МИНИСТЕРСТВО ОБРАЗОВАНИЯ И НАУКИ РОССИЙСКОЙ ФЕДЕРАЦИИ
федеральное государственное бюджетное образовательное учреждение
высшего образования
«Забайкальский государственный университет»
(ЗабГУ)

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Corporate Governance
Teaching Materials

Учебное пособие
для студентов направления Менеджмент

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Разработано в соответствии с требованиями федерального государственного образовательного стандарта подготовки Магистров по дисциплине «Корпоративное управление».

Учебное пособие представляет собой набор презентаций и слайдов по изучению дисциплины.

Для магистрантов направления 080100.62 «Экономика», профилей «Налоги и налогообложение», «Бухгалтерский учет, анализ и аудит», «Экономика предприятий и организаций»

ПРЕДИСЛОВИЕ

Данное учебное пособие разработано в рамках реализации проекта TEMPUS IV «Усиление высшего образования в области Финансов в Сибири и на Дальнем Востоке России» - «Strengthening higher education in the sphere of Finance in Siberia and Far East of Russia EduSFE» 543891-TEMPUS-1-2013-1-RU-TEMPUS-JPCR.

Между университетами партнерами программы, а именно между ФГБОУ ВО «Забайкальский государственный университет» и Университетом г. Умео (Швеция) заключено соглашение по обучению в магистратуре в формате 1+1. Corporate Governance является одним из предметов, входящих в базовую часть программы обучения и преподается на английском языке.

Структура пособия построена в соответствии с рассматриваемым лекционным материалом и представляет собой набор презентаций и слайдов, которые помогут слушателям лучше подготовиться и освоить теоретическую часть курса.

INTRODUCTION

Corporate governance is concerned with the management of interactions between dispersed investors and the reconciliation of possible conflicts of interest between various corporate stakeholders. The literature on corporate governance discusses, among other things, the role and responsibility of owners, the role and responsibility of boards, executive compensation, internal control, disclosure of governance arrangements as well as historical explanations about different corporate governance systems. Many countries also have corporate governance codes that public companies can or have to follow. During the course students are given an overview of theoretical perspectives influencing regulatory practices as well as recent trends related to corporate governance.

Expected learning outcomes

After completing this course, students should be able to:

Describe the purpose of corporate governance; i.e. why is corporate governance deemed important.

Assess the primary roles of various groups tasked with responsibilities for corporate governance (e.g. boards of directors, internal committees).

Compare and contrast regulatory systems guiding approaches to corporate governance emphasizing the advantages and disadvantages of each system from various theoretical perspectives

Assess the limits of corporate governance and evaluate corporate governance practices in firms.

Evaluate corporate governance regulatory schemes from an ethical perspective.

Consult profit and non-profit organizations of different forms of ownership including financial and credit ones on the matters of their financial activities.

ОГЛАВЛЕНИЕ

1. Lecture 1 - Defining Corporate Governance

Learning Outcomes. By the end of this lecture you should be able to:

- define corporate governance in a variety of ways
- explain the different theoretical approaches to corporate governance
- appreciate why corporate governance is an increasingly important issue for business at a global level.

Рисунок 1.1

Ethical Issues in Corporate Governance

- The social impact of poor corporate governance is substantial
- Executive remuneration is a SOCIAL issue not a financial issue
- Recent scandal involving the manipulation of the LIBOR rate – how could this happen?
- government select committee and resulting fines

Рисунок 1.2

What is Corporate Governance?

- There is no single, accepted definition of corporate governance
- Corporate governance has been defined as
- *"the way in which companies are directed and controlled“*
- *(The Cadbury Report 1992)*

Рисунок 1.3

- Spectrum of definitions ranging from narrow (shareholder-oriented) to broad (stakeholder-oriented)

- *The system of checks and balances, both internal and external to companies, which ensures that companies discharge their accountability to all their stakeholders and act in a socially responsible way in all areas of their business activity.*

Рисунок 1.4

Definitions of Corporate Governance

- . . . the process of supervision and control intended to ensure that the company's management acts in accordance with the interests of shareholders

Рисунок 1.5

Broadening corporate governance

- As we are beginning to see in the wake of the financial crisis the definition of corporate governance as simply the narrow relationship between companies and shareholders is inadequate
- Corporate governance, i.e. The way companies are controlled and run, is about far more than simply maximising shareholder wealth
- This is what the module addresses

Рисунок 1.6

Theoretical Frameworks

- Definitions of corporate governance relate directly to the preferred theoretical framework

- **Agency Theory**
- The shareholder-oriented view
- Separation of ownership and control
- US and UK
- Berle and Means (1932)

Рисунок 1.7

- Agents -
- Managers of the company
- Principal - Shareholder
- Managers tempted to supplement their salaries

Monitoring and Bonding

- Costly!

Рисунок 1.8

How can shareholders control agents?

- voting at annual general meetings
- take-over mechanism
- passing of shareholder resolutions
- divesting (selling their shares)
- one-to-one meetings
- regulation or formal guidance
- Markets are not perfectly competitive and therefore intervention is necessary
- Since early 1990s 'voluntary' codes of practice and policy documents

Рисунок 1.9

Stakeholder Theory

- 1970s
- Freeman (1984)
- Hold a ‘stake’ not solely a ‘share’ in companies
- shareholders
- employees
- suppliers
- customers
- creditors
- local communities
- the environment
- animal species/biodiversity
- future generations

Рисунок 1.10

Stakeholder versus Agency

- Can companies maximize shareholder wealth AND satisfy a broad range of stakeholder needs?
- Problems of balancing needs of stakeholders
- Often different groups have diverse and contradictory needs and concerns

Рисунок 1.11

- There is:
- *" . . . an ongoing struggle between economic views of the firm which are decidedly silent on the moral implications of the modern corporation, and ethicists who place the need for understanding ethical implications in a central role in the field of business ethics"*
- (Shankman, 1999, p. 319)

Рисунок 1.12

Shankman (1999) felt stakeholder theory encapsulates agency theory because:

- stakeholder theory is the necessary outcome of agency theory
- agency theory is at best a narrow form of stakeholder theory;
- the assumptions about human behaviour and motivation implicit in agency theory are contradictory
- all theories of the firm must uphold an implicit moral minimum that includes certain fundamental rights

Рисунок 1.13

The Enlightened Shareholder approach is based on a growing belief that:

- maximising **stakeholder** welfare/wealth leads to long-term value maximisation
- creating value for stakeholders is synonymous with creating financial value for shareholders
- ignoring the needs of stakeholders can lead to lower financial performance and even corporate failure – LOOK AT BP and the Gulf of Mexico!
- corporate social, ethical and environmental performance are indicators of management quality
- Adopted by the recent review of company law and the new version of UK company law

Рисунок 1.14

Stakeholder inclusive approach

- The King Report III (2009) developed in South Africa is probably the most advanced set of corporate governance principles in the world
- Distinguishes between Enlightened Shareholder and Stakeholder Inclusive approaches
- Although Enlightened Shareholder represents an improvement on the Agency approach, we need to move on

Рисунок 1.15

Corporate Social Responsibility

- There is an urgent need for all society to address stakeholder issues:
- Human rights
- Treatment of employees
- treatment of customers
- Climate change
- The Stern Report
- United Nations Working Party

Рисунок 1.16

- Companies are pervasive in their impact on society and on the environment
- They have to be called to account for their actions
- They have to be accountable to society
- They have to behave responsibly
- Things are changing but is the change happening quickly enough?

Рисунок 1.17

- Corporate Governance is about improving companies' ACCOUNTABILITY to shareholders and to non-shareholding stakeholders
- Sustainable, accountable companies are the only means of ensuring a safe global environment for the future

Рисунок 1.18

The Global Financial Crisis

- The collapse of banks around the world has been attributed partly to **bad corporate governance**
- excessive remuneration encouraging the taking of excessive risks
- poor understanding of risks by board members
- Inadequate risk management systems and systems of internal control

Рисунок 1.19

More causes:

- Bad boardroom ethics
- Lack of personal integrity
- Excessive greed among boardroom members
- Inadequate risk disclosures
- Lack of linkage between audit, internal audit, board

Рисунок 1.20

Who Suffers from Bad Corporate Governance?

- EVERYONE!
- People with savings
- People who hold shares
- People who have borrowed
- People who own houses
- People who pay taxes
- People who lose their jobs
- People who are retired
- University students, lecturers, schools
- Hospitals and patients

Рисунок 1.21

2. Lecture 2 - Corporate Governance weaknesses and failures

Aim. This lecture considers ways in which corporate governance weaknesses have contributed to corporate failure, particularly in the context of the ongoing global financial crisis.

Learning outcomes. By the end of this lecture, you should be able to:

- discuss the link between corporate governance and corporate financial performance;
- explain the contribution of corporate governance weaknesses to corporate failure.

The Maxwell Affair 1991

- Greatest fraud of the 20th century
- Maxwell Communication Corporation and Mirror Group Newspapers
- Stole £727 million from the pension funds of the two public companies, as well as from the companies' assets
- £1 billion was lost from shareholder value after the public companies crashed

Рисунок 2.1

Profile (from BBC Website)

- Born on 10 June, 1923 in Czechslovakia
- Founder and publisher of Pergamon Press from 1949 to 1991
- Labour MP from 1964 to 1970
- Chairman and chief executive of Maxwell Communications Corporation from 1981 to 1991
- Chairman of Mirror Group Newspapers from 1984 to 1991
- Chairman and chief executive of Macmillan from 1988 to 1991
- Died on 5 November 1991

Рисунок 2.2

Corporate governance problems in case

- lack of segregation of positions of power
- Robert Maxwell was both *chief executive and chairman* of Maxwell Communication Corporation
- chairman and chief executive in MacMillan Publishers
- *non-executive directors* did not appear to perform an independent function
- *audit function* did not perform effectively
- *pension fund trustees* failed to examine Maxwell's financial activities in sufficient detail
- pension fund *regulators* failed to investigate and control Maxwell's activities

Рисунок 2.3

Why is good corporate governance important?

- Growing perception in the financial markets that good corporate governance is associated positively with financial performance

Рисунок 2.4

- McKinsey & Company (2000) found:
- global investors were willing to pay a significant premium for companies which are well-governed
- MacKenzie (2004) found:
- the best governed S&P 500 companies outperformed the worst governed by 8.5% per annum between 1990 and 1999

Рисунок 2.5

- Deutsche Bank Securities found:
- investment in the FTSE 100's best governed companies would have produced 35% higher returns than investment in the worst governed over a three year period
- Mercer Investment Consulting (2006) found:
- more than half of investment managers worldwide believe that corporate governance is a material issue for the performance of individual assets

Рисунок 2.6

Corporate Governance and Corporate Failure
The Collapse of Enron: Category of Disaster

- **The Collapse of Enron: Category of Disaster**
- 1999 Enron’s sales reached $40.1 billion
- 2000 revenues reached over $100 billion
- February 2001 company’s stock market value
- Was $60 billion

Рисунок 2.7

- **August 2001**
- Jeffrey Skilling (CEO) left the company
- **November 2001**
- S&P downgraded Enron's debt to junk bond status
- **October 2001**
- Enron's shares fell by 19%
- **December 2001**
- Enron filed for bankruptcy
- **January 2002**
- Kenneth Lay resigned

Рисунок 2.8

- **January 2002**
- Arthur Andersen fired partner in charge of Enron's audit,David Duncan, for ordering disposal of documents
- **March 2002**
- Berardino resigned as chief executive of Andersen
- **October 2002** Andrew Fastow, former finance director of Enron, charged with: money laundering securities wire and mail fraud conspiracy to inflate profits

Рисунок 2.9

Enron’s devious accounting

- Recorded profits from a joint venture with Blockbuster Video that never materialized
- One ‘special purpose’ vehicle, Chewco, created by Enron to offload liabilities for off-balance-sheet financing purposes

Рисунок 2.10

The Trial and the Human Dimension

- **January 2006** Trials of top ex-directors began
- Federal investigators were convinced top directors:
- responsible for use of creative accounting to conceal debt and massage reported profits
- **25th May 2006** Lay and Skilling were convicted on fraud charges
- Lay found guilty on all six charges of fraud and conspiracy
- Skilling found guilty on 19 charges of fraud, conspiracy, insider trading and making false statements

Рисунок 2.11

Corporate Governance problems in Enron

- Unfettered power in the hand of the chief executive
- Non-executive directors ineffective
- Poor moral character of directors
- Lack of understanding of risk and derivatives used

Рисунок 2.12

Ethics and Corporate Governance

- Corporate governance is wrapped up with the ethics of individuals
- No matter how many mechanisms are in place to ensure that companies are run in an accountable manner, people at the top can act unethically
- ACCA Reports on Ethics

Рисунок 2.13

The Global Financial Crisis

- The banking sector worldwide has collapsed due to bad corporate governance and risk management
- "ACCA believes that the credit crunch can therefore be viewed, in large part, as a failure in corporate governance“
- (Moxey and Berendt, 2008, p.4)

Рисунок 2.14

Corporate Governance Weaknesses Contributing to the Credit Crunch

- a failure in institutions to appreciate and manage the interconnection between the inherent business risks and remuneration incentives
- remuneration structures/bonuses that encouraged excessive short-termism. This neither supports prudent risk management nor works in the interests of long-term owners
- risk management departments in banks that lacked influence or power
- Weaknesses in reporting on risk and financial transactions
- a lack of accountability generally within organizations and between them and their owners

Рисунок 2.15

Further contributory factors

- over-complexity of products and lack of understanding by management of the associated risks
- excessive reliance on leverage in banks' business models
- Inter-connectedness of financial institutions
- misalignment between the interests of originators of, and investors in, complex financial products
- failure to appreciate cultural and motivational factors, a rigidity of thinking, a lack of desire to change, an attitude of 'it is not my problem', inappropriate vision/drivers and, human greed
- lack of training to enable senior management and board members to understand underlying business models and products, leading to poor oversight by senior executives and a lack of rigorous challenge by independent non-executive directors
- complacency after a prolonged bull market
- LACK of BOARDROOM ETHICS

Рисунок 2.16

3. Lecture 3 - Corporate Governance Reform in the UK

Aim. We now consider the process of corporate governance reform within the UK environment examining the various codes of practice and their evolution.

By the end of this discussion, you should be able to:

- outline UK corporate governance codes of practice and policy documents

- appreciate the importance of the UK 'comply or explain' approach.

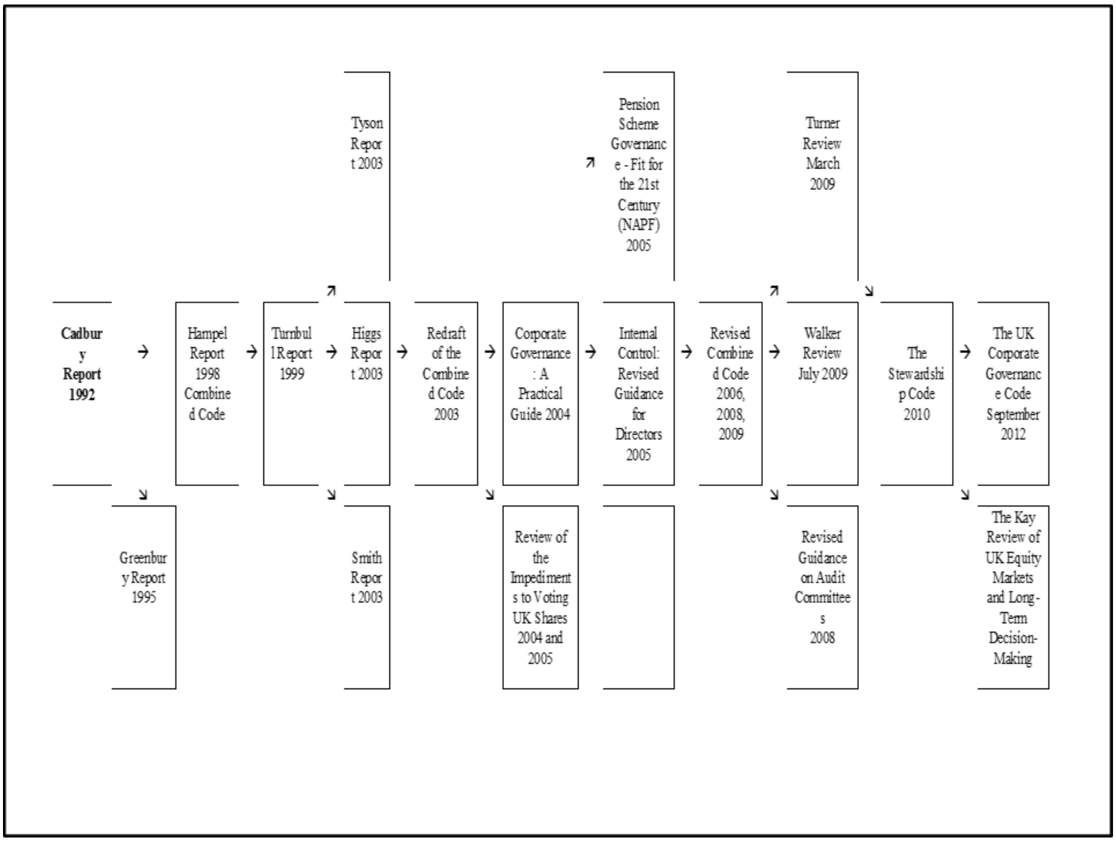


Рисунок 3.1

Codes of Practice

- The Cadbury Code (December 1992) *Report of the Committee on the Financial Aspects of Corporate Governance: The Code of Best Practice*

- *The beginning of corporate governance codes of best practice around the world*

Рисунок 3.2

The Committee on the Financial Aspects of Corporate Governance

- board of directors
- auditing
- Shareholders

- Radical recommendations relating to institutional investors: will examine these next week

Рисунок 3.3

The Greenbury Report 1995

Рисунок 3.4

- *"Fat Cat"* incidents British Gas 1995
- Need to establish a balance between directors' salaries and their performance
- Need to attract appropriate calibre of director
- Need to ensure they are not paid excessively
- Need to ensure accountability to shareholders and other stakeholders
- Very relevant issue at the moment in banks

Рисунок 3.5

The Hampel Report 1998

- Successor to both Cadbury and Greenbury
- Resulted in The Combined Code

Рисунок 3.6

The Turnbull Report 1999

- The Combined Code (1998) dealt with internal control in Provisions D.2.1 and D.2.2
- Established to address internal control issues

Рисунок 3.7

The Higgs Report 2003

- Reaction to fall of Enron
- Role and profile of non-executive directors (NEDs)
- Outlined last week the research carried out by the Higgs Report which showed that NEDs were generally ‘pale stale and male’

Рисунок 3.8

The Tyson Report 2003

- Recruitment and Development of Non-Executive Directors
- Higgs Report had called for a group to be created consisting of business leaders *inter alia*, who would examine ways in which companies could broaden the gene pool of board membership – boardroom diversity

Рисунок 3.9

The Smith Report 2003

- An accompaniment to the Higgs Report
- Examined the role of the audit committee in UK corporate governance
- The Smith Guidance was revised in March 2008

Рисунок 3.10

Consultation on Further Revision of the Combined Code

January 2006, FRC began consultation on small changes to the Combined Code

- relax current guidance such that the company chairman may be allowed to sit on the remuneration committee
- adding new provisions regarding companies including a 'vote withheld' box on AGM proxy voting forms
- publishing the results of resolutions voted on a show of hands

Рисунок 3.11

Walker Review 2009

- Review in reaction to the banking crisis
- Remit:
- “To examine corporate governance in the UK banking industry and make recommendations, including in the following areas: the effectiveness of risk management at board level, including the incentives in remuneration policy to manage risk effectively; the balance of skills, experience and independence required on the boards of UK banking institutions; the effectiveness of board practices and the performance of audit, risk, remuneration and nomination committees; the role of institutional shareholders in engaging effectively with companies and monitoring of boards; and whether the UK approach is consistent with international practice and how national and international best practice can be promulgated” (Walker Review, 2009, p. 5)

Рисунок 3.12

Conclusions of Walker Review

- The Combined Code was deemed fit for purpose and the comply or explain approach continues to be viewed as the most effective means of improving corporate governance in the sector.
- Weaknesses in board effectiveness were more attributable to behavioural patterns than to organization, with one of the main problems identified as a lack of challenge of executives before decisions are taken regarding risk and strategy
- needs to be a significant increase in time commitment from non-executive directors.

Рисунок 3.13

Further conclusions

- Boards should devote significantly more time to risk and risk management, with increased attention paid to monitoring risk and discussing risk appetite and tolerance.
- Core institutional investors should engage more effectively with investee companies in order to ensure a focus on long-term value and performance.
- there needs to be a significant improvement in the structuring of remuneration policy.

Рисунок 3.14

Stewardship Code 2010

- Aims
- to enhance the quality of engagement between institutional investors and companies to help improve long-term returns to shareholders and the efficient exercise of governance responsibilities by setting out good practice on engagement with investee companies to which the FRC believes institutional investors should aspire
- Will discuss this in more detail next week

Рисунок 3.15

Corporate Governance Code 2012

- In 2012, the Combined Code was replaced by a new updated Corporate Governance Code
- Revisions include audit committees having to disclose information to shareholders on how they have discharged their responsibilities and how they have assessed the external audit's effectiveness
- Also companies need to explain their policies on boardroom diversity
- The updated Code (and a slightly modified Stewardship Code) were effective from 1st October 2012.

Рисунок 3.16

Kay Review 2012

- Professor John Kay invited by the Secretary of State for Business, Innovation and Skills in June 2011 to review the extent to which UK equity markets are providing adequate support to British business in order for the UK to gain and maintain competitive advantage in global markets
- Kay Review highlighted a lack of trust and an ongoing short-termist culture as root problems within the UK financial services sector
- We discuss principles and recommendations in next week's lecture

Рисунок 3.17

Reactive

- As we can see from the above codes of practice they all tended to be reactive to corporate failures of crises:
- Maxwell and others – Cadbury
- Enron - Higgs/Smith
- Banking crisis – Walker/Stewardship Code and the Kay Review

Рисунок 3.18

Comply or explain

- Inkeeping with the preferred approach of company law in the UK
- Self-regulation of the City of London financial institutions
- Compliance in spirit rather than in letter
- Adopted across the EU

Рисунок 3.19

Compliance statements

- *"BP complied throughout 2005 with the provisions of the Combined Code Principles of Good Governance and Code of Best Practice, **except in the following aspects:***
- *A.4.4 Letters of appointment do not set out fixed time commitments since the schedule of board and committee meetings is subject to change according to the exigencies of the business. All directors are expected to demonstrate their commitment to the work of the board on an ongoing basis. This is reviewed by the nomination committee in recommending candidates for annual re-election.*
- *B.1.4 The amount of fees received by executive directors in respect of their service on outside boards is not disclosed since this information is not considered relevant to BP. (BP, 2005, p.163)*

Рисунок 3.20

M&S 2012 annual report

- The 2010 UK Corporate Governance Code is the standard against which we were required to measure ourselves in 2011/12. We are pleased to confirm that we complied with the UK Corporate Governance Code 2010 for the period under review **with the exception that**, for a short period of six weeks, the number of independent non-executive directors on the Board, excluding the Chairman, dropped **below half as required by the Code**. This was due to a timing difference between the retirement of Louise Patten in July and Vindi Banga joining the Board in September. Given that the Board was not scheduled to – and did not – meet during this short period, we feel our governance was not impacted.

