

Protecting investors



- New Zealand provides the strongest minority investor protections in related-party transactions as measured by *Doing Business*—for the ninth year in a row.
- *Doing Business* recorded 9 legal changes strengthening minority investor protections in related-party transactions between June 2012 and June 2013 and 54 in the past 5 years.
- The United Arab Emirates made the biggest improvement in the strength of investor protections in 2012/13.
- Burundi has advanced the furthest toward the frontier in regulatory practice in protecting investors in related-party transactions since 2009.
- Increasing disclosure requirements was the most common feature of investor protection reforms in the past 5 years.
- Among regions, economies in Europe and Central Asia have strengthened investor protections the most since 2009—increasing disclosure obligations and amending the approval process for related-party transactions.

For more information on good practices and research related to protecting investors, visit <http://www.doingbusiness.org/data/exploretopics/protecting-investors>. For more on the methodology, see the section on protecting investors in the data notes.

Following suspicions raised by shareholders and former executives, the Japanese group Olympus Corporation admitted to overpaying for goods and services purchased from related parties. In one instance Olympus executives agreed to consultancy fees of more than 30% for the \$2 billion acquisition of medical equipment maker Gyrus Group. They did so to hide losses. In 2012 shareholders filed a lawsuit seeking \$240 million in compensation for the resulting losses on their investments.¹

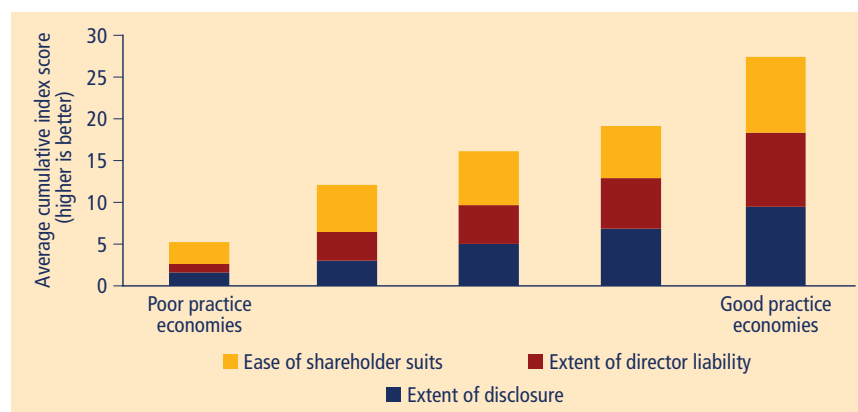
Obtaining capital is essential for entrepreneurs. But investors may be reluctant to provide funding if corporate insiders might simply pocket the funds. When legislation does not allow minority shareholders to bring suits and hold company directors accountable, investors tend to refrain from funding corporations unless they become controlling

shareholders—reducing an economy's ability to finance private sector growth.

A recent OECD study highlighted how policy makers have strengthened regulation to prevent the potential damage that related-party transactions can cause to investor confidence. Measures taken to improve effectiveness include increasing scrutiny by market supervisors, establishing specialized courts and offsetting legal fees for shareholder actions.² Another study shows that minority shareholder expropriation by controlling shareholders is the main channel through which corporate governance affects firm value.³

Doing Business assesses the strength of minority shareholder protections against directors' misuse of corporate assets for personal gain. The indicators measure 3 aspects of investor protections: approval

