Corporate Governance *(Gathered Articles)*: A North America, Europe, Africa, Oceania & Asia 21st Century Perspective 1st Edition

RUDOLPH.PATRICK.T.MUTESWA

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PREFACE TO THE FIRST EDITION

The basis of creating a strong ethical and well governed organization relies on the adoption of corporate governance guidelines and standards by an organization since the level of effectiveness of decisions made by business leaders in an organization on a daily basis are consistently guided by these guidelines or standards. In general the establishment of an effective corporate governance framework is one of the definite pathways that can be used by an organization of any type or size to create value for its internal and external stakeholders. The purpose of this book is to educate readers on the importance of implementing transparent, fair, accountable and credible business practices in the boardroom and the entire organization as this is now inevitable in this highly dynamic 21st century business environment in both profit-making and nonprofit making organizations. Another purpose of this book was to educate readers about the positive impact played by the implementation of good corporate governance practices by organizations today and the various ways organizations can now use to reduce operational risk while simultaneously creating value for their various stakeholders. Lastly, another aim of this book was to contribute to the board of director profession, field of management & business leadership focusing on the development and upholding of corporate governance principles by board of directors or executive directors by publishing a free *eBook* and *a print hard copy* to empower all chairpersons, company secretaries, board of directors, CEOs, COOs, CFOs, managers, head of departments (*namely: human resources, marketing, operations & supply chain, finance, information technology, research & development, legal affairs and so on*), business executives and so on. This book specifically targeted people in the continent of Africa, North America, Europe, Oceania and Asia in order to provide them with basic knowledge about corporate governance in the boardroom or other departments of the organization since a book is '*a source of wisdom*' that can positively influence others to become better people in society. Furthermore, l wrote this book to help promote a culture of book writing amongst young adults or middle aged people of this 21st century in order to enhance knowledge sharing or academic wisdom through book publishing in both developed and developing countries to help promote good corporate governance practices in organizations. I noticed that in this life we live today humanity can only progress through consistent learning or knowledge sharing and the desire for consistent learning can only be strengthened through book writing and rigorously promoting a culture of book writing amongst all people located across the world in various career-fields.

Acknowledgement:

I would like to thank my 6 (*four brothers & two sisters*) siblings for tirelessly supporting me towards my education and personal life goals. I would also like to take this opportunity to greatly thank my late parents, aunties and uncles for the great role they played in my childhood. Furthermore, I shall forever be grateful to the great men and women in the continent of Africa, North America, Europe, Oceania and Asia who contributed in the writing of this book in particular all the named leading 'iconic' entrepreneurs, business leaders, organizations & the various information sources cited in this book.

Chapter 1: Introduction to corporate governance

After studying this chapter you should be able to:

- Define the meaning of the terms: governance and corporate governance.
- Highlight the parties that are responsible for corporate governance in an organization.
- Describe the challenges and successes of corporate governance in developing, emerging and transitional economies.
- Outline the advantages of corporate governance to an organization.
- Describe the three types of corporate governance. Discuss the 12 principles of effective corporate governance.

1.1 Introduction

The foundation to successfully having a transparent and efficient organization is good corporate governance. In an organization a team effort is needed to successfully adopt and implement the corporate governance guidelines and standards. The key components of corporate governance that organizations must implement in order to attain effective corporate governance rules and practices include: fairness, accountability, responsibility and transparency. "Corporate Governance - it is, in essence, a toolkit that enables management and the board to deal more effectively with the challenges of running a company. Corporate governance ensures that businesses have appropriate decision-making processes and controls in place so that the interests of all stakeholders (shareholders, employees, suppliers, customers and the community) are balanced"[1] (ICSA The Governance Institute, 2019, www.icsa.org.uk/). Traditionally good governance is critical in the business world since it is a key determinant that helps to layout the infrastructure that is needed to enhance the quality of choices that are made by business leaders in organizations on a day-to-day basis (ICSA The Governance Institute, 2019, www.icsa.org.uk/). "Good quality, ethical decision-making builds sustainable businesses and enables them to create long-term value more effectively" (ICSA The Governance Institute, 2019,

[1] ICSA The Governance Institute (2019) *What is Corporate Governance*? Available from: https://www.icsa.org.uk/about-us/policy/what-is-corporate-governance

www.icsa.org.uk/). The meaning of the term corporate governance will be discussed in the following section.

1.2 Definition of terms

It is critical to first understand the meaning of a term that will be used in a book chapter and how it will be applied in the literature. There are several definitions of the term ‘corporate governance’ that have been published in books, journals, business magazines, Internet websites and so on. *“Governance* at a corporate level includes the processes through which a company’s objectives are set and pursued in the context of the social, regulatory and market environment. It is concerned with practices and procedures for trying to make sure that a company is run in such a way that it achieves its objectives, while ensuring that stakeholders can have confidence that their trust in that company is well founded”[2] (ICSA The Governance Institute, 2019, www.icsa.org.uk/). Furthermore, according to ICSA The Governance Institute (2019) *corporate governance* is the system of rules, practices and processes by which a company is directed and controlled. *Corporate Governance* refers to the way in which companies are governed and to what purpose. It identifies who has power and accountability, and who makes decisions (ICSA The Governance Institute, 2019, www.icsa.org.uk/). “Worldwide, the definition of *corporate governance* may include regional nuances, but corporate governance in Canada involves regulatory and market mechanisms, and reconciling the roles and relationships between numerous corporate stakeholders within an organization and the governance goals within a corporation” (Governance Professionals of Canada, 2018, https://gpcanada.org/). In general organizations are guided by the Companies Act when it comes to the adoption and implementation of corporate governance rules, practices and standards in a fair and transparent manner. [3]For example, in the United Kingdom the Companies Act 2006 helps to guide

[2] ICSA The Governance Institute (2019) *What is Corporate Governance*? Available from: https://www.icsa.org.uk/about-us/policy/what-is-corporate-governance

[3] United Kingdom Legislation.gov.uk (2018) *Companies Act 2006*. Available from; www.legislation.gov.uk/ukpga/2006/46/pdfs/ukpga_20060046_en.pdf [Accessed 2018, 25 November] © Legislation.gov.uk, 2018. This information is licensed under the Open Government Licence v3.0. To view this licence, visit http://www.nationalarchives.gov.uk/doc/open-government-licence/ OGL v3.0

organizations in terms of corporate governance. The parties that are responsible for corporate governance in an organization will be outlined in the following section.

1.3 Parties responsible for corporate governance in an organization

"GPC members hold a variety of positions within public, private, Crown corporations, and not-for profits across Canada and the United States. Some common job titles include: Board Secretary, CEO, CFO, Compliance Officer, Corporate Secretary, Corporate Administrator, Corporate Counsel, Corporate Director, Director, Executive, General Counsel, Lawyer, Manager of Corporate Affairs, or President and so on"[4] (Governance Professionals of Canada, 2019, https://gpcanada.org/page-19838). The next section will cover aspects of corporate governance in developing, emerging and transitional economies.

1.4 Corporate governance in developing, emerging and transitional economies

[5]According to the Center for International Private Enterprise (2002:2) few topics are more central to the international business and development agendas than corporate governance. A series of events over the last two decades have placed corporate governance issues as a top concern for both the international business community and the international financial institutions. Yet, in today's globalized economy, companies and countries with weak corporate governance systems are likely to suffer serious consequences above and beyond financial scandals and crises. What is increasingly clear is that how corporations are governed - commonly referred to as corporate governance - largely determines the fate of individual companies and entire economies in the age of globalization. Globalization and financial market liberalization have opened up new, international markets with the possibility of reaping stunning profits. Yet it has also exposed companies to fierce competition and to considerable capital fluctuations (Center for International Private Enterprise, 2002:2, https://www.cipe.org/legacy/publication-

[4] Governance Professionals of Canada (2019) *GPC Job Posting Guidelines & Process*. Available from: https://gpcanada.org/page-19838

[5] Center for International Private Enterprise (2002) *Instituting Corporate Governance in Developing, Emerging and Transitional Economies: A Handbook*. Available from: https://www.cipe.org/legacy/publication-docs/CGHANDBOOK.pdf [Accessed 2019, 10 August] p1-25

docs/CGHANDBOOK.pdf). [6]"*Corporate governance challenges in developing, emerging and transitional economies*. Establishing any one of these institutions is a necessary and challenging undertaking without which democratic markets and corporate governance cannot take root. The fate of entire economies hinges on meeting these challenges. Success requires that the private and the public sectors work together to establish the necessary legal and regulatory framework and a climate of trust through ethical behavior and oversight. While the set of institutions described above is designed to be comprehensive, each region is in a different stage of establishing a democratic, market-based framework and a corporate governance system. Hence, each nation has its own particular set of challenges. Some of the general challenges confronting developing, emerging and transitional economies include:

• Establishing a rule-based (as opposed to a relationship-based) system of governance;

• Combating vested interests;

• Dismantling pyramid ownership structures that allow insiders to control and, at times, siphon off assets from publicly owned firms based on very little direct equity ownership and thus few consequences;

• Severing links such as cross shareholdings between banks and corporations;

• Establishing property rights systems that clearly and easily identify true owners even if the state is the owner; (When the state is an owner, it is important to indicate which state branch or department enjoys ownership and the accompanying rights and responsibilities.);

• De-politicizing decision-making and establishing firewalls between the government and management in corporatized companies where the state is a dominant or majority shareholder;

• Protecting and enforcing minority shareholders' rights;

• Preventing asset stripping after mass privatization;

[6] Center for International Private Enterprise (2002) *Instituting Corporate Governance in Developing, Emerging and Transitional Economies: A Handbook*. Available from: https://www.cipe.org/legacy/publication-docs/CGHANDBOOK.pdf [Accessed 2019, 10 August] p1-25

• Finding active owners and skilled managers amid diffuse ownership structures;

• Promoting good governance within family-owned and concentrated ownership structures; and

• Cultivating technical and professional know-how[7] (Center for International Private Enterprise, 2002:24, https://www.cipe.org/legacy/publication-docs/CGHANDBOOK.pdf). In the following section the various advantages of corporate governance to an organization will be covered in the following section.

1.5 Advantages of corporate governance to an organization

"How can corporate governance help companies and national economies? Corporate governance helps companies and economies to attract investment and strengthen the foundation for long-term economic performance and competitiveness in several ways. First, by demanding transparency in corporate transactions, in accounting and auditing procedures, in purchasing, and in all of the myriad individual business transactions corporate governance attacks the supply side of the corruption relationship. Corruption drains companies' resources and erodes competitiveness driving away investors. Second, corporate governance procedures improve the management of the firm by helping firm managers and boards to develop a sound company strategy, and by ensuring that mergers and acquisitions are undertaken for sound business reasons, and that compensation systems reflect performance. This helps companies to attract investment on favorable terms and enhances firm performance. Third, by adopting standards for transparency in dealing with investors and creditors, a strong system of corporate governance helps to prevent systemic banking crises even in countries where most firms are not actively traded on stock markets. Taking the next step and adopting bankruptcy procedures also helps to ensure that there are methods for dealing with business failures that are fair to all stakeholders, including workers as well as owners and creditors. Without adequate bankruptcy procedures, especially enforcement systems, there is little to prevent insiders from stripping the remaining value out of an insolvent firm to their own benefit. This happened on a wide scale during many

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[7] Center for International Private Enterprise (2002) *Instituting Corporate Governance in Developing, Emerging and Transitional Economies: A Handbook*. Available from: https://www.cipe.org/legacy/publication-docs/CGHANDBOOK.pdf [Accessed 2019, 10 August] p1-25

of the privatization efforts in transitional and emerging markets with disastrous results[8] (Center for International Private Enterprise, 2002:3, https://www.cipe.org/legacy/publication-docs/CGHANDBOOK.pdf).

"Corporate governance is also very beneficial in many regards. For instance, when running a company, it can be easy to violate rules and regulations if you don't have legal experience. Putting corporate governance procedures in place can help you comply with these laws so that you spend your time focusing on your company's success. Corporate governance provides a set of rules you can follow to better manage your company, while steering clear of ethical violations. If you're diligent about following corporate governance regulations, you can also boost your company's reputation. A company with a strong reputation will have an easier time attracting investors and developing strong relationships with customers. Corporate governance, because it helps your company abide by the law, can also reduce the likelihood of expensive fines or lawsuits"[9] (Upcounsel. 2019, www.upcounsel.com). According to Palmer, J. cited in the Corporate Governance Institute (2019) *holding directors accountable.* A clearly defined and tailored Corporate Governance Framework® enables the board to quickly adopt a stakeholder-inclusive approach, by overseeing the opportunities and risks within the organisation. Board members are required to evaluate and consider the legitimate and reasonable needs of all stakeholders when establishing and identifying those governance components which are important to the organisation. The governance framework provides a mechanism for stakeholders (in particular investors) to more easily hold the board accountable for managing the organisation in a responsible and sustainable manner. *Improves enterprise wide risk management*. Although the Corporate Governance Framework® helps to identify governance components requiring urgent attention, it should not be substituted for a corporate risk register. The latter is integrated into a Corporate Governance Framework® as a subset of each governance component. The risk register records the granular details of the risks, impact thereof and associated action plans for

[8] Center for International Private Enterprise (2002) *Instituting Corporate Governance in Developing, Emerging and Transitional Economies: A Handbook*. Available from: https://www.cipe.org/legacy/publication-docs/CGHANDBOOK.pdf [Accessed 2019, 10 August] p1-25

[9] Upcounsel (2019) *Pros and Cons of Corporate Governance*. Available from: https://www.upcounsel.com/pros-and-cons-of-corporate-governance

each governance component and area of business – as such it can inform the RAG status of a governance component. The Corporate Governance Framework®, however, provides a holistic structure for governance processes starting with the board and strategic management, and extending to operations via the management level and the supply chain. The governance framework presents a singular high level view of the concentration of risk within the organisation. Such information can also be invaluable when evaluating an acquisition, or preparing for the organisation's next phase of growth. *Facilitates integrated reporting.* The availability of a Corporate Governance Framework® makes it much easier for an organisation to provide relevant, concise, holistic and timeous information on the strategic direction, performance, risks and opportunities facing the business. By focusing and reporting on material items — and how these are inter-linked — the board is able to foster a culture of transparent and meaningful communication and in so doing, continuously build a relation of trust with each of its key stakeholders[10] (Palmer, 2019, https://corgovinstitute.com). [11]According to E-Corporate Social and Responsibility (*E-CSR.net*) (2019) *9 Positive Impacts of Corporate Governance in Companies*. A good corporate governance system:

• Ensures that the management of a company considers the best interests of everyone;

• Helps companies deliver long-term corporate success and economic growth;

• Maintains the confidence of investors and as consequence companies raise capital efficiently and effectively;

• Has a positive impact on the price of shares as it improves the trust in the market;

• Improves the control over management and information systems (such as security or risk management)

[10] Palmer, J. (2019) *Tangible Benefits of a Corporate Governance Framework*. Available from: https://corgovinstitute.com/tangible-benefits-corporate-governance-framwork/ [Accessed 2019, 10 August] The Corporate Governance Framework® is a registered trademark of CGF.

