NepalUSA CHAMBER

N E W S L E T T E R Volume 10, Issue 5 Mar/Apr 2005

LAYING THE GROUNDWORK FOR ECONOMIC GROWTH

by Ira M. Millstein

Solid corporate governance is becoming increasingly crucial to attracting investment capital. Developing countries in particular stand to gain by adopting systems that bolster investor trust through transparency and rule of law.

Corporate governance is entering a phase of global convergence, driven by the growing recognition that countries need to attract and protect all investors, both foreign and domestic. The equation is clear: global capital will generally flow at favorable rates to where it is best protected, but will not flow at all or will flow at higher-risk rates where protections are uncertain or nonexistent.

In many countries whose legal systems are rooted in British common law, the interests of shareholders are held to be paramount in most corporate decisions. However, this has not been the case throughout the rest of the world—at least not until now.

Countries that have traditionally fostered notions of partnerships between management, employees, and other stakeholders, have other social priorities, or have mixed government-private ownership arrangements are now recognizing investor protection as an important signal to potential capital providers. This is especially the case for developing countries. They need to demonstrate adoption of corporate governance principles so as to foster investor trust and attract capital, which will in turn lead to investment and economic growth. Of course, these principles need to be tailored to fit local needs—one size will not fit all. But there are certain fundamentals that cannot be ignored.

Corporate governance comprises a combination of regulatory rules and private sector-driven guidelines. In countries with more sophisticated financial markets, corporate governance rules and structures are contained in laws protecting property rights and shareholder rights through legislation, accompanying regulations, judicial decisions, and stock exchange listing rules. This is the essential enabling governmental infrastructure. In addition to formal rules, corporations adopt best-practice principles and guidelines, which are continually being developed by the private sector and academia in response to prevailing market conditions and investor demands. Developing countries need to take both elements— governmental infrastructure and best practices—into account.

THE ROLE OF THE CORPORATION

Understanding corporate governance requires an understanding of the concept of the corporation and the position it occupies in the business world. This understanding will demonstrate why corporate governance, as I have described it, is essential to legitimizing the corporation's role in society and providing a vehicle for economic growth.

The corporation is an entity created by law. It has existed in some form or another for hundreds of years, and its essential features have stayed virtually the same over that whole period.

One of the most important features of a corporation is limited liability, which allows people to invest money or other property in the corporation without any of their other personal assets being placed at risk in the event the company fails. This money is locked away in the company, and investors are denied any sort of meaningful

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Corporate Governance: The Development Challenge

by Charles Oman and Damoe; Blume

Developing countries face the challenge of transforming political and economic governance arrangements from relationship-based systems into rules-based systems. Many must enhance their ability to address corporate insiders' abusive use of schemes to expropriate or divert resources from other stakeholders. With enforcement at the heart of the challenge, the appropriate balance between regulatory and voluntary initiatives remains an open question.

Recent spectacular corporate governance failures in the United States and Europe remind us that such breakdowns can severely affect the lives of thousands—employees, retirees, savers, creditors, customers, suppliers—in countries where market economies are well developed. But is corporate governance important in the developing world, including so-called emerging-market and transition economies, where national economies tend to be dominated by large family-owned, state-owned, and/or foreign-owned companies that do not have shares widely traded on local stock markets and where a multitude of small noncorporate forms of enterprise often account for a significant proportion of local employment and output? Until recently, few people thought so.

Only after the financial crises of 1997-1999 in Asia, Russia, and Brazil did heightened concern for global financial stability draw attention to the problems of "crony capitalism" and poor corporate

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access to it. For example, they cannot demand that the company pay a dividend or give back any of the capital. Their capital is at risk because while the investors profit if the corporation succeeds, they can lose it all if the corporation fails. After contributing money or other property to a company, investors are issued shares, which represent the entitlement to a reward for assuming this risk. In most cases, shares are freely transferable, so shareholders can sell their shares to other investors. Or they can "walk away" from a corporation entirely if they wish.