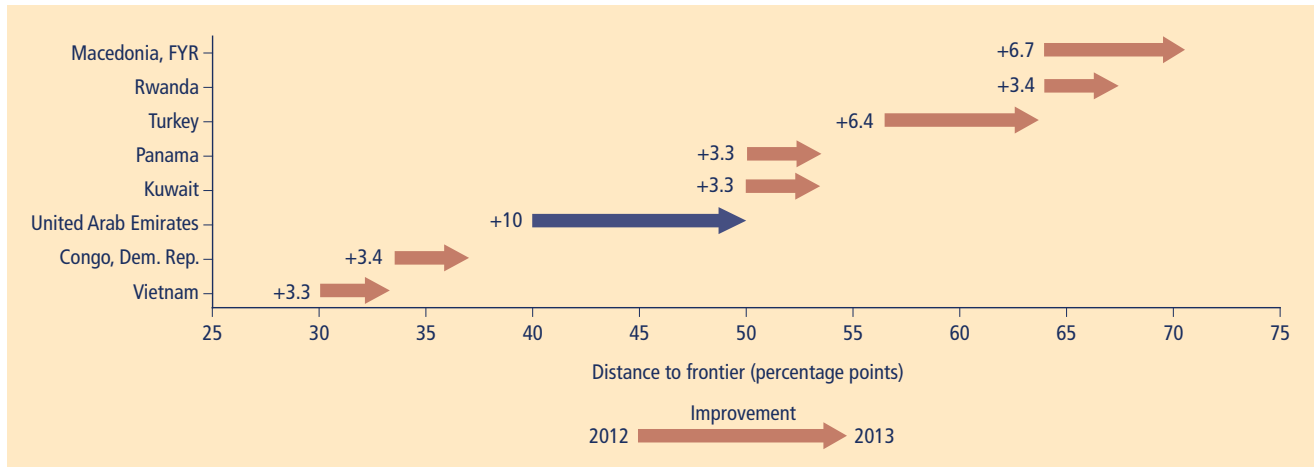
FIGURE 15.1 Economies with extensive legislation on related-party transactions address the 3 aspects of regulation measured by *Doing Business*



Note: Poor practice economies are the 5 lowest-ranked economies on the strength of investor protections. The second column represents the 5 economies ranked from 140 to 144 on the strength of investor protections. The third column represents the 5 economies ranked from 93 to 97. The fourth column represents the 5 economies ranked from 45 to 49. Good practice economies are the 5 top-ranked economies.

Source: *Doing Business* database.

FIGURE 15.2 The United Arab Emirates strengthened investor protections the most in 2012/13



Note: The distance to frontier scores shown in the figure indicate how far each economy is from the best performance achieved by any economy on the protecting investors indicators since DB2006 (2005). The scores are normalized to range between 0 and 100, with 100 representing the frontier.
 Source: *Doing Business* database.

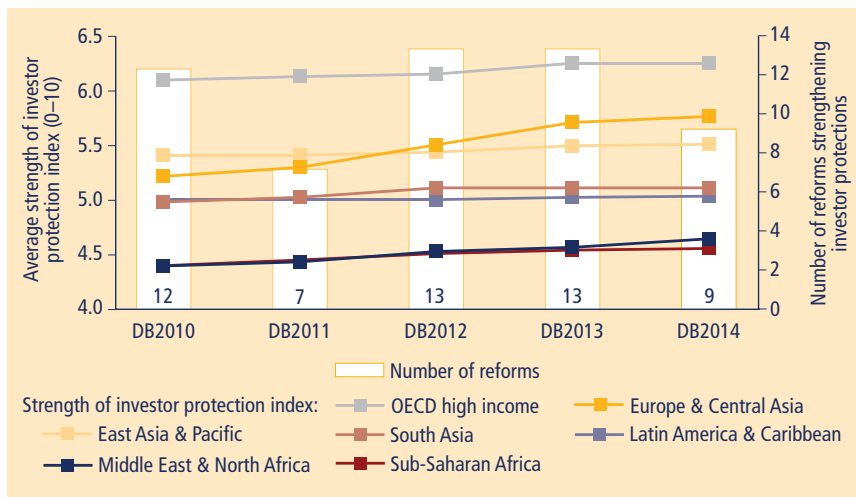
and transparency of related-party transactions (extent of disclosure index), liability of company directors for self-dealing (extent of director liability index) and shareholders' ability to obtain corporate documents before and during derivative or direct shareholder litigation (ease of shareholder suits index; figure 15.1). The standard case study assumes a related-party transaction between 2 companies where 1 individual is the controlling

shareholder and a member of the boards of directors of both. The transaction is overpriced and causes damages to the buying company.

Though seemingly narrow in scope, regulation of related-party transactions involves many aspects of an economy's legal framework. Securities regulation, company law and procedural rules governing

civil or commercial jurisdictions all play a role. In New Zealand the Companies Act, Financial Reporting Act, Securities Market Act, Exchange Listing Rules, Evidence Act, Limitation Act, Judicature Act, High Court Rules and Rules of Professional Conduct for Barristers and Solicitors are all taken into account by *Doing Business*. Together they create the most detailed and stringent regulation applying specifically to related-party transactions as measured by *Doing Business*.