Рисунок 3.21

M&S Annual Report 2012

- we have sought to **avoid a box-ticking approach**. Using the key themes of the Code, we focus on how governance supports and protects the M&S business in a practical way.
- On our online annual report you will find our approach to
- Leadership
- Effectiveness
- Accountability
- Engagement and Relations with Shareholders
- The governance of our pension scheme
- Remuneration

Рисунок 3.22

M&S Governance framework

- Our Governance Framework is **constantly reviewed** and sets out the roles, accountabilities and expectations for our directors and our structures. It also details a schedule of matters reserved for the Board's decision, detailing key aspects of the Company's affairs that the Board does not delegate

Рисунок 3.23

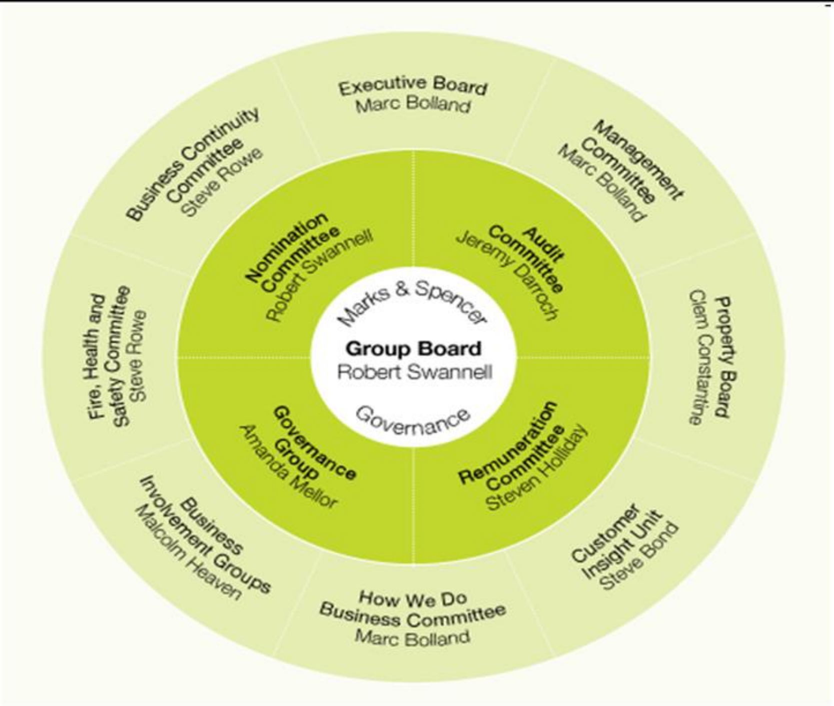


Рисунок 3.24

Royal Bank of Scotland RBS
From 2011 annual report

- The RBS Group continually seeks to maintain high standards of corporate governance whilst remaining on the forefront with compliance best practice.
- We aim to comply to all materials respects within the UK Corporate Governance Code issued by the Financial Reporting Council (June 2010).

Рисунок 3.25

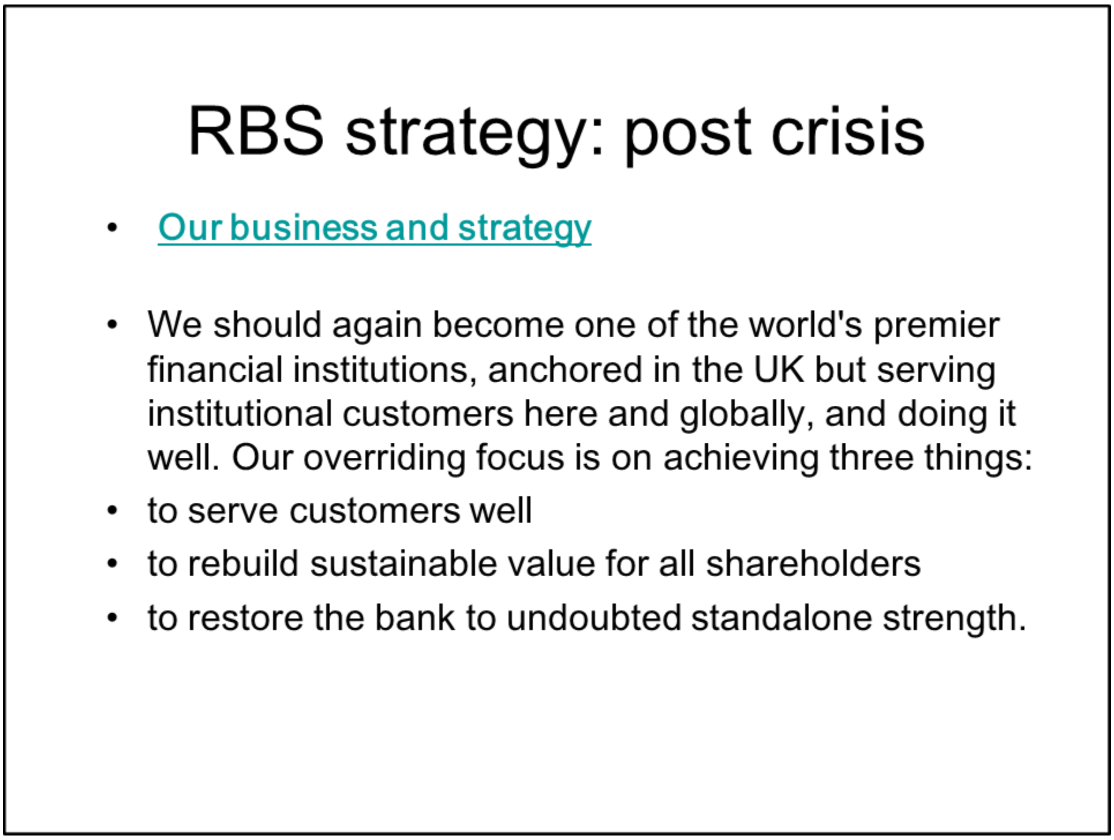


Рисунок 3.26

Рисунок 3.27

Group Audit Committee

- Assists the Board in discharging its responsibilities in relation to the disclosure of the financial affairs of the Group.

Рисунок 3.28

Board Risk Committee

- Provides oversight and advice to the Board in relation to current and potential future risk exposures of the Group and future risk strategy, including determination of risk appetite and tolerance.

Рисунок 3.29

Group Remuneration Committee

- Overview of the Group's remuneration policy and remuneration governance framework, ensuring that remuneration arrangements are consistent with and promote effective risk management.

Рисунок 3.30

Group Nomination Committee

- Assists the Board in the formal selection and appointment of directors having regard to the overall balance of skills, knowledge, experience and diversity on the Board.

Рисунок 3.31

Group Sustainability Committee

- Reviews the Group's overall sustainability strategy, values and policies and aligning the Group's approach to the range of social, environmental and ethical issues.

Рисунок 3.32

Group Executive Committee

- Manages Group wide issues and operational issues material to the broader Group. The committee considers Group strategy, finance and budget, capital allocations, risk strategy and policy and risk management.

Рисунок 3.33

Group Management Committee

- Operates with delegated authority from the Executive Committee and is responsible for recommending strategy and monitoring performance of the Group and its subsidiaries.

Рисунок 3.34

Summary

- Companies disclose significant amounts of corporate governance related information on their websites and in their annual reports
- This includes detailed information on compliance and exceptions
- Keeping up with changes in corporate governance policies is a challenge
- Must avoid box-ticking approach

Рисунок 3.35

4. Lecture 4 - The Role of boards in Corporate Governance

Aim. This lecture aims to examine the role of boards of directors in corporate governance, mainly from a UK perspective, with reference to the academic literature.

Learning outcomes. By the end of this lecture, you should be able to:

- explain the main initiatives introduced in the UK to improve the effectiveness of boards of directors;
- evaluate the impact of these initiatives on board function;
- discuss the findings of academic research relating to the effectiveness of boards as a corporate governance mechanism.

Corporate Governance: A Practical Guide
An 'effective board' should have:

- clear strategy aligned to capabilities
- vigorous (strong) implementation of strategy
- key performance drivers monitored
- effective risk management
- sharp focus on views of City and other key stakeholders
- regular evaluation of board performance.

Рисунок 4.1

The Fish Rots from the Head (Garratt, 1996)

- Said boards spent too much time ‘managing’
- Not enough time ‘directing’
- Should be 'learning boards'
- The Fish Rots from the Head: **The Crisis in Our Boardrooms: Developing the Crucial Skills of the Competent Director**
- Book revised and rewritten 2003 and 2010

Рисунок 4.2

Other books by Bob Garratt on Boards

- **Thin on Top: Why Corporate Governance Matters and how to Measure and Improve Board performance**
- **The learning Organization**

Рисунок 4.3

Unitary and Two-tier Board Structures

Unitary boards (UK, US)

- executive and non-executive directors
- make decisions as a unified group

Two-tier boards (Germany, Taiwan)

- 2 separate boards
- management board
- supervisory board

Рисунок 4.4

Two-Tier Board

Management board

- only executives
- focuses on operational issues
- headed by chief executive

Supervisory board

- only non-executive directors
- deals with other strategic decisions
- oversees the management board
- chairman sits as a non-executive
- often a vehicle for stakeholder inclusion

Рисунок 4.5

One-Tier model
UK & USA

- We examine 3 mechanisms for improving corporate governance in boards
- **Splitting chairman/chief executive position**
- **Improving effectiveness of NEDs**
- **Curbing excessive executive remuneration (anti fat cat)**

Рисунок 4.6

Splitting the Role of Chairman and Chief Executive: one-tier boards

Chairman

- pivotal role in helping the board to achieve its potential
- responsible for leading the board
- responsible for setting the board agenda
- responsible for ensuring board effectiveness
- 'conductor of an orchestra'

Рисунок 4.7

Chief Executive

- determines corporate strategy
- manages day to day running of business

Рисунок 4.8

Cadbury Report emphasised:

- No individual could gain ‘unfettered’ control of the decision-making process
- Should be a clear division of responsibility at the top of the company, ensuring balance of power
- 90% UK listed companies split roles after Cadbury

Рисунок 4.9

Higgs Report (2003) re-emphasized split roles:

- "The roles of chairman and chief executive should not be exercised by the same individual"
- The essence of these recommendations, among others made by Higgs, was incorporated in the Combined Code in July 2003.

Рисунок 4.10

Research into Split Roles

- Donaldson and Davies (1994)
- Splitting roles can reduce agency problems and result in improved corporate performance because of more independent decision making
- Peel and O'Donnell (1995)
- Found that splitting roles led to significantly higher financial performance

Рисунок 4.11

Split Roles in the US

- US has been slower to take up split roles
- But things are changing
- CEO wields excessive power
- US boards are excessively large
- *"American companies should adopt the common European practice of separating the jobs of chairman and chief executive, entrenching a check at the heart of their corporate governance systems*. " (*The Economist*)

Рисунок 4.12

The Role of Non-executive Directors (NEDs)

- Collapse of Enron focused attention on NEDs as did the banking crisis
- **Tyson Report specified NED role:**
- provide advice and direction to company management in developing and evaluating strategy
- Monitor company management in strategy implementation and performance
- monitor company's legal and ethical performance
- Monitor veracity and adequacy of financial/ other company information provided to investors and other stakeholders
- assume responsibility for appointing, evaluating and, where necessary, removing senior management
- planning succession for top management positions.

Рисунок 4.13

Byrd and Hickman (1992, p.196)

- "The inside directors provide valuable information about the firm's activities, while **outside directors may contribute both expertise and objectivity** in evaluating the managers' decisions. The corporate board, with its mix of expertise, independence, and legal power, is a potentially powerful governance mechanism“

Рисунок 4.14

Higgs Report emphasized NEDs must have:

- integrity
- high ethical standards
- sound judgement
- ability and willingness to challenge issues
- strong interpersonal skills
- ***"no crooks, no cronies, no cowards*"!**

Рисунок 4.15

Spira and Bender (2004)

- discussed tension between the strategic and monitoring roles of NEDs

Cadbury Report recommended:

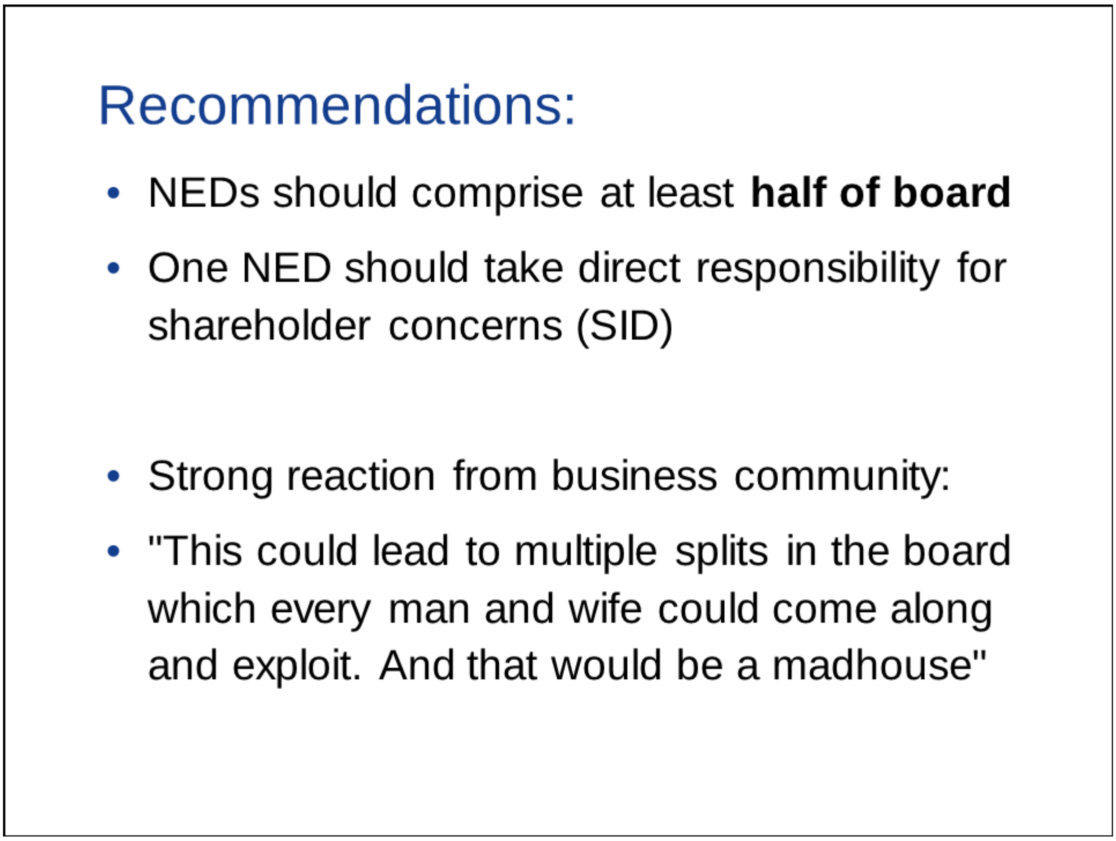
- minimum of 3 NEDs
- majority NEDs should be independent

Рисунок 4.16

Higgs Report 20 January 2003 based on 3 pieces of research:

- **data** on the size, composition and membership of boards and committees in the 2,200 UK listed companies, as well as the age and gender of their directors
- **survey** of 605 executive directors, non-executive directors and chairmen of UK listed companies conducted by MORI
- **interviews** of 40 directors in top UK listed companies carried out by academics in the field

Рисунок 4.17



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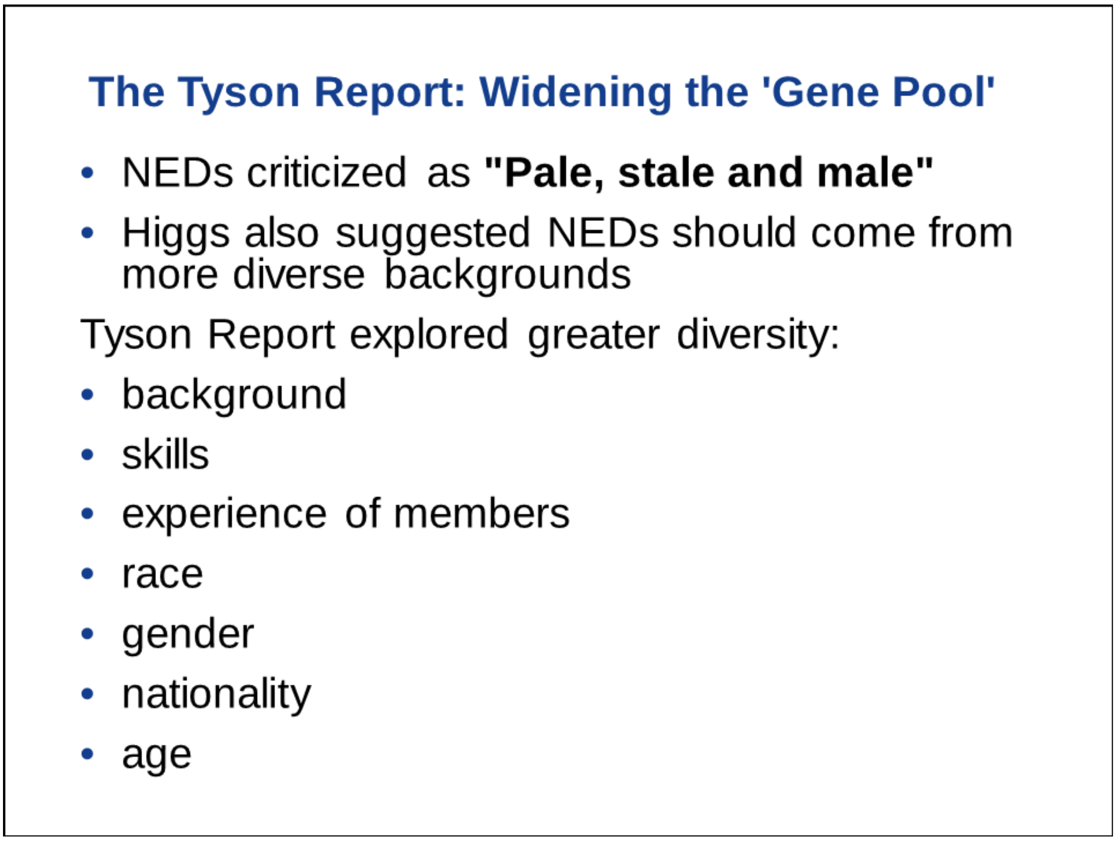


Рисунок 4.19

Milliken and Martins (1996)

- Emphasized the importance of board diversity to effectiveness and financial performance
- Widening boardroom diversity also helps companies engender trust among their stakeholders

Рисунок 4.20

Some organisations providing broader source of NEDs

- Association of Executive Search Consultants
- Charity and Fundraising Appointments
- High Tech Women
- City Women's Network.
- **City Women** Network is the Community of Senior Business **Women** in London

Рисунок 4.21

NEDs and the Credit Crunch

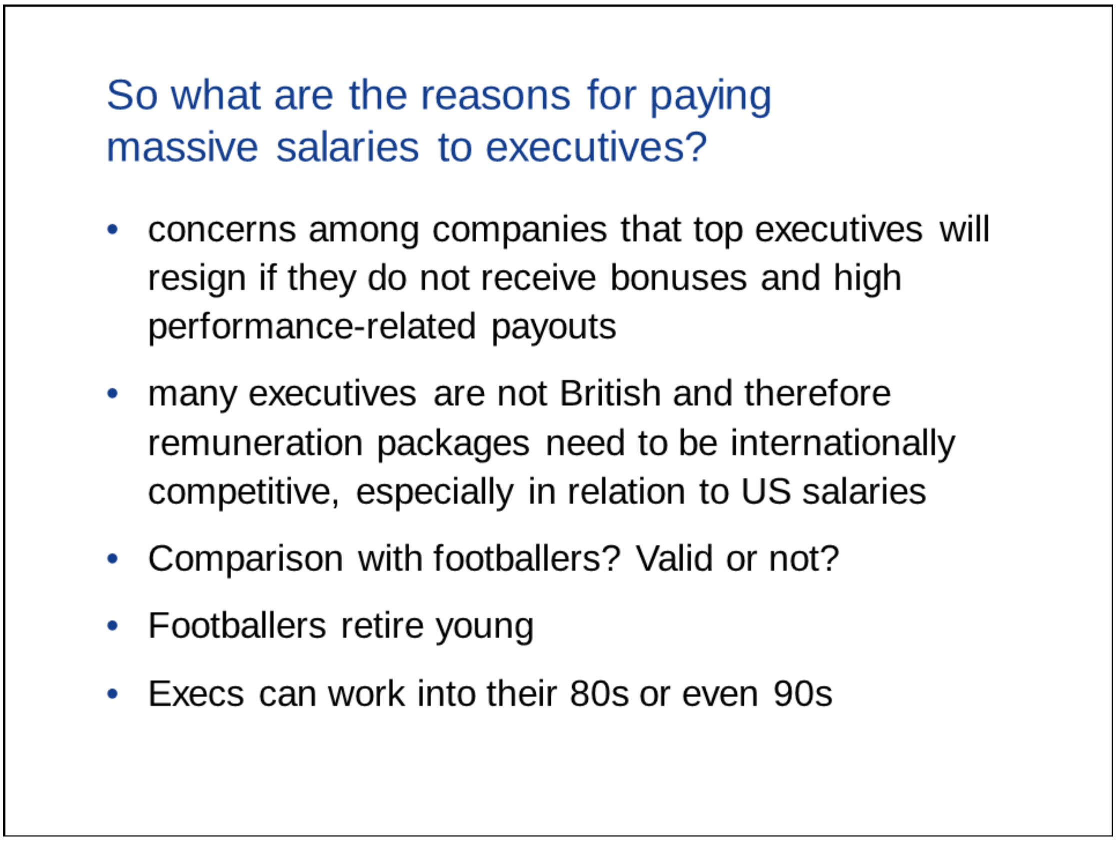
- Deficiencies in NEDs role within financial institutions contributed to current global financial crisis
- **FT article during financial crisis said companies need to:**
- improve the qualifications and on-going training for NEDs
- pay more attention to the relevant experience and competence when recruiting NEDs
- Increase the time commitment given by NEDs