[11] E-Corporate Social and Responsibility (*E-CSR.net*) (2019) *What are is the Purpose of Corporate Governance? What are the Benefits?* Available from: https://e-csr.net/definitions/corporate-governance-definition-purpose-and-benefits/

• Gives guidance to the owners and managers about what are the goals and strategy of the company;

• Minimizes wastages, corruption, risks, and mismanagement;

• Helps to create a strong brand reputation;

• Most importantly – it makes companies more resilient[12] (E-CSR.net, 2019, https://e-csr.net/). The following section will help to highlight the different types of corporate governance.

1.6 Types of corporate governance

The common mechanisms of corporate governance are often implemented by large corporations (*in particular stock exchange listed public organizations*) as a way to administer their operational activities due to their large sizes and high-knowledge intensive processes[13] (Vitez, 2017, https://bizfluent.com). Business performance improvement and the management of an organization's rules and practices can easily be attained via implementing mechanisms of corporate governance. The popular mechanisms of corporate governance are depicted in Figure 1.1 below.

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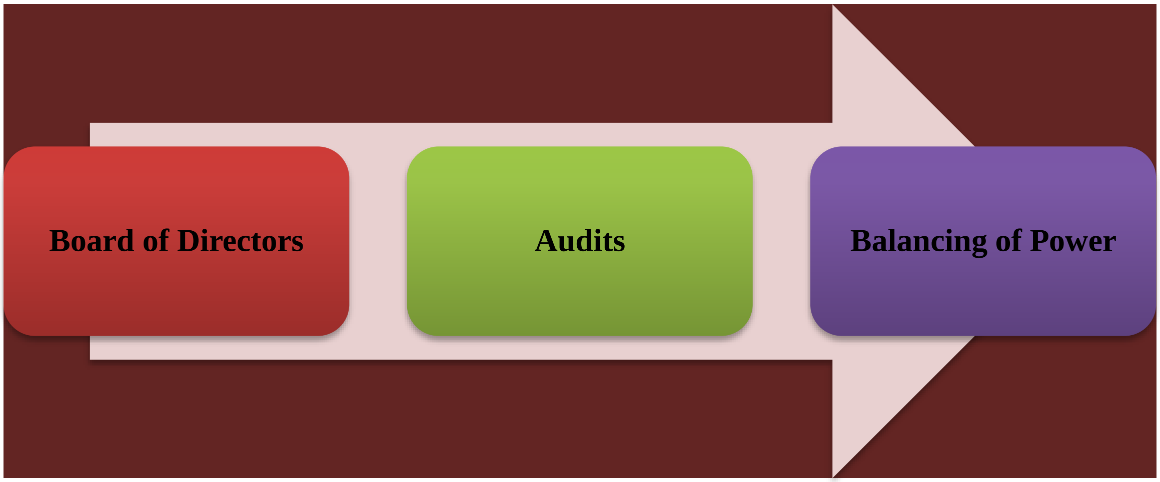
[12] E-Corporate Social and Responsibility (*E-CSR.net*) (2019) *What are is the Purpose of Corporate Governance? What are the Benefits?* Available from: https://e-csr.net/definitions/corporate-governance-definition-purpose-and-benefits/

[13] Vitez, O. (2017) *Mechanisms*. Available from: https://bizfluent.com/list-7168617-three-types-corporate-governance-mechanisms.html Leaf Group © 2019 Leaf Group, Ltd. U.S.A. All rights reserved.

Figure1.1 Three mechanisms of corporate governance



Source: Modified: (Vitez, O., 2017, https://bizfluent.com/) Leaf Group © 2019

As previously highlighted by Figure 1.1 the mechanisms of corporate governance are as follows:

1.6.1 [14]*Board of Directors.* One of the key responsibilities of a board member in any profit making organization is to put the interests of the organization first and followed by the interests of the shareholders or owners of the organization when carrying-out their day-to-day duties. Naturally there is a no direct connection or line of communication that exists between the shareholders, executive directors and managers in an organization therefore the board of directors often serve as a reliable formal interlink that is used to inform, advise or update shareholders on all matters related to shareholders, executive directors and managers and vice versa. Another key fiduciary duty of the board of directors is to regularly assess the performance levels of executive directors (*such as the CEO, COO or CFO*) and dismissing executives who fail to enhance the organization's year-on-year financial results. In most of the organizations (*both non-profit and profit making organizations*) on a yearly basis shareholders or council/members (*in the case of nonprofit organizations*) carryout elections during the annual general meeting (AGM) to elect board members they believe will be able to lead the organization for the next financial year or board term (*usually 1-5 years per term and a board's*

[14] Vitez, O. (2017) *Mechanisms*. Available from: https://bizfluent.com/list-7168617-three-types-corporate-governance-mechanisms.html Leaf Group © 2019 Leaf Group, Ltd. U.S.A. All rights reserved.

term limit is often stipulated in the corporate governance code of the organization). Some of the privately owned organizations that are large in terms of size or market value tend to have board of directors as part of their organizational structure hierarchical levels and it is important to highlight the fact that the importance or power of board of directors in privately-owned organizations is reduced when shareholders are not present[15] (Vitez, 2017, https://bizfluent.com).

1.6.2 Audits. The independent evaluations or assessments of all the organization's departments, units, divisions, businesses and financial operational activities after every financial year, half or quarterly year is referred to as audits. The main purpose of mechanisms in organizations is to guide organizations on how they can adhere to global or national financial accounting principles, standards, rules and other relevant practices. Independent evaluations of organizations (*audits*) play a critical role of producing unbiased evaluations of the organizations activities in the form of audit reports that shareholders, investors, financial institutions and the community depend on when assessing an organization's overall performance and governance status (*in order to determine whether it is good or poor*). When an organization regularly carries-out audits its: competitive advantage, market position, corporate image and brand value increases in the market while on the other hand audits also make the organization to become much more attractive to other organizations in terms of forming joint ventures, strategic alliances or partnerships since most of the well led organizations prefer to collaborate with an organization that has a well documented and traceable record of conducting its everyday activities in a ethical and accountable manner (Vitez, 2017, https://bizfluent.com).

1.6.3 Balance of Power. Equal power can only be attained and maintained in an organization via creating mechanisms that inhibit one person from having the ability to abuse or misuse the organization's scarce resources (*namely: financial, human capital & technological resources*). In general the division of tasks or responsibilities in an organization based on career specialization, skills or experience amongst board of directors, executive management including employees helps to safe guard the resources of the organization from misuse or abuse by an individual since it helps to keep an individual's tasks or duties within reasonable limits

[15] Vitez, O. (2017) *Mechanisms*. Available from: https://bizfluent.com/list-7168617-three-types-corporate-governance-mechanisms.html Leaf Group © 2019 Leaf Group, Ltd. U.S.A. All rights reserved.

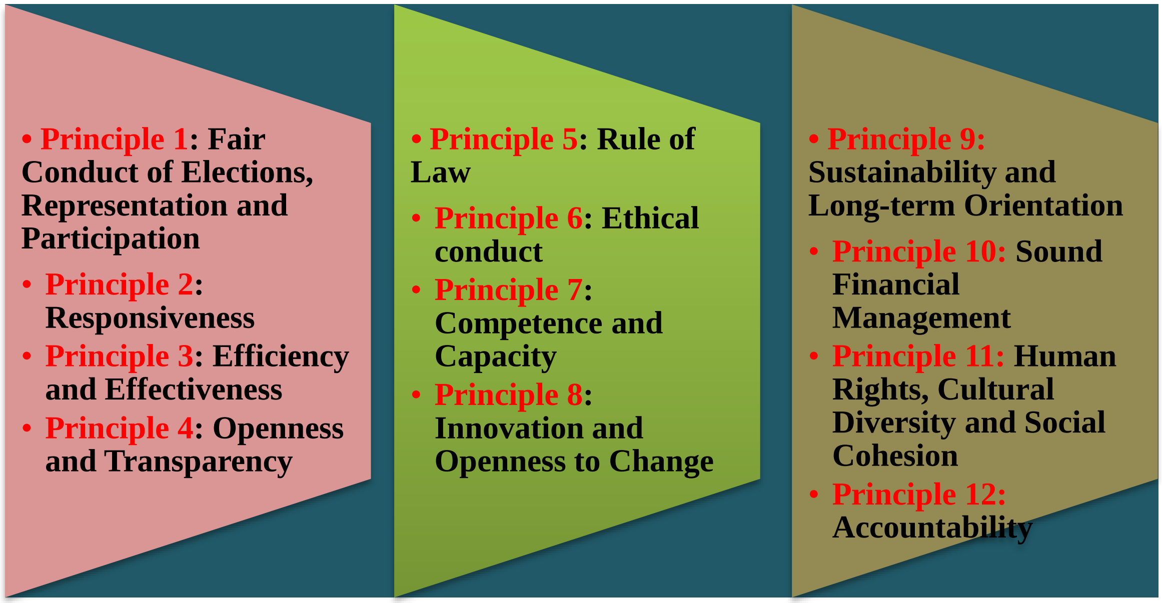
that can be controlled and or easily assessed. In addition the total number of activities that a department or division in an organization carries-out can easily be divided by corporate governance. The establishment of clearly designed specific responsibilities or duties helps to ensure that the organization maintains its flexibility towards adapting new operational changes or the recruitment of new people or directors can consistently be done without negatively affecting the operational activities of the organization (Vitez, 2017, https://bizfluent.com). The principles of corporate governance will be covered in the following section.

1.7 The traits and or principles of effective corporate governance

There are various traits and or principles that can be used to identify good corporate governance in an organization. It is the fiduciary duty of the board of directors to ensure that good corporate governance principles are practiced in the organization on a continuous basis. [16]Some of the principles of good corporate governance were highlighted by the Council of Europe (2019) *12 Principles of Good Governance and European Label of Governance Excellence (ELoGE)* via www.coe.int/ © Council of Europe. and these will be depicted by Figure 1.2 below.

[16] Council of Europe (2019) *12 Principles of Good Governance and European Label of Governance Excellence (ELoGE)*. Available from: https://www.coe.int/en/web/good-governance/12-principles-and-eloge#{%2225565951%22:[11]} © Council of Europe.

Figure 1.2 The 12 principles of good corporate governance



Source: Modified (Council of Europe, 2019, https://www.coe.int/) © Council of Europe.

The 12 principles of good corporate governance that were previously highlighted by Figure 1.2 above will now be further explained below. [17]According to the Council of Europe (2019):

Principle 1

Fair Conduct of Elections, Representation and Participation

• There is always an honest attempt to mediate between various legitimate interests and to reach a broad consensus on what is in the best interest of the whole community and on how this can be achieved

• Decisions are taken according to the will of the many, while the rights and legitimate interests of the few are respected.

[17] Council of Europe (2019) *12 Principles of Good Governance and European Label of Governance Excellence (ELoGE)*. Available from: https://www.coe.int/en/web/good-governance/12-principles-and-eloge#{%2225565951%22:[11]} © Council of Europe.

Principle 2

Responsiveness

• Objectives, rules, structures, and procedures are adapted to the legitimate expectations and needs of citizens.

• Public services are delivered, and requests and complaints are responded to within a reasonable timeframe.

Principle 3

Efficiency and Effectiveness

• Results meet the agreed objectives.

• Best possible use is made of the resources available.

• Performance management systems make it possible to evaluate and enhance the efficiency and effectiveness of services.

• Audits are carried out at regular intervals to assess and improve performance[18].

Principle 4

Openness and Transparency

• Decisions are taken and enforced in accordance with rules and regulations.

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[18] Council of Europe (2019) *12 Principles of Good Governance and European Label of Governance Excellence (ELoGE)*. Available from: https://www.coe.int/en/web/good-governance/12-principles-and-eloge#{%2225565951%22:[11]} © Council of Europe.

• There is public access to all information which is not classified for well-specified reasons as provided for by law (such as the protection of privacy or ensuring the fairness of procurement procedures).

• Information on decisions, implementation of policies and results is made available to the public in such a way as to enable it to effectively follow and contribute to the work of the local authority.

Principle 5

Rule of Law

• The local authorities abide by the law and judicial decisions.

• Rules and regulations are adopted in accordance with procedures provided for by law and are enforced impartially[19].

“Partial reproduction; please see [link] for full text”. https://www.coe.int/en/web/good-governance/12-principles-and-eloge#{%2225565951%22:[11]} © Council of Europe.

Principle 6

Ethical conduct

• The public good is placed before individual interests.

• There are effective measures to prevent and combat all forms of corruption.

• Conflicts of interest are declared in a timely manner and persons involved must abstain from taking part in relevant decisions.

“Partial reproduction; please see [link] for full text”. https://www.coe.int/en/web/good-governance/12-principles-and-eloge#{%2225565951%22:[11]} © Council of Europe.

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[19] Council of Europe (2019) *12 Principles of Good Governance and European Label of Governance Excellence (ELoGE)*. Available from: https://www.coe.int/en/web/good-governance/12-principles-and-eloge#{%2225565951%22:[11]} © Council of Europe.

Principle 7

Competence and Capacity

• The professional skills of those who deliver governance are continuously maintained and strengthened in order to improve their output and impact.

• Public officials are motivated to continuously improve their performance.

• Practical methods and procedures are created and used in order to transform skills into capacity and to produce better results.

Principle 8

Innovation and Openness to Change

• New and efficient solutions to problems are sought and advantage is taken of modern methods of service provision.

• There is readiness to pilot and experiment new programmes and to learn from the experience of others.

• A climate favourable to change is created in the interest of achieving better results[20].

Principle 9

Sustainability and Long-term Orientation

• The needs of future generations are taken into account in current policies.

• The sustainability of the community is constantly taken into account.

• Decisions strive to internalise all costs and not to transfer problems and tensions, be they environmental, structural, financial, economic or social, to future generations.

[20] Council of Europe (2019) *12 Principles of Good Governance and European Label of Governance Excellence (ELoGE)*. Available from: [https://www.coe.int/en/web/good-governance/12-principles-and-eloge#{%2225565951%22:[11]}](https://www.coe.int/en/web/good-governance/12-principles-and-eloge#{%2225565951%22:[11]}) © Council of Europe.

