Chapter 6

Corporate Governance

Corporate Governance

- **Corporate governance** is "the system by which companies are directed and controlled"
  (Cadbury Committee, 1992).
- **Corporate governance** is The framework of rules and practices by which a board of directors ensures accountability, fairness, and transparency in a company's relationship with its all stakeholders (financiers, customers, management, employees, government, and the community).

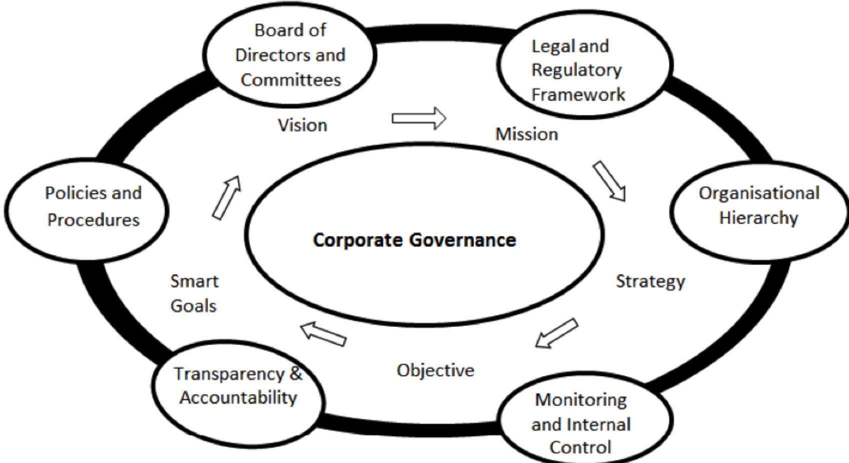
3

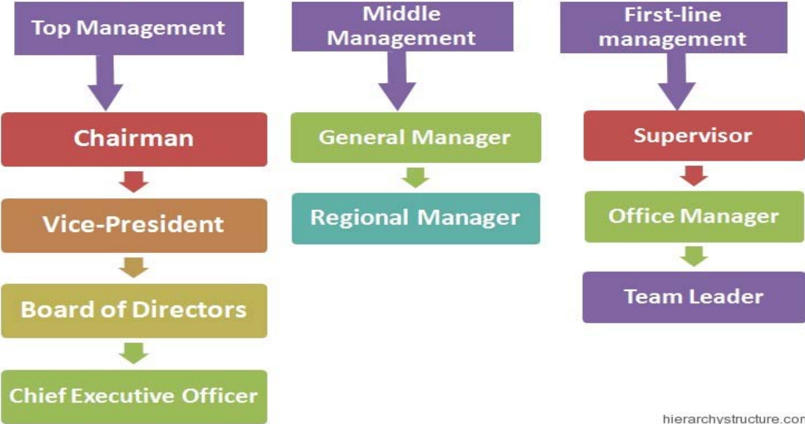
Corporate Governance

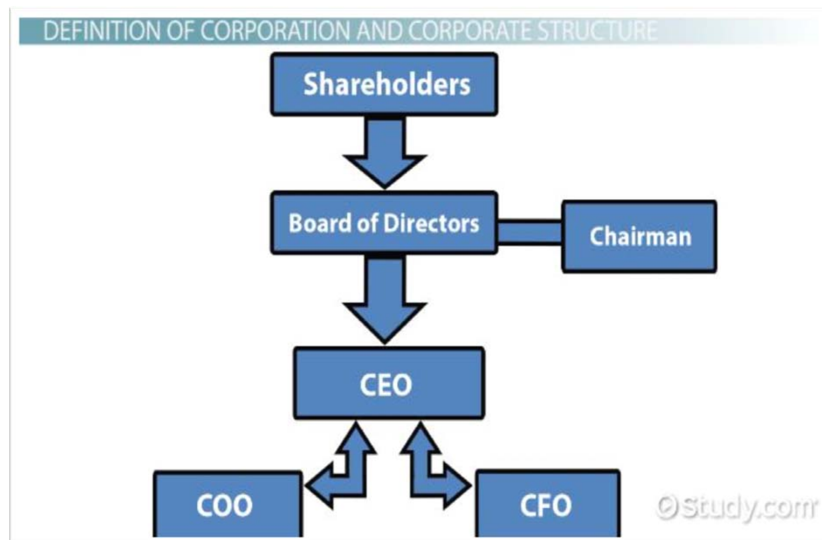
- "Corporate governance involves a set of relationships between a company's management, board of Directors, shareholders and other stakeholders.. also
- the structure through which objectives of the company are set, and the means of achieving those objectives and monitoring performance are determined."
- Focused on preventing corporate collapses such as **Enron collapse.**

4

Corporate Governance







Corporate governance

Corporate Governance aims :

1. Define relationships between a company's management, its board of directors, shareholders and other stakeholders.
2. Provide a structure through which the company's objectives are set, and how they are achieved and monitored.
3. Recognize the value of business ethics and corporate awareness of society interests to reputation and long-term success.

Benefits of Corporate Governance?

1. Better access to external finance.
2. Lower costs of capital – interest rates on loans.
3. Improved company performance – sustainability.
4. Higher firm evaluation and share performance.
5. Reduced risk of corporate crisis and scandals.