FIGURE 15.3 European and Central Asian economies improved the most on investor protections against self-dealing



Note: To ensure accurate comparisons, the figure shows data for the same 183 economies for all years, from DB2010 (2009) to DB2014 (2013). The economies added to the *Doing Business* sample after 2009 and so excluded here are Barbados, Libya, Malta, Myanmar, San Marino and South Sudan. This figure uses regional classifications for 2013.
 Source: *Doing Business* database.

WHO REFORMED INVESTOR PROTECTIONS IN 2012/13?

Nine economies implemented legal changes strengthening minority investor protections in related-party transactions between June 2012 and June 2013. The United Arab Emirates was the economy improving minority shareholder protections the most in 2012/13 (figure 15.2). Ministerial Decree 239-1, adopted in August 2012, requires companies to include in their annual financial statements detailed information on transactions concluded in the past year with parties closely related to the company through family ties, cross-investments or common executives. No such disclosure obligation previously existed. It also entitles any shareholder of a company to file a petition in court seeking to suspend transactions allegedly concluded in breach of the law's

TABLE 15.1 Who strengthened investor protections in 2012/13—and what did they do?

Feature	Economies	Some highlights
Increased disclosure requirements	Democratic Republic of Congo; Panama; United Arab Emirates; Vietnam	Panama amended its rules on form, content and timing for communication of significant events of issuers registered with the National Securities Commission. The sale or acquisition of assets that represent 10% or more of a company's value must now be publicly disclosed.
Made it easier to sue directors	Democratic Republic of Congo; Turkey; United Arab Emirates	Turkey adopted a new Commercial Code. Interested directors are now required to reveal profits from related-party transactions.
Regulated approval of related-party transactions	Democratic Republic of Congo; Greece	The Democratic Republic of Congo adopted the Organization for the Harmonization of Business Law in Africa's Uniform Act on Commercial Companies and Economic Interest Groups. Now both shareholders and boards of directors must approve related-party transactions.
Increased access to corporate information	Rwanda; Turkey	Rwanda adopted the Law Relating to the Civil, Commercial, Labor and Administrative Procedure 21/2012, which amends provisions of the Civil Procedure Code. The parties are now entitled to confront each other in civil and commercial hearings and, with court authorization, cross-examine witnesses.
Allowed company inspections by external auditors	Kuwait	Kuwait amended its Companies Law. Shareholders who hold 5% of the shares of a company may now request the Ministry of Commerce and Industry to appoint an external auditor to inspect the company.

Source: *Doing Business* database.

requirements. In addition, Kuwait amended its Companies Law, making it possible to appoint external auditors to inspect companies.

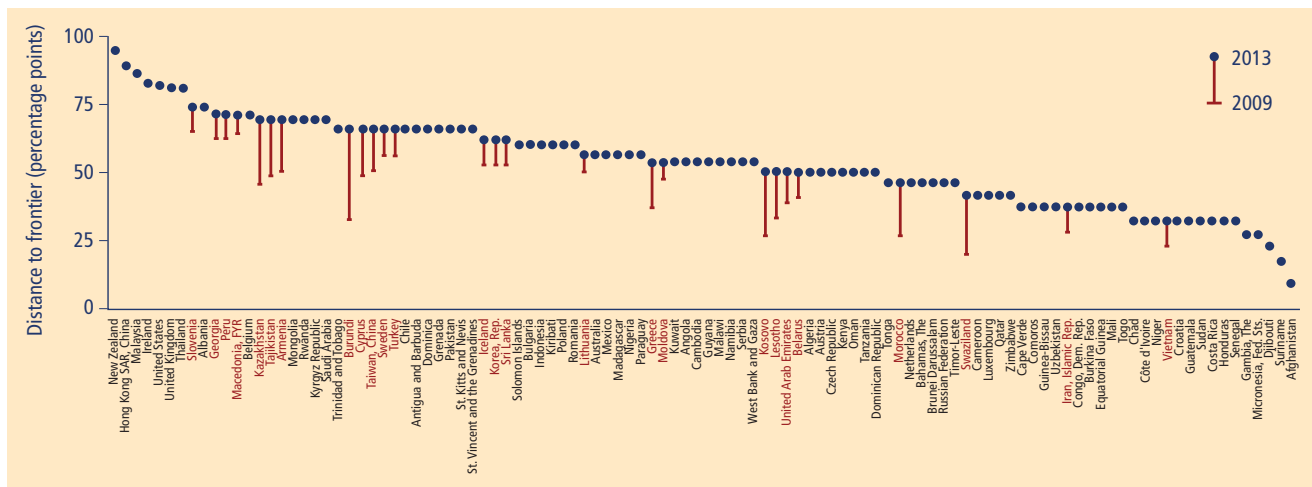
Two economies in Sub-Saharan Africa also amended legislation to better protect minority shareholders (table 15.1). The Democratic Republic of Congo joined the