Another key feature of a corporation is perpetual existence. The corporation's ability to continue indefinitely gives stability to the enterprise by ensuring that businesses can survive their founders.

The corporation became the dominant form of business organization in response to a need for growth capital. It is the most efficient way to amass large amounts of capital. Shareholders are able to invest in companies without risk of personal liability and do not need to rely on the reputation or trustworthiness of their fellow investors as they would in a partnership. They can also spread their risk by investing in a number of different companies, with the aim of maximizing their overall return.

THE BOARD OF DIRECTORS

In exchange for the benefits of limited liability, perpetual life, and transferability of shares, investors grant the power to run the corporation to a group of people entrusted with the task of making decisions in the best interests of the company and all of its investors, not just a particular segment of investors. In this way, the corporation is not directed by special-interest investors, and the shareholders are protected against one another's unique agendas. This group of entrusted people, elected by shareholders, is called the board of directors.

Much of the law regulating corporations relates to the board of directors, with many of the specific rules designed to foster investor confidence that directors will do the right thing. The board is responsible for managing or directing the business and affairs of the company. In practice, the board delegates its authority to make day-to-day decisions concerning the operation of the company to full-time employees. Boards appoint a chief executive officer (CEO) to coordinate and oversee these management efforts, and the CEO, in turn, is empowered to hire the top managers.

But the interests of shareholders, directors, and managers can sometimes conflict. For instance, some shareholders may wish to receive a dividend, while other shareholders and management may prefer to reinvest profits and promote internal corporate growth. The board is required to manage these conflicting interests by making decisions in the best interests of the company and all of its shareholders.

CONVERGING MODELS OF CORPORATE GOVERNANCE

In many common-law countries, shareholders are the constituents to whom directors have primary regard in the decision-making process. Other countries such as France, Germany, and the Netherlands have historically placed emphasis on the interests of other stakeholders, including employees, creditors, customers, suppliers, and the community in which the corporation operates. The current corporate governance climate is tending toward convergence of these models.

Investor interests are increasingly paramount as a result of the global nature of modern investments, the rise of the institutional investor as a dominant player, and the related focus on protecting investment—regardless of where the corporate headquarters are located. Moreover, corporate boards are increasingly aware of the need to treat nonshareholder constituents fairly and have regard for their interests so that the corporation can succeed financially, as well as live up to the demands for social responsibility placed on it by those stakeholders and others. The convergence is thus from both sides. For example, when Johnson & Johnson, a pharmaceutical manufacturer, immediately and voluntarily removed all possibly tampered-with bottles of Tylenol from distribution, it showed responsibility beyond the bottom line.

Accountability to shareholders and the other stakeholders is assured by a set of duties—spelled out to one degree or another in many developed countries—with which directors must comply in making decisions. These duties are known as fiduciary duties. They include the duty to exercise care, the duty to be loyal to the company, the duty to be candid and transparent, and the duty to act in good faith. A breach of any one of these duties can result in potential director liability to either government regulators or shareholders. In the United States, for example, shareholders may institute lawsuits against directors in their own right or on behalf of the company to gain redress for an alleged breach of fiduciary duty. Such cases abound in the United States, as witness the host of shareholder suits against Enron, Tyco, and WorldCom, among many others. Some suits have merit and some not, but the possibility of such suits is a strong motivation for better director performance.

Shareholders can also do the "Wall Street walk" and sell their shares if they are unhappy with what is happening at the company. And regulators can step in for more egregious behavior. In other countries, the existence and enforceability of these directors' duties vary significantly. But it is also becoming clear that duties without enforceability may be hollow.

RISK TAKING AND ACCOUNTABILITY

It might be reasonable to wonder whether directors would be comfortable making decisions that might result in good returns to the company but that are either inherently risky or uncertain. The law assists directors in this regard by freeing them of liability for their decisions, provided they act in good faith and with care and diligence. In the United States, for example, this is achieved by means of court-made law. In addition, companies can assume the costs of defending directors who act in good faith, and they can also purchase insurance to cover such costs. All of this works together with the duties outlined above to reduce the risk of mistakes without sacrificing economic efficiency in decision making.