Рисунок 4.22

Executive Remuneration

- ‘Fat cats’
- Higgs Report
- Company chairmen in FTSE 100 companies were earning **£426,000** per annum on average in 2003!
- Now salaries can be well over a million (without bonuses)
- This is now a **social** as well as a financial issue

Рисунок 4.23



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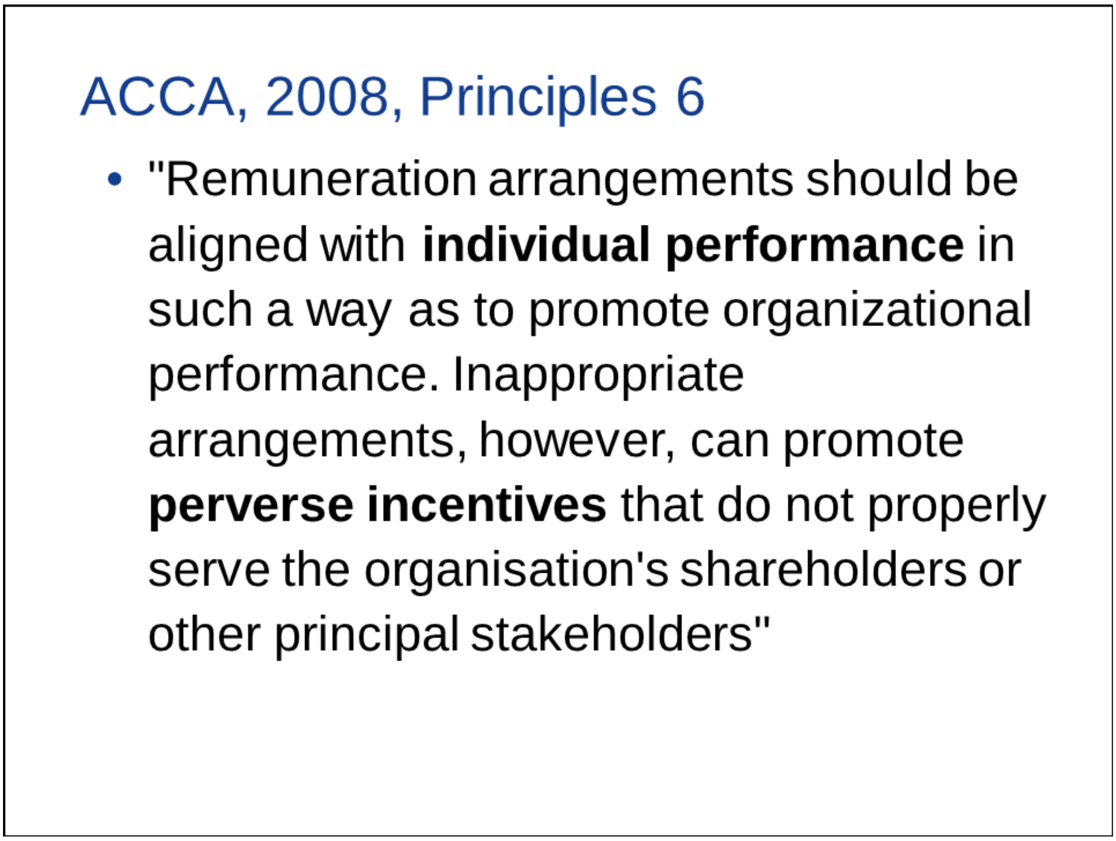
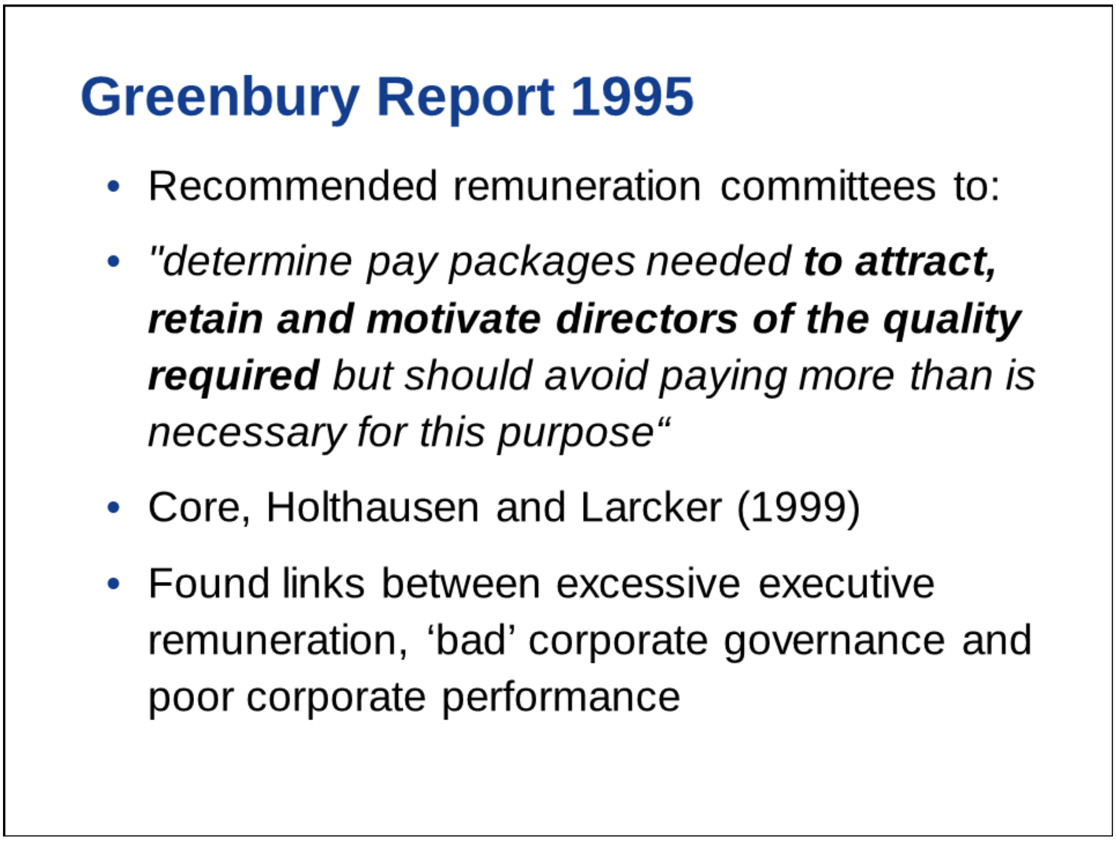


Рисунок 4.25



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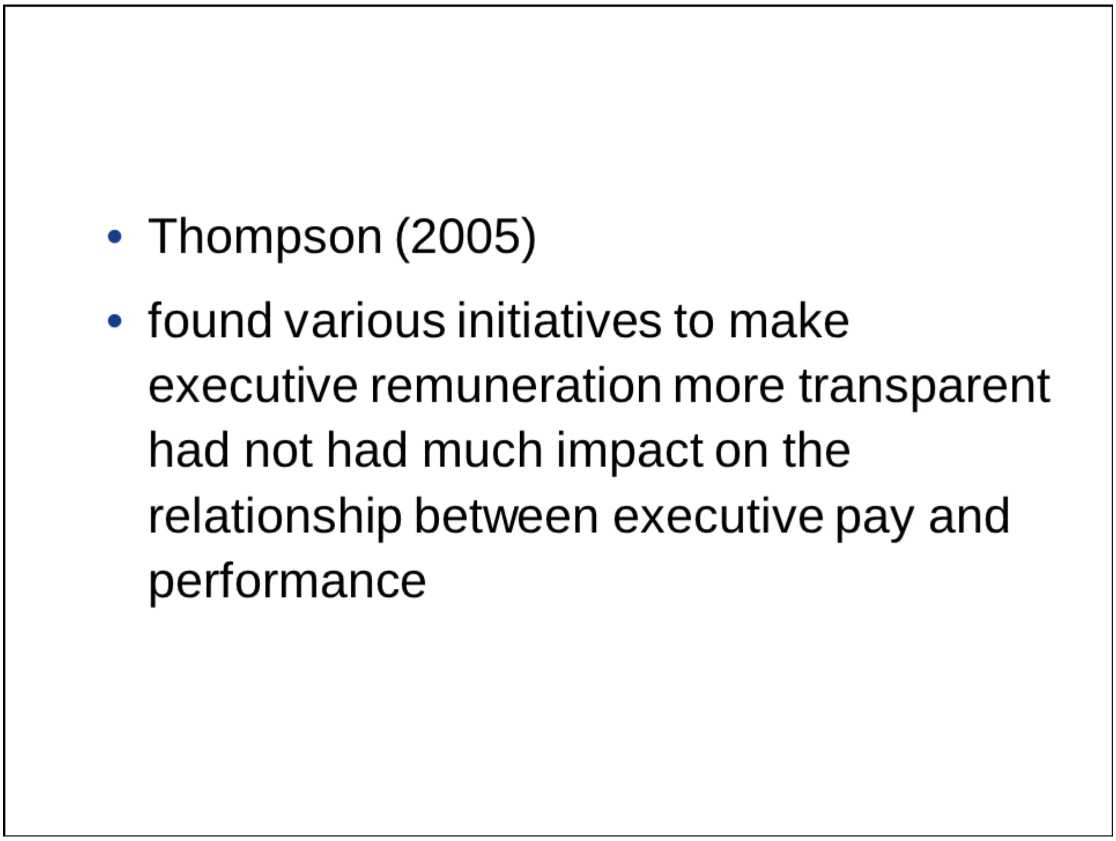

Рисунок 4.27

Voting on Directors' Remuneration

- October 2001 the Government announced proposals to produce an annual directors' remuneration report that would be approved by shareholders
- No need to legislate as investors have acted in this area

Рисунок 4.28

Bonuses and the Financial Crisis

- January 2009
- French President, Nicolas Sarkozy, insisted on bonuses and dividends being reduced for executives in French banks
- BNP Paribas, France's largest bank, chairman and chief executive forwent their 2008 bonuses voluntarily, in response to public dissatisfaction

Рисунок 4.29

UK Shareholders, Remuneration and the Global Financial Crisis

- Grave concerns about excessive remuneration packages
- Institutional investor representative bodies (ABI) (NAPF) cautioned companies against paying out large bonuses to senior executives
- UK institutional shareholders voted against remuneration policies
- Discussion on taxing bank directors’ bonuses when peoples’ taxes are paying off the banks’ debts!
- Currently discussion on broadening areas of shareholder voting on remuneration

Рисунок 4.30

Shareholder Spring 2012

- In the UK, 2012 witnessed a ‘shareholder’ spring’ with shareholders taking a far more proactive stance when voting than in the past
- institutional investors accused many companies of continually paying multimillion pound bonuses to their executive board members
- Investors voted against proposed remuneration policies for a whole host of companies including Aviva, Barclays, Citigroup, UBS
- At last institutional shareholder voting on remuneration may be becoming more than a rubber stamping affair.

Рисунок 4.31

The High Pay Commission: Cheques with Balances 2011

- report investigating excessive executive remuneration published by the High Pay Commission
- independent inquiry created with the aim to explore high pay and make recommendations
- Recommendations:
- **Executives should receive a basic salary, with only one additional performance related element being awarded when this is inkeeping with the long-term aims of the company**

Рисунок 4.32

Recommendations…

- Remuneration reports should be **standardized**
- Investment managers should disclose full information on how they **vote on remuneration** as well as on other issues
- There should be **employee representation on remuneration committees** remuneration committees should generally be more diverse
- A **permanent body** should be set up to monitor high pay
- Despite the efforts of this commission, pay remains extraordinarily high when we are still feeling the repercussions of the financial crisis and are being forced into austerity measures. Certainly the idea of bringing in non-executives and independent directors from other sectors (the public sector, universities, health boards etc) may help to rationalize private sector views on pay.

Рисунок 4.33

BP website disclosures on executive remuneration January 2014 download

- BP operates an Executive Directors' Incentive Plan ("EDIP") as part of the long-term remuneration of Executive Directors. Awards of shares under the EDIP are based upon performance over a three-year period.

Рисунок 4.34

- In assessing performance, comparative total shareholder return is measured against a comparative group of the "oil majors" and a ranking produced. The Board Remuneration Committee ("RemCo") then considers the resulting award and has the discretion to increase or decrease that award based upon its assessment of the events over the three-year period. The RemCo can determine to make no change to the award.

Рисунок 4.35

- The Board will disclose in the annual BP Directors Remuneration Report the principles that the RemCo took into consideration and describe the process used in determining an award that the RemCo makes under the EDIP, which will include BP’s operational health, safety and environmental performance.

Рисунок 4.36

Antony Burgmans, KBE
Chairman of the remuneration committee for BP

Рисунок 4.37

BP Directors’ Remuneration Report

- Bob Dudley
- Salary **$1,726**
- Cash bonus **$837**
- Other emoluments **$110**
- Total **$2,673**
- **Pension**
- Pension value increase **$7,317**
- **Total including pension $9,990**

Рисунок 4.38

Boardroom diversity?

- increasing attention in recent years in the UK and elsewhere
- diversity at all levels is now recognized as a path to enhancing boardroom effectiveness as well as corporate performance
- recently published **‘Women on Boards’** report in the UK (2011)
- In 2011 FTSE100 boards consisted on average of 87.5% men and 12.5% women

Рисунок 4.39

Women on Boards Report

- McKinsey & Company (2007) concluded that companies with **a larger proportion of women at board and top management level perform better**
- Research shows companies with higher proportion of women on boards outperformed rival companies
- 4 key tenets of the business case for gender diversity:
- improving performance
- accessing the widest talent pool
- being more responsive to the market
- achieving better corporate governance

Рисунок 4.40

Research on Gender differences?

- Distinct differences between men's and women's risk preferences and behaviours
- Women are **more risk averse** and that their presence on boards helps to reduce insolvency risk
- Are quotas (i.e. setting a mandatory proportion of women, for example 30%) necessary?
- Some countries (eg Norway) have now introduced mandatory quotas for the number of women in the boardrooms of listed companies
- UK has adopted a less regulated approach inkeeping with voluntary spirit of UK corporate governance

Рисунок 4.41

RECIPE FOR A GOOD BOARD

- *The board should meet frequently*
- *The board should maintain a good balance of power*
- *An individual should not be allowed to dominate board meetings and decision making*
- *Members of the board should be open to other members' suggestions*
- *There should be a high level of trust between board members*
- *Board members should be ethical and have a high level of integrity*
- *There must be a high level of effective communication between members of the board*
- *The board should be responsible for the financial statements*
- *Non-executive directors should (generally) provide an independent viewpoint*

Рисунок 4.42

- *The board should be open to new ideas and strategies*
- *Board members should not be opposed to change*
- *The board must possess an in-depth understanding of the company's business*
- *The board must be dynamic in nature*
- *The board must understand the inherent risks of the business*
- *The board must be prepared to take calculated risks: no risk no return*
- *The board must communicate with shareholders, be aware of shareholder needs and translate them into management strategy*
- *The board must be aware of stakeholder issues and be prepared to engage actively with their stakeholders*
- *As education becomes increasingly important, board members should not be averse to attending training courses*

Рисунок 4.43

Ethical Health of Boards
ACCA, 2008, Principle 2

- "Boards should set the **right tone** and behave accordingly, paying particular attention to ensuring the continuing ethical health of their organizations. Directors should regard one of their responsibilities as being **guardians of the corporate conscience** … Boards should ensure they have appropriate procedures for **monitoring their organisation's 'ethical health**'"

Рисунок 4.44

Ethics and Morality

- Corporate governance effectiveness may be linked to morality
- Ethics and morals are overlapping but also different
- Ethics in business have been widely discussed and ethics is becoming a central element in corporate governance and accountability
- Morality however is more intangible.

Рисунок 4.45

How do ethics and morality contribute to business?

- "… business dealings would [not] be possible without **some modicum of trust and honesty.** Similarly, it is not unreasonable to contend that directors have certain **moral obligations** to those who provide finance, regardless of their legal requirements …. There is to some extent a common corporate governance morality" (West, 2009, p.116).

Рисунок 4.46

In summary

- Splitting roles, making NEDs more effective and aligning remuneration with performance (curbing excess) are mechanisms of enhancing corporate accountability to shareholders and other stakeholders
- The ongoing financial crisis has also emphasised the need for boards to behave in an ethical and moral manner

Рисунок 4.47

5. Lecture 5 - The role of institutional investors in corporate governance

Aim. This lecture explores the role of institutional investors in corporate governance, mainly from a UK perspective.

Learning outcomes. By the end of this lecture, you should be able to:

- highlight the important monitoring role that institutional investors play in UK corporate governance
- discuss the complex web of ownership that arises from institutional investment
- consider ways in which institutional investors are becoming more active in corporate governance
- Appreciate the importance of the Walker Review, the Stewardship Code and the Kay Review.

Рисунок 5.1

In this lecture :

- First we will deal with the monitoring role played by institutional investors and the concept of stewardship
- Second we will discuss the need for improved governance within investment institutions

Рисунок 5.2

The monitoring role of institutional investors: a need for shareholder activism

- Agrawal and Knoeber (1996) emphasized:
- *" . . . concentrated shareholding by institutions . . . can increase managerial monitoring and so improve firm performance"*

Рисунок 5.3

The Transformation of UK Institutional Ownership

Berle and Means (1932)

- Described share ownership as ‘dispersed’ in US (UK)
- 1990s saw shift to ownership concentrated in investment institutions:
- pension funds, life insurance companies
- unit trusts, investment trusts
- This has now shifted again in the last decade

Рисунок 5.4

Transformation of UK listed company ownership

- **1963**
- 54% individual shareholders
- **1992**
- 51.9% insurance companies and pension funds
- 8.5% unit and investment trusts
- 20% individual shareholders
- 12.8% overseas investors
- **1998**
- 60% institutional investors
- **Around 2000**
- Over 70% institutional investors

Рисунок 5.5

Recent changes: different situation

- The UK is currently experiencing another phase of transformation in the structure of share ownership as dominance by the UK institutional investment community is starting to give way to increasing ownership of listed company shares by foreign investment institutions, private individuals (again) and hedge funds

Рисунок 5.6

Fall in Institutional Investor Ownership of UK Listed Companies

- The proportion of UK listed company share ownership held by UK investors fell to less than a third by 2008
- “More recently, regulation of pension and life funds, and the maturity of pension funds, has led both pension trustees and insurers to reduce their exposure to equity markets” (Kay Review, 2012, p.29)

Рисунок 5.7

Kay Review (2012)

- Kay Review (2012) states that ownership of UK listed company shares by pension funds and insurance companies now account for around 20% whereas the proportion held by non-UK holders is over 40%
- Individual shareholders now own about 11% of UK equity
- Kay concludes that "…the pattern of shareholding is much more fragmented than formerly" (Kay Review, 2012, p.29).

Рисунок 5.8

- This second shift in ownership structure back to a more fragmented pattern has big implications for governance
- Although institutional investors still have a significant potential to influence companies it is less than 10 years ago

Рисунок 5.9

Рисунок 5.10

Рисунок 5.11

The Growth of Institutional Investor Activism

- *"Given the weight of their votes, the way in which institutional shareholders use their power to influence the standards of corporate governance is of fundamental importance. Their readiness to do this turns on the degree to which they see it as their responsibility as owners, and in the interest of those whose money they are investing, to bring about changes in companies when necessary, rather than selling their shares"*

- The Cadbury Report, 1992

Рисунок 5.12

Cadbury Report suggested institutional investors should :

- encourage regular one-to-one meetings with directors of their investee companies (‘engagement and dialogue’)

- make positive use of their voting rights

- pay attention to the composition of the board of directors in their investee companies

Рисунок 5.13

Institutional Investor Voting

- Stapledon (1995)
- Until 1990s level of voting fairly low

- Mallin (1999)
- Significant increase in recent years

- Hampel Report
- Overall voting levels remain at about 40%

Рисунок 5.14

Engagement & Dialogue

- **Combined Code :**
- Institutional shareholders *should be ready, where practicable, to enter into a dialogue* with companies based on the mutual understanding of objectives.
- **Higgs Report**
- Institutional investors *should enter into a dialogue* with companies based on the mutual understanding of objectives
- **Senior Independent Director (SID)**
- Should represent investors' interests on the board

Рисунок 5.15

Failure of Engagement in the Financial Crisis

- Institutional investors have been partly blamed for the financial crisis
- Paul Myners targeted them as a scape goat in speeches
- Financial Times (2009) suggested engagement failed to avert the financial crisis, even though they were aware of the problems
- IMA was questioned by the Treasury Select Committee in January 2009
- IMA stated that investors lost confidence in the banking sector and sold shares in 2005

Рисунок 5.16

- Where investors engaged with banks it did not work
- Despite 55 meetings between one bank and shareholders before nationalization, the crisis could not be averted
- Engagement with banks before crisis did not change behaviour of directors/banks
- **IMA has concerns that institutional investors do not have enough information or influence to be able to influence board behaviour**

Рисунок 5.17

The Walker Review

- Many codes of corporate governance best practice have been reactionary
- In the wake of the financial crisis, the Walker Review has examined the causes of the crisis
- Specifically, the review made recommendation for institutional investors

Рисунок 5.18

Walker stated:

- The limited institutional efforts at engagement with several UK banks had little impact in restraining management before the crisis phase
- Levels of voting against bank resolutions rarely exceeded 10 per cent

Рисунок 5.19

Walker recommended

- Board evaluation should provide an indication of the nature and extent of communication with major shareholders

Рисунок 5.20

Walker recommended:

- The FRC’s remit should be extended to include establishing Principles of best practice in stewardship by institutional investors and fund managers.
- The Code on the Responsibilities of Institutional Investors, prepared by the ISC should become the Stewardship Code.
- Should have equivalent status to Combined Code