• There is a broad and long-term perspective on the future of the local community along with a sense of what is needed for such development.

• There is an understanding of the historical, cultural and social complexities in which this perspective is grounded[21].

Principle 10

Sound Financial Management

• Prudence is observed in financial management, including in the contracting and use of loans, in the estimation of resources, revenues and reserves, and in the use of exceptional revenue.

• Risks are properly estimated and managed, including by the publication of consolidated accounts and, in the case of public-private partnerships, by sharing the risks realistically.

Principle 11

Human rights, Cultural Diversity and Social Cohesion

• Within the local authority's sphere of influence, human rights are respected, protected and implemented, and discrimination on any grounds is combated.

• Cultural diversity is treated as an asset, and continuous efforts are made to ensure that all have a stake in the local community, identify with it and do not feel excluded.

• Social cohesion and the integration of disadvantaged areas are promoted.

• Access to essential services is preserved, in particular for the most disadvantaged sections of the population.

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[21] Council of Europe (2019) *12 Principles of Good Governance and European Label of Governance Excellence (ELoGE)*. Available from: https://www.coe.int/en/web/good-governance/12-principles-and-eloge#{%2225565951%22:[11]} © Council of Europe.

Principle 12

Accountability

• All decision-makers, collective and individual, take responsibility for their decisions.

• Decisions are reported on, explained and can be sanctioned.

• There are effective remedies against maladministration and against actions of local authorities which infringe civil rights[22] (Council of Europe, 2019, https://www.coe.int/en/web/good-governance/12-principles-and-eloge#{%2225565951%22:[11]}) © Council of Europe. The conclusion of this chapter will be covered in the following section.

1.8 Conclusion

Organizations that are well known in the global market for being ethical, transparent and fair have a well established foundation of good corporate governance. The involvement of everyone in the organization in implementing the corporate governance guidelines and standards is critical. In general the key components of corporate governance that organizations must implement in order to attain effective corporate governance rules and practices include: fairness, accountability, responsibility and transparency. It can therefore be concluded that corporate governance helps the leadership of an organization to better manage the day-to-day issues faced by the organization in its operational activities.

1.9 Review questions

1) What is the meaning of the terms: 'governance' and 'corporate governance'?

2) List the parties that are responsible for corporate governance in an organization?

3) Discuss the challenges and successes of corporate governance in developing, emerging and transitional economies?

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[22] Council of Europe (2019) *12 Principles of Good Governance and European Label of Governance Excellence (ELoGE)*. Available from: https://www.coe.int/en/web/good-governance/12-principles-and-eloge#{%2225565951%22:[11]} © Council of Europe.

4) Outline and explain the advantages of corporate governance to an organization?

5) Identify the three types or mechanisms of corporate governance? Describe the 12 principles of effective corporate governance?

Chapter 2: Stakeholders of corporate governance in an organization

After reading this chapter you should be able to:

- Explain the meaning of the terms stakeholder and shareholder.
- Identify the difference between a stakeholder and a shareholder.
- Outline the internal and external stakeholders of corporate governance. Describe the impact of corporate governance.
- Discuss the factors affecting good corporate governance in organizations.
- Explain the myths about corporate governance.

2.1 Introduction

"Corporate governance is the structure and processes designed to create long-term value"[23][24] (NEDonBoard, 2019, www.nedonboard.com). In general all the activities that are carried-out by an organization on a daily basis have either a positive or negative impact on certain individuals or organizations. Corporate governance guidelines are the 'tool' that is used to help reduce the negative impact of the organization's day-to-day activities on other individuals or organizations in all geographical areas it carries-out its operation. The fact that corporate governance is a system that helps to regulate and provide guidance to an organization's board of directors, management and employees on how to conduct transparent, fair and credible business practices plays a critical role on the positive impact the organization's operational activities have on its

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[23] NEDonBoard (2019) *What are the Key Differences Between Executive and Non Executive Directors*. Available from: https://www.nedonboard.com/what-are-the-key-differences-between-executive-and-non-executive-directors/ [Accessed 2019, 10 August] ***NEDonBoard is the UK professional body for non-executive directors and board members.***

[24] NEDonBoard (2019) *The 5 Factors that Contribute to An Effective Corporate Governance*. Available from: https://www.nedonboard.com/the-5-factors-that-contribute-to-an-effective-corporate-governance/ [Accessed 2019, 10 August] ***NEDonBoard is the UK professional body for non-executive directors and board members.***

external stakeholders. An organization has both internal and external stakeholders that influence the organization's corporate governance practices and standards. Nowadays change has become the key factor that has led to corporate governance placing more emphasis on enhancing the ethics culture, governance rules and policies of the organization in such a way that enables the organization to gain the confidence, support and trust of its stakeholders.

2.2 Definition of terms

There are numerous definitions that have been developed in the field of corporate governance by academics, business gurus, industry experts and researchers. The term *stakeholder* refers to any individual, an organization or a third party that has an interest in the organization in terms of its services, products, resources, corporate brand, assets, processes or systems and they can either be negatively or positively affected by the activities of the organization on a daily or yearly basis (Rudolph. Patrick. T. Muteswa, 2019). Generally the term '*internal*' is interchangeably used with the term '*inside*' whilst on the other hand the term '*external*' is interchangeably used with the term '*outside*' and therefore it can be argued academically that the use of the terms interchangeably is correct as all the terms share the same meaning. The differences that exist between a stakeholder and a shareholder will be highlighted in the following section.

2.3 What is the difference between a 'stakeholder' and 'shareholder'

Surprisingly, some of the business professionals and owners still make the mistake of confusing the meaning of the term stakeholder with that of a shareholder. These two terms completely have different definitions altogether. Table 2.1 will help depict the differences that exist between a stakeholder and a shareholder.

Table 2.1 Differences between a stakeholder and a shareholder

Stakeholder	Shareholder
"A stakeholder is not necessarily a shareholder"[25] (Corporate Finance Institute, 2019).	"A shareholder is a stakeholder of the company" (Corporate Finance Institute, 2019).
"A stakeholder is an interested party in the	"A shareholder is a person who owns an equity

[25] Corporate Finance Institute (2019) *Stakeholder vs Shareholder*. Available from: https://corporatefinanceinstitute.com/resources/knowledge/finance/stakeholder-vs-shareholder/

company's performance for reasons other than capital appreciation" (Corporate Finance Institute, 2019).	stock in the company and therefore holds an ownership stake in the company" (Corporate Finance Institute, 2019).
"A stakeholder is a party that has an interest in the company's success or failure. A stakeholder can affect or be affected by the company's policies and objectives" (Corporate Finance Institute, 2019).	"A shareholder is any party, either an individual, company or institution that owns at least one share of a company and, therefore with a financial interest in its profitability. Shareholders may be individual investors who are saving part of their salaries in preparation for retirement or large corporations and who hope to exercise a vote in the management of a company" (Corporate Finance Institute, 2019).

Source: (Corporate Finance Institute, 2019, https://corporatefinanceinstitute.com)

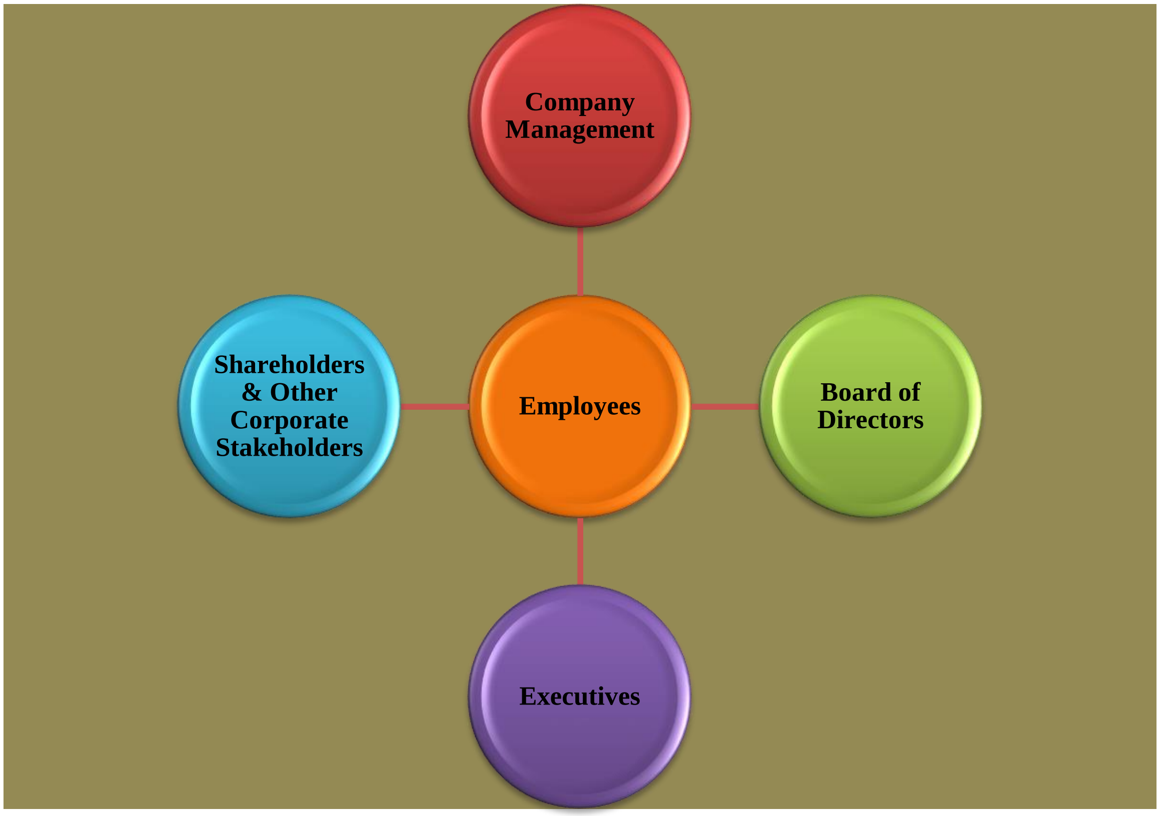
In the following section the internal stakeholders of corporate governance practices in an organization will be covered in-depth.

2.4 Internal stakeholders of corporate governance

In an organization the parties that have an interest in the organization's inside governance guidelines and practices are many. [26]The five internal governance stakeholders that were identified by the Governance of Professionals Canada (2019) are depicted in Figure 2.1 below.

[26] Governance Professionals of Canada (2019) *About Corporate Governance*. Available from: https://www.gpcanada.org/About-corporate-governance

Figure 2.1 Five internal governance stakeholders



Source: Modified (Governance of Professionals Canada, 2019, www.gpcanada.org; NEDonBoard, 2019, www.nedonboard.com; Acca Global, 2012:3, www.accaglobal.com)

The different internal governance stakeholders that were highlighted by Figure 2.1 above will be further highlighted below.

2.4.1 Company management

These are senior management of the organization who are tasked with managing the day-to-day operational activities of the organization in a particular area of specialization whilst being guided and directed by the corporate governance rules and standards of the organization. Company management includes: head of departments or functional department managers in specializations: such as marketing, human resources, operations, information technology and finance.

2.4.2 Executive

An 'executive' is an employee of the organization who is tasked with the duty of formulating strategy, planning, directing and organizing the daily management activities of the organization and they have the authority to delegate the operational control activities to their subordinates who include functional department managers. For instance CEOs, CFOs or COOs are all typical examples of executives found in an organization who are superiors to the marketing, human resources, finance, operations, research & development, information technology managers or head of departments. In countries such as the United States of America executive directors such as the CEO, CFO and COO are part of the board of directors. ""Executive directors hold a position on the board of directors. They have "*executive responsibility" for running the company's business***.** Executive directors are a company employee, usually a senior executive, and a board member. On top of their full-time executive position, they are appointed to the board, typically by the Nomination Committee or the Board of Directors itself. The CEO, the Managing Director and the CFO are executives that are typically members of the board""[27] (NEDonBoard, 2019, www.nedonboard.com).

2.4.3 Board of directors

[28]According to Acca Global (2012:3) nearly all companies are managed by a board of directors, appointed or elected by the shareholders to run the company on their behalf. In most countries, the directors are subject to periodic (often annual) re-election by the shareholders. This would appear to give the shareholders ultimate power, but in most sectors it is recognised that

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[27] NEDonBoard (2019) *What are the Key Differences Between Executive and Non Executive Directors*. Available from: https://www.nedonboard.com/what-are-the-key-differences-between-executive-and-non-executive-directors/ [Accessed 2019, 10 August] ***NEDonBoard is the UK professional body for non-executive directors and board members.***

[28] Acca Global (2012) *Relevant to Foundation Level Paper and Acca Qualification Paper F1*. Available from: https://www.accaglobal.com/content/dam/acca/global/PDF-students/2012s/sa_oct12-f1fab_governance.pdf [Accessed 2019, 10 August] p1-3

performance can only be judged over the medium to long-term (Acca Global, 2012:3, www.accaglobal.com).

2.4.4 Shareholders and stakeholders

In general shareholders and stakeholders are interested in the internal governance of an organization. "A *shareholder* is a person who owns an equity stock in the company and therefore holds an ownership stake in the company"[29] (Corporate Finance Institute, 2019, https://corporatefinanceinstitute.com).

2.4.5 Employees

"An *employee* is someone you hire and pay for their work, which you use to benefit your business. But, not all workers you hire and pay are employees. You must determine the worker's classification"[30] (DeWitt, 2018, www.patriotsoftware.com). The fact that employees provide the organization with their skills and knowledge labor services makes them require guidance on how to perform their duties in a manner that is in line with the governance rules and standards of the organization. The following section will help highlight the external stakeholders of corporate governance.

2.5 External stakeholders of corporate governance

Notably in each and every organization the parties that have an interest in the organization's outside governance guidelines and practices are many. The six external governance stakeholders that were identified by the Governance of Professionals Canada (2019) are depicted in Figure 2.2 below.

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[29] Corporate Finance Institute (2019) *Stakeholder vs Shareholder*. Available from: https://corporatefinanceinstitute.com/resources/knowledge/finance/stakeholder-vs-shareholder/

[30] DeWitt, K. (2018) *Who is An Employee*. Available from; https://www.patriotsoftware.com/payroll/training/blog/who-is-an-employee/

Figure 2.2 Six external governance stakeholders

Source: (Governance of Professionals Canada, 2019, www.gpcanada.org)

The different external governance stakeholders that were highlighted by Figure 2.2 above will be further highlighted below.

2.5.1 Shareholder

In general any form of legal entity or person that invests its scarce financial resources in any organization in order to own a financial interest is automatically called a *shareholder*. By virtue of having a financial interest in the organization shareholders are highly interested in the external governance guidelines of the organization[31] (Corporate Finance Institute, 2019, https://corporatefinanceinstitute.com).

