



UNIT 8: PRINCIPLES OF CORPORATE GOVERNANCE

CORPORATE GOVERNANCE



- Corporate governance refers to the system of rules, practices, and processes by which a company is directed and controlled.
- It encompasses the relationships between a company's management, board of directors, shareholders, and other stakeholders.
- The objective of corporate governance is to promote transparency, accountability, fairness, and ethical behavior within the organization, ultimately enhancing the long-term value and sustainability of the company.

KEY ASPECTS OF CORPORATE GOVERNANCE

- **Board of Directors:** The board of directors plays a crucial role in corporate governance. It provides oversight and guidance to the management team, sets strategic objectives, and makes key decisions on behalf of the company. The board ensures that the interests of shareholders and stakeholders are represented and that management operates in the best interests of the company.
- **Shareholder Rights:** Corporate governance recognizes and protects the rights of shareholders, who are the owners of the company. Shareholders have the right to participate in decision-making, receive relevant and timely information, and exercise their voting rights. Effective corporate governance ensures that shareholder rights are respected and that they have a mechanism to hold management accountable.

KEY ASPECTS OF CORPORATE GOVERNANCE



- **Transparency and Disclosure:** Corporate governance promotes transparency and disclosure of information to shareholders and stakeholders. Companies are expected to provide accurate and timely information about their financial performance, risks, and operations.
- Transparent disclosure helps stakeholders make informed decisions and assess the company's performance, governance practices, and risk exposure.

KEY ASPECTS OF CORPORATE GOVERNANCE



- **Ethical Conduct and Accountability:** Corporate governance promotes ethical behavior and accountability within the company. It establishes a framework for preventing conflicts of interest, fraud, and misconduct.
- Companies are encouraged to adopt codes of conduct and policies that guide ethical behavior and promote integrity throughout the organization. Accountability mechanisms, such as internal controls and external audits, help ensure compliance and safeguard the interests of stakeholders.

KEY ASPECTS OF CORPORATE GOVERNANCE

- **Risk Management:** Effective corporate governance includes robust risk management processes. Companies are expected to identify and assess risks, implement risk mitigation strategies, and regularly review and monitor risk exposures. The board of directors plays a critical role in overseeing the risk management framework and ensuring that appropriate controls are in place to manage and mitigate risks.
- **Stakeholder Engagement:** Corporate governance recognizes the importance of engaging with stakeholders beyond shareholders, including employees, customers, suppliers, and the broader community. Companies are encouraged to consider the interests of these stakeholders and engage in meaningful dialogue to understand their concerns and expectations. Stakeholder engagement helps build trust, foster long-term relationships, and promote sustainable business practices.

THE UK CORPORATE GOVERNANCE DEBATE



The UK corporate governance debate revolves around ongoing discussions, reforms, and considerations related to the effectiveness and adequacy of corporate governance practices in UK companies. Key areas of focus in this debate include:

- **Board Diversity:** There is an emphasis on increasing diversity within boards of directors, particularly in terms of gender, ethnicity, and skills. The debate centers around the need for more inclusive representation, considering the positive impact diverse perspectives can have on decision-making, risk management, and long-term performance.

THE UK CORPORATE GOVERNANCE DEBATE

- **Executive Pay:** The issue of executive pay is a significant aspect of the corporate governance debate. There is concern about the level of executive remuneration and the link between pay and company performance. Calls for greater transparency, shareholder input, and aligning executive pay with long-term sustainable performance are key considerations.
- **Shareholder Rights and Engagement:** The debate focuses on the rights and engagement of shareholders in corporate decision-making. This includes discussions on enhancing shareholder voting powers, ensuring effective shareholder scrutiny of board actions, and encouraging shareholder activism to hold companies accountable.

THE UK CORPORATE GOVERNANCE DEBATE



- **Corporate Culture and Ethics:** The importance of corporate culture and ethics in driving responsible and sustainable business practices is a central part of the debate.
- Discussions center around promoting a culture of integrity, transparency, and ethical behavior within companies, as well as improving mechanisms to identify and address misconduct.