To illustrate, consider this scenario: The board of a gold mining company is deciding whether to purchase an expensive license

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governance in some emerging-market economies. Since then, the perceived threat to global financial markets and the pressures engendered by that perception have waned. The danger is that local efforts to enhance corporate governance in the developing world will lose momentum as a consequence.

Instead, those efforts need to be strengthened. Research by the Organization for Economic Cooperation and Development (OECD) on the importance of local corporate governance for sustained productivity growth in the developing world, as well as the OECD's regional corporate governance roundtables in Asia, Latin America, Eurasia, Southeast Europe, and Russia, show that the quality of local corporate governance is critically important for the success of long-term development efforts throughout the developing world today.

RULES AND RELATIONSHIPS

A country's system of corporate governance comprises formal and informal rules, along with accepted practices and enforcement mechanisms, private and public. Taken together, these govern the relationships between the people who effectively control corporations (corporate insiders) and those who invest in them. Well-governed companies with actively traded shares should be able to raise funds from noncontrolling investors at significantly lower cost than poorly governed companies because of the premium potential investors can be expected to demand for taking the risk to invest in less well-governed companies.

Corporate governance continues to be seen by some as relatively unimportant in developing countries, in large part because of the small number of firms there with widely traded shares.

The poor quality of local systems of corporate governance lies at the heart of one of the greatest challenges facing most countries in the developing world: how to successfully—often in the face of covert or overt resistance from powerful, locally entrenched interest groups—transform local systems of economic and political governance, including those of corporate governance, from systems that tend to be highly personalized and strongly relationship based into systems that are more effectively rules based.

In many of today's OECD countries, the transformation from predominantly relationship-based to rules-based systems of economic and political governance took place largely before the spectacular rise and rapid global spread late in the 19th century of the giant manufacturing corporation and the displacement of proprietary capitalism (unincorporated individually owned business) by global corporate capitalism.

Today's developing countries thus face a challenge unknown to many OECD countries: how to move from relationship-based to rules-based systems of governance at a time when large private- and state-owned corporations play significant roles in local economies (whether or not their shares trade actively in a local stock market) and therefore tend strongly to influence local systems of governance.

OLIGOPOLISTIC RIVALRY AND CORPORATE INSIDERS

The importance and difficulty of this challenge are reflected in the pervasiveness of two often mutually reinforcing phenomena in the developing world. One is the considerable extent to which corporate insiders are able to manipulate the economic environment to extract financial income not matched by corresponding labor or investment. Insiders display a predictable reluctance to divulge information needed to measure the values of their corporations. Nevertheless, the difference between the price paid for a controlling bloc of a company's shares and the price others paid for the shares in the open market can be used as an objective indicator of those values. During the 1990s, the difference averaged 33 percent in Latin America and 35 percent in central European transition economies, for example, as contrasted with 2 percent in South Africa, the United States, and the United Kingdom, and 8 percent in non-Anglo-Saxon Europe.

The other phenomenon is the impact of oligopolistic rivalry among powerful interest groups entrenched in local structures of economic and political power. (An oligopoly is a market with so few suppliers that the behavior of any one of them will affect price and competition.) Such groups are sometimes called distributional coalitions because of their tendency to spend significant financial, physical, and human resources in attempts to defend and/or expand their bases for value extraction rather than invest resources in the creation of new wealth for their national economies and themselves. They generally include insiders in major private and public corporations.

STRATEGIES OF OWNERSHIP

Three techniques are widely used by insiders throughout the developing world to expropriate or divert resources from corporations in ways that deprive noncontrolling investors and other corporate stakeholders of wealth that would be considered their fair share in countries with sound corporate governance. Most important is the use of pyramidal corporate ownership structures in which one firm holds a controlling equity share in one or more other firms (the "second layer"), each of which, in turn, holds a controlling share of one or more other firms (the "third layer"). Such pyramids allow insiders who control the company at the top to effectively control the resources of all the firms in the pyramid, even though their nominal ownership of all those other firms, especially in the lower layers, may be quite small.