Рисунок 5.21

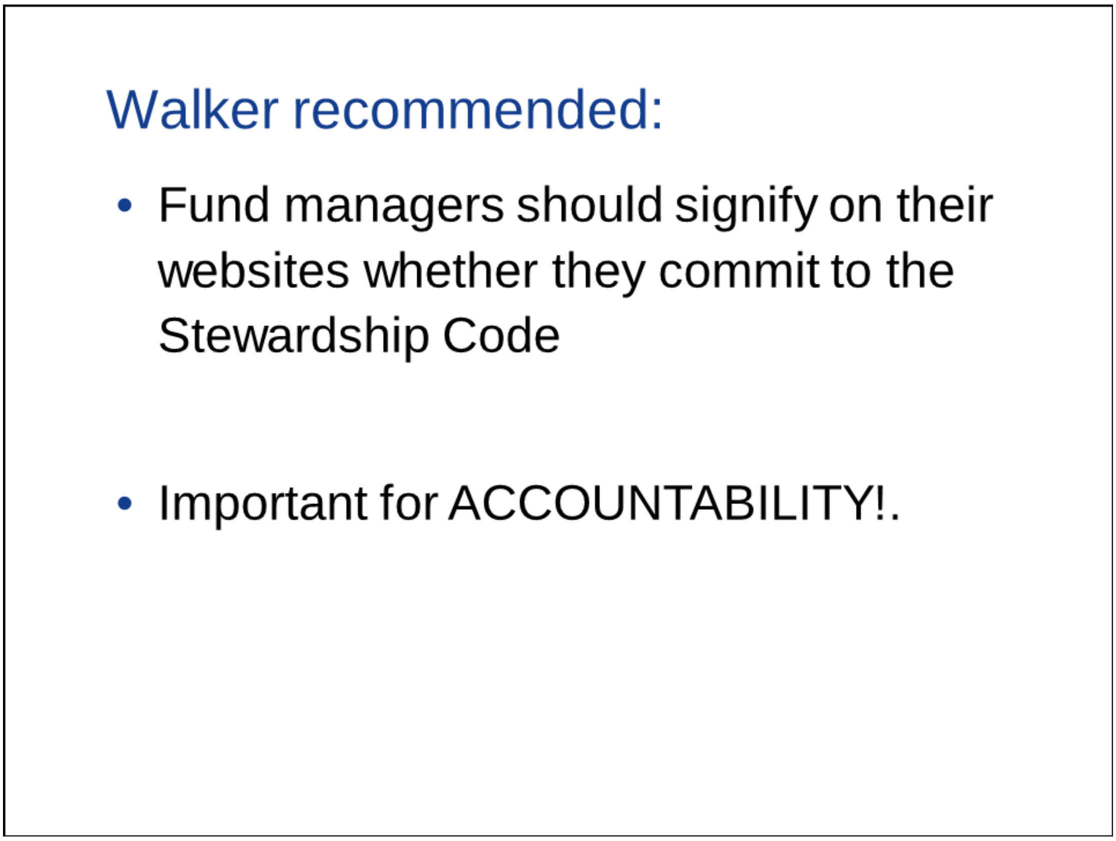

Рисунок 5.22

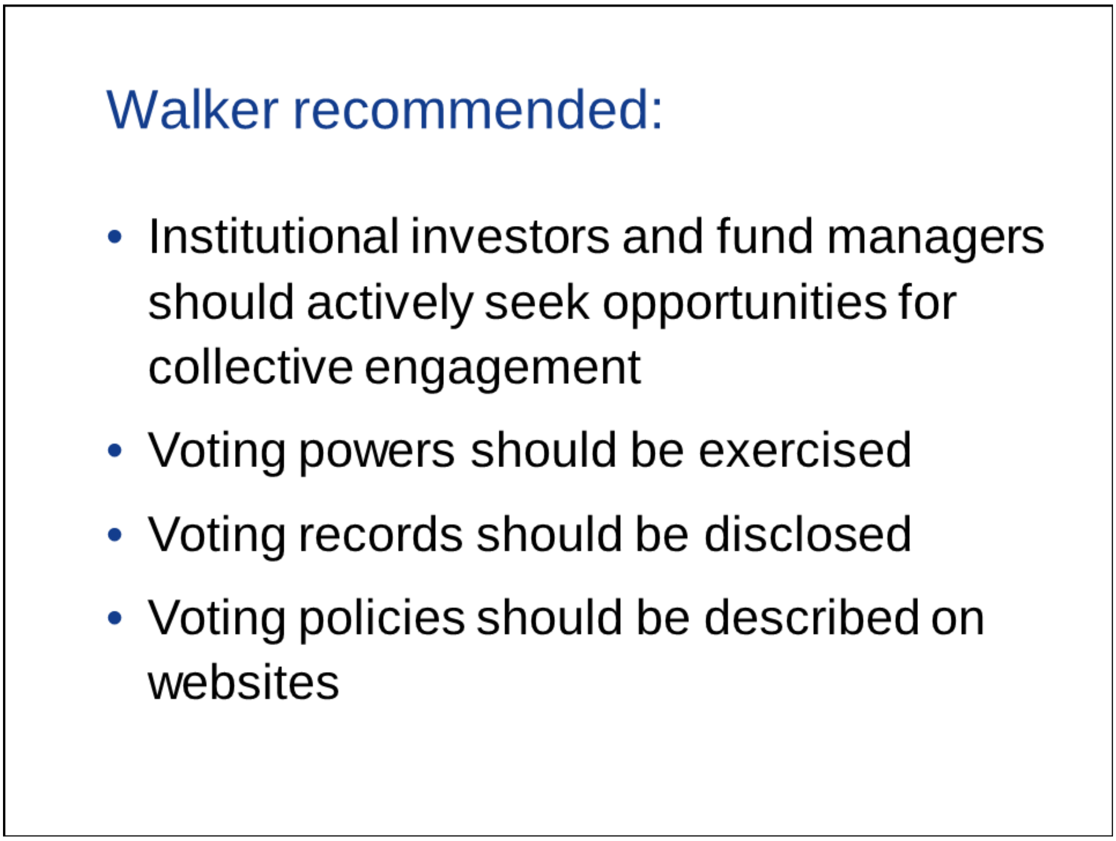

Рисунок 5.23

Walker identified barriers to engagement

- Effective dialogue requires large senior resource commitment on the part of fund managers
- free-rider benefit that may be generated for those who do not contribute to the engagement process

Рисунок 5.24

Barriers to engagement

- Resistance of some major boards to engage in effective dialogue
- When chairmen engage with major shareholders there is often a disappointing response
- Boards dissatisfied with level and quality of shareholder representation in meetings
- Hubris/complacency at board level

Рисунок 5.25

The Stewardship Code

- *Principle 1: Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities*
- *Principle 2: Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship and this policy should be publicly disclosed.*

Рисунок 5.26

Code cont.

- *Principle 3: Institutional investors should monitor their investee companies*
- *Principle 4: Institutional investors should establish clear guidelines on*
- *when and how they will escalate their activities as a method of protecting*
- *and enhancing shareholder value*

Рисунок 5.27

Code cont.

- *Principle 5: Institutional investors should be willing to act collectively with other investors where appropriate*
- *Principle 6: Institutional investors should have a clear policy on voting and disclosure of voting activity*
- *Principle 7: Institutional investors should report periodically on their stewardship and voting activities*

Рисунок 5.28

Overall Walker Conclusion

- *There is a need for better engagement between fund managers acting on behalf of their clients as beneficial owners, and the boards of investee companies. Experience in the recent crisis phase has forcefully illustrated that while shareholders enjoy limited liability in respect of their investee companies, in the case of major banks the taxpayer has been obliged to assume effectively unlimited liability. This further underlines the importance of discharge of the responsibility of shareholders as owners, which has been inadequately acknowledged in the past… there should be clear disclosure of the fund manager's business model, so that the beneficial shareholder is able to make an informed choice when placing a fund management mandate".*

Рисунок 5.29

Summary

- Not only companies have to be accountable
- Shareholders, especially institutional investors, need to be responsible by being ACTIVE owners

Рисунок 5.30

Academic research into engagement & dialogue

- John Holland
- Has spent the last 20 years investigating the private process of ‘reporting’ (engagement and dialogue) between institutional investors and their investee companies

Рисунок 5.31

Holland's work

- Holland has developed a methodology which has allowed him to develop theoretical frameworks to explain and describe the private financial reporting process

Рисунок 5.32

Holland (ABR) used interview data to detect disclosure themes

- Data used to develop a model of connected themes of corporate private disclosure to institutional shareholders
- Data used to compare financial reporting and institutional-company links as disclosure mechanisms.
- Data used to investigate how these disclosure mechanisms interacted to form a more comprehensive disclosure system.

Рисунок 5.33

Holland's model

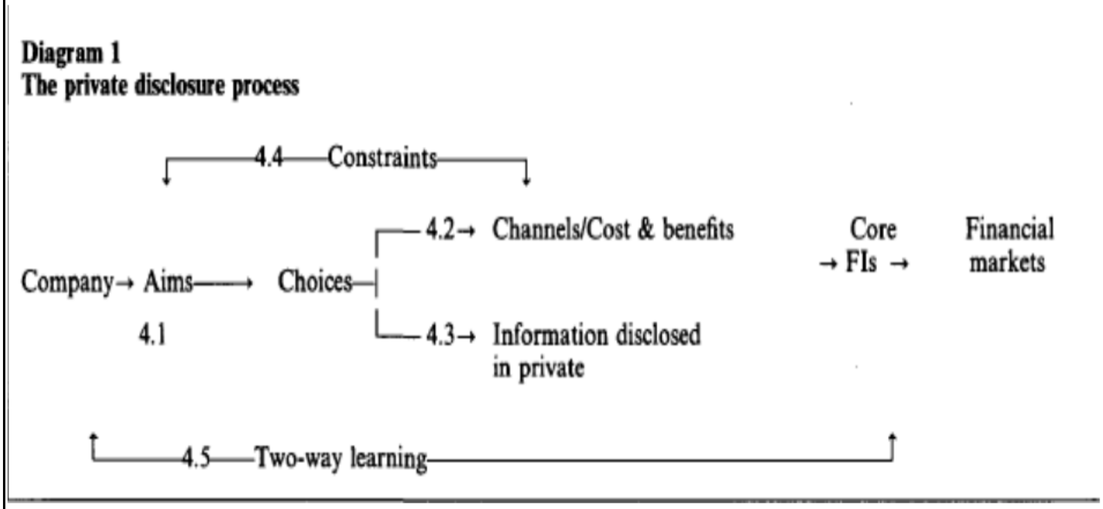

Рисунок 5.34

Problems with private reporting

- Holland, J. and Stoner G. (1996). 'Dissemination of price-sensitive information and management of voluntary corporate disclosure'.
- *Accounting and Business Research,* 26(4): 295-313.

Рисунок 5.35

Price sensitive information (PSI)

- an important constraint
- exchange guidance on price sensitive information (PSI)
- Companies cannot disclose information to their investors in private which is price sensitive
- Investor may trade on this information

- Other problems:
- Perceptions of competitive disadvantage
- Costs of private disclosures

Рисунок 5.36

“Trust and control in Anglo-American systems of corporate governance: the individualising and socialising effects of processes of accountability”

- Roberts applies a Foucauldian view of discipline and power relations to agency theory
- Shows how traditional agency theory is too simplistic in the way it views power relations between shareholders and investees

Рисунок 5.37

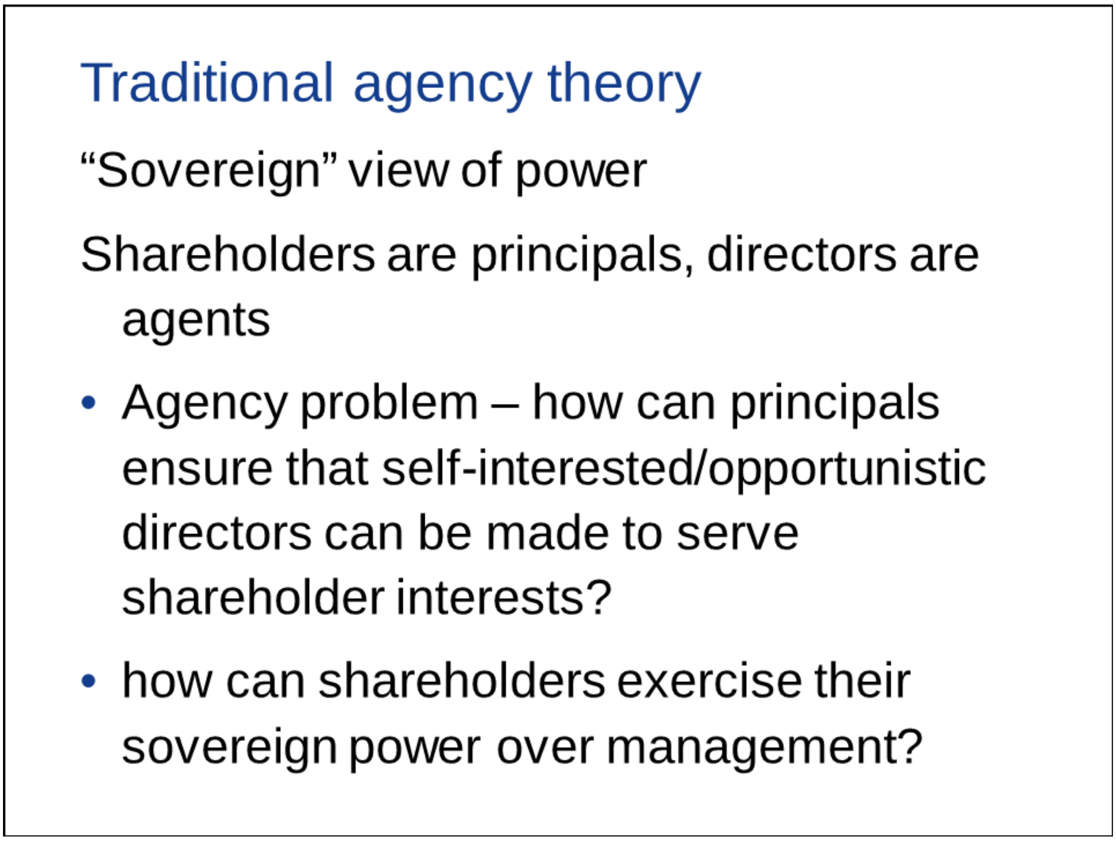

Рисунок 5.38

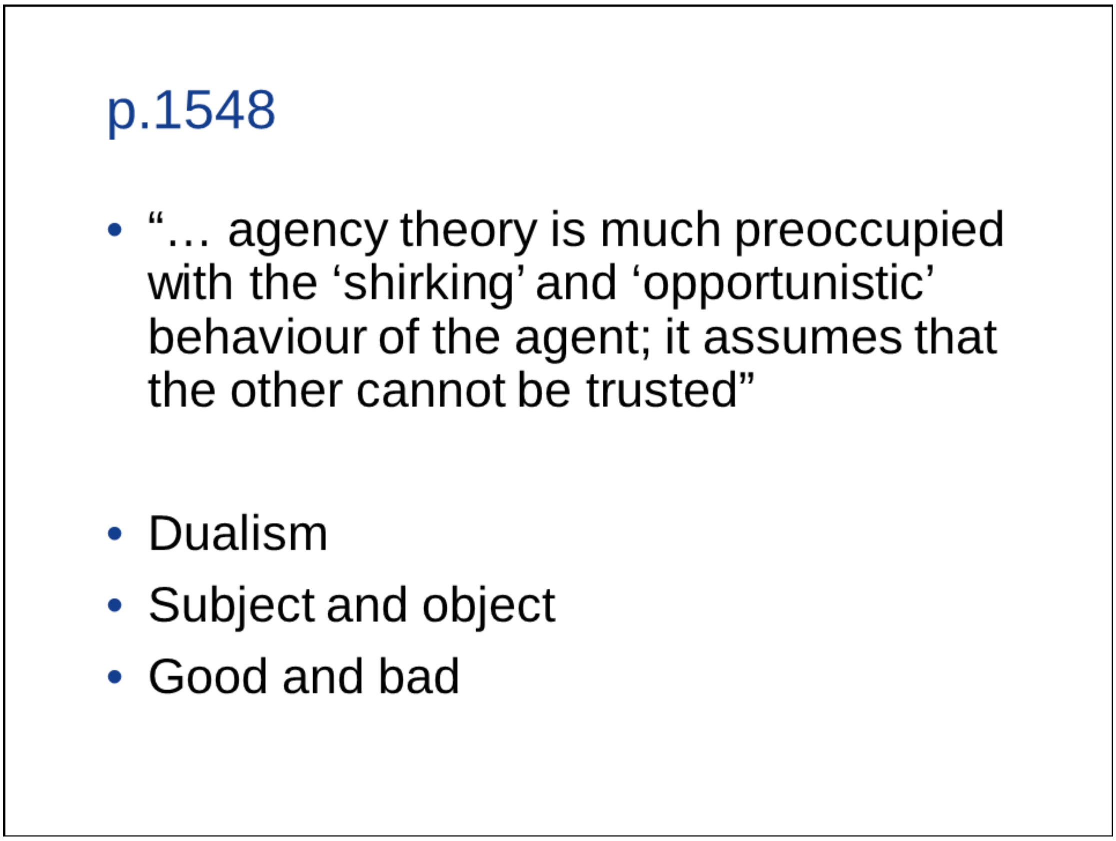

Рисунок 5.39

Traditional view of power

- Shareholder ‘power’ viewed as negative, punitive and disciplinary
- Voting against directors
- Voting to remove directors
- Voting against pay
- Voting for a takeover

Рисунок 5.40

Foucauldian view

- Power is not as simplistic as in the traditional agency model
- Power is more ‘positive’ than suggested by traditional agency theory
- Power relations produce subjectivity
- Disciplinary power works ‘in advance of its exercise by encouraging ‘SELF DISCIPLINE’

Рисунок 5.41

Foucauldian view

- Managers become the ‘subject’
- Accounting is a disciplinary mechanism which forces managers to look at themselves (as through a mirror)
- Transparency/visibility through accounts makes managers defensive of themselves and they elaborate themselves – i.e. become Narcissistic

Рисунок 5.42

Effect of visibility: accounting

- Accounting information creates a powerful field of visibility (p.1552)
- The accounting process serves to
- “…’normalise’ and ‘individualise’ producing in those subject to a field of visibility a defensive or assertive preoccupation with the self and how the self is seen”

Рисунок 5.43

“In the mirror of the market: the disciplinary effects of company/fund manager meetings”

- Roberts (2006) applies Foucault’s theory of disciplinary power to the face-to-face meetings between institutional investors and their investee companies

Рисунок 5.44

Roberts 2006, p.278

- “… explores the conduct of private face-to-face meetings of chief executives and finance directors with fund managers and analysts from their major investors, and the vital role these meetings play in shaping executive subjectivity…”

Рисунок 5.45

Characteristics of meetings

- Anxiety on the side of the company
- Anxiety about the ‘picture’ that the investor forms about the company
- Leads to :
  - Rehearsal/preparation
  - Self-discipline
  - Careful construction of the corporate self

Рисунок 5.46

Roberts (2006) p.286

- “… it is only in the context of the face-to-face meetings that investor expectations can be made to play directly upon the bodies of the CEO and finance director in their attention not just to their words but also to their tone, mood, gesture and interaction”

Рисунок 5.47

One-on-one meetings:

- ‘normalise’ executives
- ‘shape executive subjectivity’

- In other words makes them self-conscious and causes them to manage impressions/ paint a good picture of the company/ concern themselves with appearances

Рисунок 5.48

Summary

- We have considered Holland’s work on private reporting – engagement & dialogue
- We have looked at the insights provided by a Foucauldian view of disciplinary power into:
- Agency theory
- Corporate governance
- the process of engagement and dialogue in one-on-one meetings between institutional investors and investees

Рисунок 5.49

6. Lecture 6 - The Role of Transparency, Internal Control and Risk Management in Corporate Governance

Aim. We now discuss ways in which corporate transparency, internal control and risk management contribute to corporate governance and the mechanisms which contribute to transparency.

Learning outcomes. By the end you should be able to:

- emphasise the essential role played by corporate disclosure in corporate governance
- define internal control, risk and risk management
- appreciate the importance of the audit function
- introduce the emerging areas of governance reporting and forward-looking narrative reporting.

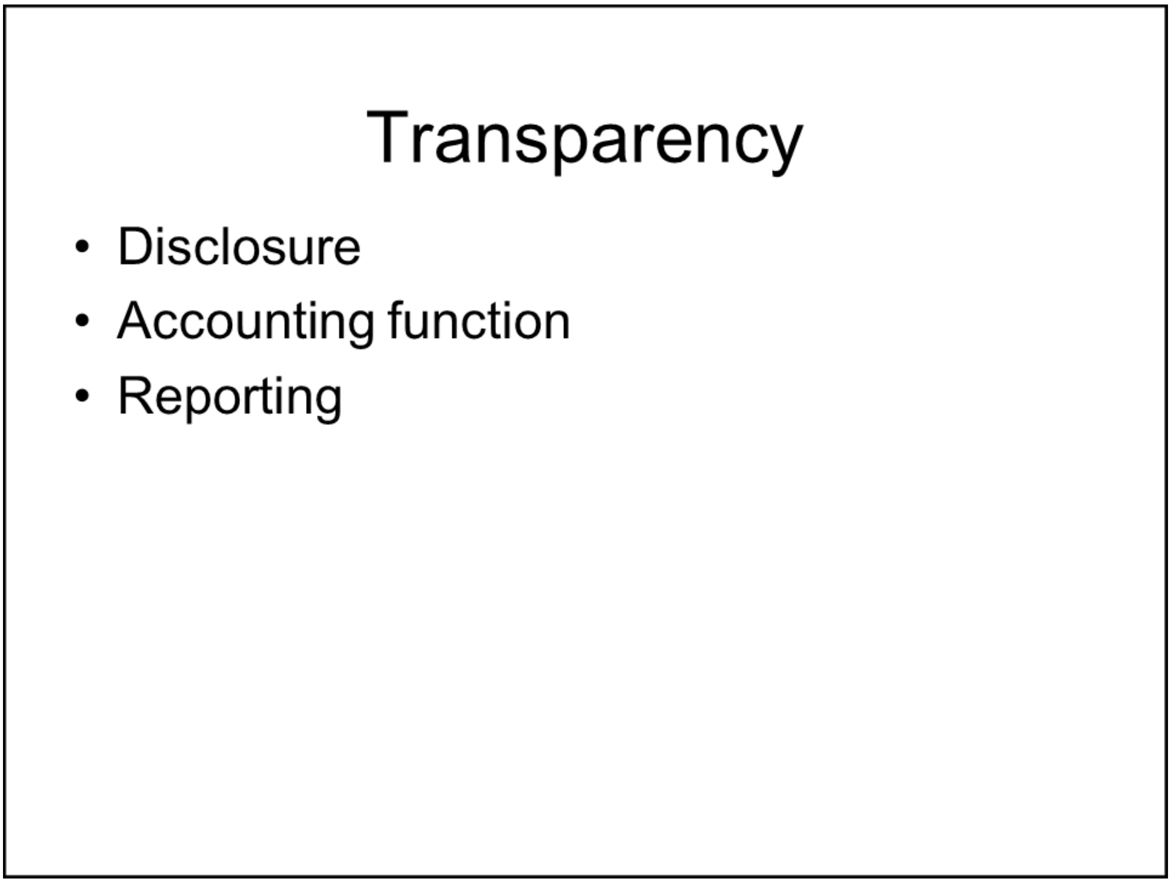

Рисунок 6.1

Disclosure and Corporate Governance

- The *lifeblood of markets is information* and barriers to the flow of relevant information represent imperfections in the market . . . The more the activities of companies are *transparent*, the more accurately will their securities be valued.
- (Cadbury Report, 1992, p. 33)

Рисунок 6.2

- Transparency through disclosure of information is crucial to the efficient functioning of corporate governance systems
- (Leuz and Verrecchia, 2000).