THE UK CORPORATE GOVERNANCE DEBATE

- **Stakeholder Engagement:** There is an increasing recognition of the importance of stakeholder engagement beyond shareholders, including employees, customers, suppliers, and the wider community. The debate focuses on how to effectively integrate stakeholder interests into corporate decision-making processes and ensure their voices are heard.
- **Long-Termism and Sustainability:** The debate highlights the need for companies to take a long-term view and prioritize sustainable business practices. Discussions revolve around aligning corporate strategy with environmental, social, and governance (ESG) considerations, as well as promoting responsible investment and long-term value creation.

THE UK CORPORATE GOVERNANCE DEBATE



- **Reporting and Disclosure:** There is a focus on improving the quality and transparency of corporate reporting and disclosure.
- Discussions include calls for more comprehensive and meaningful reporting of non-financial information, such as ESG factors, to provide stakeholders with a more holistic view of company performance.

THE UK CORPORATE GOVERNANCE DEBATE

- **Board Effectiveness:** The effectiveness of boards of directors is a recurring topic in the debate. Discussions center around board composition, independence, accountability, and the role of non-executive directors in providing effective oversight and challenging management decisions.
- The UK corporate governance debate involves various stakeholders, including regulators, shareholders, institutional investors, companies, industry bodies, and civil society organizations. It reflects ongoing efforts to enhance corporate governance practices, align them with evolving societal expectations, and foster responsible and sustainable business conduct. Reforms and developments in corporate governance codes, legislation, and market practices often stem from this debate.

THE CADBURY COMMITTEE

- The Cadbury Committee, formally known as the Committee on the Financial Aspects of Corporate Governance, was established by the Financial Reporting Council, LSE (London Stock Exchange) and the combined accounting bodies. It was named after its chairman, Sir Adrian Cadbury, and its primary objective was to address concerns about corporate governance practices in UK companies.
- The committee was formed in response to several high-profile corporate failures and scandals that highlighted deficiencies in corporate governance, including the collapse of Polly Peck International and the Maxwell Group. The Cadbury Committee was tasked with developing recommendations to strengthen corporate governance standards and restore public confidence in UK companies.
- Key recommendations made by the Cadbury Committee in its 1992 report include:

RECOMMENDATIONS OF THE CADBURY COMMITTEE

- **The Establishment of a Code of Best Practice:** The committee recommended the creation of a voluntary code of best practice for corporate governance. This code, known as the Cadbury Code, laid down principles and guidelines to guide companies in their corporate governance practices.
- **Role and Composition of Boards of Directors:** The committee emphasized the importance of a strong and independent board of directors. It recommended that boards should have a balance of executive and non-executive directors, with a sufficient number of independent non-executive directors to provide objective oversight and challenge management decisions.
- **Audit Committees:** The Cadbury Committee recommended the establishment of audit committees composed of non-executive directors. These committees would be responsible for overseeing financial reporting, internal controls, and external audit processes.

RECOMMENDATIONS OF THE CADBURY COMMITTEE



- **Audit Committees:** The Cadbury Committee recommended the establishment of audit committees composed of non-executive directors.
- These committees would be responsible for overseeing financial reporting, internal controls, and external audit processes.

RECOMMENDATIONS OF THE CADBURY COMMITTEE

- **Internal Controls and Risk Management:** The committee stressed the importance of robust internal control systems and risk management processes within companies. It recommended that boards should regularly review the effectiveness of internal controls and risk management systems.
- **Shareholder Rights:** The Cadbury Committee highlighted the need to protect and enhance the rights of shareholders. It recommended that shareholders should have access to timely and accurate information, and that mechanisms should be in place to facilitate their active participation and voting at general meetings.

The Cadbury Code and its recommendations had a significant impact on corporate governance practices in the UK. The code was initially voluntary, but later evolved into the UK Corporate Governance Code, which is now overseen by the Financial Reporting Council (FRC). The FRC periodically updates and revises the code to reflect changing expectations and developments in corporate governance.

THE CADBURY COMMITTEE

- The Cadbury Committee's work helped establish a foundation for corporate governance practices in the UK, promoting transparency, accountability, and responsible business conduct. It also inspired similar initiatives and developments in corporate governance frameworks globally.
- The LSE implemented the Cadbury recommendations on a **comply-or-explain** basis (i.e. if you do not comply you need to explain why), and subsequently the Cadbury model has been adopted by stock exchanges around the world.
- However, one of its main criticisms is its failure to define what **independence** in the context of non-executive directors was. This caused problems as companies regularly appointed ex-executive directors and friends of board members as non-executive directors.