Contemporary Corporate Governance

- Contemporary corporate governance started in 1**992** with the **Cadbury report** in the UK.
- **Cadbury report** was the result of several high profile company scandals and collapses.
- **Sir George Adrian Cadbury** was a Director of the Bank of England from "1970–1994".
- He was Chairman of the UK Committee on the Financial Aspects of Corporate Governance which published its Report and Code of Best Practice (Cadbury Report and code of Best Practice) in 1992.
- https://www.youtube.com/watch?v=ZfC7ykLKy4M

Cadbury Report 1992

- **The Cadbury Report**: titled *Financial Aspects of Corporate Governance*, is a report of a committee chaired by ***Adrian Cadbury*** that sets out recommendations on the arrangement of company board of directors and accounting systems to reduce corporate governance risks and failures.
- The report's recommendations have been adopted in varying degree by the **European Union**, the **United States**, and others.

Cadbury Report Recommendations

1. Wider use of independent directors.
2. Introduction of audit committee.
3. Separation between Chairman and CEO.
4. Protect rights of Shareholders.
5. Recognize the rights of Stakeholders.
6. Timely and accurate Disclosure.

Corporate Governance Parties

1. **Shareholders** : those that own the company.
2. **Board of Directors** : Guardians of the Company's assets for the Shareholders.
3. **Managers:** who use the company's assets.

Majority/Minority Shareholder

- Majority Shareholder is a person or entity that owns and controls more than 50 percent of a company's shares (founder of the company).
  - Generally, a majority shareholder has more power than all of the other shareholders combined. S/he also has the authority to do things that other shareholders do not have, such as replacing a corporation's officers or board of directors.
- Minority shareholder is a shareholder who owns less than 50 percent of the total shares of a company's shares .
  - Generally, a minority shareholders don't have any real say in the running of the company, and do not have any control over the board of directors

Principals of Corporate Governance

1. **Accountability.**
2. **Fairness.**
3. **Transparency.**
4. **Independence.**

1. Accountability

- Ensure that management is accountable to the Board of Directors.
- Ensure that the Board of Directors is accountable to shareholders.

17

2. Fairness

- Protect Shareholders rights.
- Treat all shareholders including minorities, equitably.
- Provide effective redress for violations.

18

3. Transparency

- Ensure timely, accurate disclosure on all material matters, including the financial situation, performance, ownership and corporate governance.

4. Independence

- Independent Directors and Advisers. **i.e.** free from the influence of others.

Elements of Corporate Governance

1. **Good Board practices.**
2. **Control Environment.**
3. **Transparent Disclosure.**
4. **Well-defined shareholder rights.**
5. **Board Commitment.**

1. Good Board Practices

- Clearly defined roles and authorities.
- Appropriate Board procedures.
- Director compensation in line with best practice.
- Board self-evaluation and training conducted.

2. Control Environment

- Internal control procedures.
- Independent external auditor conducts audits.
- Independent Internal audit committee established.
- Management Information systems established.

23

3. Transparent Disclosure

- Financial Information disclosed.
- Non-Financial Information disclosed.
- Financials prepared according to International Financial Reporting Standards (IFRS).
- High-Quality annual report published.

24

4. Well-Defined Shareholder Rights

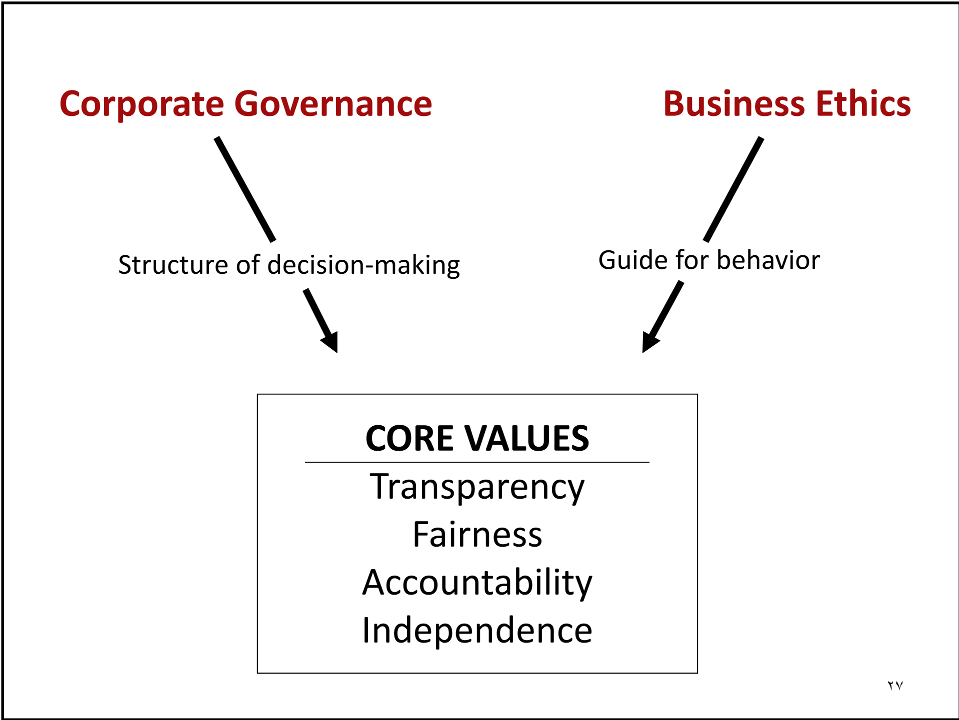
- Minority shareholder rights formalized.
- Well-organized shareholder meetings conducted.
- Policy on extraordinary transactions.
- Clearly defined and explicit dividend policy.

25

5. Board Commitment

- The Board has created a corporate governance committee.
- Appropriate resources are committed to corporate governance initiatives.
- Policies and procedures have been formalized and distributed to relevant staff.

26


Corporate Governance
Business Ethics
Structure of decision-making
Guide for behavior
CORE VALUES
Transparency
Fairness
Accountability
Independence
٢٧