

Corporate governance for
unlisted companies

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Corporate governance for unlisted companies

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Introduction

Introduction

In numbers

Unlisted companies account for more than 75% of EU GDP.

Around 70 % of Luxembourgish companies are family owned businesses which corresponds to 20,000 companies

70 % of the family owned businesses are SMEs.

Introduction

In numbers

According to a US study carried out over the course of 60 years, the findings are as follows:

- 80% of family owned businesses did not survive
- Amongst these 80%, upon each generation change, almost 30% disappeared after 30 years of existence

Introduction

In numbers

Luxembourg's experience is almost similar.

In Luxembourg, based on data available for 2008, only 30% of the family businesses survive until the second generation and only 10 to 15% to the third generation.

In the context of the economic crisis, unlisted companies have to look for drivers of change and new models able to deliver welfare.

History

Historical roots of corporate governance



Historical roots of corporate governance

Emergence

Different interpretations of corporate governance have been traced by national circumstances and historical events.

- **COULD THE RECENT ECONOMIC CRISIS BE RELATED TO CORPORATE GOVERNANCE?**
- OECD report: "Corporate Governance and the Financial Crisis – Conclusions and emerging good practices to enhance implementation of the Principles", 25 February 2010

Corporate governance today



Corporate governance today

What is Corporate Governance? “

“It consists of practices, principles and values that guide a company and its business every day, at all levels of the organization.”

- Has the potential to significantly boost growth.
- For example, in recent years, many countries have adopted corporate governance codes.

Corporate governance today

Why does corporate governance matter to unlisted companies?

- Performance and internal efficiency
- Managing patient capital and illiquidity risk
- Building corporate reputation

Comparisons

European and Anglo-Saxon models



Comparisons

European and Anglo-Saxon models

	SWM	CWM
Objective	<ul style="list-style-type: none">•Maximize return to shareholders.	<ul style="list-style-type: none">•To enhance wealth and power of the company as a whole.•To benefit shareholder and stakeholders (i.e. management, employees, suppliers, creditors).
Risk	<ul style="list-style-type: none">•Borne entirely by shareholders•Measured by the earnings and share price.•Added risk that the company's shares may bring to a diversified portfolio.•Doesn't include operational risk.	<ul style="list-style-type: none">•Risk measured as operating and financial risk.•Measured by product market variability.
Shareholder voting power	On a « one share one vote » basis.	Usually long-term loyal shareholders as opposed to short-term portfolio investors.
Share options	Used to motivate the management and employees	Not used, as only benefits the management.

Comparisons

European and Anglo-Saxon models

The Anglo-Saxon model - Shareholder Wealth Maximization (SWM):

- Different approaches:
 - In the USA
 - Board of directors choose CEO who has broad management power – must obtain board approval for major decisions.
 - In the UK
 - The « comply or explain » code of governance, enlisting principles such as separation of CEO and chairman, minimum number of non-executive directors.

Comparisons

European and Anglo-Saxon models

The European model - Corporate Wealth Maximization (CWM):

- Two styles of board structures:
 - One-tier board structure
 - CEO holds position of chairman of the management board (Comité de direction)
 - Two-tier board structure
 - Formal division of power between chairman of the supervisory board and the CEO who heads the management board

Listed and unlisted companies



Listed and unlisted companies

Setting the scene on the backdrop of listed companies' regulation

- Copying the widely-recognised principles of best practice for listed companies is not a viable solution.
- Listed companies may be run by professional managers without significant ownership stakes.
- External shareholders can exercise effective oversight and control over management and the board of directors.

Listed and unlisted companies

- This is often a challenge due to the remoteness of most external shareholders from company decision-making.
- In contrast, most unlisted enterprises are owned and controlled by single individuals or coalitions of company insiders (e.g. a family).
- Good governance in this context is not a question of protecting the interest of absentee shareholders.

Listed and unlisted companies

Corporate governance challenges are different

- In many respects, unlisted companies face a greater corporate governance challenge than listed companies.
- Unlisted companies are of particular importance in countries with less developed capital markets.
- But even in more developed economies, most small and medium-sized enterprises are not publicly listed on regulated equity markets.

Developed and emerging economies



Comparisons

Developed and emerging economies

Case study: India

- Securities and Exchange Board of India brought in international standards of corporate governance for listed companies.
- Shift in corporate environment from predominantly family groups to professionally run businesses.