THE GREENBURY COMMITTEE

- The Greenbury Committee, officially known as the Committee on Executive Compensation, was established in the United Kingdom in 1995. The committee was chaired by Sir Richard Greenbury and was formed to address concerns about excessive executive pay and to provide recommendations for improving transparency and accountability in executive remuneration practices.
- The committee was established in the wake of public and shareholder discontent regarding the levels of executive pay and the perceived lack of alignment between executive compensation and company performance. The Greenbury Committee aimed to restore public trust and confidence in corporate governance practices, specifically focusing on executive pay.
- Key recommendations made by the Greenbury Committee in its 1995 report include:

RECOMMENDATIONS OF THE GREENBURY COMMITTEE

- **Disclosure of Executive Pay:** The committee recommended that companies should disclose the remuneration details of individual directors, including salary, bonuses, share options, pensions, and other benefits. The aim was to enhance transparency and allow shareholders to assess the appropriateness of executive pay.
- **Independent Remuneration Committees:** The Greenbury Committee recommended that companies should establish remuneration committees comprised solely of independent non-executive directors. These committees would be responsible for determining executive pay, ensuring it is fair, performance-based, and aligned with company objectives.

RECOMMENDATIONS OF THE GREENBURY COMMITTEE



- **Performance-related Pay:** The committee emphasized the importance of performance-related pay, recommending that a significant proportion of executive remuneration should be linked to company performance.
- This was intended to align executive incentives with shareholder interests and promote a stronger link between pay and performance.

RECOMMENDATIONS OF THE GREENBURY COMMITTEE

- **Shareholder Approval:** The Greenbury Committee recommended that shareholders should have a formal vote on executive pay. This would allow shareholders to express their views on remuneration policies and specific pay packages.
- **Simplified and Understandable Pay Structures:** The committee stressed the importance of clear and simple executive pay structures that are easily understandable by shareholders. The aim was to reduce complexity and provide clarity on how executive pay is determined.
- The recommendations of the Greenbury Committee significantly influenced executive remuneration practices in the UK. Many of its recommendations were incorporated into the UK Corporate Governance Code, which sets out best practice principles for corporate governance in the UK. The code includes guidelines on executive pay and disclosure requirements, reflecting the principles advocated by the Greenbury Committee.

THE HIGGS REVIEW

- The Higgs Review, led by Sir Derek Higgs aimed to examine the role and effectiveness of non-executive directors (NEDs) in corporate governance.
- **The key recommendation** of the Higgs Review was to provide a good definition of independence for NEDs. A NED will now only be considered independent when the board determines that:
 - - The Director is independent in character and judgment;

THE HIGGS REVIEW



- There are no relationships/circumstances which can affect the Director's judgment such as
 - - [The Director is/has been an employee of the company;
 - - has/had a business relationship with the company;
 - - is being paid by the company other than director's fee; has family ties to the company;
 - - holds cross-directorship links with other directors of other companies;
 - - represents a significant shareholder of the company; has served on board for 10 years]

KEY ASPECTS & RECOMMENDATIONS OF THE HIGGS REVIEW

- **Definition and Role of NEDs:** The Higgs Review provided a clear definition of NEDs as individuals who are not involved in the day-to-day management of the company but contribute their expertise, objectivity, and independent judgment to the board. It emphasized that NEDs should act in the best interests of the company and its shareholders.
- **Independence and Accountability:** The review recommended that a sufficient number of NEDs should be independent from management and free from any conflicts of interest. It stressed the importance of NEDs being able to exercise independent judgment, challenge management decisions, and hold executives accountable.
- **Appointment and Recruitment:** The Higgs Review recommended that the appointment process for NEDs should be based on merit, ensuring that individuals have the skills, experience, and diversity required to contribute effectively to the board. It suggested that companies should establish nomination committees to oversee the selection and appointment of NEDs.