Also important are cross-shareholdings (firms that possess each other's shares) and multiple share classes (shares in the same company that have different voting rights, with insiders' shares having disproportionately high voting rights). Used in combination, these techniques make it possible for corporate insiders to control corporate assets worth considerably more than their nominal ownership rights, or, in the case of managers, their nominal remuneration, would justify.

Corporate insiders' use of techniques to defend or enlarge their share of power vis-à-vis rivals also tends to reduce or eliminate the need to seek alternative means to access outside finance, notably through better corporate governance. These techniques offer dominant shareholder-managers, prevalent in much of the developing world, an added advantage from their perspective. Rather than having to dilute their control, as would occur with the sale of equity to raise funds from outside investors, they actually increase it, sometimes considerably, beyond their nominal ownership rights.

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Unfortunately, these techniques also create strong incentives for corporate insiders to pursue abusive self-dealing and related activities with the sizable corporate resources they control. Not only do such activities constitute severe market distortions, but they lead corporations to behave in ways that significantly increase both rigidities and volatility in the local economy. In economies that lack abundant capital, they create strong incentives for corporations to invest heavily in capital-intensive facilities, which often remain underused. They provide incentives for corporate insiders to pursue strategic rivalry among themselves that costs society dearly in wasted resources and foregone opportunities for needed change.

Corporate insiders' widespread use of pyramidal ownership structures, cross-shareholdings, and multiple share classes thus goes far in explaining their tendency to resist pressures to improve corporate governance in many developing countries. It also goes far in explaining the severe waste, market distortions, and often massive misallocation of human and material resources associated with corruption and crony capitalism in too many of those countries.

WHAT TO DO?

The challenge for many developing countries is to break out of this vicious circle. Doing so requires better understanding of the importance of corporate governance for developing countries today.

The OECD has been working to increase this understanding through its Development Center's research and informal policy dialogue on corporate governance and through its regional policy dialogue programs in Asia, Latin America, Southeast Europe, Eurasia, the Middle East and North Africa, Russia, and China. By bringing together public sector decision makers, regulators, companies, investors, and other stakeholders in each region, these roundtables help build coalitions for reform. Policy discussions have revolved around the OECD's Principles of Corporate Governance, with each region developing recommendations adapted to local conditions, issued in the form of regional white papers.

High on the list of priorities for reform in many developing countries must be enhancing the capacity to address the problem of insiders' abusive use of multiple share classes, cross-shareholding, and pyramidal corporate control structures. In many countries, this will require significantly greater public disclosure of share ownership and stronger measures to ensure basic property rights of ownership for domestic and foreign minority shareholders.

The key challenge in many countries today is not so much how to design better corporate governance laws and regulations—many now have good ones on the books—but how to enforce them effectively. Many developing countries have too much and sometimes conflicting regulation that proves to be too difficult to enforce.

Adequate enforcement, which is at the heart of the challenge of moving from relationship- to rules-based systems of corporate governance, raises the issues of voluntary versus mandatory approaches and of the need for strengthened regulatory and judicial institutions to enforce them.

ENFORCEMENT CONSIDERATIONS

Many OECD countries favor an approach to regulation and enforcement that combines relatively high disclosure standards with considerable reliance on voluntary governance mechanisms. Debate is ongoing in OECD countries as to an appropriate balance between regulatory and voluntary initiatives. For developing countries, further questions can be raised as to the effectiveness of voluntary mechanisms, given these countries' relatively weak institutions of rules-based governance and weak third-party monitoring capabilities. The large information gap from which corporate insiders benefit at the expense of public shareholders, especially in countries with concentrated ownership structures and poor protection of minority shareholders' rights, means that governments will continue to have a central role to play.

The role of regulatory and judicial institutions in public enforcement is particularly important for developing countries. Recent experience highlights the potential value for these countries of having a strong and politically independent, yet fully accountable, securities regulatory commission that is well funded and endowed with adequate investigative and regulatory powers. True for all countries, this experience is especially relevant for countries that have weak judicial systems, not least because of the considerable time it can take to strengthen a country's judiciary system.