Organization for the Harmonization of Business Law in Africa in July 2012. As a result the organization's Uniform Act on Commercial Companies and Economic Interest Groups became applicable. The act provides approval and disclosure requirements for related-party transactions and makes it possible to sue directors for mismanagement of company affairs.

Rwanda allowed parties to confront each other in civil and commercial hearings and, with court authorization, cross-examine witnesses.

WHAT HAVE WE LEARNED FROM 5 YEARS OF DATA?

FIGURE 15.4 Burundi has advanced the most toward the frontier in protecting investors over the past 5 years



Note: The distance to frontier scores shown in the figure indicate how far each economy is from the best performance achieved by any economy on the protecting investors indicators since DB2006 (2005). The scores are normalized to range between 0 and 100, with 100 representing the frontier. The data refer to the 183 economies included in DB2010 (though for practical reasons the figure does not show all 183). Barbados, Libya, Malta, Myanmar, San Marino and South Sudan were added in subsequent years. The vertical bars show the improvement in the 26 economies advancing the most toward the frontier in protecting investors between 2009 and 2013.

Source: *Doing Business* database.

Over the past 5 years Europe and Central Asia has been the most active region in strengthening minority shareholder protections against self-dealing, continuing a trend of closing the gap with OECD high-income economies (figure 15.3). Almost half the economies in the region (48%) implemented at least 1 such reform, followed by 35% in the Middle East and North Africa, 20% in East Asia and the Pacific, 19% among OECD high-income economies, 18% in Latin America and the Caribbean, 15% in Sub-Saharan Africa and 13% in South Asia.

During that period the most common change has been increasing disclosure obligations and amending the approval process for related-party transactions—with 70% of reformers doing so—as opposed to, for example, increasing director liability or access to evidence. Among OECD high-income economies that share was even higher, at 85%.

Contrary to global trends, most economies in Latin America and the Caribbean that amended legislation focused on increasing the liability of company directors in cases of prejudicial related-party transactions. Meanwhile, Sub-Saharan Africa had the largest share of economies undertaking a comprehensive overhaul of regulations affecting all 3 aspects of investor protections measured by *Doing Business*.

Over the past 5 years Albania, Burundi, Kosovo, Mexico, Rwanda, Swaziland, Tajikistan and Thailand have been among the economies making comprehensive changes to several areas of regulation that affect the protections of minority shareholders in related-party transactions. Burundi, the economy that has advanced the furthest toward the frontier in regulatory practice in protecting investors since 2009, did so by thoroughly updating the way private companies are governed (figure 15.4). A new Company

Law enacted in May 2011 introduced several good practices and principles designed to prevent the misuse of corporate funds, such as shareholder approval for related-party transactions, extensive disclosure requirements, prior external review of related-party transactions and explicit penalties for company executives found liable in case of losses.

NOTES

This topic note was written by Hervé Kaddoura and Nadine Abi Chakra.

1. Hiroko Tabuchi, "Arrests in Olympus Scandal Point to Widening Inquiry Into a Cover-Up," *New York Times*, February 16, 2012, <http://www.nytimes.com/2012/02/17/business/global/7-arrested-in-olympus-accounting-cover-up.html>.
2. OECD 2012.
3. Bae and others 2012.