KEY ASPECTS & RECOMMENDATIONS OF THE HIGGS REVIEW

- **Time Commitment and Training:** The review highlighted the importance of NEDs dedicating sufficient time and effort to their roles. It recommended that companies should provide appropriate training and support to NEDs to enhance their understanding of the company's business, industry, and governance responsibilities.
- **Board Evaluation:** The Higgs Review emphasized the need for regular board evaluations to assess the effectiveness of NEDs and the overall board. It suggested that evaluations should be conducted externally at least once every three years.
- **Disclosure and Transparency:** The review recommended that companies should provide clear and comprehensive disclosure regarding the roles, responsibilities, and remuneration of NEDs. This would enable shareholders and stakeholders to understand the contribution and independence of NEDs.

THE MAURITIAN NATIONAL CODE OF CORPORATE GOVERNANCE

- The Mauritian National Code of Corporate Governance refers to the corporate governance guidelines and principles established by the Financial Reporting Council (FRC) in Mauritius. The FRC is the regulatory body responsible for setting and promoting corporate governance standards in Mauritius.
- Mauritius has recognised the significance of good corporate governance and it has chosen the principles- based approach as the UK unlike the United States rules-based approach.

THE MAURITIAN NATIONAL CODE OF CORPORATE GOVERNANCE



- The rules-based approach is defined as the approach which incorporates the good corporate governance principles into the law so that any company which does not abide by these principles will be sanctioned. There will be a breach of the law. The United States has adopted the rules-based approach. Refer to the Sarbanes Oxley Act 2002.
- The principles-based approach to corporate governance followed in Mauritius provides a flexible framework that promotes best practices while allowing companies to adapt to their specific circumstances.

THE PRINCIPLES-BASED APPROACH

- The principles-based approach to corporate governance in Mauritius provides flexibility and adaptability, allowing companies to adopt governance practices that suit their specific circumstances while adhering to fundamental principles. It encourages continuous improvement and self-regulation within the business community, promoting a culture of good governance that benefits both companies and the broader society.
- It's worth noting that while the principles-based approach provides guidance, it is also important for regulators, industry bodies, and companies themselves to actively monitor and enforce compliance with governance standards, ensuring that the principles are effectively implemented and upheld.

THE APPLY AND EXPLAIN CONCEPT

- Mauritius has embraced the “apply and explain” concept to corporate governance.
- The "apply and explain" concept in corporate governance refers to a regulatory approach that requires companies to apply governance principles and practices and provide explanations for their specific implementation. It encourages companies to not only comply with governance requirements but also to provide transparency and accountability by explaining how they have applied those principles in their particular context.
- The apply and explain concept aims to strike a balance between providing flexibility for companies to adopt governance practices that suit their specific needs and ensuring transparency and accountability to stakeholders. It recognizes that there is no one-size-fits-all approach to corporate governance and allows companies to exercise judgment and make informed decisions in applying governance principles to their unique circumstances.

PUBLIC INTEREST ENTITIES

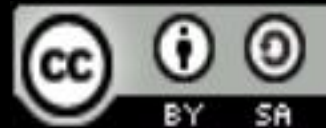
- It is important to highlight that not all companies in Mauritius are required to apply the Code. Had this been the case, many small private companies would have incurred high compliance costs which would have in turn led to their closure. All public interest entities are required to abide by the requirements of the Code. These entities include the following:
 - - All listed companies;
 - - All banks and non-banking financial institutions
 - - Any company having, during the 2 consecutive preceding years, at least one of the following:
(An annual turnover exceeding MUR 500 million; Total assets exceeding MUR 500 million.)
 - - Any group company having, during the 2 consecutive preceding years, at least one of the following: (An annual turnover exceeding 1 billion rupees; Total assets exceeding 1 billion rupees.)

THE EIGHT CORPORATE GOVERNANCE PRINCIPLES

- Mauritius has established the following eight corporate governance principles that serve as a framework for good governance practices in the country:
 - Principle 1: Governance Structure
 - Principle 2: The Structure of the Board and its Committees
 - Principle 3: Director Appointment Procedures
 - Principle 4: Director Duties, Remuneration and Performance
 - Principle 5: Risk Governance and Internal Control
 - Principle 6: Reporting with Integrity
 - Principle 7: Audit
 - Principle 8: Relations with Shareholders and Other Key Stakeholders



This presentation is made available to you with a



licence.