Рисунок 6.3

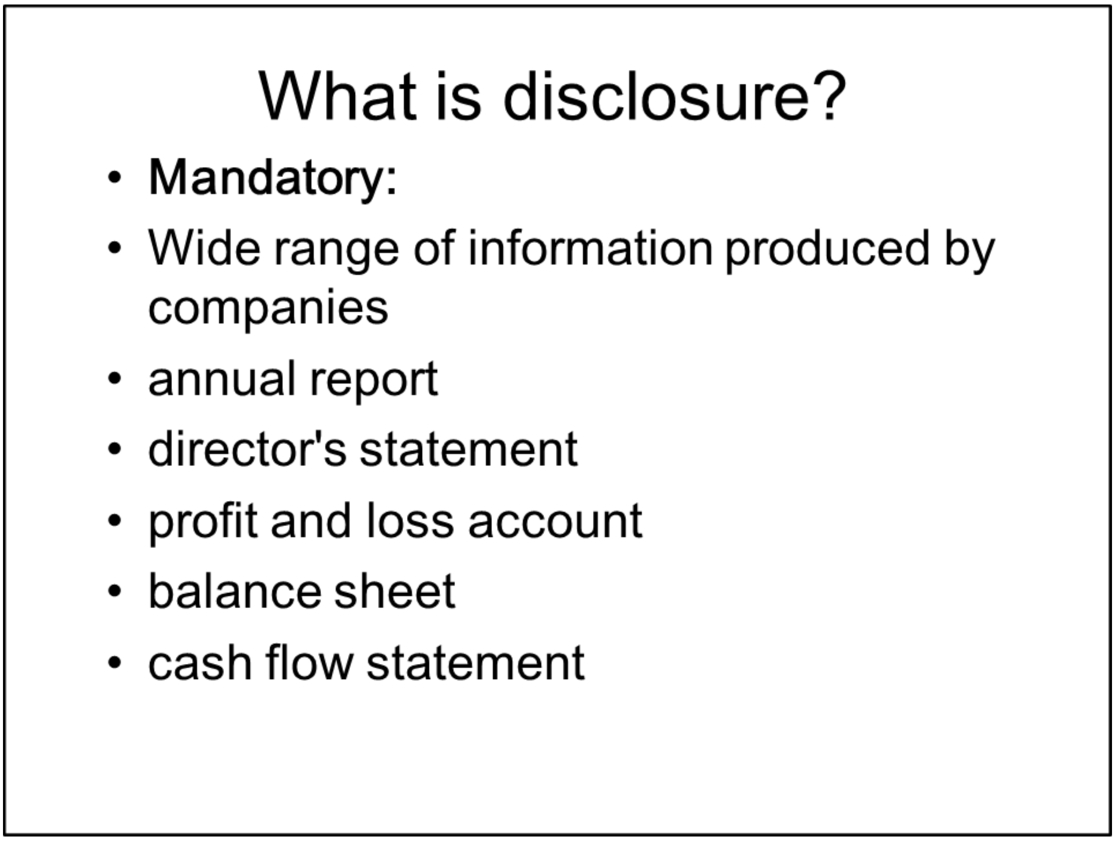

Рисунок 6.4

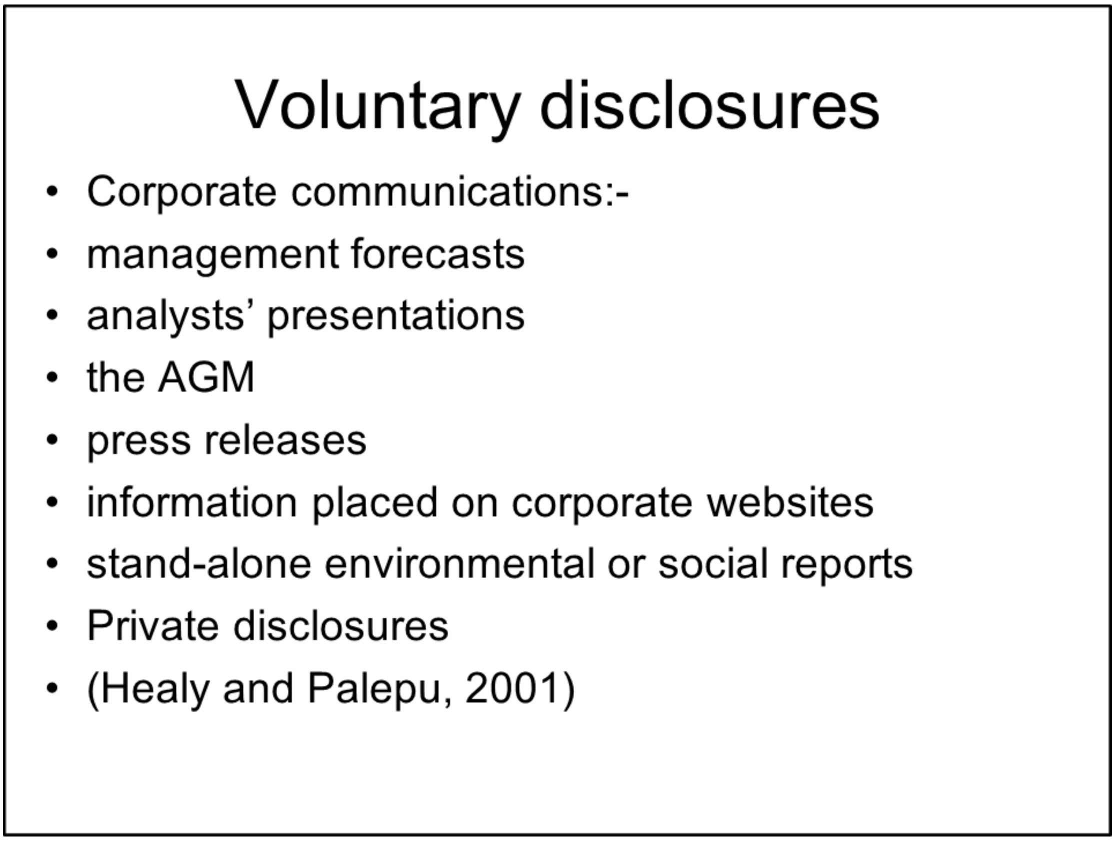

Рисунок 6.5

Рисунок 6.6

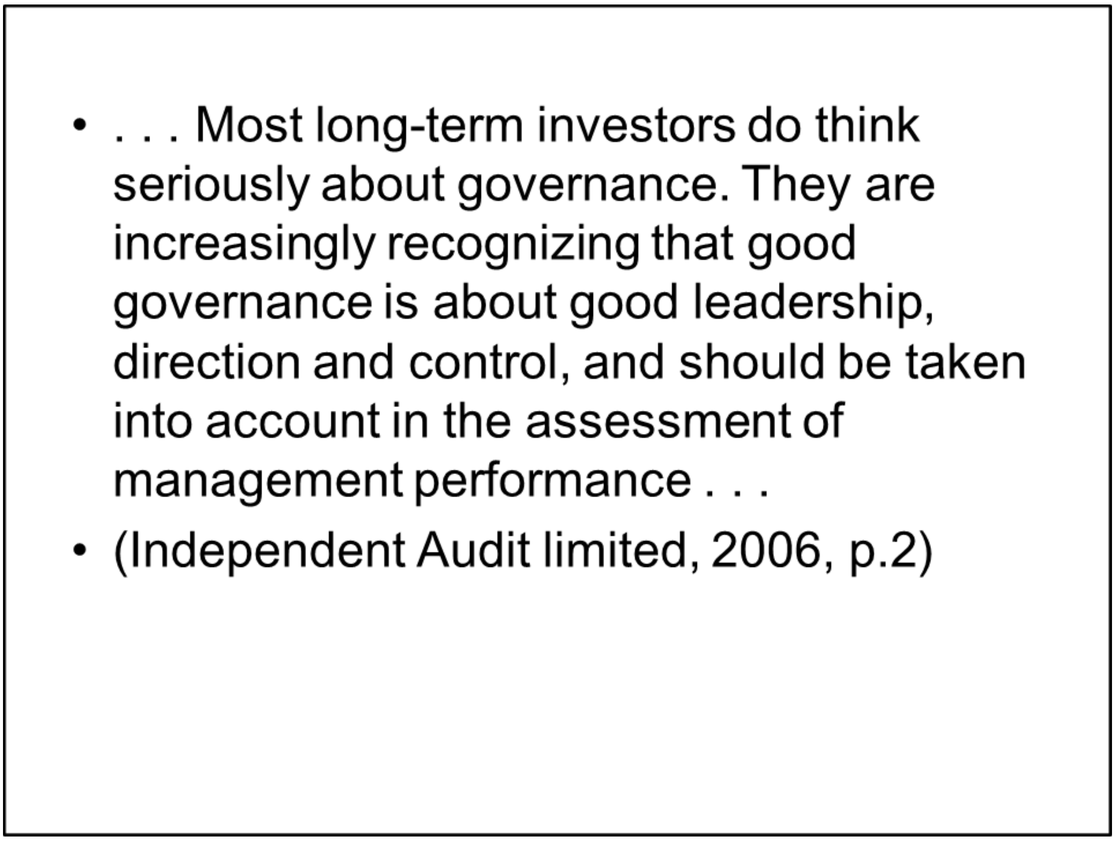

Рисунок 6.7

The report found that investors unanimously require:

- less boilerplate disclosures, with the focus on quality not quantity
- inclusion of illustrative examples to provide insight
- governance reporting that reflects each individual company's approach to corporate governance, reflecting its strategy and culture

Рисунок 6.8

- a focus on current, relevant issues to avoid year-on-year repetition of themes
- a focus on the role boards play and a link with performance rather than a description of what it does
- discussion of how board membership contributes to corporate strategy
- information about the effectiveness of the non-executive directors' role in challenging executive management and complementing the skills of the executives

Рисунок 6.9

- The report also highlighted the potential for better governance reporting to contribute to the growing dialogue between companies and their investors

Рисунок 6.10

The reporting framework is based on recommended questions for boards

- What is the board's role and what did it do?
- What gives the board confidence it has the right people?
- How did the board work together?
- How did management support the workings of the board?
- How did the board ensure it was fully effective?
- How did dialogue with investors help the board to meet its objectives?

Рисунок 6.11

- Report stresses a need for greater self-evaluation and reflexivity in the board's reporting of their own effectiveness

Рисунок 6.12

BP's (2005) annual report comments that

- "The board continued its ongoing evaluation processes to assess its performance and identified areas in which its effectiveness, policies or processes might be enhanced. A formal evaluation of board process and effectiveness was undertaken, drawing on internal resources, individual questionnaires and interviews were completed; no individual performance problems were identified. The results showed an improvement from the previous evaluation, particularly in board committee process and activities, while also identifying areas for further improvement. Regular evaluation of board effectiveness underpins our confidence in BP's governance policies and processes and affords opportunity for their development" (BP, 2005, p.161).

Рисунок 6.13

- Report does not mention STAKEHOLDERS!
- Promotes long-term shareholder interest
- May encourage 'cherry picking' not critical self-evaluation

Рисунок 6.14

The Operating and Financial Review Fiasco

- narrative disclosure
- forward-looking
- makes information accessible to broad range of report users

Рисунок 6.15

Business Review requirements:

- fair review of the business
- description of principal risks and uncertainties facing the company
- balanced and comprehensive analysis of the development and performance of the business during the financial year and the position of the business at the end of the year
- requirement (to the extent necessary) to include financial key performance indicators and (where appropriate) non-financial key performance indicators.
- Far less effective for stakeholder accountability

Рисунок 6.16

Timeline of OFR Events: Solomon and Edgley (2007)

5 May 2004: The government announces its plans for a mandatory OFR

↓

1 April 2005: New provisions were inserted into the Companies Act 1985 requiring quoted companies to produce a statutory OFR for reporting periods commencing on or after 1 April 2005

↓

10 May 2005: The ASB published Reporting Standard 1 (RS1)

↓

28 Nov 2005: (i) Gordon Brown announced that the mandatory OFR would be scrapped. He told CBI members that while SER reflected best practice, he understood concerns about the extra administrative costs of the "gold-plated regulatory requirement" and that was why he was abolishing the OFR.
(ii) All companies must still comply with the extended Business Review (BR) requirements originally introduced at the same time as the OFR. The BR forms part of the Directors' Report, and complies with the minimum requirements of the EU Accounts Modernisation Directive.

Рисунок 6.17

14 Dec 2005: Ethical investors, charities, academic institutions and faith groups wrote to Gordon Brown criticising his decision to abolish the OFR

↓

15 Dec 2005: The DTI Minister Alun Michael invited views on narrative reporting by 15 February 2006

↓

11 Jan 2006: Friends of The Earth (FoE) filed an application for a judicial review of the decision

↓

12 Jan 2006: A group of major asset management groups wrote to the DTI concerned that companies' reporting efforts could be destabilized by a lack of government guidance following the end of the mandatory OFR. Legislation passed to withdraw the OFR requirement.

Рисунок 6.18

26 Jan 2006: The ASB converted RS1 into non statutory best practice guidance (Reporting Statement 1)

↓

1 Feb 2006: Alun Michael announced renewed consultation on how the Company Law Reform (CLR) Bill might be amended. The consultation on the BR, which had been due to close on 14 February was extended until 24 March.

↓

2 Feb 2006: FoE claimed victory and issued a press release stating that the Government has been forced into a dramatic climb down over abolition of the mandatory OFR following an imminent legal challenge by FoE. The Treasury had also agreed to pay FoE's legal costs in order to avoid the group taking the judicial review to Court

↓

24 Mar 2006: The CBI issued an official response to the DTI supporting the Government's decision to abolish the OFR but retain BRs.

↓

3 May 2006: Amendments were made to the CLR Bill to give effect to changes to the content of companies' BRs. Alun Michael announced "Quoted companies will need to ensure that…their business review includes: *(a)* the main trends and factors likely to affect the future development, performance and position of the company's business; and *(b)* information about:

(i) environmental matters (including the impact of the company's business on the environment),

(ii) the company's employees, and

(iii) social and community issues, including information about any policies of the company in relation to those matters and the effectiveness of those policies. Directors will need to state in their Review if they do not think it necessary to include information about (i), (ii) or (iii) above.

FoE issued a press release attacking the Government's announcement that it would not be re-instating the OFR. FoE welcomed new reporting requirements which stated companies must provide information on environmental matters but warned that the amendments to the CLR Reform Bill would fail to remedy companies' worst abuses of the environment both here and overseas.

Рисунок 6.19

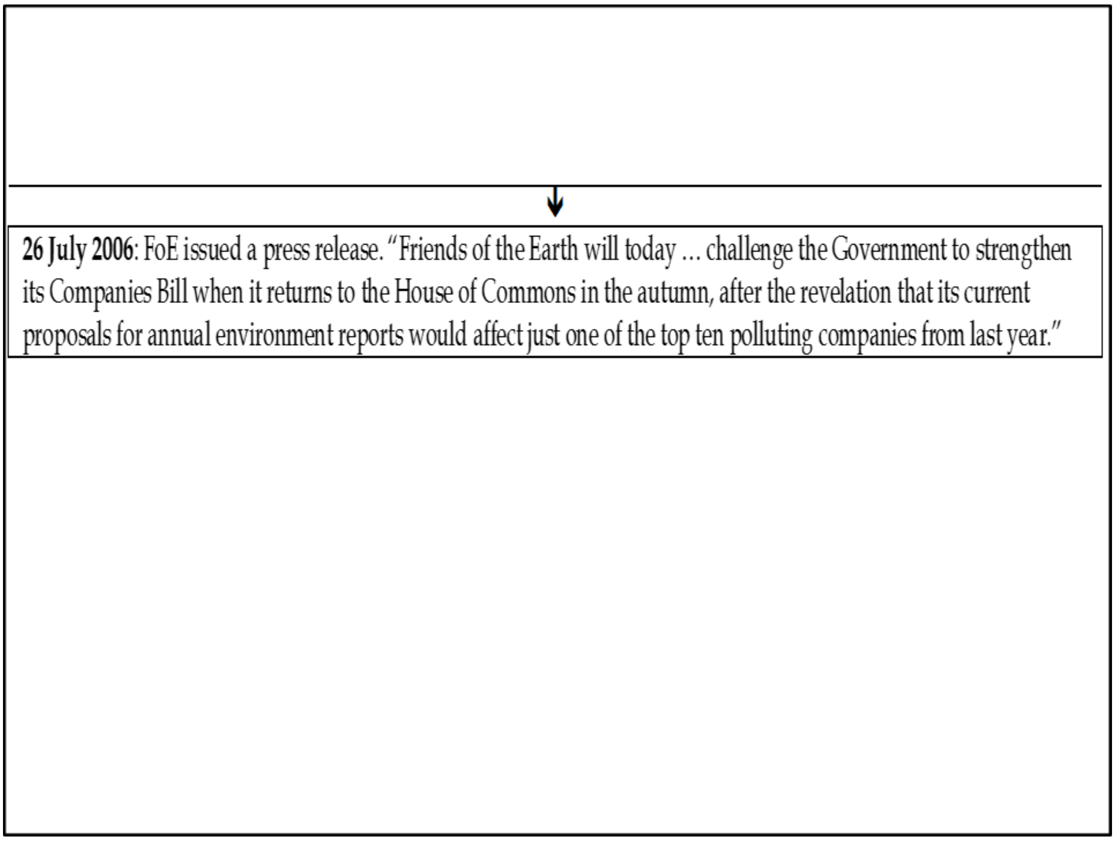

Рисунок 6.20

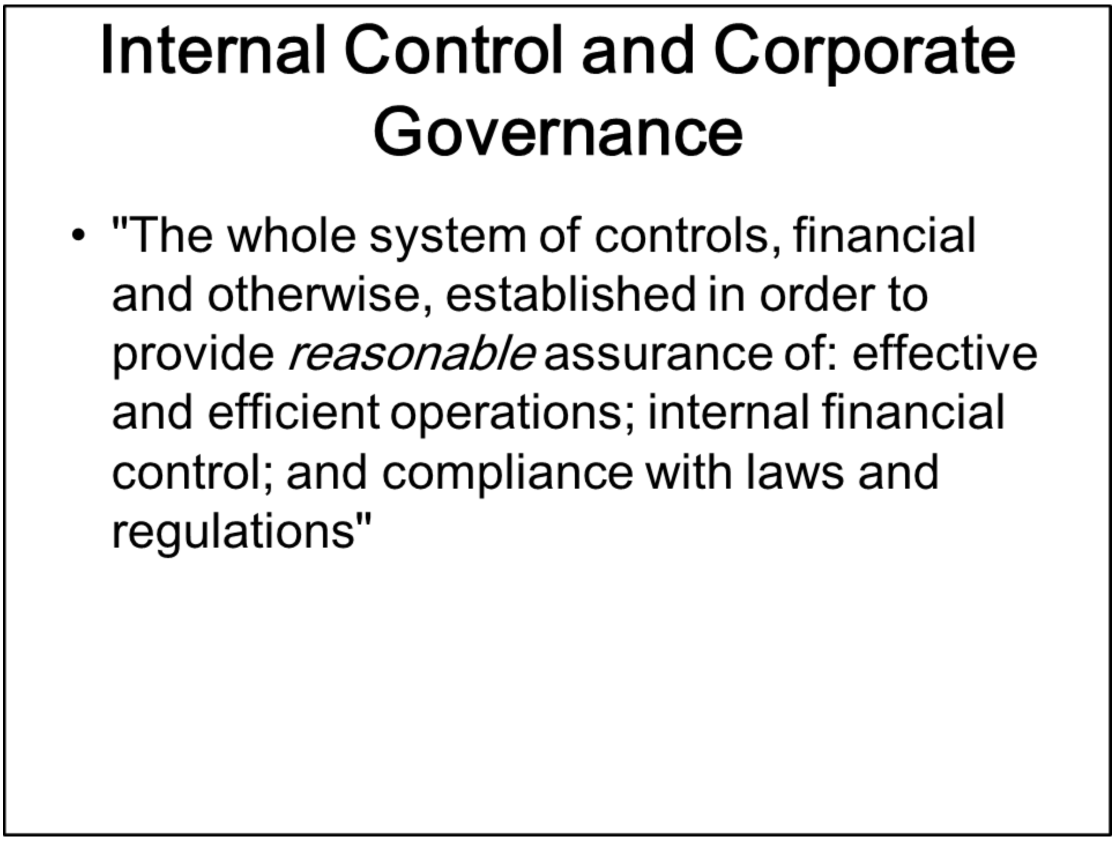

Рисунок 6.21

Turnbull Report 1999

- Explicit framework for internal control
- Based on best practice
- Made implicit best practice explicit

Рисунок 6.22

The Turnbull Framework

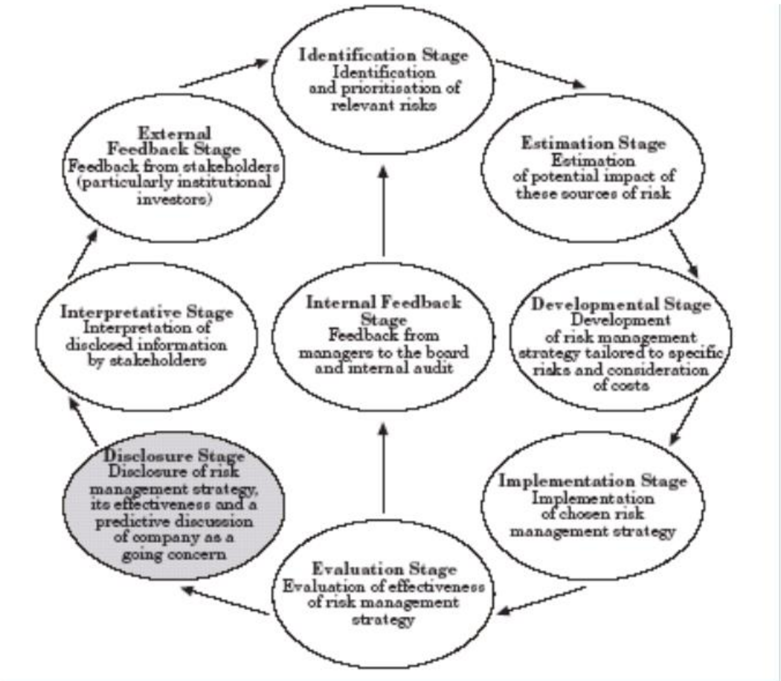

Рисунок 6.23

Revised Guidance on Internal Control (FRC, 2005)

- Confirmed flexible, principles-based approach
- Endorsed original Turnbull Report

Рисунок 6.24

Summary of the Main Revisions to the Turnbull Guidance in 2005

- A new preface was added to encourage boards to review on a continuing basis their application of the guidance and consider the internal control statement as an opportunity to communicate to their shareholders how they manage risk and internal control.