Policymakers should not, however, perceive the choice between regulatory and judicial means of enforcement as an either/or choice; they should see those means as complementary and mutually reinforcing. From a long-term development perspective, few institutions are more important for sound rules-based governance and long-term growth in a country than a well-functioning judiciary. This is true not only because a country's corporate governance system comprises considerably more than its securities laws and their enforcement, including credible contract enforcement, but also because of the danger that those with responsibility to regulate, such as a securities commission, may be corrupted or unduly influenced by those whose actions they are intended to monitor and regulate. It is in countries most burdened by the behavior of powerful distributional coalitions, whose entrenchment is often reflected in a lack of national judiciary independence and accountability, that the risk of corruption or excessive influence tends to be greatest.

Developing a competent, politically independent, and well-funded judiciary is vitally important for enhancing the contribution of corporate governance to corporate performance and long-term national development.

The strong resistance to many of the changes needed to enhance corporate governance often asserts itself through relationship-based systems of public governance. The relative weakening or collapse of those systems in many countries in recent years may constitute a window of opportunity for countries to overcome resistance to changes that are needed as much in their systems of public governance as in those of corporate governance.

The broader point is not only that sound corporate governance requires sound public governance, but also that sound government today requires sound corporate governance. Given the power of corporate insiders and their close relationships with

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to prospect in an area that has a 20 percent chance of yielding valuable gold deposits. A risk-averse group of directors might reject the opportunity if there were a possibility that shareholders could sue them if it were discovered that there were no deposits. Decisions such as those, at an aggregate level, would be disastrous for business because fearful directors might make many economically inefficient decisions. Once the specter of personal liability is removed, those same directors should be more likely to make more efficient decisions. This overall system protects directors under what is known as the business judgment rule. Courts will protect directors who use business judgment in good faith and with care and diligence.

NOURISHING INVESTOR TRUST

The legal requirements relating to directors form part of a larger framework aimed at nourishing investor trust in the corporate form. Many of these are structural in nature, including those ushered in by the corporate governance reforms of recent years, such as mandatory director independence, committee structures requiring independent directors to meet alone without management present in order to discuss frankly and openly whatever they wish, and an active audit committee.

Recently, the corporate governance movement has begun to focus on other ways of bolstering the integrity of directors and managers. For instance, U.S. Securities and Exchange Commission Chairman William Donaldson has emphasized the importance of directors and senior management setting the right tone at the top in terms of high ethical standards. Going forward, the corporate governance movement will be striving to find directors with a moral compass who are endowed with qualities revered by 18th-century economist Adam Smith, such as prudence, justice, beneficence, temperance, decency, and moderation. Boards comprising people possessing at least some of these qualities should foster investor trust in the board and the corporation. Moreover, directors with a demonstrable moral compass should be more inclined to make risky but efficient decisions, since courts will be less likely to impose liability upon such persons.

The existence of a solid corporate governance regime will be important to an individual investor's decision whether to buy shares in a company. Investors are unlikely to want to commit their funds to a corporation whose board and management cannot be trusted to do the right thing for all the shareholders. The decision of each potential investor to invest or not invest in a company can be aggregated at the national level to illustrate the importance of corporate governance on a macro scale. If a country or region has

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KEY OECD PRINCIPLES OF CORPORATE GOVERNANCE

I. Ensuring the basis for an effective corporate governance framework

The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among diferent supervisory, regulatory and enforcement authorities.

II. The rights of shareholders and key ownership functions

The corporate governance framework should protect and facilitate the exercise of shareholders rights.

III. The equitable treatment of shareholders

The coporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redness for violation of their rights.

IV. The role of stakeholders in corporate governance

The corporate governance framework should recognize the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financiall sound enterprises.

V. Disclosure and transparency

The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.

VI. The responsibilities of the board

The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.