[31] Governance Professionals of Canada (2019) *About Corporate Governance*. Available from: https://www.gpcanada.org/About-corporate-governance

2.5.2 Debtholders

A *debt holder* is also called a *bondholder* as they can either be an organization, a person or a third party that is owed money by another legal entity or institution through their ownership of its bonds which usually mature after a certain time period and a specific amount of money must be paid back to the bondholder or debt holder.

2.5.3 Trade creditors

A *trade creditor* is an organization, institution, third party or any form legal entity that supplies the organization with its goods or services without the need of an immediate cash payment upon the receipt of the goods or services due to a credit term arrangement that exists between the organization and the supplier with the later being recorded as a trade creditor in the organization's balance sheet (Rudolph. Patrick. T. Muteswa, 2019).

2.5.4 Supplier

A *supplier* is also called a *vendor* and is an individual, institution or organization that provides either tangible (goods) or intangible (services) materials that are used in the production of finished goods or services of an organization on a regular basis.

2.5.5 Customers

Generally a *customer* can also be called a *client* in service business operations thus they refer to any legal entity or individual that buys the organization's goods or services after paying a certain amount of money set by the organization as the price of the product or service that allows them to own and or consume the purchased goods or services anytime convenient to them (Rudolph. Patrick. T. Muteswa, 2019).

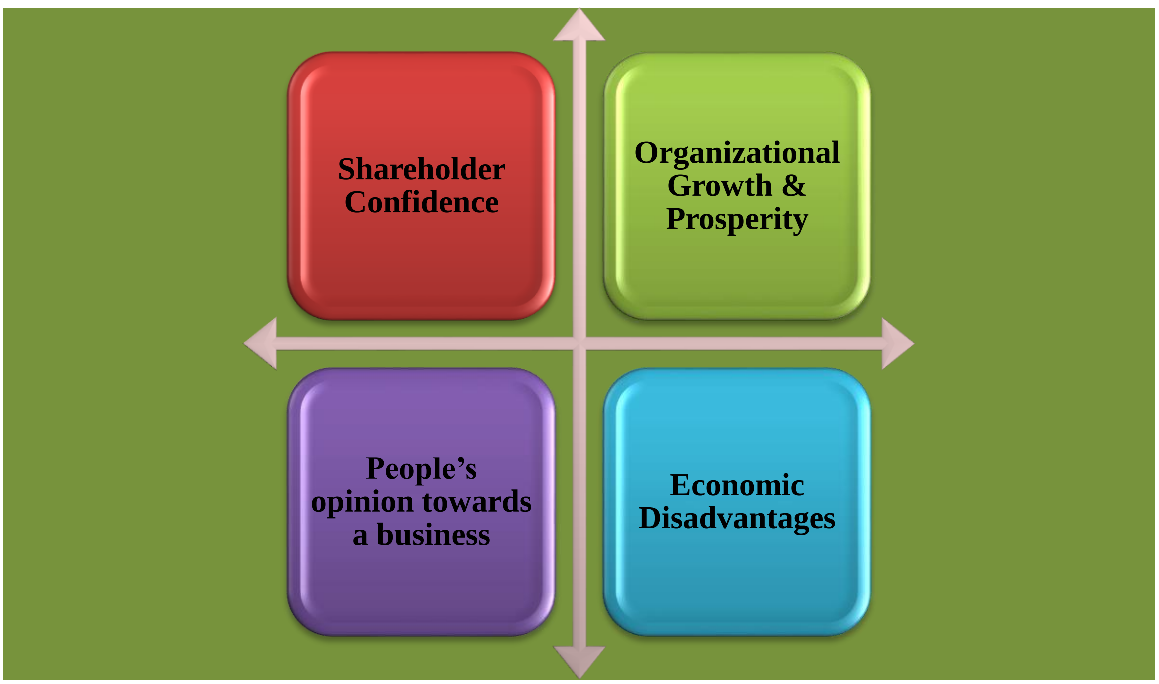
2.5.6 Community

A *community* is a geographical area that encompasses social groups of different sizes that share uniform values, culture, beliefs or lifestyle and it often falls within the jurisdiction of the organization's day-to-day operational activities thereby it can be positively or negatively affected by its operations in one way or another (Rudolph. Patrick. T. Muteswa, 2019). It important to note that the definition of the term 'community' previously highlighted is only applicable to the context of this book chapter only. The following section will cover the impact of corporate governance on internal and external stakeholders.

2.6 Impact of corporate governance

Corporate governance practices are implemented within an organization and yet they have effects that reach beyond the premises of the organization. The impact of corporate governance in an organization varies based on the type, size and industry sector of the organization. Figure 2.3 will help to depict the four effects of corporate governance in an organization.

Figure 2.3 Four effects of corporate governance



Source: (Lister, 2017, https://bizfluent.com) Leaf Group © 2017

As depicted by Figure 2.3 the four effects of corporate governance practices in an organization will be further discussed in detail and these include:

2.6.1 Shareholder Confidence. The upholdment and proper implementation of corporate governance in an organization can help yield good benefits of improving shareholder confidence since good corporate governance helps to reaffirm the shareholders that the organization is consistently making well calculated strategic decisions in its day-to-day activities and that all its in-house activities are well coordinated or integrated to boost efficiency and effectiveness. One of the main push factors that makes shareholders to inject more capital revenue into an organization is good corporate governance thus confident shareholders tend to inject more capital revenue into an organization due to fact that they will be fully knowledgeable of the fact that they have an increased probability of earning higher return yields on their capital investment than in poorly governed organizations. While on the other hand the injection of more investment capital from shareholders has a ripple effect of boosting market confidence in the organization which ultimately results in both the market and asset value of the organization increasing simultaneously[32] (Lister, 2017, https://bizfluent.com).

2.6.2 Organizational Growth and prosperity. Generally when the market/asset value of the organization increases the organization automatically starts to enjoy easy accessibility to capital financing to use in acquiring its goods, services, resources or assets to use to maintain its growth. The long term benefits of good corporate governance on the organization's growth involves the enhanced ability of accessing new or more financial capital to use to expand the organization into new markets (*both domestic and foreign*), innovate the currently existing range of products/services and or create new products/services. Well governed organizations enjoy the advantage of easy accessibility to capital financing due to the fact that investors or shareholders are often more comfortable towards investing their scarce financial resources into an effectively managed organization that adheres to corporate governance guidelines which are used as tools that help to provide definite pathways the leaders of the organization can follow in order to make informed decisions on a day-to-day basis (Lister, 2017, https://bizfluent.com).

2.6.3 Economic disadvantages. An organization that adapts and implements ineffective corporate governance policies, practices or principles has an increased probability of attracting a poor corporate image in the market accompanied by reduced market confidence. When there is inadequate knowledge or adherence to good corporate governance principles by the CEO, COO or CFO in managing the day-to-day activities of the organization numerous miscalculated, unethical, untransparent and wrong decisions are made while on the other hand

[32] Lister, J. (2017) *Corporate Governance Effects*. Available from: https://bizfluent.com/info-8019695-corporate-governance-effects.html Leaf Group © 2017 Leaf Group, Ltd. U.S.A. All rights reserved.

these wrong decisions have a ripple effect of reducing the total net-worth of the organization. Furthermore, wrong decisions can result in the organization failing to fulfill all of its day-to-day financial responsibilities. For instance the 2009 global economic downturn was a result of negative market effects which were caused by ineffective corporate governance practices that had been adopted and implemented by business leaders in organizations and these led to: (1) massive job cuts, (2) shutdowns of many organizations and (3) the loss of global market shares by several organizations'[33] (Lister, 2017, https://bizfluent.com).

2.6.4 People's opinion towards a business. The principles of corporate governance that are followed by an organization tend to have a strong influence on its corporate image it attracts from ordinary people, customers or the community at large. A powerful corporate image and corporate brand is usually attained as a result of the organization achieving the following: (1) adhering to the principles of financial accounting and management of being transparent and ethical when carrying-out monetary spending, (2) offering employees, executive management and board of directors a highly conducive working environment that offers equal opportunity, workplace rights, democracy, effective compensation management and so on, (3) the adoption and implementation of effective sustainable environmental conservation policies and practices in all of the organization's systems, production processes, supply chain management (SCM), marketing, distribution and so on. Generally the trust of the external stakeholders of the organization such as its community, media, suppliers, customers and so on is normally earned and it is not simply 'given' to the organization. Therefore, when the organization does not make an effort to adopt or adhere to the national laws governing environmental protection and degradation it is more likely to attract a negative corporate image and mistrust from the community, media, suppliers, customers and so on (Lister, 2017, https://bizfluent.com). The following section will cover the factors that influence corporate governance practices and standards in an organization.

[33] Lister, J. (2017) *Corporate Governance Effects*. Available from: https://bizfluent.com/info-8019695-corporate-governance-effects.html Leaf Group © 2017 Leaf Group, Ltd. U.S.A. All rights reserved.

2.7 Factors influencing corporate governance in organizations

"Around the world, the corporate governance landscape is shifting, as efforts to improve business practices and policies gain support and momentum. The wave of reform has become visible everywhere and it is certain to continue to rise. *Three factors* are driving these developments. *First*, today's deep economic uncertainty has broadened ordinary people's awareness of the influence that companies have on politics, policy, and their own daily lives. *Second*, there has been a burgeoning awareness among governments that economic growth requires a proactive regulatory approach. Robust and resilient economies need strong businesses, and to build strong businesses, governments must play a role in ensuring high-integrity oversight of business activity. Company stewardship and country stewardship are increasingly linked, and authorities now recognize that paying to ensure good governance now is far less costly (both financially and politically) than paying for the consequences of bad governance later. The *third*, and perhaps most important, factor underpinning recent changes in corporate governance has been the sharp rise in cross-border investing. Sovereign wealth funds, pension funds, global investment banks, and hedge funds do not invest only in their own backyard. They scour the planet looking for places to put their money, and they expect companies that receive it to play by rational rules. International investors are in a unique position to encourage, or even enforce, global best practices in corporate governance"[34] (Marcus, 2015, www.weforum.org). Some of the various additional factors that are influencing corporate governance in organizations nowadays include the following:

2.7.1 The Corporate Governance Code

"Corporate governance is the structure and processes designed to create long-term value. The *UK Corporate Governance Code* has evolved from its original formulation produced in 1992 by the Cadbury Committee. While the 1992 edition of the code was quite succinct and focused on control and accountability, the current version is much broader. But failures and scandals have continued while the Code has been meaningfully strengthened. A company can have an extremely sophisticated governance but things may still go wrong. Compliance with the

[34] Marcus, L.P. (2015) *3 Factors Driving Better Corporate Governance*. Available from: https://www.weforum.org/agenda/2015/08/3-factors-driving-better-corporate-governance/

Corporate Governance Code is not sufficient. There are other factors contributing to effective corporate governance" (NEDonBoard, 2019, www.nedonboard.com).

2.7.2 Ethics corporate culture

Good corporate governance in an organization is achieved through upholding ethical practices. Therefore this puts pressure on boards to place more emphasis towards adopting an ethical corporate culture through making this a top priority in board meetings. Various corporate scandals have been exposed over the past number of years in the various forms of media around the world and this is a clear indicator that there is a huge appetite for ethics and corporate governance guidance by modern day managers, executive directors and board of directors when dealing with controversial ethics-related issues in organizations. It is quite obvious that all the people who are tasked with decision-making duties in organizations tend to make them based on their corporate culture, values and knowledge. All change initiatives in organizations often succeed when they receive adequate top leadership support and this also applies to the adoption of an ethics' culture in an organization where top leadership support is viewed as the 'key ingredient to success'. It is important to point-out the fact that a code of ethics is a step towards attaining victory of successfully creating an ethics culture in the organization. Notably, it should be clearly highlighted that an outright victory towards creating an ethics culture in the organization can only be achieved if board of directors lead the way by simply doing the following: (1) creating a conducive environment at the workplace that promotes an ethical corporate culture, (2) crafting well designed ethics policies that promote ethical practices across the organization, (3) carefully creating effective strategies that help to design innovation and result-oriented ethical behavior, (4) creating formal ethics and governance frameworks and so on[35] (Valls, 2019, https://ethicalboardroom.com/why-boards-should-care-about-creating-an-ethical-work-culture/).

[35] Valls, J. (2019) *Why Boards Should Care About Creating An Ethical Work Culture*. Available from: https://ethicalboardroom.com/why-boards-should-care-about-creating-an-ethical-work-culture/

2.7.3 Skills and the credibility of the board of directors

Each and every board consists of highly skilled and well experienced directors who have successfully developed a good reputation in the business world as being honest, fair and responsible in carrying-out their day-to-day board duties over a long period of time in their respective careers. The appointment of effective business leaders in the board who inspire everyone in the organization to practice ethical behavior, strong work culture, honesty, teamwork and be results-orientated tends to naturally boost business performance since everyone in the organization commits themselves towards implementing and abiding by the corporate governance rules of the organization on a daily basis. All conversations about good corporate governance start with the organization's leadership since they are the role models who must clearly communicate about: (1) the set standards of corporate governance and (2) benefits of practicing the adopted corporate governance rules and practices at the workplace whilst simultaneously holding the people they lead accountable towards those adopted corporate governance rules. When an organization adopts and implements good corporate governance rules and practices it automatically becomes well recognized as being an organization with a high level of integrity in terms of good corporate governance practices.

2.7.4 Refresher training programs focusing on the roles of board of directors

Training can be defined as an instructor-led human resources management activity that focuses on the sharing of knowledge, skills and character to an individual or group of people in order to assist them to enhance their job performance and productivity levels at the workplace[36] [37]

[36] Masadeh, M. (2012) Training, Education, Development and Learning: What is the Difference? *European Scientific Journal Vol 8(10),* p63-65.