Рисунок 6.25

2005 review of Turnbull

- The introduction was reorganized to reinforce the message that the guidance aims to reflect sound business practice as well as to aid companies in complying with the internal control requirements of the Combined Code.

Рисунок 6.26

- The new guidance emphasized the need for directors to apply the same standard of care when reviewing the effectiveness of internal control as when exercising their general duties.

Рисунок 6.27

- The revised guidance required boards to confirm in their annual report that they have taken the action necessary to remedy any significant failings or weaknesses identified from their review of the effectiveness of the internal control system.
- They are also required to include in the annual report information considered necessary to aid shareholders in understanding the main features of the company's risk management processes and system of internal control.

Рисунок 6.28

Review of Turnbull recommended:

- Self-evaluative disclosure of how board has dealt with any weaknesses or failings identified from their review of the internal control system

Рисунок 6.29

Paper's findings from investor interviews

- institutional investors viewed risk disclosure as decision useful
- Investors felt that better risk disclosure improved their investment decisions
- Investors felt risk disclosure by UK companies was inadequate
- Investors wanted to support voluntary framework of disclosure

Рисунок 6.30

Sarbanes-Oxley

- USA's response to the collapse of Enron
- Developed new regulation
- USA environment takes a mandatory approach to corporate governance
- UK uses comply or explain

Рисунок 6.31

Sarbanes-Oxley: The Impact

- All US companies forced to submit an annual assessment of the effectiveness of their internal control systems to the Security Exchange Council (SEC)

Рисунок 6.32

Sarbanes Oxley required

- Companies' independent auditors forced to audit and report on the internal control reports produced by management, in the same way as they audit the financial statements

Рисунок 6.33

Sarbanes Oxley required

- company's principal executive officer and principal financial officer must sign two certifications, making them personally responsible for the correctness of the financial reporting

Рисунок 6.34

Sarbanes-Oxley

- emphasized the need for auditor independence

Рисунок 6.35

Significant Impact on Audit Fees

- Big four accounting firms doubled their audit fees with US clients within a short space of time following the introduction of the Sarbanes-Oxley Act

Рисунок 6.36

The Role of Audit in Corporate Governance

- The annual audit is one of the cornerstones of corporate governance . . . The audit provides an external and objective check on the way in which the financial statements have been prepared and presented.
- (Cadbury Report, 1992, p. 36, para. 5.1)

Рисунок 6.37

Auditor Independence

- Balance between close relationship and preserving independence
- *Provision of non-audit services*
- . . . we do not believe it would be right to seek to impose specific restrictions on the auditor's supply of non-audit services through the vehicle of Code guidance. We are sceptical of a prescriptive approach, since we believe that there are no clear-cut, universal answers . . . there may be genuine benefits to efficiency and effectiveness from auditors doing non-audit work. (Smith Report, 2003, p. 27, para. 35)

Рисунок 6.38

- *Rotation of auditors*
- Smith Report
- *Audit committees*
- Cadbury Report recommended that all companies should establish audit committees

Рисунок 6.39

- Recent research has shown that there is convergence in corporate governance within Europe in the area of audit committees.
- Collier and Zaman (2005) found
- wide adoption by European countries of the audit committee concept

Рисунок 6.40

Research into the Effectiveness of the Audit Function

- We do have—not officially, not publicly—concerns about their independence overall . . . you would be amazed at how, when you speak to auditors, from big firms as well as little firms, at drinks parties, at non-official events, and when they are in isolation (you would never get this if you had an audit conference), they often say that they are amazed that more does not come to light or that they often get their arm twisted by management—not from their own practice but of the companies they are auditing—to not worry about it, it is under control. I do find that quite alarming. What do you do about it? You cannot go out and say, ’Investment management believes that the auditing profession is completely corrupt!’.

Рисунок 6.41

7. Lecture 7 - Global Corporate Governance

Aim.

- appreciate the diversity of corporate governance systems worldwide;
- discuss the characteristics of the insider-oriented versus the outsider-oriented categorisation for corporate governance systems at an international level;
- consider the influence of legal systems, and other factors, on the evolution of corporate governance systems;
- Consider examples, especially South Africa and the King Reports.

Рисунок 7.1

	Individual country codes	N	Regional Codes
1992	UK	1	
1993			
1994	Canada, South Africa	2	
1995	Australia, France	2	
1996	Spain	1	
1997	Japan, the Netherlands, USA	3	
1998	Belgium, Germany, India, Italy, Thailand	5	
1999	Greece, Hong Kong, Ireland, Mexico, Portugal, South Korea	6	*OECD* *ICGN* *Commonwealth*
2000	Denmark, Indonesia, Malaysia, Philippines, Romania	5	
2001	China, Czech Republic, Malta, Peru, Singapore, Sweden, Uganda	7	
2002	Austria, Cyprus, Hungary, Kenya, Oman, Pakistan, Poland, Russia, Slovakia, Switzerland, Taiwan	11	
2003	Finland, FYR Macedonia, Lithuania, New Zealand, Nigeria, Turkey, Ukraine, Panama	7	*Latin America*
2004	Argentina, Bangladesh, Brazil, Iceland, Mauritius, Norway, Slovenia	7	*OECD*
2005	Jamaica, Latvia	2	*ICGN* *MENA*
2006	Egypt, Estonia, Lebanon, Luxembourg, Macedonia, Nigeria, Sri Lanka, Israel, Saudi Arabia, Trinidad & Tobago	10	
2007	Bulgaria, Bosnia & Herzegovina, Colombia, Jordan, Kazakhstan, Moldova, Mongolia	7	
2008	Morocco, Serbia, Tunisia, Qatar	4	
2009	Algeria, Croatia, Georgia, Montenegro	*4*	*ICGN*
2010	Armenia, Bahrain, Ghana, Malawi, Yemen	5	
2011	Azerbaijan, Botswana, Guernsey	2	
2012	?		

Рисунок 7.2

Insider versus Outsider Systems

Insider	Outsider
Firms owned predominantly by inside shareholders who also wield control over management	Large firms controlled by managers but owned predominantly by outside shareholders
System characterised by little separation of ownership and control such that agency problems are rare	System characterised by separation of ownership and control which engenders significant agency problems
Hostile take-over activity is rare	Frequent hostile take-overs acting as a disciplining mechanism on company management

Рисунок 7.3

Insider versus Outsider Systems

Insider	Outsider
Concentration of ownership in a small group of shareholders (founding family members, other companies through pyramidal structures, state ownership)	Dispersed ownership
Excessive control by a small group of 'insider' shareholders	Moderate control by a large range of shareholders
Wealth transfer from minority shareholders to majority shareholders	No transfer of wealth from minority shareholders to majority shareholders

Рисунок 7.4

Insider versus Outsider Systems

Insider	Outsider
Weak investor protection in company law	Strong investor protection in company law
Potential for abuse of power by majority shareholders	Potential for shareholder democracy
Majority shareholders tend to have more 'voice' in their investee companies	Shareholding characterised more by 'exit' than by 'voice'

Рисунок 7.5

Research into Corporate Governance Systems Worldwide

- Shleifer and Vishny (1997) surveyed the extant research into corporate governance, focusing on the influence of countries' legal systems on corporate governance
- investor legal protection and ownership concentration
- High degree of legal investor protection was necessary to persuade investors to hand their money over to companies

Рисунок 7.6

La Porta, Lopez-de-Silanes, Shleifer and Vishny (1997)

- Explained there were three general legal traditions operating across the globe
- French origin legal system is known to afford the lowest level of investor protection
- English origin legal system of common law affords the highest level of investor protection
- German and Scandinavian origin legal systems lie somewhere in between

Рисунок 7.7

Concluded:

- Legal systems characterised by low levels of investor protection were found to be associated with poorly developed capital markets
- Without strong investor protection, management can expropriate shareholders' funds

Рисунок 7.8

Implications

- A negative by-product of corporate governance systems which are characterized by weak investor protection is the potentially negative effect on corporate risk-taking
- Dominant managerial shareholders invest in low-risk, conservative investment projects which do not create value for the company in order to protect their own position within the company (Mishra, 2011).
- Poor investor protection is significantly related to sub-optimal investment policies, low levels of corporate risk-taking and consequently low growth (John et al., 2008)

Рисунок 7.9

Implications:

- Consequently, the early body of work by La Porta et al. presents a case for supporting the **Anglo-American style of capitalism** as being the most successful model for societies because it leads to the development of the **strongest and largest capital markets** and therefore to stronger economic development

Рисунок 7.10

New research

- Recent research has called into serious question some of the findings and implications of the body of work by La Porta et al.
- La Porta et al. (2008) questioned their earlier work, as they reflected on whether other underlying factors may be producing the links between legal systems and capital markets (via investor protection) which they wrote about a decade earlier.

Рисунок 7.11

La Porta et al (2008) modified their earlier findings:

- "…. There is by now a great deal of evidence that legal origins influence legal rules and regulations, which in turn have substantial impact on important economic outcomes …. Much of this evidence suggests that common law is associated with better economic outcomes than French civil law…. But it is less clear that legal origins predict aggregate growth" (La Porta et al., 2008, p.302).

Рисунок 7.12

Collison et al. (2012)

- "…their [La Porta et al's] restricted set of criteria for assessing prosperity has obscured very important implications of aspects of their work for wider society"

- They refute Porta et al's conclusion that the Anglo-Saxon model is the 'best' for society

Рисунок 7.13

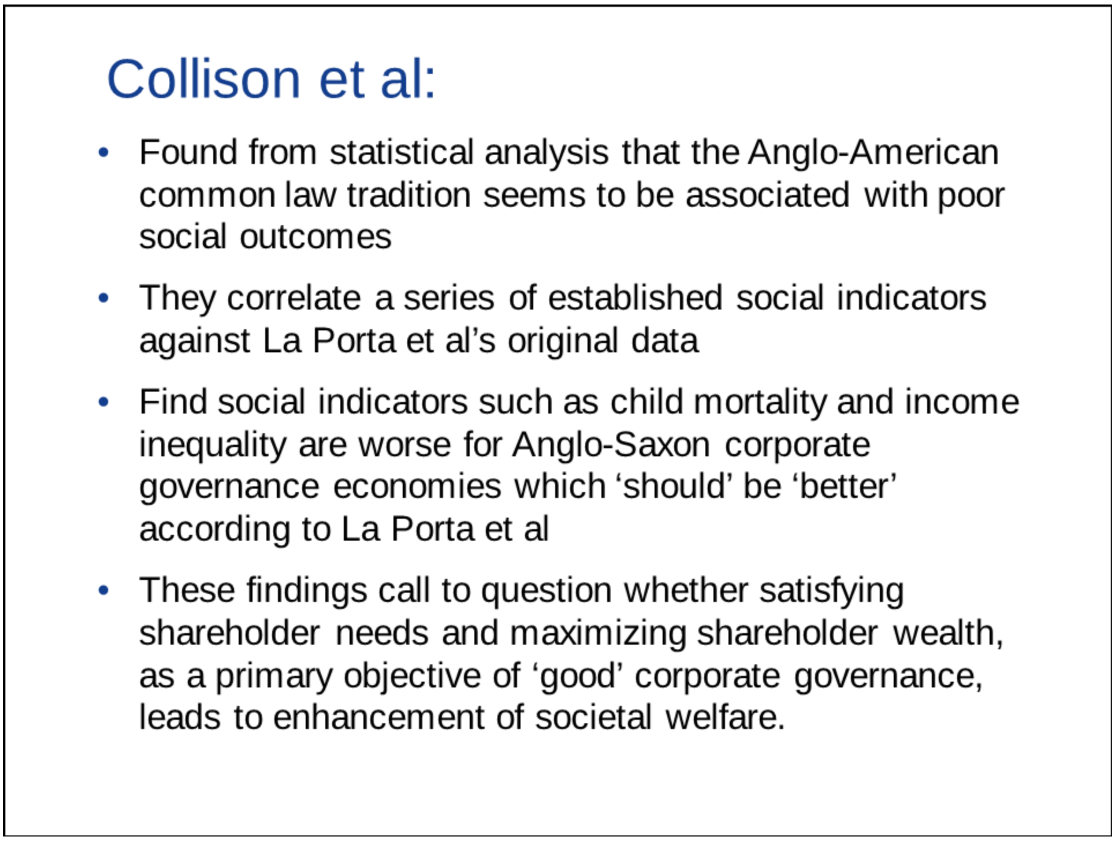

Рисунок 7.14

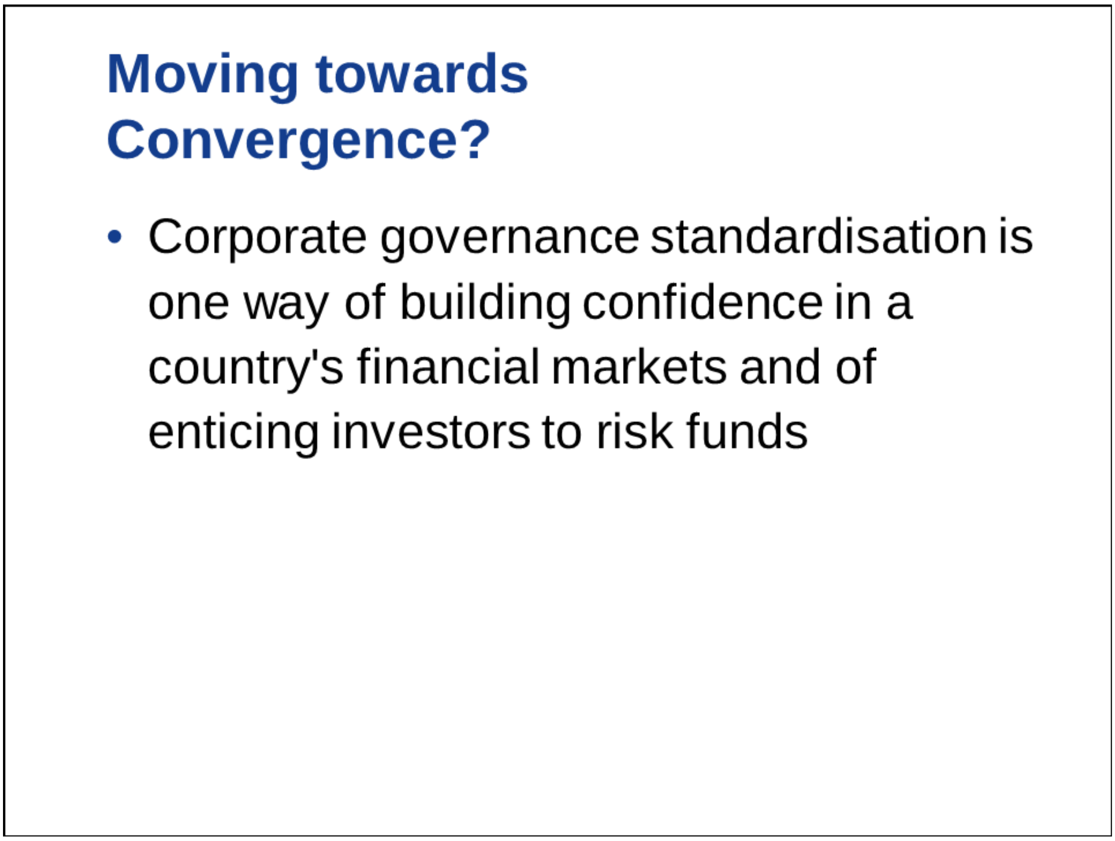

Рисунок 7.15

The OECD Principles

- First OECD Principles (1999)
- Organisation for Economic Co-operation and Development
- ***The Revised OECD Principles 2004***
- OECD has expanded to include 30 members, with the accession of the Slovak Republic in December 2000
- The OECD Principles (2004) stated that the 1999 principles provided specific guidance for legislative and regulatory initiatives in OECD member countries but also in non-member states
- The 1999 principles have been thoroughly reviewed in order to take account of recent developments and experiences in both OECD member and non-member countries

Рисунок 7.16

- In reviewing the 1999 principles, the OECD drew on a the findings of a comprehensive survey of how member countries addressed a variety of corporate governance challenges
- The revised principles have maintained the spirit of a non-binding and principles-based approach, which recognised the need to adapt implementation to varying economic, legal and cultural situations
- The need for sound corporate governance systems at a global level is reinforced in the preamble to the revised principles,

Рисунок 7.17

- "If countries are to reap the full benefits of the global capital market, and if they are to attract long-term 'patient' capital, corporate governance arrangements must be credible, well understood across borders and adhere to internationally accepted principles" (OECD, 2004, p.13).

Рисунок 7.18

The revised principles cover the following areas :

- (i) Ensuring the basis for an effective corporate governance framework;
- (ii) The rights of shareholders and key ownership functions;
- (iii) The equitable treatment of shareholders;
- (iv) The role of stakeholders;
- (v) Disclosure and transparency; and
- (vi) The responsibilities of the board. It seems that stakeholders have been given greater weight in the redrafted version of the principles.

Рисунок 7.19

The ICGN Statement on the OECD Principles

- **The International Corporate Governance Network (ICGN)**
- is an international organisation comprising of many groups interested in corporate governance reform
- OECD (2004) stressed that good standards of corporate governance are essential if countries are to attract international investment
- ***The CalPERS Principles***
- CalPERS, the California Public Employees' Retirement System

Рисунок 7.20

The Outcome of Corporate Governance Convergence

- A 'one size fits all' approach is unrealistic, as "alien practices cannot be transplanted or imposed"
- Potential for countries to be forced into Anglo-American style capitalism
- Mayer (2000) argued against corporate governance convergence suggesting that systems should remain inherently different so as to promote competition and take advantage of comparative advantage

Рисунок 7.21

Рисунок 7.22

Рисунок 7.23

Comply or Explain in EU

- Commission has decided that legislation should not be the driving force for EU corporate governance reform
- Harmonising corporate governance across EU, through legislation, the forced adoption of a common code, is not a practicale possibility
- EU Commission has decided to apply the *'comply or explain'* approach to corporate governance

Рисунок 7.24

The Important Role of Shareholders in the EU

- Commission has established that the driving force for good corporate governance should be shareholders
- Shareholders are an essential corporate governance mechanism for holding companies to account
- They should be fully informed and should act responsibly by exercising their voting rights

Рисунок 7.25

Shareholder Voting Rights in EU

- There are ongoing problems with corporate governance reform within the EU
- If shareholders are to drive corporate governance reform, they need to be able to exercise their rights
- There are significant obstacles to cross-border voting at the moment
- A key issue for the Commission is to facilitate cross-border voting.

Рисунок 7.26

Control-Enhancing Mechanisms and the 'One Share One Vote' Debate

- Debate surrounding

  "One share: One vote"
- Every shareholder SHOULD own one voting right for every share he/she owns
- This is a core corporate governance principle, deriving from the established need to treat all shareholders equally (OECD, 2004).

Рисунок 7.27

- In many EU companies the ratio can be ten, twenty, or even one hundred votes per share, for certain, privileged shareholders
- The privileged shareholders can be, for example, founding family members
- Even where shares are sold to other shareholders, the rights on the new shares are often different (one share: one vote) such that the founding family members retain control.

Рисунок 7.28

ABI Study (2005)
(See Directions Paper)

- Association of British Insurers (ABI) study examined application of 'one share one vote' principle in EU
- Examined capital structure of EU companies to establish what proportion applied the 'one share one vote' principle
- Findings indicated that 65% of companies applied 'one share one vote', but identified some 'striking' exceptions to the principle
- Multiple voting rights were found, especially in France, Sweden and the Netherlands

Рисунок 7.29

EU Study 2007

- EU produced an in-depth report on the proportionality principle:
- *"proportionality between ultimate economic risk and control means that share capital which has an unlimited right to participate in the profits of the company or in the residue on liquidation, and only such share capital,* **should normally carry control rights, in proportion to the risk carried**. *The holders of these rights to the residual profits and assets of the company are best equipped to decide on the affairs of the company as the ultimate effects of their decisions will be borne by them"*

Рисунок 7.30

- This study identified a far wider range of control-enhancing mechanisms which do not follow the proportionality principle, but which are used widely throughout member states
- The findings of the study suggest that a 'one share one vote' policy would not difficulties of excessive control by concentrations of shareholders.

Рисунок 7.31

Other control-enhancing mechanisms include:

- pyramidal structures, available in all the member states surveyed and used in three-quarters of them;
- shareholder agreements available in all the countries surveyed and used in 69% of them, and;
- cross shareholdings used in 31% of the countries surveyed

Рисунок 7.32

- Although 'one share one vote' has been advocated by institutional investor representative organisations, there has been resistance from the EU corporate community, who favour investor choice, with transparency, rather than regulation of dual share classes, being the essential mechanism of accountability

Рисунок 7.33

Board Structure and Performance in EU

- EU-wide adoption of good corporate governance practice with respect to the appointment of non-executive directors on corporate boards
- BUT
- definition of independence has been applied in a 'flexible' manner.
- Most EU member states disclosing remuneration

Рисунок 7.34

Choice of Language for Corporate Communications

- Which language should be used for the annual general meeting?
- Which language should corporate disclosures and documents be presented in?
- How can shareholders exercise informed votes if they cannot understand the language in which voting forms are presented?

Рисунок 7.35

Latest EU approach

- Recent green paper on corporate governance produced by the EU Commission emphasized the implications of good corporate governance for trust,
- “Corporate governance and corporate social responsibility are key elements in building people’s trust in the single market. They also contribute to the competitiveness of European business, because well run, sustainable companies are best placed to contribute to the ambitious growth targets set by ‘Agenda 2020’” (European Commission, 2011, p.2).