Table A1.1: Country Economic Indicators - Nepal

Item	2000	2001	2002	2003	2004[a]
	Fiscal Year				
A. Income and Growth					
1. GDP per Capita ($ current)	243	241	233	242	271
2. GDP Growth (% in constant prices)	6.0	4.8	(0.4)	2.9	3.3
Agriculture	4.9	5.5	2.2	2.5	3.9
Industry	8.7	3.2	2.9	3.0	1.0
Services	5.7	5.3	(1.4)	3.3	4.3
	(% of GDP)				
B. Saving and Investment (current and market prices)					
1. Gross Fixed Capital Formation	19.3	19.0	19.3	19.1	19.2
2. Gross National Saving	19.0	18.9	16.4	15.2	14.8
	(annual % change)				
C. Money and Inflation					
1. Consumer Price Index[b]	3.5	2.4	2.9	4.8	4.0
2. Total Liquidity (M2)	21.8	15.2	4.4	9.8	12.8
	(% of GDP)				
D. Government Finance					
1. Revenue and Grants	12.2	13.0	13.1	14.5	14.6
2. Expenditure and Onlending	15.5	17.6	17.0	16.0	16.1
3. Overall Fiscal Surplus (deficit)	(3.3)	(4.5)	(3.9)	(1.5)	(1.5)
E. Balance of Payments					
1. Merchandise Trade Balance (% of GDP)	(13.8)	(13.7)	(12.6)	(15.4)	(15.7)
2. Current Account Balance (% of GDP)	4.5	4.9	4.3	2.5	2.9
3. Merchandise Export ($) Growth (annual % change)	-	11.7	(20.3)	(13.8)	14.9
4. Merchandise Import ($) Growth (annual % change)	-	6.7	(15.3)	7.1	16.0
F. External Payments Indicators					
1. Gross Official Reserves (including gold, $ million)	952	1,009.3	1,030.6	1,158.8	1,446.5
Months of Current year's imports of goods and services	6.2	6.9	7.4	7.9	8.2
2. External Debt Service (% of exports of goods and services)	6.0	6.8	8.5	10.3	10.3
3. Total External Debt (% of GDP)	48.0	47.1	50.8	48.8	47.0
G. Memorandum Items					
1. GDP (current prices, NRs billion)	379.5	410.8	422.3	454.9	494.9
2. Exchange Rate (NRs/$, average)	69.0	73.7	76.7	77.9	73.8
3. Population (million)	22.5	23.2	23.7	24.2	24.8

GDP = gross domestic product, NRs = Nepalese rupees.

[a] Preliminary estimates and staff estimates.

[b] Annual percentage change (period average).

Sources: Ministry of Finance. 2004 Economic Survey. Kathmandu; Central Bureau of Statistics. 2004. National Accounts of Nepal. Kathmandu; and additional information provided to Asian Development Bank staff.