[37] Manpower Services Commission (1981) Glossary of Training Terms. London: HMSO

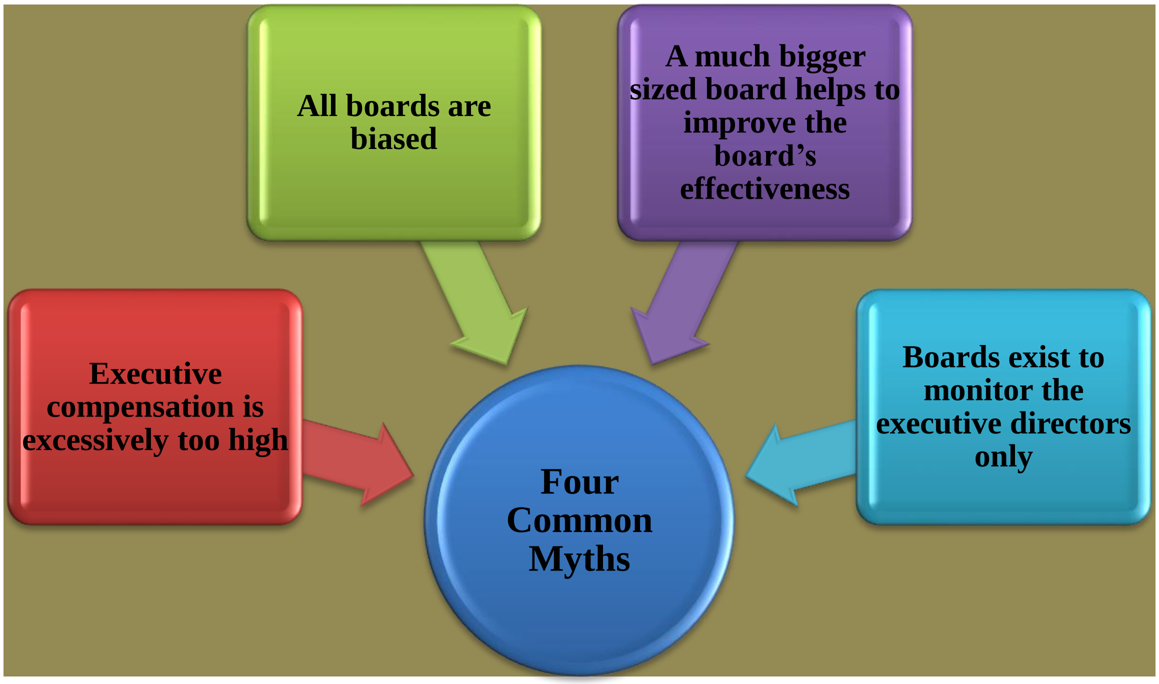
[38](Manpower Services Commission, 1981; Masadeh, 2012:63). On the other hand *training* itself can be defined as a learning process that can be conducted 'on-the-job' and or 'off-the-job' in order to directly improve the performance of the trainee in performing their job related duties (Masadeh, 2012:63). Board of director refresher training helps to trigger quick, analytical and decisive thinking in the board of directors which results in faster problem solving abilities. Regular corporate governance and director fiduciary roles training helps the board of directors to be consistently kept abreast with new latest skills, knowledge and concepts on all matters related to corporate governance, honesty, transparency, accountability and integrity so that they may easily cope with changes in the micro and macro business environment. Refresher training that focuses on the roles of board of directors helps them to improve their skills of foreseeing the future through effective planning strategies while decision-making skills can be enhanced through proper analysis of factual information that is available at a particular time period. Generally corporate governance in an organization is influenced by refresher training programs of board directors as they often focus on the fundamental legal duties of directors. Thus, refresher training often enables board of directors to easily boost their effectiveness and efficiency in their job performance which ultimately results in the organization attaining reputable high good social responsibility ratings in the communities it operates. In the following section the myths about corporate governance are covered in-depth.

2.8 Myths about corporate governance

There are numerous myths that have been communicated in various textbooks, journals, magazines, websites and so on about corporate governance practices of boards. Some of the common myths about the corporate governance of a board are depicted in Figure 2.4 below.

[38] Manpower Services Commission (1981) *Glossary of Training Terms.* London: Department of Employment now the Department for Work and Pensions. Available from: https://www.gov.uk/government/ © Legislation.gov.uk, 2018. This information is licensed under the Open Government Licence v3.0. To view this licence, visit http://www.nationalarchives.gov.uk/doc/open-government-licence/ OGL v3.0

Figure 2.4 Four common myths about the corporate governance of a board



The four common myths about corporate governance by boards in an organization will be further discussed as follows:

2.8.1 Executive compensation is excessively too high

One of the most popular misconceptions about business executives is that they are excessively compensated in organizations. It is important to point-out the fact that in some nonprofit organizations board of directors volunteer their services (*free of charge*) in order to share their labour skills and expertise in helping the organization to achieve its set goals or vision. For instance, the provision of humanitarian aid to certain communities located across the world or a specific geographical area. In some of the organizations nowadays compensation is now linked to performance including bonuses and incentives thus when the organization performs poorly executives receive normal compensation and only when the organization performs exceptionally well that is when the executive directors and the board of directors receive high compensation (*bonuses and incentives*) and generally this compensation arrangement is often applied to everyone employed in the organization.

2.8.2 All boards are biased

There is a common belief that boards do not make tough decisions against executive directors in an organization such as the CEO, COO and CFO especially when they are the responsible of making decisions to nominate members of the board. This myth is completely untrue due to the fact that board of directors play a key role in the monitoring of executive directors and they also formulate policies they are supposed to implement. Furthermore, when executives have failed to meet their performance target at the workplace the board has the obligation to dismiss the executive directors or a give them a formal warning. It is important to point-out the fact that board of directors and executive directors have the fiduciary duty to represent the interests of shareholders and other stakeholders of the organization therefore board of directors are legally obliged to act in a fair, transparent and accountable manner when handling issues related to executive directors in the organization.

2.8.3 A much bigger sized board helps to improve the board's effectiveness

A common myth or misconception that is often made by shareholders and nomination committees in organizations is that they often weigh the size of a board as being equal to the board's effectiveness. In general this myth is wrong since both a small or large board can produce the same results if the appropriate people are hired and well trained on a regular basis. In addition individual board members' skills, qualifications, experience and their work ethics culture play a significant role in influencing their effectiveness, performance and innovativeness in the boardroom.

2.8.4 Boards exist to monitor the executive directors only

The myth that states the following: '*boards exist to monitor the executive directors only*' is completely untrue. It is important to point out the fact that 'one of the many roles' of a board is to monitor the performance and activities of executive directors in an organization such as the CEO, COO and or CFO. However, the 'other roles of a board' in a profit-making organization are many and these will be highlighted below. [39]According to the International Centre for Corporate Governance, *Duties of Board Members* (2018):

2.8.4.1 Management of the Company

• Set a corporate strategy in accordance with the vision and mission of the company, its statutes, if possible, set the strategy that is aligned with the owner's strategy.

• Analyse strengths, weaknesses, opportunities and threats that concern the company (*SWOT Analysis*) keeping in mind company's strategy.

2.8.4.2 Company organisation

• Decide upon composition of a Board and appoint a chairperson, a vice chairperson and a board secretary.

• Establish a remuneration policy that sets compensation for duties and responsibilities carried out by members of the board and includes provisions for compensation for additional functions performed by members and other expenses.

2.8.4.3 Financial management of the company

• Issue directives to the used accounting principles, including the design of the financial statements. Carry out a periodic revision of the long-term financial plans in accordance with the business plan.

• Set the budget on an annual basis, including the investment budget, which can be used as a basis for planning or to check for deviations from planned targets.

2.8.4.4 Appointment, Monitoring and Dismissal of Management

• Recruit, select and appoint members of management in accordance with the organisational chart.

[39] International Centre for Corporate Governance (2018) *Duties of Board Members*. Available from: https://www.icfcg.org/board-tools/duties-of-board-members.pdf

• Determine the compensation of the executive management including expenses and profit sharing regulations.

• Decide upon conclusion, modification and termination of labor contracts including job descriptions of the executive management.

2.8.4.5 Preparation of the Business Reports and the AGM

• Hold editorial responsibility for the formulation of the annual report, consisting of financial statements, annual report and consolidated financial statements.

• Decide whether to publish an annual report, in particular, on the Internet or on how to distribute printed copies (International Centre for Corporate Governance, 2018, www.icfcg.org). The conclusion of this chapter will be covered in the following section.

2.9 Conclusion

Value based corporate governance is now the main focus of most of the organizations around the world through effective structures and processes. Operational activities of organizations have either a positive or negative impact on certain individuals or organizations. Corporate governance guidelines help the organization to act in a responsible, fair and honest manner in carrying-out its day-to-day activities. It can be concluded that the factors that influence corporate governance include: the corporate governance code, ethics corporate culture, refresher training programs of board directors about their roles and the skills of the board of directors.

2.10 Review questions

1) What is the meaning of the term ‘stakeholder’?

2) Identify the three differences that exist between a stakeholder and a shareholder?

3) Describe four internal stakeholders and five external stakeholders of an organization?

4) Explain the impact of corporate governance in today’s business environment? Identify the four factors affecting good corporate governance in an organization?

5) Discuss five myths about corporate governance?

Chapter 3: Core principles of corporate governance and sustainable development

After reading this chapter you should be able to:

- Define the following terms: principles, fairness and consistency.
- List the four benefits of principles of corporate governance.
- Explain the characteristics of the key principles of corporate governance.
- Discuss the three models of corporate governance. Explain in greater detail the LOGIC of governance.
- Define the term sustainable development. Highlight the relationship between sustainable development and corporate governance.

3.1 Introduction

"""The quality of the governance of a firm is as dependent on the organizational structure and decision making processes of the firm, as to the quality of the key people that make up the board and the management team. [40]Being trustworthy is an important asset and source of power for corporations as well as it is for individuals. In order to attract financial and human capital to the corporation and to ensure sustainability of value creation, the governance mechanisms should ensure to gain the trust of all stakeholders. Therefore, good governance is a lot more than compliance. Good corporate governance is a culture and a climate of *Consistency, Responsibility, Accountability, Fairness, Transparency, and Effectiveness that is Deployed* throughout the organization. (The "CRAFTED" principles of governance). The board of directors is the most important element in corporate structures. Issues such as the composition of the board of directors, the issues that the board focuses on, processes they follow for decision making and how they Learn to continuously improve the governance of the corporation critically influence the quality of decisions and the management quality. Good corporate governance is very important for economic development, not only for the individual company, but also for the

[40] Dr. Yılmaz Argüden cited in International Finance Corporation (2010) *A Corporate Governance Model: Building Responsible Boards and Sustainable Business*. Available from: https://openknowledge.worldbank.org/bitstream/handle/10986/11098/538910BRI0GCGF10Box345633B01PUBLIC1.pdf?sequence=1&isAllowed=y

economy as a whole. Therefore, quality of governance should be continuously improved and good governance should be promoted. However, what is not measured, cannot be improved. Hence, there is a need for a model to measure the quality of corporate governance””[41] (Dr. Yılmaz Argüden cited in International Finance Corporation, 2010:3-4, https://openknowledge.worldbank.org/bitstream/handle/10986/11098/538910BRI0GCGF10Box345633B01PUBLIC1.pdf?sequence=1&isAllowed=y). [42]“A number of major changes have taken place in capital markets over recent years. These include: the growing importance of non-equity financial instruments; new types of equity owners; changes in the services offered by, and the use of, intermediaries; and pressures to harmonise internationally diverse practices in corporate governance. These changes and controversies present significant challenges to existing models of corporate governance. Moreover, the changing nature of capital markets tests the validity of existing models of corporate governance” (The Institute of Chartered Accountants in England and Wales, 2013:2, www.icaew.com). In the following section the definition of terms will be covered in detail.

3.2 Definition of terms

Definitions help to simply the meaning of terms. The four terms that will be defined in this chapter include: fairness, principles, responsibility and accountability. A *principle* refers to a rule, norm, a habitual belief that shapes behavior in a manner that upholds what an individual, society or organization strongly values (Rudolph. Patrick. T. Muteswa, 2019). In the context of this book ‘principles’ are the rules or guidelines of corporate governance. “*Responsibility* refers to having the duty to conduct a specific action, task, role or obligation as expected over a specific period of time” (Rudolph. Patrick.T. Muteswa, 2019). In the context of this textbook board of directors and senior management have the responsibility of upholding good corporate

[41] Dr. Yılmaz Argüden cited in International Finance Corporation (2010) *A Corporate Governance Model: Building Responsible Boards and Sustainable Business*. Available from: https://openknowledge.worldbank.org/bitstream/handle/10986/11098/538910BRI0GCGF10Box345633B01PUBLIC1.pdf?sequence=1&isAllowed=y

[42] The Institute of Chartered Accountants in England and Wales (2013) *What are the Overarching Principles of Corporate Governance?* Available from: https://www.icaew.com/-/media/corporate/files/technical/corporate-governance/dialogue-in-corporate-governance/what-are-the-overarching-principles-of-corporate-governance.ashx?la=en

governance practices in the organization. *"Accountability* is whereby an individual, organization, institution or any legal entity is willing to become liable for any act, decision or results that may be considered to be unethical, wrong and unjust" (Rudolph. Patrick.T. Muteswa, 2019). For the purposes of this book accountability is whereby the board of directors and senior management are willing to become liable for any act, decision or results that may be considered to be unethical, wrong and unjust to the internal and external stakeholders of the organization. *"Fairness* is whereby equal treatment is uniformly applied to everyone dealing with an organization, institution, person or any form of legal entity and it is done in a way that is in direct alignment with relevant legislation and or rules" (Rudolph. Patrick.T. Muteswa, 2019). "*Consistency* refers to maintaining continuity or regularly doing something the same way" (Rudolph. Patrick.T. Muteswa, 2019). Corporate governance codes help to maintain consistency of adhering to good corporate governance practices by the board of directors and senior management. In the next section the advantages of the core principles of corporate governance will be outlined in detail.

3.3 What are the core principles of corporate governance

"Main principles of corporate governance are: consistency, responsibility, accountability, fairness, transparency, and effectiveness that are deployed throughout the organization. Companies have an influence in mobilizing not only their own resources, but also the resources of others in the value chain. Therefore consistency of the policies creates the right expectations in the value chain and helps the value chain to be stronger as a whole. In order to create value, a balanced risk taking and making difficult decisions on a timely basis are essential. Therefore, decision makers at all levels should assume the responsibility to take initiative and be accountable for their decisions. Each decision requires balancing the interests of different stakeholders. Those who are deemed to be fair in their decisions are able to establish longer term relationships which are critical for long term sustainable development. Every company needs to gain the trust of others not only for financial resources, but also for all other resources that it uses to create value. Trust can only be gained with transparency. Unless the mobilized resources are used effectively, it would not be possible to mobilize additional resources. Therefore, effectiveness and the communication of effectiveness are critical for long term success. As each decision maker within the organization has an important role in establishing the reputation of the corporation, deployment of these principles throughout the organization is important for having successful corporate governance"[43] (Dr. Yılmaz Argüden cited in International Finance Corporation, 2010:3, https://openknowledge.worldbank.org/). "*Overarching Principles*. We have identified the following five overarching principles. Though generally derived from the UK Corporate Governance Code, they also underpin other corporate governance codes. Most components of existing codes should relate to one or more of these principles. However, some of the principles go beyond the current scope of codes.