Рисунок 7.36

Commission's approach to dealing with such problems in corporate governance is as follows:

- 1. Consultation
- 2. Recommendation or directive
- 3. *Ex post* evaluation
- 4. If recommendations or directives do not deliver then their usefulness is questionable
- 5. *Ex post,* if objectives not achieved, what can be done next?
- An evaluation is necessary after regulation

Рисунок 7.37

Рисунок 7.38

Рисунок 7.39

- Mervyn King consults and advises on corporate legal issues. He is recognised internationally as an expert on corporate governance and sustainability. He sits as an arbitrator and as a mediator. He is a founding member of the Arbitration Foundation of Southern Africa and for some eight years was the South African judge at the ICC International Court of Arbitration in Paris. He has acted as an Inspector of Companies and a Commissioner of Inquiries into the affairs of companies. He has chaired many meetings for the compromise of creditors of companies and the rearrangement of shareholders' interests. He has spoken at conferences and lectured on corporate issues in 38 countries. He is a regular speaker on radio and television talk shows and ran his own television series, "King on Governance"

Рисунок 7.40

- The successive South African King Reports (I, II and III) represent a genuine and successful attempt to create a corporate governance framework and set of guiding principles which combine the best features of Anglo-Saxon corporate governance recommendations with the specific cultural, political and socio-economic characteristics of South Africa
- King III fuses the highest levels of corporate governance best practice embodied in Cadbury and its successors with a passionate commitment to stakeholder accountability and a sensitivity to the idiosyncrasies of the South African socio-political environment

Рисунок 7.41

King III 2009

- reinforces South Africa's leading role in corporate governance and especially in embedding stakeholder accountability at the heart of corporate governance
- King III states that each of the new Code's Principles, "… is of equal important and together forms a holistic approach to governance" (King III, 2009, p.19).

Рисунок 7.42

King III 2009 Principles

- ensuring ethical leadership and corporate citizenship
- ensuring effective boards of directors
- ensuring effective audit committees
- ensuring effective governance of risk
- ensuring effective governance of information technology
- ensuring compliance with laws, rules, codes and standards

Рисунок 7.43

King III 2009 Principles cont.

- ensuring effective internal audit
- ensuring effective governance of stakeholder relationships
- ensuring an integrated approach to reporting and disclosure
- The most significant outcome of King III was the introduction of mandatory integrated reporting for companies listed primarily on the JSE

Рисунок 7.44

Corporate Governance in Developing Economies: The Case of Uganda

- South Africa is a leader in governance but is still an emerging economy
- Research into corporate governance in Africa is in its infancy
- Study by Wanyama (2007) represents the first attempt to reflect on corporate governance issues in Uganda
- Issues and conclusions apply to many developing economies

Рисунок 7.45

Wanyama (2007)

- Research aimed:-
- to examine whether principles of corporate governance have led to significant improvements in corporate governance in Ugandan companies
- To discover whether guidelines are enough to develop good corporate governance, or whether more is needed.

Рисунок 7.46

Wanyama *et al.* (2007, p.16).

- "… the level of implementation of corporate governance guidelines in Uganda is poor …. attributed ….to the lack of an appropriate framework to support implementation and enforce compliance with the guidelines"

Рисунок 7.47

Factors Impeding Corporate Governance Improvements in Uganda

- **Cultural and social factors:-**
- pressure from extended families for financial support, leading to bribery and corrupt practices
- hierarchical structures (heads of families/ age)
- Sexism
- Tribalism
- **Economic factors:-**
- tax levels
- Remuneration
- inflation and poverty

Рисунок 7.48

Other problems

- Shareholder advocacy (means by which shareholders can hold boards to account) was identified as a serious weakness in Ugandan corporate governance
- Family ownership structures make it difficult for shareholders to exercise their rights in Uganda.

Рисунок 7.49

A Need for More Ethical Business Practices

- Unethical conduct significant obstacle to good corporate governance:-
- sexual harassment of employees;
- fear of whistleblowing
- political and other corporate appointments not based on merit
- bribery and corruption
- poor accounting disclosures
- lack of ethics among senior corporate employees, such as integrity, punctuality, honesty and accountability
- inadequate protection of employees' rights, leading to exploitation and harassment

Рисунок 7.50

Wanyama suggested:

- "… extra resources need to be provided to enable the legal, regulatory and enforcement agencies to perform their work adequately, while the governance framework also needs to take into account the specific cultural context of Uganda, where respect for elders and the protection of the family is a major concern. In addition, the economic policies of the country need to be scrutinised to ensure that they foster and nurture good corporate governance practices in Uganda, most fundamentally by ensuring that the population … receives a fair wage or living allowance so that the motivation to cheat or take bribes is reduced"

Рисунок 7.51

Ethical issues in international corporate governance

- A major issue in developing and emerging economies is bribery and corruption
- Despite the development of corporate governance codes of practice and international efforts to move towards corporate governance convergence, there is still evidence that bribery is a continuing problem in international business transactions
- OECD is concerned that corruption and bribery within multinational businesses damages corporate governance
- Discourages investment and damages countries' international competitiveness
- OECD have focused on putting mechanisms in place to ensure that multinational companies' financial statements and accounts do not allow for transactions connected to corruptive practices

Рисунок 7.52

OECD (2011)

- corrupt practices result in the diversion of funds which is detrimental to efforts in developing economies to enhance social and environmental welfare as well as economic welfare. International efforts to tackle poverty are thwarted by bribery and corruption within the corporate community
- Ethics and corporate governance are entwined and cannot be treated in isolation from each other

Рисунок 7.53

Global Convergence of Corporate Governance

- Involves striking a balance between retaining individual characteristics of a country and adopting a market-based, Anglo-Saxon form of governance
- Involves improving ETHICS in business
- Involves improving corporate governance in SPIRIT not just by following codes of practice

Рисунок 7.54

8. Lecture 8 - A holistic model of governance and accountability

Aim. This lecture aims to show how corporate governance encompasses far more than a narrow, shareholder perspective and needs to incorporate the needs of diverse stakeholders: a holistic model.

Learning outcomes:

- consider the growth of corporate social responsibility highlighting the potentially strong impact of corporate behaviour on a wide range of stakeholders;
- emphasise the importance of establishing a positive relationship between corporate social responsibility and corporate financial performance;
- discuss sustainability reporting as a way in which companies can discharge their accountability to a wide range of stakeholders;
- Consider the growth and characteristics of integrated reporting;
- discuss the use of stakeholder engagement to discharge broader corporate accountability.

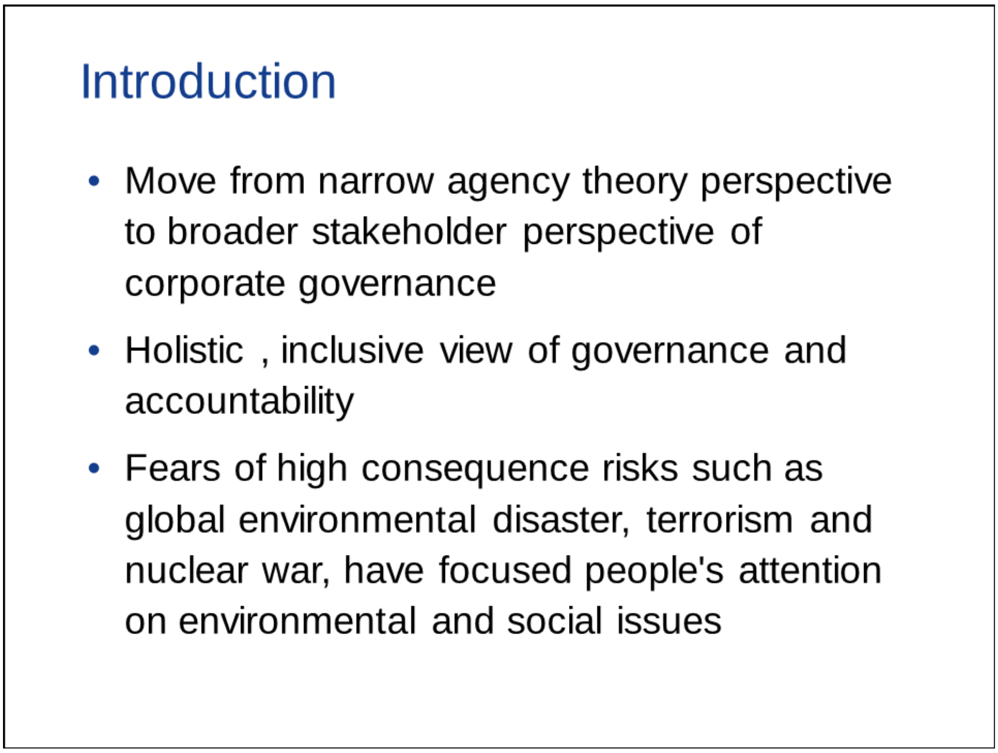

Рисунок 8.1

Mechanisms of holistic corporate governance

- Sustainability reporting
- Assurance of sustainability reports
- Stakeholder engagement
- Responsible investment

Рисунок 8.2

Sustainability Reporting Accounting for What?

- Sustainability Reporting involves companies disclosing information on their impact on the environment and on society
- Stakeholders affected by corporate activities include: employees, local communities, animal and plant species
- High impact issues such as climate change, global warming and child labour attract media attention and companies need to deal with them

Рисунок 8.3

Terminology

- Social accounting
- Sustainability reporting
- Social disclosure
- Social reporting/corporate social reporting
- Social and environmental accounting
- Social, environmental and ethical reporting
- Corporate responsibility reporting/disclosure

Рисунок 8.4

Gray's (1987) definition

- Corporate social reporting is the process of communicating the social and environmental effects of organisation's economic actions to particular interest groups within society and to society at large. As such, it involves extending the accountability of organisations beyond the traditional role of providing a financial account to the owners of capital, in particular, shareholders. Such an extension is predicated upon the assumption that companies do have wider responsibilities than simply to make money for their shareholders

Рисунок 8.5

Sustainability and a Stakeholder Perspective

- Stakeholder perspective consistent with corporate social responsibility
- Brundtland Commission (WCED, 1987)
- Sustainable development implies development that meets the needs of the present without compromising the ability of future generations to meet their own needs

Рисунок 8.6

Sustainability

- Organisations attempt to attain sustainable development
- Sustainability for a company involves balancing 3 aspects:
- economic growth
- Social factors
- Environmental factors

Рисунок 8.7

Sustainability Reporting

- Interest in sustainability has encouraged companies to orient their disclosure toward a sustainability objective
- Global Reporting Initiative (GRI)
- produced sustainability reporting guidelines
- economic, environmental and social performance
- **TASK: go an look at the latest version of the GRI**

Рисунок 8.8

Format

- Sustainability or Corporate responsibility reporting can be:
- Stand-alone CR reports
- Sustainability information Integrated into annual reports or integrated reporting

Рисунок 8.9

KPMG (2008) on Corporate Responsibility Reporting

- corporate responsibility reporting has become mainstream with nearly 80% or the world's largest 250 companies issuing reports, as opposed to 50% in the 2005 survey
- corporate responsibility reporting is now the 'norm' not the exception for the world's largest companies
- climate change reporting is increasing but needs to improve substantially

Рисунок 8.10

The KPMG (2011) *International Survey of Corporate Responsibility Reporting*

- stated that corporate responsibility reporting had become a ‘*de facto* law’ for business and that it ‘came of age’ in 2011
- found that 95% of the largest 250 companies in the world were, by 2011, reporting corporate responsibility information
- found that two-thirds of those companies which were still not reporting on their corporate social responsibility activities were based in the USA.

Рисунок 8.11

The KPMG Survey of Corporate Responsibility Reporting 2013

- There has been a dramatic increase in CR reporting rates in Asia Pacific over the last two years. almost three quarters (71 percent) of companies based in asia Pacific now publish CR reports – an increase of 22 percentage points since 2011 when less than half (49 percent) did so.

Рисунок 8.12

- The Americas have now overtaken Europe as the leading CR reporting region, largely due to an increase in CR reporting in Latin America.
- Seventy six percent of companies in the Americas now report on CR,
- 73 percent in Europe
- 71 percent in Asia Pacific.

Рисунок 8.13

- The highest growth in CR reporting since 2011 has been seen in:
- India (+53 percentage points),
- Chile (+46),
- Singapore (+37),
- australia (+25),
- taiwan (+19)
- China (+16).

Рисунок 8.14

CR reporting is now undeniably a mainstream business practice worldwide, undertaken by almost three quarters (71 percent) of the 4,100 companies surveyed in 2013.

Рисунок 8.15

Across sectors

- In all sectors more than half of companies report on CR, meaning reporting can be considered standard global practice irrespective of industry

Рисунок 8.16

By Sector

- Some sectors have taken big steps over the past years. the automotive and telecommunications & media sectors now have some of the highest levels of CR reporting

Рисунок 8.17

To report or not to report?
The debate is over

- Companies should no longer ask whether or not they should publish a Cr report. We believe that debate is over. the high rates of Cr reporting in all regions suggest it is now standard business practice worldwide. the leaders of n100 or G250 companies that still do not publish Cr reports should ask themselves whether it benefits them to continue swimming against the tide or whether it puts them at risk.

Рисунок 8.18

- the important questions now are “what?” and “how?” – or, in other words, it is now about the quality of Cr reporting and the best means to reach relevant audiences. this includes assessing what is material for the business, proper engagement with stakeholders, having an honest communication strategy including openness about challenges and putting in place the underlying processes to gather and check data.

Рисунок 8.19

In financial reports?

- Over half of reporting companies worldwide (51 percent) now include CR information in their annual financial reports. this is a striking rise since 2011 (when only 20 percent did so) and 2008 (only 9 percent). the direction of travel is clear and with more than half of companies researched now including CR data in their financial reports, this can arguably be considered as standard global practice.

Рисунок 8.20

Illustrations of sustainability reporting Companies‘ Disclosure Aims

- Our approach recognizes that, in order to operate effectively in harmony with all our stakeholders, we must strive to achieve the highest standards of environmental management, health and safety performance and social partnerships in our business … our statement of business principles … recognize that genuine, transparent and mutually beneficial partnerships with our stakeholders are central to our long-term success (Xstrata)

Рисунок 8.21

Health and Safety Disclosures

- I must, however, report with deep regret the deaths of 49 people (21 employees and 28 contractors) in our operations last year. This is particularly distressing because we have been making steady progress in reducing the frequency of deaths and injuries over the last few years (Anglo American, 2004, p.2)

Рисунок 8.22

Environmental Disclosures

- Especially pertinent for extractive industry
- By the end of 2004, 84 per cent of operations had implemented ISO 14001 or an equivalent environmental management system and 72 per cent of the total number of operations were already certified (Rio Tinto, 2004, p.20).

Рисунок 8.23

Biodiversity and Animal Species

- Loss of biodiversity due to competing land use is a significant risk for native ecosystems around the world. To obtain and retain a licence to operate, mining and metal production companies must exceed community and legislative expectations for environmental stewardship (Xstrata, 2004, p.48).
- Please read paper linked on blackboard: “Problematising Accounting for Biodiversity”
- Jones and Solomon, AAAJ 2013

Рисунок 8.24

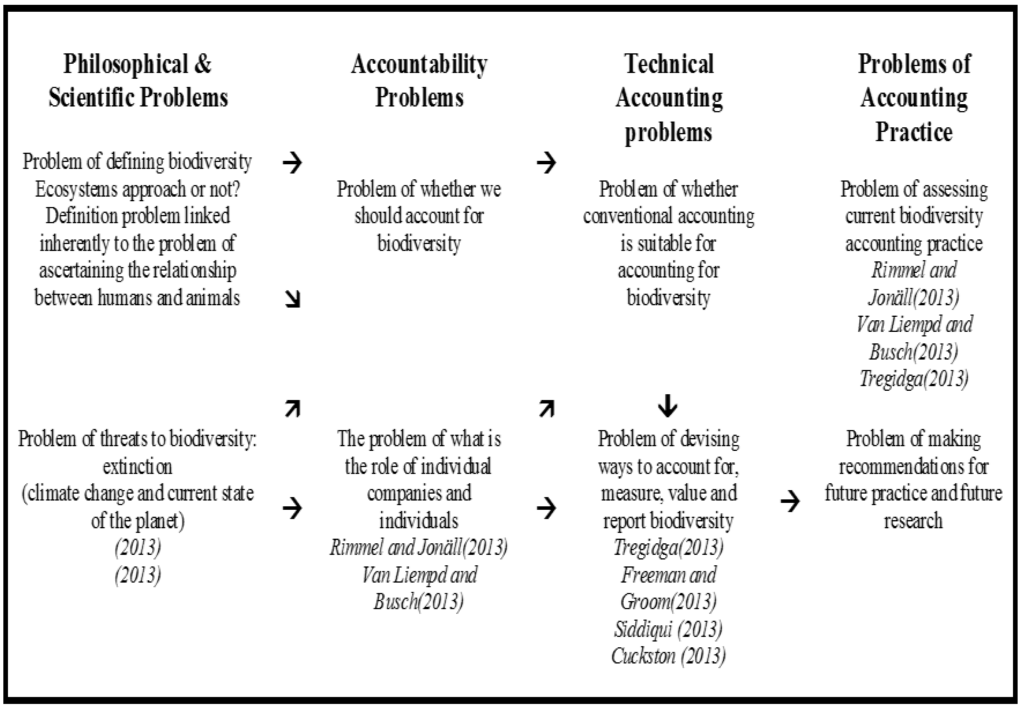

Рисунок 8.25

Photographic Images

- crocodiles
- indigenous tree and their seeds
- lakes
- forests
- mountains
- grasses
- kangaroos
- elephants
- rivers
- rhinos
- puppies
- deer

Рисунок 8.26

Climate Change

- A critical issue for business and finance as well as for the Planet

Рисунок 8.27

Climate Change Blogs

- "The debate about the reality of climate change is over. Climate change is a fact, and it poses the greatest single global threat faced by humankind in our generation"

- L. Craig Johnstone, Deputy High Commissioner, UNHCR 10/03/2009 16:15

Рисунок 8.28

The Growing Threat of Climate Change

- The Intergovernmental Panel on Climate Change (IPCC) was set up in 1988 to assess the situation for climate change.
- The IPCC estimates that by the end of the 21st century, global temperatures will have risen by 1.5 to 5.8 degrees centigrade.
- Recent updates suggest an even more serious and urgent situation

Рисунок 8.29

Main climate change impacts

- Significant warming
- Unpredictable changes in weather patterns
- Storms, cyclones, hurricanes
- catastrophic effects on biodiversity
- Rising sea levels – extensive flooding globally
- Increased acidity of the oceans

Рисунок 8.30

Why are climate change and other social and environmental issues relevant to corporate governance?

- The sole aim of companies to maximise profitability and shareholder wealth has come seriously into question in more recent times
- Pursuing profit at the expense of damage to the environment, local communities, employees and other stakeholders is not a route many people support any longer

Рисунок 8.31

Crunch Question:
Does Corporate Social Responsibility Improve Financial Performance?

- Innovest Strategic Value Advisors rates companies according to a wide spectrum of social, environmental and corporate governance issues
- have provided evidence that companies with superior social and environmental ratings, as well as better corporate governance, also have the best performing shares

Рисунок 8.32

Summary

- Concerns in the academic literature that sustainability reporting is PR-driven, focusing more on impression management and cherry-picking than on genuine stakeholder accountability

Рисунок 8.33

9. Lecture 9 - Assurance of Sustainability Reports, Stakeholder engagement

Aim. This lecture aims to discuss a range of issues relating to the assurance of sustainability reports and integrated reports including motives for assurance, costs and attitudes towards the assurance. Also, students will consider the important role stakeholder engagement as a mechanism of holistic corporate governance and accountability.

Learning outcomes. By the end of the lecture you will have a good understanding of current practice in sustainability reporting assurance and stakeholder engagement.

Рисунок 9.1

Reports on materiality and assurance

- AccountAbility (2003) *Redefining materiality*, AccountAbility, London.
- AccountAbility (2006a) *The Materiality Report*, AccountAbility, London.
- AccountAbility (2006b) *AA1000 Guidance Note on the Principles of Materiality, Completeness and Responsiveness as they Relate to the AA1000 Assurance Standard*, AccountAbility, London.
- AccountAbility (2008a) *AA1000 Assurance Standard*, AccountAbility, London.
- AccountAbility (2008b) *AA 1000 AccountAbility Principles Standard*, AccountAbility, London.
- AccountAbility (2013) *Redefining materiality II. Why it matters, who's involved and what it means for corporate leaders and boards*, AccountAbility, New York.

Рисунок 9.2

Assurance of Sustainability Reports

- As we have discussed, sustainability reporting within the UK is voluntary in nature
- Therefore academic studies have explored why companies produce voluntary sustainabiliy disclosures
- Similarly, the assurance of sustainability reports is voluntary
- BUT assurance has increased with the spread of sustainability reporting

Рисунок 9.3

Illustration of Sustainability Assurance Statement

- We believe that the 2004 Sustainable development review is a fair and balanced representation of Rio Tinto's programmes and performance. Subject to the comments set out below, we believe that it covers the key issues that interested parties need to know to inform decision making (ie is relevant), does not avoid major issues (ie is complete), fairly reflects programmes and performance on the ground (ie is accurate), and that Rio Tinto has taken on views from outside the Group (ie is responsive) (Rio Tinto, 2004, p.36).

Рисунок 9.4

BP Independent Assurance Statement on their Sustainability Report 2013

- BP’s Sustainability Review 2013 (the Report) has been prepared by the management of BP plc., who are responsible for the collection and presentation of information within it. Our responsibility, in accordance with BP management’s instructions, is to carry out a ‘limited level’ assurance engagement on the Report. We do not accept or assume any responsibility for any other purpose or to any other person or organisation. Any reliance any such third party may place on the Report is entirely at its own risk.

Рисунок 9.5

Support from academic literature for SERA

- There has been support for verification of environmental and social disclosure in the academic literature
- Sustainability reporting will not be credible to the user unless the information is externally audited

Рисунок 9.6

- The European Commission emphasized that external assurance of social and environmental reporting was necessary to deter criticism that it was simply a public relations exercise without substance

Рисунок 9.7

- Adams and Evans (2004) also stated that external verification was important to the credibility of social and environmental reporting
- Indeed, the whole objective of social and environmental reporting is undermined unless robust assurance processes are introduced

Рисунок 9.8

- From a legitimacy theory viewpoint, if companies desire to maintain their license to operate, then verification of voluntary social and environmental reporting represents an important element in this legitimization process.

Рисунок 9.9

Who are the assurors?