Comparisons

Developed and emerging economies

- Status of corporate governance is not the same in all emerging countries
- In many developing countries the business community is increasingly recognizing the lost opportunities
- There is a rising interest by the general public in developing countries to invest in listed companies

SMEs and Family Owned Businesses

SMEs and Family Owned Businesses

Specificities

- Family businesses: « organization wherein two or more family members influence the management of an enterprise »
- SME defines itself *inter alia* by the size of its headcount:
 - « Micro »: < 10 employees
 - « Small »: < 50 employees
 - « Medium-sized » : <250 employees
- Common points: strong involvement of shareholders

SMEs and Family Owned Businesses

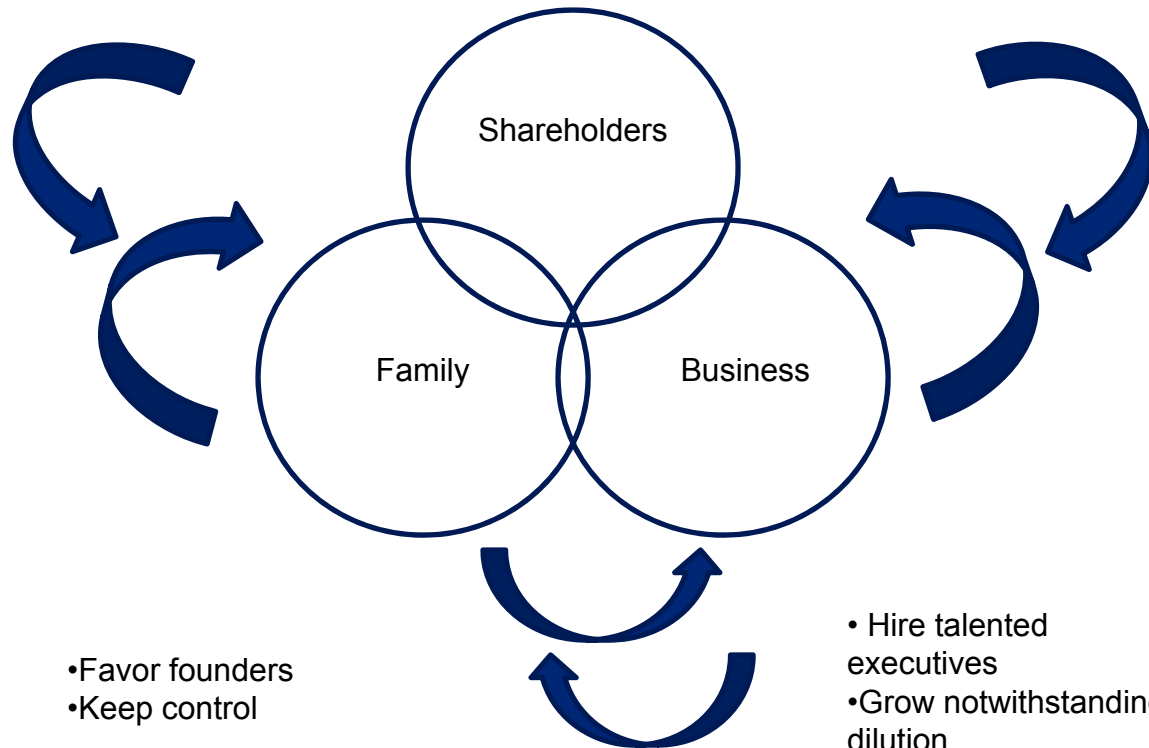
Areas of influence

- 3 key actors coexist
- The objectives are all legitimate but conflicting to some extent

- Have liquid securities
- Equal treatment: one share-one vote

- Impose shareholder's agreement
- Organize power through branches. Genealogical importance.