• **Leadership -** An effective board should head each company, steering the company to meet its business purpose in both the short and long term.

• **Capability -** The board should have an appropriate mix of skills, experience and independence to enable its members to discharge their duties and responsibilities effectively.

• **Accountability -** The board should communicate to the company's shareholders and other stakeholders at regular intervals, a fair, balanced and understandable assessment of how the company is achieving its business purpose and meeting its other responsibilities.

• **Sustainability** - The board should guide the business to create value and allocate it fairly and sustainably to reinvestment and distributions to stakeholders, including shareholders, directors, employees and customers.

• **Integrity** - The board should lead the company to conduct its business in a fair and transparent manner that can withstand scrutiny by stakeholders"[44] (The Institute of Chartered Accountants in England and Wales, 2013:3, www.icaew.com/). The following section will cover the advantages of principles of corporate governance.

[43] Dr. Yılmaz Argüden cited in International Finance Corporation (2010) *A Corporate Governance Model: Building Responsible Boards and Sustainable Business*. Available from: https://openknowledge.worldbank.org/bitstream/handle/10986/11098/538910BRI0GCGF10Box345633B01PUBLIC1.pdf?sequence=1&isAllowed=y

[44] The Institute of Chartered Accountants in England and Wales (2013) *What are the Overarching Principles of Corporate Governance?* Available from: https://www.icaew.com/-/media/corporate/files/technical/corporate-governance/dialogue-in-corporate-governance/what-are-the-overarching-principles-of-corporate-governance.ashx?la=en

3.4 Advantages of principles of corporate governance

"*Benefits of setting out overarching principles*. Adhering to overarching principles can guide companies on issues that have threatened public confidence and trust in business in the wake of the global financial crisis. They can also provide broad guidelines for dealing with contentious governance issues such as board composition, diversity, executive remuneration and corporate taxation. Even where issues will result in new regulations or law in due course, overarching principles can function as interim measures. The scope of the proposed overarching principles is wider than the UK Corporate Governance Code. This reflects what is expected of companies in the context of the financial crisis and changes in capital markets. Overarching principles can contribute to open and dynamic board processes. The board can focus on how to best apply them in running the business and achieving their business purpose. This requires a different approach to compliance with laws and regulations. Overarching principles can also help board members examine their decision making critically and challenge whether they remain focused on the business purpose and other responsibilities. This should facilitate better understanding of corporate governance, more rigorous internal processes and more effective engagement with stakeholders. Overarching principles of corporate governance are implicit and hard to identify in existing codes. These codes tend to become longer and more complex over time"[45] (The Institute of Chartered Accountants in England and Wales, 2013:4, www.icaew.com). The following section will cover the characteristics of the principles of corporate governance.

3.5 Characteristics of the key principles of corporate governance

According to The Institute of Chartered Accountants in England and Wales (2013:4) *the characteristics of the overarching principles.* The proposed overarching principles should help companies to achieve their unique business purpose responsibly, yet with freedom to determine how. We want overarching principles to be:

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[45] The Institute of Chartered Accountants in England and Wales (2013) *What are the Overarching Principles of Corporate Governance?* Available from: https://www.icaew.com/-/media/corporate/files/technical/corporate-governance/dialogue-in-corporate-governance/what-are-the-overarching-principles-of-corporate-governance.ashx?la=en

• *Linked to business purpose***.** Overarching principles should relate to the overall purpose of the company. Overarching principles should contribute to, though not guarantee, the achievement of a company's business purpose.

• *Related to outcomes***.** Overarching principles should state intended outcomes or effects which compliance with specific governance practices and procedures aims to achieve. Scope details, examples and explanations of how principles apply to specific areas may be useful, but they are application guidance. By contrast, overarching principles should describe a mind-set that drives board members' behaviour and the corporate culture.

• *Focused on what is most important*. Overarching principles should be distinct and relevant to the most important outcomes only.

• *Clear and concise*. Overarching principles should be easy for boards and stakeholders to understand. This should open board decisions and behaviour to challenge and help win internal and external support.

• *Durable.* Overarching principles should be robust to withstand the test of time. This does not preclude the principles and their application adapting to change through consultation with stakeholders.

• *Widely accepted***.** Overarching principles should be aspirational and command acceptance among the company and its stakeholders. Even though achieving them might be difficult and take time, such acceptance among stakeholders enhances trust in the overarching principles and the company that seeks to apply them[46] (The Institute of Chartered Accountants in England and Wales, 2013:4, www.icaew.com). The next section will cover the three corporate governance models in-depth.

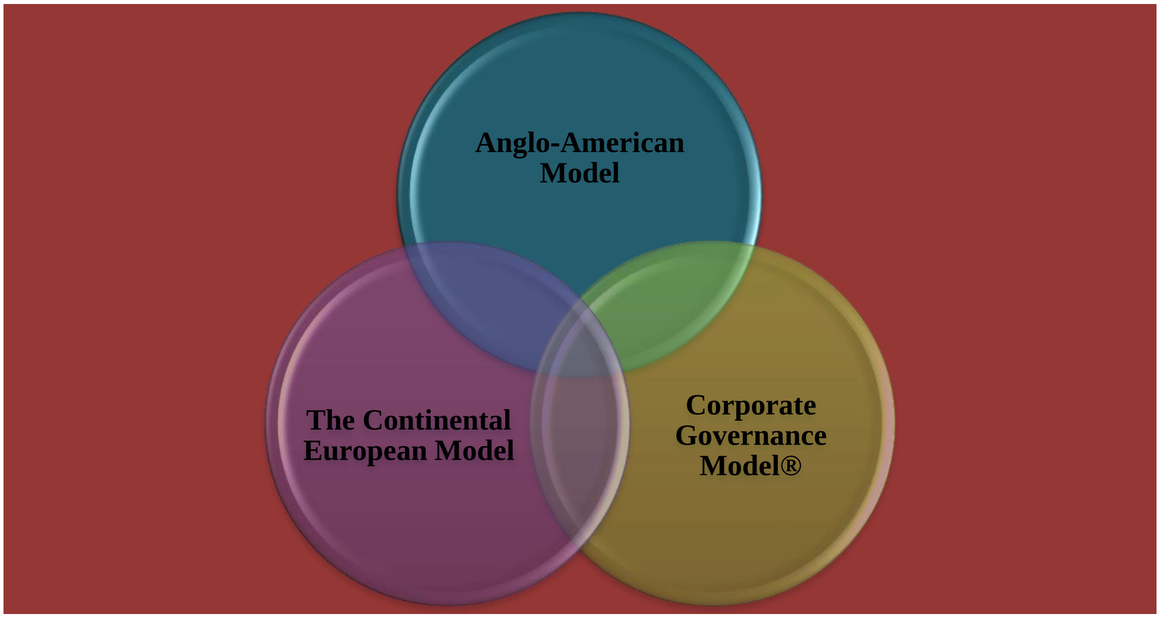
[46] The Institute of Chartered Accountants in England and Wales (2013) *What are the Overarching Principles of Corporate Governance?* Available from: https://www.icaew.com/-/media/corporate/files/technical/corporate-governance/dialogue-in-corporate-governance/what-are-the-overarching-principles-of-corporate-governance.ashx?la=en

3.6 Corporate governance models

[47]"Most attempts to measure the quality of corporate governance focus on compliance related issues. The various rating models also seem to focus on the inputs of governance, such as the composition of the boards, the separation of the CEO and Chairman roles. But do not pay sufficient attention to quality of information and decision making processes, or output measures such as the brand image, employee and customer satisfaction indices, or profitability and value creation. Also, most measures fail to incorporate any inter temporal measures of learning and development in governance" (Dr. Yılmaz Argüden cited in International Finance Corporation, 2010:5,https://openknowledge.worldbank.org/bitstream/handle/10986/11098/538910BRI0GCGF10Box345633B01PUBLIC1.pdf?sequence=1&isAllowed=y). The three models of governance that will be highlighted in this textbook will be depicted by Figure 3.1 below.

[47] Dr. Yılmaz Argüden cited in International Finance Corporation (2010) *A Corporate Governance Model: Building Responsible Boards and Sustainable Business*. Available from: https://openknowledge.worldbank.org/bitstream/handle/10986/11098/538910BRI0GCGF10Box345633B01PUBLIC1.pdf?sequence=1&isAllowed=y [Accessed 2019, 10 August] p1-15

Figure 3.1 Three models of corporate governance



Sources: Modified: (O'Connell, 2019, https://bizfluent.com; E-Corporate Social Responsibility, 2019, https://e-csr.net/; Dr. Yılmaz Argüden cited in IFC, 2010:3-6)

The three models of corporate governance that were previously highlighted by Figure 3.1 will be further explained and these include the following:

3.6.1 Anglo-American model

One of the most popular corporate governance models is the Anglo-American model which is also referred to as the Anglo-Saxon Model and it is implemented in countries that include the United States of America, the United Kingdom, Canada, Australia and so on. The foundation of the Anglo-US model is centered on the principle of shareholders who may be in the form of entities or human beings who are not from inside the organization but from outside the organization. The three principals that are part of the three sides of the triangle of corporate governance found in the Anglo-US model include: the board of directors, shareholders and management. The Anglo-US model was established or devised in such a manner that enables it to divide the ownership and control of an organization of any size or type. As a result of this most of the boards nowadays are comprised of both independent (*outside directors*) and non-independent directors (*inside directors or executive directors such as CEO, COO or CFO*). In general for the past several decades it has been the norm that organizations must appoint a single individual to become both the CEO and chairman of the board. The fact that more power was traditionally centralized towards one individual in the organization (*who also occupied the key job positions of a CEO and chairman*) ended-up creating the need to appoint an increased number of independent directors in the boards of several organizations. One of the most pivotal part of the Anglo-US model is consistent, timely and relevant communication channels between the three principals of the corporate governance triangle in the Anglo-US model (namely: *shareholders, management and the board*) and generally all the critical decisions of the organization are subjected to a voting system that is conducted by the shareholders of the organization[48] (O'Connell, 2019, https://bizfluent.com). A key element of this model is that capital markets often play a significant role in determining the activities of the organization through the supervision of shareholders.

3.6.2 The Continental European model

[49] *"The Continental European Model of Corporate Governance*. On the other hand, in Continental European countries such as Italy, France or Germany, shareholders groups hold large percentages of the total number of shares that are publicly traded and most shares are held by private companies, followed by financial institutions and in the last place by private persons. In these countries, fewer companies are publicly traded and people tend to invest their savings on an individual basis, instead of betting on the capital market. This means that in this model there is a high concentration of capital in a few shareholders that made big investments and took big risks too. This model is often associated with the stakeholder theory, as it also assumes the importance of companies having stakeholder engagement processes to strengthen the firms' legitimacy to operate" (E-Corporate Social Responsibility, 2019, https://e-csr.net/).

[48] O'Connell, B. (2019) *Models of Corporate Governance*. Available from: https://bizfluent.com/list-6710522-models-corporate-governance.html Leaf Group © 2019 Leaf Group, Ltd. U.S.A. All rights reserved.

[49] E-Corporate Social Responsibility (CSR) (2019) *Corporate Governance – Definition, Purpose & Benefits*. Available from: https://e-csr.net/definitions/corporate-governance-definition-purpose-and-benefits/

3.6.3 'Corporate Governance Model®'

[50]According to Dr. Yılmaz Argüden cited in International Finance Corporation (2010:3-6) Therefore, we have developed a Corporate Governance Model® that tries to remedy these shortcomings. The essence of the Model is to evaluate how the "CRAFTED" principles are applied to the "LOGIC" of governance. (Oversight, Guidance, Information, Culture, and continuous Learning). The Model aims to incorporate not only structural aspects of governance such as the composition of the boards, but also behavioral aspects such as the evaluation of sufficient number of alternatives in decision making, the quality of information that forms the basis of sound judgment, the culture of decision making, the processes, and the results of oversight and guidance functions of the board of directors. *Dimensions of the Model*. Corporate governance is a management culture rather than a list of codes. "CRAFTED" governance principles are the backbone of the Model. But the Model does not use corporate governance principles as a checklist, rather the Model tests how these principles are applied to the main activities of the board such as oversight, strategic guidance, choosing the top managers or board members, and improving its own processes. The evaluation and backbone of the Model stands on four main areas, three of which are input measures and the last area relates to output measures.

Inputs:

• Right People

• Right Team

• Right Processes

Outputs:

• Improvement in Business Results

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[50] Dr. Yılmaz Argüden cited in International Finance Corporation (2010) *A Corporate Governance Model: Building Responsible Boards and Sustainable Business*. Available from: https://openknowledge.worldbank.org/bitstream/handle/10986/11098/538910BRI0GCGF10Box345633B01PUBLIC1.pdf?sequence=1&isAllowed=y

Right People: Personal knowledge, skills, competencies, and experiences directly affect the quality of the board decision making. [51]Personal attitudes and manners also have an important role in strengthening both the team and the processes of governance. Therefore, the ability of the board members to express their opinions independently, to contribute a visionary perspective, and to make sound judgments are critical. Their ability to make the right choices for top management roles is also evaluated.

Right Team: As a role model, the team that makes up the board of directors should ensure the formation and improvement of the company culture with their behavior while executing their basic functions: strategic guidance and oversight. Right Team concept considers subjects like: complementary skills of the members, ability to work as a team, or avoiding group thinking pitfalls, etc.

Right Processes: Processes are applications of standards and identified governance approaches. They involve issues such as how information is provided to the board, how the board agenda is set, what the decision making rules are, what kind of resources are made available to the board, how the board monitors and improves its own performance. In fact board of directors, with its oversight function, has the responsibility to monitor the conformity between the principles and execution.

Improvement in Business Results: Continuous system development has an important impact in corporate learning processes. In monitoring results, one should look at comparisons with budgets, prior accomplishments, peers and best in class examples. Also, trends are as important as the current results. Therefore, positive trends in the business results are considered as an important indicator of success.

The three input areas "*Right People*", "*Right Team*" and "*Right Processes*" are evaluated in five dimensions. These five dimensions are grouped as the "*LOGIC*" of Corporate Governance. As shown with the graphical model, these five dimensions are:

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[51] Dr. Yılmaz Argüden cited in International Finance Corporation (2010) *A Corporate Governance Model: Building Responsible Boards and Sustainable Business*. Available from: https://openknowledge.worldbank.org/bitstream/handle/10986/11098/538910BRI0GCGF10Box345633B01PUBLIC1.pdf?sequence=1&isAllowed=y

• Learning

• Oversight

• Guidance

• Information, and

• Culture[52] (Dr. Yılmaz Argüden cited in International Finance Corporation, 2010:3, https://openknowledge.worldbank.org/bitstream/handle/10986/11098/538910BRI0GCGF10Box345633B01PUBLIC1.pdf?sequence=1&isAllowed=y). The LOGIC of governance will be covered in the following section.