- environmental consultants within their existing framework;
- a registered auditor of the Environmental Auditors Registration Association;
- scientists within their existing framework;
- internal management team;
- a new professional body that includes accountants, scientists and environmental consultants;
- accountants within their existing framework;

Рисунок 9.10

KPMG 2011

- KPMG (2011) suggest that companies which produce some form of corporate responsibility reporting ‘should’ want to have this information assured in order to verify the quality and reliability of their disclosures.
- They concludes, “…. companies without an external assurance program not only run the risk of restatements in the future, but also send the message that CR information is not held in as high regard as financial information, which is frequently assured in most businesses”

Рисунок 9.11

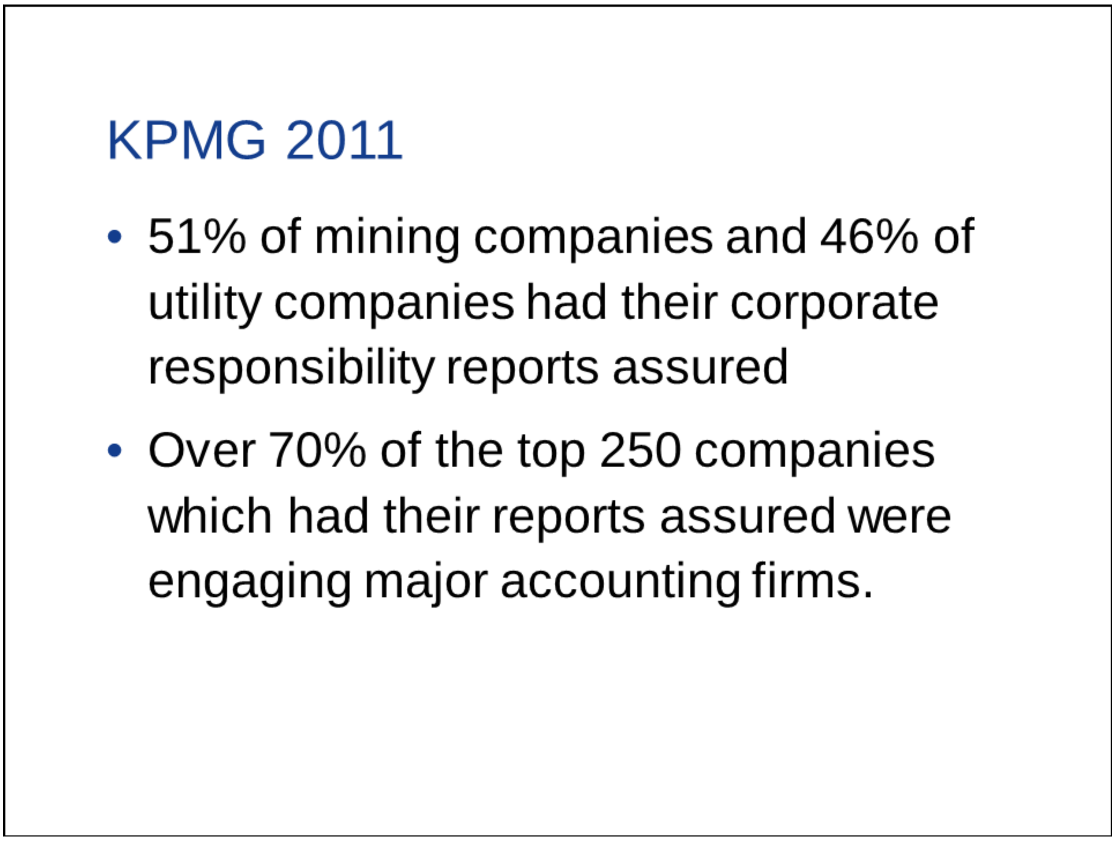

Рисунок 9.12

Рисунок 9.13

KPMG View

- Many companies now face significant pressure to give stakeholders confidence in what they say and assurance can help provide this credibility. the question for leaders is therefore no longer “should we assure our Cr data?” rather “why would we not?” and “how do we choose the appropriate assurance option that meets stakeholders’ needs and puts us ahead of our peers?”.

Рисунок 9.14

Academic critique

- There has been substantial criticism of verification statements in the literature
- Ball *et al*. (2000) used content analysis to evaluate the extent to which verification statements of 72 ‘leading-edge' corporate environmental reports promoted organizational transparency and the empowerment of external stakeholders
- Concluded that although the environmental reports were mainly addressed to external stakeholders, there was confusion over the extent to which companies were really carrying out the exercise for internal constituencies.

Рисунок 9.15

Managerial capture

- Despite the rapid growth of SER and SERA, the value of this assurance process in terms of genuine stakeholder inclusivity and accountability has been questioned

Research has shown that stakeholder input into the assurance process was the exception rather than the rule

Рисунок 9.16

Managerial capture

- Ball *et al*. (2000) identified managerial capture of environmental verification
- Owen *et al*. (2000) define ‘managerial capture' in this context as, “… the concept that sees management take control of the whole process (including the degree of stakeholder inclusion) by strategically collecting and disseminating only the information it deems appropriate to advance the corporate image, rather than being truly transparent and accountable to the society it serves” (p. 85).

Рисунок 9.17

- Jones and Solomon (2010) canvassed the views of corporate social responsibility (CSR) managers in FTSE 100 listed companies on the verification of social and environmental reports

Рисунок 9.18

Jones & Solomon (2010)

- Found a reluctance by companies to wholeheartedly endorse external verification of social and environmental reports for a variety of reasons
  - interviewees' belief that social and environmental reporting was relatively unimportant and complex.
  - the cost in money and managerial resources of verification was considered an obstacle
  - apparent lack of independence of the audit.

Рисунок 9.19

Jones & Solomon (2010)

- The findings supported the view from earlier literature that there was managerial and professional capture of the social and environmental audit process
- Interviewees confirmed that the verification process was dominated more by internal control concerns than by a genuine desire to discharge accountability to stakeholders

Рисунок 9.20

Stakeholder Inclusivity in Sustainability Reports?

- **Edgley, Jones and Solomon (AAAJ, 2010)**
- Found evidence of growing stakeholder inclusivity in the process of assurance of sustainability reports
- Essential if the process is to enhance stakeholder accountability rather than simply add to managerial capture

Рисунок 9.21

Stakeholder Engagement

- An essential mechanism of holistic governance and stakeholder accountability
- Described as,
- "... a range of diverse, qualitative information gathering methods“ (Thomson and Bebbington)
- about non-shareholding stakeholders
- Scepticism concerning the true value of the engagement process to the stakeholders themselves

Рисунок 9.22

Poor mechanism of accountability

- "Within the engagement processes we have been involved in, the scope of engagement was largely controlled by the organisation ... Whilst there was scope for active participation by stakeholders the dialogue was in the direction of stakeholders to the organisation. They appear to be a way for the organisation to learn about those outside, not for the stakeholders to learn about the organisation. These were not mutual learning exchanges and they did not develop meaningful dialogic exchanges"
- (Thomson and Bebbington, 2002, p.29).

Рисунок 9.23

Model of stakeholder engagement

- A model has been developed which rests on the 'ideal speech situation' theorized in the works of Habermas, a German critical theorist.
- Earlier academic accounting literature has explored the applicability of Habermas' ideal speech situation to corporate engagement with stakeholders

Рисунок 9.24

- If stakeholder engagement between companies and their diverse stakeholders, in forums/meetings, was carried out according to a Habermasian ideal speech situation, then there would be no chance that the company would exert power or influence over their stakeholders
- All stakeholders' views would be listened to and considered seriously

Рисунок 9.25

Analysing the Cadbury Takeover

- As soon as Kraft took over Cadbury’s they closed an old Cadbury factory, the Somerdale Plant, with negative impacts on obviously employees but also the local community
- Interviews with members of the local community as well as ex-employees of the plant revealed very little engagement with employees during the closure of the plant
- Where information was passed to stakeholders the people interviewed felt that the information was misleading leaving them feeling betrayed and angry, hardly representative of an ideal speech situation.

Рисунок 9.26

Summary

- A holistic approach to corporate governance is critical to ensuring long-term wealth creation and growth
- Sustainability and CSR are important for corporate performance
- There is a business case motive for a holistic approach
- Mechanisms of holistic corporate governance include sustainability reporting, assurance and stakeholder engagement

Рисунок 9.27

10. Lecture 10 - Responsible Investment

The Aim is to consider the important role that institutional investors are playing in broadening the corporate governance agenda and in driving corporate social responsibility, by increasingly taking account of environmental, social and governance (ESG) factors in their investment decisions.

Learning outcomes. After this lecture, you should be able to:

- highlight the important role that institutional investors are playing in progressing corporate social responsibility and encouraging greater accountability to a broad range of stakeholders;

- consider the growth of socially responsible investment in the UK, highlighting the ways in which socially responsible investment has moved from a marginal to a mainstream area of institutional investment;

- discuss the potential implications of the socially responsible investment movement for companies, their stakeholders and ultimately for society.

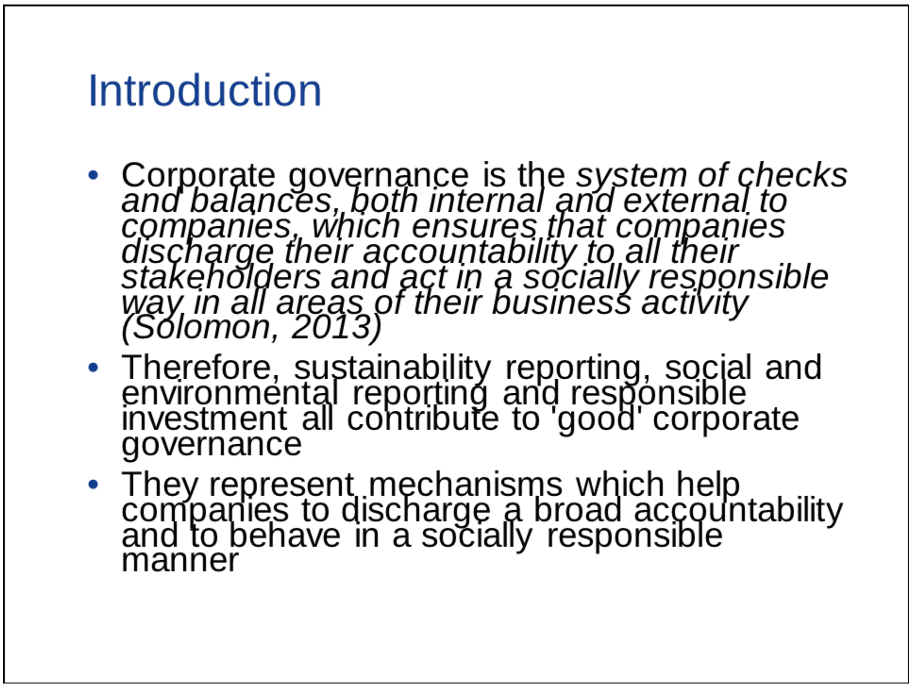

Рисунок 10.1

- Companies are producing sustainability reports, social and environmental reports, corporate social responsibility reports etc.
- BUT to what extent is this being driven by the institutional investment community?
- If investment institutions are not interested in this information, it is unlikely that companies will be genuinely interested in producing it

Рисунок 10.2

The power of institutional investors

- The proportion of UK listed company share ownership held by UK investors is around a third
- non-UK investors hold over 40%
- Institutional investors hold significant power over their investee companies through voting rights and direct engagement (private reporting channels)

Рисунок 10.3

The potential impact of investors on companies

- Decisions made by these investors have a considerable impact on the environmental and on society as a whole
- Responsible investment is a means of wielding influence over businesses to act responsibly

Рисунок 10.4

The growth of SRI

- Socially responsible investment (SRI) has moved very quickly from the periphery to the mainstream of institutional investment

Рисунок 10.5

Why has RI evolved?

- Increasing realisation among the institutional investment community that environmental, social and governance issues are actually MATERIAL
- They represent financial risks and opportunities for investors and therefore need to be accommodated into the investment decision-making

Рисунок 10.6

Government backing of SRI

- In 2004 the UK Government endorsed the important role institutional investors have to play in integrating corporate social responsibility into business by their recognition of the impacts of social and environmental factors on long-term business performance

Рисунок 10.7

Risk motive for SRI

- CalPERS (California Public Employees' Retirement System) stated that:
- . . . equity in corporations with poor social and ethical records *could represent an excessive fiduciary risk* because such firms court boycotts, lawsuits, or labor activity.

Рисунок 10.8

Win-win scenario

- Friends Provident chose SRI:
- Good corporate practice on human rights, child labour and environmental pollution is good for society, but it's also good for shareholders. As a large investor, it is right that we use our influence with companies to encourage responsible business practices while serving the financial interests of our customers.

Рисунок 10.9

Mercer Investment Consulting (2006)
Issues Associated with ESG Investment

Climate change	Environmental management	Sustainability
Corporate conventions	Globalization	Terrorism
Corporate governance	Health issues in emerging markets	Water
Employee relations	Human rights	

Рисунок 10.10

Statistics on Growth of Responsible Investment and ESG

- In the UK £4 billion was invested in ‘ethical’ funds in August 2001
- RI now an overarching investment criterion for ALL investment institutions
- 77% of the British public would like their pension funds to be invested in a socially responsible way, provided this did not harm financial returns
- 80% of pension scheme members require their schemes to operate an socially responsible investment policy

Рисунок 10.11

Practitioner research

- Mercer Investment Consulting surveyed 195 fund managers around the world
- 70% of fund managers believed that the integration of environmental, social and ethical factors into investment analysis would become mainstream in investment management within the next three to ten years
- 60% of fund managers consider that screening for social, ethical and environmental factors would be mainstream within the next three to ten years

Рисунок 10.12

- Mercer Investment (2006) canvassed 157 international institutional investors
- Confirmed that socially responsible investment was continuing to expand at a global level
- 38% of fund managers surveyed anticipated increased client demand for the integration of ESG analysis in mainstream institutional investment over the next three years.

Рисунок 10.13

Latest figures on RI

- The latest figures show substantial amounts of investment funds being managed on an ESG basis
- The latest data shows that nearly £940 billion in assets is managed responsibly in the UK
- This is approx. 14% of the total of over £6.5 trillion in responsibly managed assets tracked by sustainable investment and finance associations around the world
- (UKSIF, 2011a, p.10)

Рисунок 10.14

Latest figures…

- The latest evidence suggested that over half (54%) of all British adults with investments want to 'make money and make a difference' with their savings and investments (UKSIF, 2011a, p.11).

Рисунок 10.15

Essential question:

- Is it possible to be ethical and still to make a profit?
- Few people are prepared to accept a lower return to investment from investing in a socially responsible manner

Рисунок 10.16

Evidence

- Solomon and Solomon (2002) found strong evidence of a growing perception among the institutional investment community that SRI enhances financial returns in the long term
- Drexhage (1998) considered that investors and fund managers believe it is possible to make a difference while making a profit.

Рисунок 10.17

Cobb, Collison, Power and Stevenson (2005)

- Examined the financial performance of the FTSE4Good, and concluded that
- Investors are unlikely to be worse off by restricting their investment universe, and may well be better off
- Their interviews and questionnaires suggested that inclusion in the FTSE4Good indices was contributing significantly to stakeholder relations, as well as to internal processes such as reporting and management systems on social and environmental issues

Рисунок 10.18

Linking responsible investment to sustainability reporting

- The growth of responsible investment creates an increasing demand for sustainability reporting
- Institutional investors need better information on environmental, social and governance (ESG) issues than they had before to inform their investment decisions, as they all take account of this information in their investment portfolios

Рисунок 10.19

A growing demand for social, ethical and environmental disclosure

- ABI guidelines on SEE disclosure (2001)
- They would like company boards to state in their annual reports whether or not they:
- take regular account of the significance of SEE matters to the business of the company;
- have identified and assessed the significant risks to the company's short and long-term value arising from SEE matters, as well as the opportunities to enhance value that may arise from an appropriate response;
- have received adequate information to make this assessment and that account is taken of SEE matters in the training of directors;
- have ensured that the company has in place effective systems for managing significant risks, which where relevant incorporate performance management systems and appropriate remuneration incentives.

Рисунок 10.20

ABI Guidelines 2007

- Modification of 2001 Guidelines
- In 2007 the ABI published a set of guidelines on responsible investment disclosure (ABI, 2007)
- These guidelines represent a modification of those launched in 2001. One of the main reasons for their updating was the progress in narrative reporting since 2001, including the EU Accounts Modernisation Directive (resulting as we saw earlier in the Business Review) and the new UK Companies Act. Although the new guidelines are similar they emphasise certain aspects of narrative reporting which institutional risks in order to decide what information should be included in the annual report.

Рисунок 10.21

Investors are especially interested in reporting which:

- addresses ESG risks, within the company's entire framework of risk management and disclosures
- adopts a forward-looking approach to ESG risks
- addresses board action in managing ESG risks

It is also notable that the ABI have changed their terminology from SEE (in 2001) to ESG (in 2007)

The Guidelines also contain an appendix which lists a series of questions for companies to interrogate themselves in relation to ESG

Рисунок 10.22

- Friedman and Miles (2001) found the City of London was taking SEE issues far more seriously
- My interviews with institutional investors found they are dissatisfied with the level of social and environmental reporting
- Public disclosure is inadequate and therefore private disclosure channels are developing

Рисунок 10.23

The practice of RI

- The practice of responsible investment has changed over time as it has evolved as a form of institutional investment strategy

Рисунок 10.24

Screening to best in sector

- Early ethical investment – screening
- Excluding certain sectors
- Early SRI (2000+) – best in sector
- Invest in the best CSR performers within an industry

Рисунок 10.25

From SRI TO RI

- FROM ESG/SRI
- **TO RI**
- **Responsible Investment**

Рисунок 10.26

Principles of Responsible Investment (PRI)

- The Principles of Responsible Investment have played a significant role in the development and globalisation of responsible investment

Рисунок 10.27

PRI and globalisation

- By 2012, UNPRI had just over one thousand signatories representing a total of $30 trillion dollars of investment which equates to 25% of global assets

Рисунок 10.28

PRI investor action

- On average, institutional investors signing up to the UNPRI are commonly involved in four campaigns at any point in time, as UNPRI represents a forum for collective action and collaboration between institutional investors
- The types of issues which UNPRI signatories may collaborate on in order to change corporate behaviour include: executive pay and bonuses; board diversity; energy efficiency; carbon emissions; water usage, corruption and bribery

Рисунок 10.29

How does responsible investment work?

- **Voting by institutional investors**
  - recent shareholder spring – directors' bonuses
  - Vote on CSR-related issues

Engagement and dialogue

- one on one meetings between institutional investors and company directors on CSR issues

Рисунок 10.30

UNPRI Engagement platform

- UNPRI operate an engagement platform through the internet
- Platform acts as a forum for institutional investors to collaborate on responsible investment issues in order to influence corporate behaviour

Рисунок 10.31

UK lobby group

UKSIF

Promoting sustainable and responsible finance

Рисунок 10.32

UKSIF aims

- UKSIF aims to ensure that the UK finance sector is the world leader in advancing sustainable development through financial services.
- They provide services and opportunities for our members to work together to align investment profitability with social and environmental responsibility.

Рисунок 10.33

Private social and environmental reporting (SER)

- One of the aspects characterising the growth of responsible investment is the growth of ESG engagement
- Institutional investors have increasingly engaged with investee companies since around the turn of the century
- Engagement often takes the form of one-on-one meetings between investor and company: private SER

Рисунок 10.34

Terminology

- Private social and environmental reporting
- In an accounting context this refers to the process of engagement and dialogue between institutional investors and investee companies, specifically relating to social, ethical and environmental issues

Рисунок 10.35

Developments in UK context

- Cadbury Code (1992) set an agenda for engagement and dialogue between institutional investors and their investee companies: voting/meetings
- The Stewardship Code (2010) seeks to establish and encourage greater engagement and dialogue
- Code advises investors to escalate engagement when social and environmental problems detected

Рисунок 10.36

Literature on meetings in accounting & finance: private reporting

- 2 strands research into private reporting
- Private financial reporting: John Holland, John Roberts et al.
- Private social and environmental reporting: our work
- The separate treatment by the academic community reflects the separation of these areas within institutional investment
- Is there a convergence to research?

Рисунок 10.37

Private Social and Environmental Reporting

- Friedman and Miles (2001) found the City of London was taking social, ethical and environmental issues far more seriously
- Interviews institutional investors found they are dissatisfied with the level of social and environmental reporting (Solomon et al)
- Public disclosure is inadequate and therefore private disclosure channels are developing

Рисунок 10.38

Private social and environmental reporting

- Sparkes (2002) highlighted the growth in SEE engagement as a main indicator that SRI is moving away from the margin and into mainstream investment
- Solomon and Solomon (2006) found from interviews that engagement in this area has become formalized
- It is evolving into a two-way process, with companies asking institutional fund managers questions as well as questions being directed toward companies by shareholders

Рисунок 10.39

Private financial reporting

- Face to face meetings conducted between institutional investors and their investee companies on financial issues
- Also referred to as the process of engagement and dialogue in corporate governance

Рисунок 10.40

Private social & environmental reporting

- Content of one-on-one meetings on social and environmental/sustainability issues
- The process of engagement and dialogue on social and environmental issues which takes places between institutional investors and their investee companies
- An important mechanism of governance and accountability in socially responsible investment
- CAN be integrated into private financial reporting OR can be separate

Рисунок 10.41

Contribution of paper

Contributes to the academic accounting literature by extending the analysis of:

(i) impression management to the private reporting context

(ii) private reporting to the social and environmental context

(iii) private reporting through insights from Goffman's work.

Рисунок 10.42

General research questions

- To what extent is private SER characterised by impression management?
- Does private SER involve concealment?
- What are the consequences of impression management and concealment on institutional investor behaviour?

Рисунок 10.43

Theoretical framework: Goffman

- The Presentation of Self in Everyday Life
- Thesis of impression management, ‘front’ and concealment
- Dramaturgical metaphor
- Impressions given in human interaction may be inconsistent with ‘reality’
- Involves verbal disclosure but also ‘body idiom’
- ‘audience’ monitors ‘performance’

Рисунок 10.44

Findings

- The paper concluded from the interviews that there was substantial impression management being carried out by the company representatives in the private meetings with their investors

Рисунок 10.45

Summary

- Responsible investment has grown dramatically since the turn of the century in the UK but also globally, as evidenced by the PRI Principles
- Responsible investment is a crucial mechanism of holistic governance
- Responsible investment drives sustainability reporting and assurance

Рисунок 10.46

To conclude

- The course has covered:
- Corporate governance developments in theory and practice in the UK, Russia and globally
- International comparisons
- Mechanisms of corporate governance: boards, investors, transparency and accounting, sustainability reporting & assurance, responsible investment

Рисунок 10.47

CONCLUSION

Essentially, the aim of corporate governance processes is to maintain the rights of shareholders along with all other stakeholders. This includes a commitment to the application of standards for disclosure and transparency. Recent financial crises and failures have motivated countries around the world to publish codes for corporate governance. These include codes of conduct for ethical behaviour, which act as constant guides for day-to-day decision making. Adherence to sound ethical values has a number of benefits, including enhancing the behaviour of managers, positively motivating employees, protecting an organisation's reputation, encouraging greater respect for laws and regulations, and improving business relationships. This of course is also reflected in an organisation's overall culture, i.e. its shared values, attitudes, beliefs, standards and rules.

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