.

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<sup>40</sup> Source: STRATEGY FOR TAJIKISTAN, EBRD, July 2003

28. To clarify and remedy this situation EBRD tried to have a dialogue with TSOB representatives. But these negotiations brought no results. The EBRD discussed it with the National Bank (NBT) as well. The consultation with NBT also did not change the situation. EBRD as a result exited from its equity investment in 2003.

29. As EBRD indicated, this case shows the weaknesses in shareholders' rights and necessity in corporate governance development of regulatory enforcement.

### **B. Case No. 2: MAHIN Shareholders' Rights**

30. The joint stock company "Mahin" is a manufacturing company established by two legal persons: a local company and a foreign company. The day-to-day business activity was managed by the local investor's representatives.

31. The Ministry of Justice required the company to re-register. This requirement meant the adoption of a new charter. To make decisions on this and some other additional issues, it was decided to hold a special shareholders meeting. The fax notification about holding the meeting was sent to the foreign partner three times with explanations of the situation with a translated letter of the Ministry of Justice but the foreign company did not respond.

32. The Tajik side decided to hold meeting itself. The local shareholder justified this action based on the fact that the company could not function without compliance with legislation requirements and all these questions had to be decided forthwith. The meeting was held with Tajik side representatives and the company officials. As a result, the meeting decided to determine a new date for the special shareholder meeting where both sides should participate and discuss all important issues that directly concern the company activity. With this purpose they decided to send an additional notification and require the foreign company's attendance.

33. After more than a half-year, the other special shareholders meeting was held. Before the meeting, the Tajik side had sent two more notifications about this meeting to the foreign shareholder but without any response. The company could not postpone any longer the decision that was vital for its activity. The shareholders meeting made decisions on a number of important questions including additional share issues and the process of re-registration including approving a new charter of the company.

34. More than six months later, the foreign company sued, asking the court to adjudge both special shareholders meetings illegal as well as decisions made at these meetings. During the process, the court realized that the claim had not been signed by the required procedure established by the law and could not accept the claim.

### **C. Case No. 3: SHOH Shareholders' Rights; Lack of Regulatory Enforcement**

35. The joint stock company Shoh has both physical and legal persons as its shareholders.

36. The principal shareholder who owned more than 50% of the shares was dissatisfied with management of the company and believed that because of negligence of the management the company had poor performance. The company did not provide this shareholder complete financial statements. The principal shareholder also realized that the general director had two jobs and did not devote enough time to the company.

37. The principal shareholder found out that the management of the company had negotiated several leasing contracts (major transactions) without informing the shareholder. These contracts were concluded on real property which should not have been leased but used by the company itself. The shareholder asked the management to disclose information regarding these contracts and give some explanations on how they used the income from these transactions but management refused to present it.

38. The refusal to present information regarding these leasing transactions made the shareholder conclude that the management might hide the income and disclose wrong income statements. As a result of all this, shareholders would receive fewer dividends.

39. Since the negotiations with management of the company had brought no results, the shareholder decided to call a special meeting of shareholders. Shareholders wanted to discuss with other shareholders issues regarding governance of the company: management misconduct in governance; qualifications of company staff, need to disclose information to the shareholders on particular transactions; continuation of the general director in his post. With this purpose, the shareholder sent a letter to the company asking to hold a special shareholders meeting, indicating date and time.

40. The management of a company ignored this request. They answered the principal shareholder with a letter containing information not relevant to the issues.

41. After the company ignored the request on calling up the special meeting, the principal shareholder applied to the government entity at the Ministry of Finance that registers companies for support in holding the meeting. But the government entity does not have authority to call a shareholders meeting of a company. The principal shareholder had planned to sell his shares in the company since his rights were not protected.

#### **D. Case No. 4: Tajik Tel Shareholder Failure to Capitalize; Related Party Transaction**

42. The joint stock company Tajik Tel was founded on 1995. The founders are the JSC "Teleradiocom" – 50 % (state-owned) and Cyprus New Secular Company - NECS – 50%. Tajik Tel provides cellular services and other telecommunications. During the period of operation the company, there were violations of law and rules of corporate governance.

- (i) The Tajik promoter did not pay for its part of the shares. The requirement to pay initial capital in one year is in the Article 7 of the Law on JSC of 1991.
- (ii) NECS provided the equipment for the company on a financial lease. This transaction was done without approval of the shareholders meeting and was excessively burdensome for the company. The cost of the lease exceeded normal financial leasing costs. The equipment actually delivered amounted to only 25 % of that stipulated by the agreement. Despite this, payments for the financial lease were in full and practically ruined the company.
- (iii) The company is not registered in the Ministry of Finance shareholders register of companies. A prospectus for the issued shares also was not registered (Law on the Security Market Art. 25).
- (iv) No board meeting has been held and the Board of Directors has not been elected. When a General Director tried to summon the meeting of shareholders, they did not

come. The General Director was assigned by the NECS. Under the terms of this agreement with NECS, the General Director makes monthly reports to NECS and he has been reporting only to NECS.

- (v) The company is in the process of bankruptcy that was initiated by the creditors of the company before the Economic Court of the Republic. Despite the frequent notifications to NECS, it has not entered an appearance in Tajikistan. It has sent messages not recognizing the bankruptcy of the company.

#### **E. Case No. 5: Governance of a Company with Foreign Investor**

43. A meeting of the joint-venture stockholders of a closed joint-stock company adopted a decision on voluntary liquidation of the company. The foreign investor who owns a 49% share in the company appealed to the Economic Court with the request to nullify the decision of the meeting and the decision of the Registration Chamber to exclude the joint venture from the Uniform Public Register. The statement of claim said that the foreign investor had not known about the forthcoming meeting and the decisions being adopted at the meeting.

44. According to the decision of the Economic Court, the plaintiff's claims were declined due to the fact that at the meeting at which the decision on voluntary liquidation of the company was adopted the representative of the foreign company was present and was authorized to represent the foreign company.

45. According to a decision of the Court of the Appeal, the lower court decision was reversed because in the Regulations of the Joint Venture, the decision on termination of the company activity must be adopted with consent of the foreign participant. It is specified in the Regulations that the consent of the investor must be registered according to special form and legalized according to the Hague Convention, 1961. The citizen of Tajikistan had the right to perform as representative only "commercial and representative functions and duties." The adoption of the decision to liquidate the company was not envisaged in these functions and duties.

#### **F. Case No. 6: Precarious Ownership Rights in Shares**

46. The registrar for a joint stock company does not have a right to exclude from the register a shareholder based on the registrar's own initiative. This case is to the contrary.

47. A company that purchased shares addressed the Economic Court with the request to make an entry in the register that it be considered to be the shareholder of 1000 shares in a certain company. As the basis, the plaintiff presented the agreement of purchase-sale of shares that was concluded with a legal entity that was included in the register of this company and being the owner of the shares purchased. The right of ownership of the seller to the shares at the time of the purchase-sale agreement was confirmed with a duly executed extract from the stockholders' register.

48. The registrar opposed the plaintiff's claim because the seller had been excluded from the stockholders register because the documents on which the registration had been based were insufficient. The court sided with the registrar.