3.7 LOGIC of governance

Furthermore, according to Dr. Yılmaz Argüden cited in International Finance Corporation (2010:7-9) ***Culture (Tone at the Top):*** The tone at the top sets the corporate culture. Therefore, both the conduct of the board members and their decisions and how they communicate these decisions are critical. All the members of the board should support, improve, and guide the corporate culture with their actions. Corporate culture is the cornerstone of creating trust inside and outside of the company. Implementation of "CRAFTED" governance principles, in all its activities, helps the company in both increasing trust to company and company value. The most important role of the board is to increase company's value by being *fair* and gaining trust of all stakeholders. Boards that develop an appropriate corporate culture, structure, and ensure their sustainability are more likely to achieve better business results that are sustainable. Such a culture becomes the corporate culture only when it is *deployed* to all the *people*, particularly at the management levels of the corporation. Board members must have positive criticism attitude in their communication with the management and stakeholders. Positive thinking also has the effect of improving the quality of decision making by increasing the interaction quality and increasing participation of stakeholders. Information: The information provided through an appropriate process to the members of the board of directors to be considered is a critical input.

[52] Dr. Yılmaz Argüden cited in International Finance Corporation (2010) *A Corporate Governance Model: Building Responsible Boards and Sustainable Business*. Available from: https://openknowledge.worldbank.org/bitstream/handle/10986/11098/538910BRI0GCGF10Box345633B01PUBLIC1.pdf?sequence=1&isAllowed=y

Quality of the information has an important effect on the quality of the oversight and guidance functions of the board. Board members must have positive criticism attitude in their communication with the management and stakeholders. Positive thinking also has the effect of improving the quality of decision making by increasing the interaction quality and increasing participation of stakeholders[53].

Information: The information provided through an appropriate process to the members of the board of directors to be considered is a critical input. Quality of the information has an important effect on the quality of the oversight and guidance functions of the board. Successful corporate governance needs evaluations based on timely and accurate information. The coverage and quality of the information prepared for the board will directly affect the quality of decision making and governance. The task of the board is guiding the corporation through the assessment of multi dimensional views. For this purpose, the board needs the right information, at the right time. The two important parameters of the Corporate Governance Principles—**consistency** and **transparency**, should be emphasized when considering information. From consistency perspective, the approach in information flow to the board should be continuously monitored, evaluated, and tested, and when necessary improved. Transparency and facts based information flow will enable sound decision making and give the opportunity to solve the problems before they get serious. The *process* of information flow to the board should involve not only financial information, but also forward looking issues such as developments in the values of intangibles, employee and customer satisfaction evaluations, competitive information, comparisons with past performance, budgets, and best of class benchmarks. Also, in order to make sure that all important matters are properly evaluated an annual agenda setting to cover key parameters such as succession issues, changes in competitive environment, organic and non-organic growth opportunities should be undertaken.

Oversight: The board oversight over the effective utilization of corporation's assets and resources in line with the corporation's strategy is a critical responsibility. In order to gain the

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[53] Dr. Yılmaz Argüden cited in International Finance Corporation (2010) *A Corporate Governance Model: Building Responsible Boards and Sustainable Business*. Available from: https://openknowledge.worldbank.org/bitstream/handle/10986/11098/538910BRI0GCGF10Box345633B01PUBLIC1.pdf?sequence=1&isAllowed=y

trust of all stakeholders, improve the company value, ensure efficient use of company resources and achieve superior performance, the oversight function must evaluate multidimensional indicators. Since boards have both the role of regulating and controlling the corporation, each of their decisions and the way they are communicated have profound implications for the behavior of the management.[54] Effective oversight requires a balanced evaluation of risk-reward profile of managements' decision making. Being too risk averse, may imply missing value creating opportunities, while being too risk prone may result in impairment of value. Ensuring an adequate consideration of such judgments by a knowledgeable group of people is one of the main reasons for boards to assume the *responsibility* of oversight. Also, oversight should be consistent with motivating the management for initiative taking assuming the *responsibility* for their decisions. In addition, effective *oversight* ensures that the corporation is managed in line with the strategic decisions and corporate policies. The *accountability* of the corporation to all the stakeholders and establishing a perception that the competing interests of different stakeholders are protected in a *fair* and well balanced way.

Fairness is important in establishing an effective oversight function of the board. Basing decisions on proper information and ensuring continuous development of internal control systems, helps in establishing a culture of fairness.

Strategic Guidance: A key board responsibility is providing strategic guidance. The essence of strategy is choice. And each choice involves risks. One of the key responsibilities of the board is to make sound judgments about risk-reward equations of the management proposals. A focused strategic approach and ability to make a difference requires the choices to be *consistent* with each other. On the other hand, *effective* establishment of the priorities is a key element of corporate success. As resources are inevitably constrained, priority setting is the key to ensure successful implementation of strategic initiatives. The process of the board for determining the strategies and monitoring the results requires that assessments are available for the effects of

[54] Dr. Yılmaz Argüden cited in International Finance Corporation (2010) *A Corporate Governance Model: Building Responsible Boards and Sustainable Business*. Available from: https://openknowledge.worldbank.org/bitstream/handle/10986/11098/538910BRI0GCGF10Box345633B01PUBLIC1.pdf?sequence=1&isAllowed=y

each choice for all the stakeholders. Also, making sure that risks and reward potentials are properly assessed is a key responsibility for the board.

Learning: Development of humanity is based on continuous learning. Passion for continuous improvement requires setting hypotheses and targets, establishing processes, implementing these processes, monitoring results, learning and implementing improvements. Therefore, learning will be evaluated under three perspectives.

1. Establishing a governance approach and deployment of the approach within the company

2. Continuous evaluation and development of the structures and approach

3. Impact on business results (Dr. Yılmaz Argüden cited in International Finance Corporation, 2010:3,https://openknowledge.worldbank.org/bitstream/handle/10986/11098/538910BRI0GCGF10Box345633B01PUBLIC1.pdf?sequence=1&isAllowed=y). In the following section aspects about corporate governance and sustainable development will be highlighted in-depth.

3.8 Corporate governance and sustainable development

[55]"*What is Sustainable Development*. First of all, it is important to clarify what sustainable development is. And according to the Brundtland Commission report, sustainable development is 'the one that satisfies the needs of the present without jeopardizing the ability of future generations to meet their needs.' In order to achieve this long-term corporate sustainability goal, the sustainable development concept is built on top of three important 'pillars' that must be fulfilled by companies: economic development, social equity, and environmental protection. Although companies have been working on developing the economic 'pillar', that has to do with production, sales, and profit, it hasn't always been like this for the environmental protection and social responsibility pillars that are nowadays getting inside the companies' agendas. The environmental pillar has to do with managing pollution, waste or energy consumption issues and therefore re-optimizing value-chains. The social pillar has an external dimension that means companies making up for the communities where their activities caused some kind of damage or inconvenience. Inside the company's workplace, it also means taking good care of the employees

[55] E-Corporate Social Responsibility (CSR) (2019) *Corporate Governance – Definition, Purpose & Benefits*. Available from: https://e-csr.net/definitions/corporate-governance-definition-purpose-and-benefits/

with fair wages and benefits, ensuring diversity and inclusion and respecting basic human needs and ethics. Despite there is an ongoing debate about the meaning and application of sustainable development in a business context, it is common to assume that if a company is able to fulfill these 3 pillars, then it is a socially responsible corporation. It is usual for these kinds of organizations to voluntarily provide information concerning their triple bottom line (another expression for the 3 pillars mentioned above) not only to prove they do the talk but also to gain a competitive advantage. By its turn, this information that is provided is often called *sustainability reporting* and it can be done using standard frameworks or simply by following methods and indicators chosen by an organization"[56] (E-Corporate Social Responsibility, 2019, https://e-csr.net/).

3.8.1 The interrelation of corporate governance and sustainable development

"“There is no doubt that sustainable development has entered our lives and the way business is done. Indeed, because of it, management boards are rethinking the way they think and work, caring not only for the return rates of the companies' shares and dividends or other issues that are commonly addressed by corporate governance but considering the society and the planet as well. For different reasons, they are integrating into their policies the *3 dimensions of sustainable development* and most companies nowadays have corporate social responsibility strategies and communication plans to share their goals within its employees and other stakeholders in the outside world. Especially because of climate change, some companies have been working hard on the environmental pillar, trying to prove to consumers that they are environmentally responsible so that their reputation is safeguarded and they can benefit from all that comes with it. This is one of the main reasons for the boards' interest in the environmental performance of the companies they manage and why they're disclosing information on these issues. This information is very useful to attract *"socially responsible investors"* that follow closely the behavior of these companies. These changes in the world of corporate governance, that are indeed needed for the sake of a long-lasting world, show that sustainability is really growing in the companies' agendas through the mindset of its leaders. In the end, companies that aim to last

[56] E-Corporate Social Responsibility (CSR) (2019) *Corporate Governance – Definition, Purpose & Benefits*. Available from: https://e-csr.net/definitions/corporate-governance-definition-purpose-and-benefits/

and thrive in the economic market and in the world need to consider sustainability. They need to report their sustainability practices and live by a sustainable culture that is aware that long-term profits need CSR policies if companies are to thrive and succeed. In this way, sustainable development must take part of the corporate governance of organizations”” (E-Corporate Social Responsibility, 2019, https://e-csr.net/). In the following section the conclusion of this chapter will be covered.

3.9 Conclusion

When a board is comprised of appropriately qualified people it is more likely to produce quality results, decisions and become highly engaged in all corporate governance related issues. The value of corporate governance exceeds that of compliance since it involves the implementation of the principles of corporate governance namely; principles, responsibility, accountability, consistency and fairness. Long term corporate sustainability goals of the organization can be maintained by simply following the rules and regulations identified in the corporate governance code and national legislation.

3.10 Review questions

1) Define the following terms: principles, fairness, responsibility, accountability and consistency?

2) Identify the four benefits of principles of corporate governance?

3) Describe the characteristics of the key principles of corporate governance?

4) Discuss the three models of corporate governance? Explain in greater detail the LOGIC of governance?

5) Define the term ‘sustainable development’? Describe the relationship between sustainable development and corporate governance?

Chapter 4: Transparency

After reading this chapter you should be able to:

- Define the terms transparency and honesty.
- Discuss the importance of transparency to an organization and its board.
- Identify how an organization can create a culture of transparency. Explain the ways used to identify an organization with a culture of transparency.
- Explain how an organization can effectively practice transparency in the organization and the boardroom.
- Describe the definition of integrating business reporting. Describe the seven purposes of integrating business reporting.

4.1 Introduction

"“Every January, the world's most powerful people gather in the Swiss Alps to think through mankind's woes and ponder how to make the world a better place. The 2012 Davos meeting appears to recognise that popular confidence in leaders of politics and business is at a new low, and have set the agenda accordingly. The theme of "new models" is appropriate to a world seeking reform of the global financial system, and stronger relationships between the rulers and the governed”"[57] (Corporate Transparency: Old Problems and New Ideas, 2012, by Transparency International is licensed under CC-BYND 4.0). The new buzz word that helps create an environment of honesty and integrity in both nations and organizations is 'transparency'. "Transparency and accountability need each other and can be mutually reinforcing. Together they enable citizens to have a say about issues that matter to them and a chance to influence decision-making and hold those making decisions to account. Each concept is part of a strategy used for and by citizens to have the means, resources and opportunities to influence decision-making and affect development outcomes"[58] (Transparency-Initiative.org, 2017, www.transparency-initiative.org). "After the *financial scandals* in the early 2000s, transparency

[57] Corporate Transparency: Old Problems and New Ideas (2012) by Transparency International is licensed under CC-BYND 4.0

[58] Transparency-Initiative.org (2017) *How Do We Define Key Terms? Transparency and Accountability Glossary?* Available from: https://www.transparency-initiative.org/blog/1179/tai-definitions/

has played a bigger role in preventing fraud from happening again, especially at such a large scale. But aside from stopping the next illegal moneymaking scheme, transparency also builds a good reputation of the company in question. When shareholders feel they can trust a company, they are willing to invest more, and this greatly helps in lowering cost of capital. Therefore, a company gets its ROI on the money it spent on improving transparency. Transparency is a critical component of corporate governance because it ensures that all of a company's actions can be checked at any given time by an outside observer. This makes its processes and transactions verifiable, so if a question does come up about a step, the company can provide a clear answer" (Roman, 2019, www.azeusconvene.com). The following section will cover the definitions of terms used in this chapter.

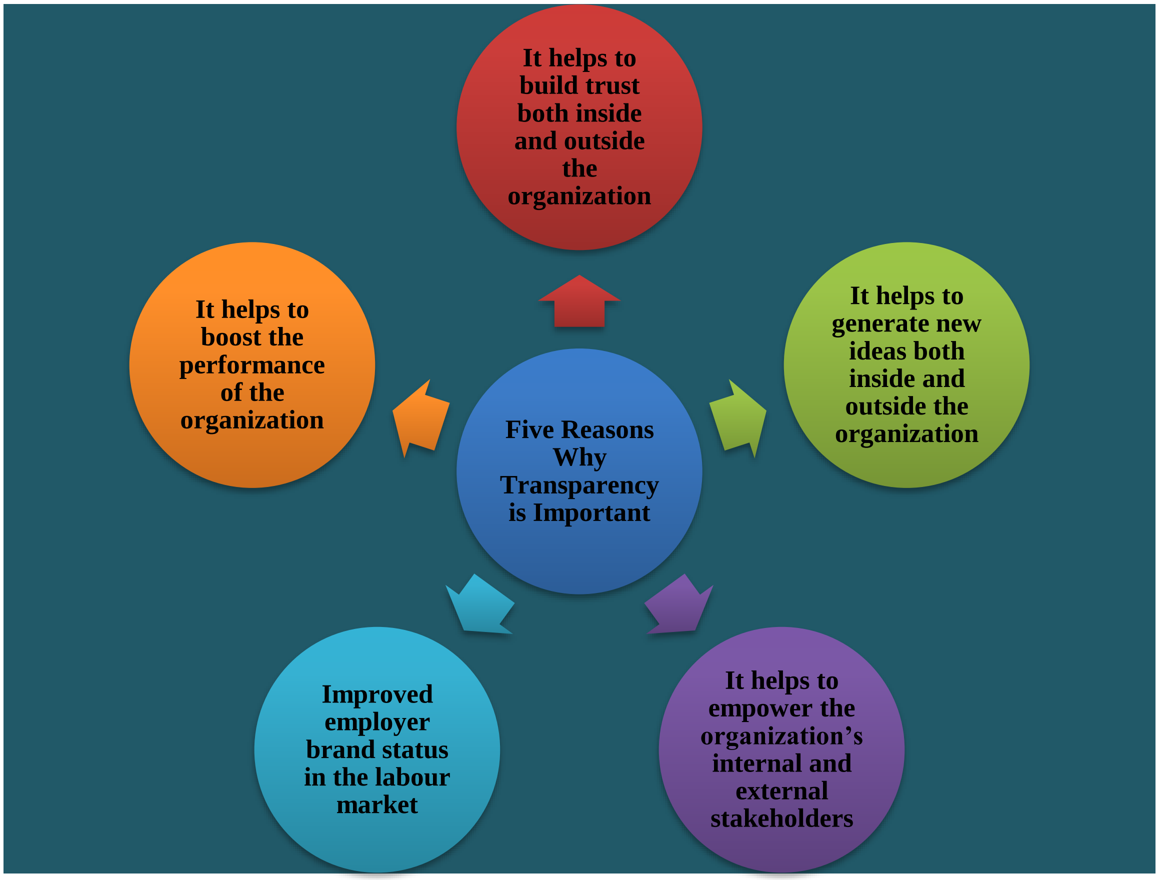
4.2 Definition of terms

In general there are several definitions of the terms 'transparency' and 'honesty'. *"What is transparency?* As a principle, public officials, civil servants, managers and directors of companies and organisations and board trustees have a duty to act visibly, predictably and understandably to promote participation and accountability"[59] (Transparency-Initiative.org, 2017, www.transparency-initiative.org). "*Honesty* can be defined as an inner motivation that drives an individual to be truthful, sincere and act with honor" (Rudolph. Patrick.T. Muteswa, 2019). The following section will discuss the importance of transparency in an organization and its board.