Table A1.2: Country Poverty and Social Indicators - Nepal

Item	1985		1990		Latest Year	
	Period					
A. Population Indicators						
1. Total Population (million)	16.2		17.9		24.8	(2004)[a]
2. Annal Population Growth Rate (% Change)	2.1		2.1		2.3	(1991-2001)
B. Social Indicators						
1. Total Fertility Rate (births/woman)	5.9		5.3		3.6	(2004)
2. Maternal Mortality Rate (per 100,000 live births)	–		850	(1991)	540	(2002)
3. Infant Mortality Rate (below 1/1,000 live births)	115.4		102.1		66.0	(2002)
4. Life Expectancy at Birth (Years)	50.9		53.6		59.6	(2002)
Female	50.0		52.9		59.4	(2002)
Male	51.6		54.2		59.9	(2002)
5. Adult Literacy (%)	26.5		30.5		48.0	(2004)
Female	9.8		14.0		33.8	(2004)
Male	42.7		47.5		64.5	(2004)
6. Primary School Gross Enrollment(%)	–		61.0		72.4	(2004)
7. Secondary School Gross Enrollment (%)	25.2		33.1		54.0	(2004)
8. Child Malnutrition (% below age 5)	69.1	(1975)	57.0	(1990)	48.0	(1995-2002)
9. Population Below Poverty Line (international,%)[b]	–		–		37.7	(1995)
10. Population with Access to Improved Water Sources (%)	–		66		72	(2001)
11. Population with Access to Improved Sanitation Facilities (%)	–		21		28	(2000)
12. Public Education Expenditure (% of GDP)	2.7		2.0		2.9	(2004)
13. Human Development Index	0.42		0.42	(1990)	0.50	(2002)
Rank/Total Number of Countries	114/130	(1987)	152/173	(1990)	140/177	(2002)
14. Gender -Related Development Index	–		0.33	(1995)	0.48	(2001)
Rank/Total Number of Countries	–		148/163	(1995)	116/177	(2001)
C. Poverty Indicators						
1. Poverty Incidence	–		–		42	(1996)
2. Percent of Poor to Total Population	–		–		42	(1996)
Urban	–		–		23	(1996)
Rural	–		–		44	(1996)
Mountain	–		–		56	(1996)
Hills	–		–		41	(1996)
Terai	–		–		42	(1996)
3. Poverty Gap	–		–		9.70	(1990-2001)
4. Poverty Severity Index	–		–		0.05	(1996)
5. Inequality (Theil L Index)	–		–		–	
6. Human Poverty Index	–		–		41.9	(2001)
Rank	–		–		70	(2001)

– = not available ; GDP = gross domestic product.
[a] Staff estimate. [b] $1 a day at 1985 international prices, adjusted for purchasing power parity.
Sources: United Ntions Development Programme. 1993, 1998, 2003, and 2004. Human Development Report. New York; Ministry of Finance. 2004. Economic Survey. Kathmandu; Nepal South Asia Centre. 1998. Nepal; Human Development Report. Kathmandu; Central Bureau of Statistics. 1996. Nepal Living Standards Survey Report. Kathmandu; World Bank.2004. WOrld Development Indicators. Washington D.C; HMG Nepal/United Nation Country Team. 2002. Mellenium Development Goals - Progress Report. 2002.

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a demonstrable governance infrastructure, public and private, its overall economy will benefit from increased local and domestic investment.

BRAZIL'S EXPERIENCE

Recent reforms in Brazil provide a useful illustration of how investor trust in the integrity of the corporation as an institution can be a crucial ingredient in the growth of capital markets. A reform program was begun at the Brazilian stock market in October 2000 after years of stagnation. In less than a year, a second market, called the Novo Mercado, was launched. The Novo Mercado prescribes strict corporate governance standards as a prerequisite to listing and has been successful in attracting investment. Corporate governance measures such as those instituted by the Novo Mercado strengthened investor confidence in the integrity of the corporate form and those who are overseeing their investment. For instance, rules regulating transactions involving a conflict of interests have promoted a transparent environment and well-informed market participants. In addition, governance measures that protect the rights of shareholders have ensured that directors and managers are accountable to investors.

The Novo Mercado demonstrated the importance to investors of openness, transparency, and the existence of good corporate governance. The lesson is not restricted to countries with stock exchanges—it applies to any corporation and country seeking new capital for growth from the increasingly sophisticated global capital markets. And it applies equally to other providers of capital such as banks, which can improve their local economies by improving both their own corporate governance, thereby attracting deposits, and the governance of borrowers, by extending loans to those borrowers with demonstrable good governance.

Developing countries can look toward corporate governance models such as those in place elsewhere in the world for guidance in crafting and instituting local corporate governance rules and principles. In the global capital market, these rules and principles can serve to bolster investor trust in the local corporate form that will ultimately lead to economic growth and prosperity. ■

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Source: eJournal USA, Economic Perspectives, February 2005.

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those who exercise political power at the highest levels, development requires simultaneous movement in the institutions of corporate and public governance from the rule of persons to the rule of law. ■

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The opinions expressed in this article do not necessarily reflect the views or policies of the U.S. government.

Source: eJournal USA, Economic Perspectives, February 2005.

Published by:

Nepal-USA Chamber of Commerce and Industry

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