- Favor founders
- Keep control



- Diversify assets
- Maximise return

- Maximise equity
- Decrease WACC

- Hire talented executives
- Grow notwithstanding dilution

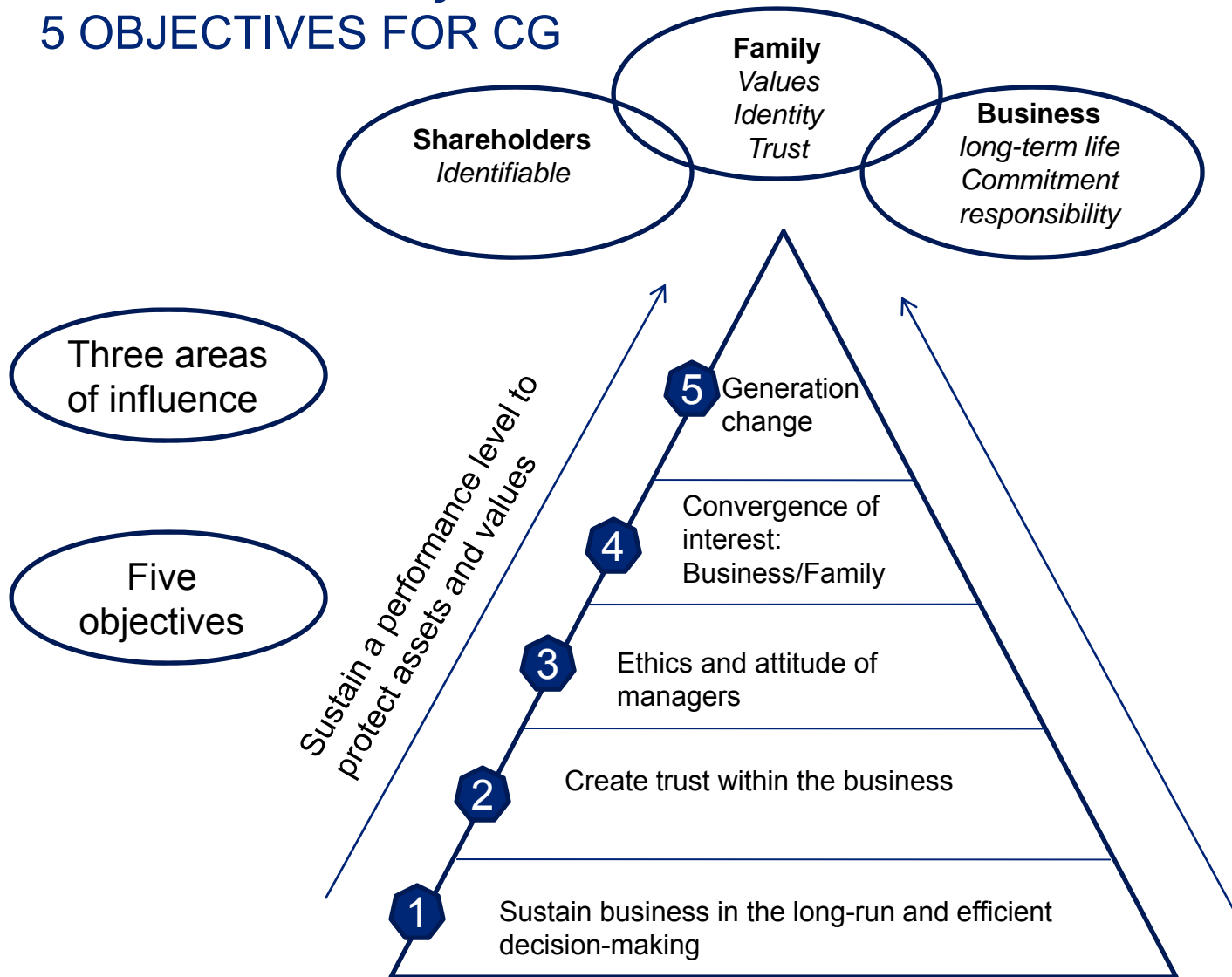
SMEs and Family Owned Businesses

Key words and perception thereof

	Business	Shareholders	Family
Money	merit	Equal treatment	needs
Assets	maximisation of equity	diversification of assets	liquidity
Authority	effectiveness of management	value creation	control
Horizon	years	months	generations
Management	elitism	value creation	genealogical
Tax system	exploitation	important	proprietary, therefore essential
....			

SMEs and Family Owned Businesses

5 OBJECTIVES FOR CG



Base of governance in family-owned SMEs

Source: Rapport de l'IFA sur la Gouvernance des PME-PMI patrimoniales, Octobre 2006

P. Vienot – Corporate Governance – HEC 2008

Panelists and open discussion

Q&A



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