4.3 Importance of transparency to an organization & its board

Organizations exist for a specific purpose and one of them is to operate in an ethical and transparent manner. Therefore when boards adopt and implement policies or strategies that enable the organization to be transparent, ethical and compliant they will be aiming to align their operational activities to the mission statement. There are several benefits that are enjoyed by an organization by adopting and implementing transparent programs or policies. Some of the reasons why transparency is important to an organization and its boards are depicted in Figure 4.1 below.

Figure 4.1 Five reasons why transparency is important in an organization



Source: Modified: (International City/County Management Association, 2013, https://icma.org/)

As previously highlighted by Figure 4.1 the five reasons why transparency is important include the following:

4.3.1 It helps to build trust both inside and outside the organization. Generally transparency involves practically making all forms of information in an organization publicly available to everyone in a manner that consistently upholds: honesty, integrity and good corporate governance standards[60]. When the organization makes information publicly available this automatically enables the organization and its board to establish or re-cement trust with both its internal stakeholders (*such as employees, management, shareholders, executive management and board*) and external stakeholders (*such as customers, suppliers, government, the community and*

[60] International City/County Management Association (ICMA) (2013) *Top 10 Benefits of Transparency*. Available from: https://icma.org/articles/article/top-10-benefits-transparency

so on) (International City/County Management Association, 2013, https://icma.org/articles/article/top-10-benefits-transparency).

4.3.2 It helps to generate new ideas both inside and outside the organization. Transparency is whereby an open and honest communication is established by the organization where information is consistently made publicly available in order to boost the generation of new ideas. One of the most effective ways of gaining new ideas is through offering both internal and external stakeholders of the organization communication platforms where they can openly suggest new ideas and interact with the organization[61] (International City/County Management Association, 2013, https://icma.org/articles/article/top-10-benefits-transparency).

4.3.3 It helps to empower the organization's internal and external stakeholders. In general trust thrives when transparency prevails in an organization and its board. When all the organization's everyday operational activities are carried-out in an honest, accountable and ethical manner the organization's stakeholders naturally become confident and empowered to take responsibility (International City/County Management Association, 2013, https://icma.org/articles/article/top-10-benefits-transparency).

4.3.4 Improved employer brand status in the labour market. One of the key advantages of transparency in an organization is that it helps to boost the employer brand status of the organization in the labour market since nowadays knowledge workers highly value employers who have the following traits: (1) make information publicly available and (2) communicate truthful facts on a regular basis. When information and business activities are managed in an honest and accountable manner a highly conducive working environment is established and this helps to strengthen the employer brand of the organization in the modern day labour market.

4.3.5 It helps to boost the performance of the organization. It has since been discovered over the past number of years that organizations that embrace a transparency culture in their everyday operational activities often perform better due to the following: (1) increased employee morale which ultimately leads to increased productivity levels as a result of the employees feeling highly valued due to the fact that they are involved in decision making processes and information

[61] International City/County Management Association (ICMA) (2013) *Top 10 Benefits of Transparency*. Available from: https://icma.org/articles/article/top-10-benefits-transparency

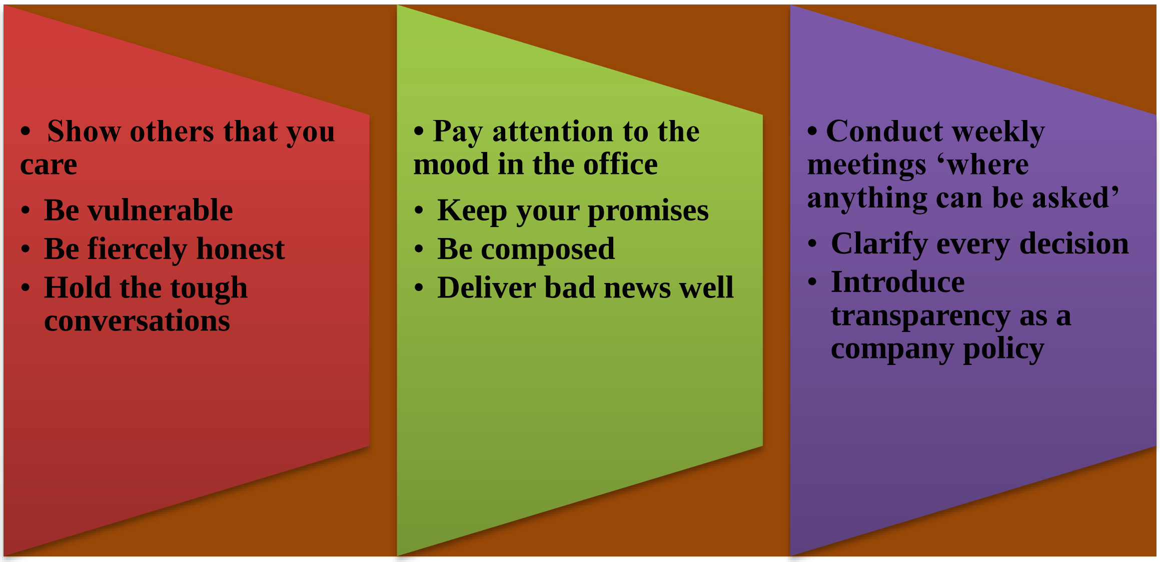
sharing with management, (2) increased innovation rates by the organization through new product developments, new patents registrations, new organizational systems or processes and so on, (3) increased market and brand value of the organization as a result of attracting a good corporate reputation in the market which also ultimately results in increased brand power. The following section will cover the different ways an organization can use to create a culture of transparency.

4.4 How to create a culture of transparency

There are several ways an organization can use to establish a transparency culture that may be adopted organization wide. "In creating a culture of transparency, a leader's actions and behaviors fabricate a workplace climate that generates trust, engagement, and buy-in from employees. Many books describe systems, modes of communication, and methods to employ to yield higher transparency. Those are important tools, but without a leader consistently behaving in ways that enlist willing employees to accomplish strategic objectives, those approaches are not sufficient"[62] (University of Florida Training and Organizational Development, Office of Human Resource Services, 2019:1, www.training.hr.ufl.edu/). The ways an organization can use to develop a culture of transparency will be depicted in Figure 4.2 below.

[62] University of Florida Training and Organizational Development, Office of Human Resource Services (2019) *Creating a Culture of Transparency*. Available from: https://www.training.hr.ufl.edu/resources/LeadershipToolkit/job_aids/CreatingaCultureofTransparency.pdf [Accessed 2019, 27 September] p1-2

Figure 4.2 Eleven ways that can be used by an organization to establish a culture of transparency



Source: Modified: (University of Florida Training and Organizational Development, Office of Human Resource Services, 2019, www.training.hr.ufl.edu/; Cullen, 2017, www.mentimeter.com).

The various ways that can be implemented by board of directors and executive management to create a culture of transparency in an organization were depicted in Figure 4.2 and these will be discussed further below. According to the University of Florida Training and Organizational Development, Office of Human Resource Services (2019:1) *Eight Things Leaders Can Do to Create Transparent Cultures*:

4.4.1. Show others that you care. Leaders must daily answer the unspoken question in employees' minds "Do you care about me?" When employees feel seen, heard, affirmed, and supported, that question turns into a conviction: "I will follow you because I know you will help me succeed." To do this leaders must intentionally nurture their relationships with direct reports and ensure that what employees need to develop professionally is provided. Human beings thrive when personal connections are forged and maintained. Relationship building creates safety, understanding, appreciation, and reliability. What people expect from their leaders is often embedded in these basic interpersonal leader-follower connections. Some leaders mistakenly believe these factors are not necessary in a workplace environment. Nothing could be further from the truth. Once leaders build this platform and maintain it, execution of strategic objectives often flourishes[63].

4.4.2. Be vulnerable. Some leaders might wince at that phrase, thinking that it will somehow diminish them in the eyes of their employees. However, most employees greatly appreciate a leader who allows them to get to know their leader's authentic self. Vulnerability demonstrates sincerity of being and builds credibility. It does require leaders to have a certain level of maturity, judgment, and self-awareness, though, to gauge the ability of employees' accurately interpreting and disseminating the information that is revealed. A key indicator of a vulnerable leader is one who asks for feedback about his/her own performance. Discovering how others perceive them, can allow leaders to better align their intentions with reality and course correct as needed to continue to build the culture of transparency they desire. Being vulnerable in this way also models for employees that feedback is a powerful tool for improvement and building a high performance team.

4.4.3 Be fiercely honest. In our work with employees across campus, at least half reveal that their leaders could be more honest. Today's employees place a premium on workplace environments that remove the fog of unknowns and deficiencies that usually creep into their minds about how decisions are made and the impact on them. When leaders hold onto information, for whatever reason, they erode trust. If leaders don't have all the pieces in place or are waiting on more data to come in, they should say so. This shows respect for employees and understanding of their concern and need for information. This type of honesty goes a long way to eliminating that pervasive feeling that there are hidden agendas. There is no better role-model than a courageous leader who is willing to be fiercely honest with good news and bad news. This

[63] University of Florida Training and Organizational Development, Office of Human Resource Services (2019) *Creating a Culture of Transparency*. Available from: https://www.training.hr.ufl.edu/resources/LeadershipToolkit/job_aids/CreatingaCultureofTransparency.pdf [Accessed 2019, 27 September] p1-2

sends the message to your employees that they can handle the information and that they can count on you to connect the dots for them when needed[64].

4.4.4. Hold the tough conversations. If you want to be a leader of a mediocre team or organization, then dance around issues of performance. This avoidance results in a loss of confidence and security. It also creates a climate where employees hold back in giving their full commitment. Why? Because employees need a workplace environment that does not tolerate uncivil interactions, unproductive gossiping, the blaming of others, and negative behaviors that jeopardize the teams' performance towards goals and objectives. Being a transparent leader means making sure that employees are crystal clear on your commitment to holding those conversations, when needed. There should be no question that inconsiderate and disrespectful behavior will not be tolerated.

4.4.5. Pay attention to the mood in the office. Emotions have a profound effect on just about everything we do in the workplace. They influence our thoughts, behaviors and attitudes. When leaders are transparent about letting employees know they are paying attention to these factors, it sends the message that they are listening, observing, and, yes, caring about the experiences employees are having within the workplace. It also reinforces a leader's awareness of how her/his own moods can "infect" the team, both positively and negatively.

4.4.6 Keep your promises. Leaders who keep their promises on the little things build trust for the big things. This sets the tone for the entire organization. Showing up on time for meetings, returning emails promptly, and following up on requests you have made of employees are examples of the little things. Being a transparent leader in this area means that you are communicating your promises clearly and cleanly so there are no misunderstandings. You avoid using vague language, such as "I will try to make the meeting," or "You will hear from me

[64] University of Florida Training and Organizational Development, Office of Human Resource Services (2019) *Creating a Culture of Transparency*. Available from: https://www.training.hr.ufl.edu/resources/LeadershipToolkit/job_aids/CreatingaCultureofTransparency.pdf [Accessed 2019, 27 September] p1-2

ASAP." And, you model for your employees, using language that is specific increases levels of accountability[65].

4.4.7. Be composed. Leaders who have self-control, poise, and patience minimize workplace anxiety and uncertainty. A leader's composure is reflected in his/her attitude, body language and overall presence. Even in the most pressure-packed moments, leaders can acknowledge that a problem is happening and still remain calm. Employees are always watching their leaders, especially in difficult times, so staying strong and confident, smiling often and authentically showing a sense of compassion neutralizes workplace chaos and creates certainty that a confident, caring, and fearless leader is in charge.

4.4.8. Deliver bad news well. Yes, as leaders, there are times that do try men's (and women's) souls. But leaders who downplay tough situations, blame others, or flat-out lie about them are not creating cultures of transparency. Delivering bad news well demonstrates courage, showing that you are a leader who, despite being personally uncomfortable, will do things for the good of the organization and team. Bad news is usually obvious to everyone, so addressing it quickly with employees is critical. Say as much as you can to employees without divulging confidences and don't play the blame game. When employees voice concern or appear upset, listen to them so they feel that you are "in it with them" and not throwing a mess on them and walking away. Make sure employees know what the steps are to correct a situation and communicate often on where you are in the process of mitigation (University of Florida Training and Organizational Development, Office of Human Resource Services, 2019:1-2, https://www.training.hr.ufl.edu/resources/LeadershipToolkit/job_aids/CreatingaCultureofTransparency.pdf).

4.4.9 Conduct weekly meetings 'where anything can be asked'. Transparency is displayed when the board, functional departments and teams conduct weekly meetings consistently where everyone attending is allowed to ask anything they would like to know about the organization or

[65] University of Florida Training and Organizational Development, Office of Human Resource Services (2019) *Creating a Culture of Transparency*. Available from: https://www.training.hr.ufl.edu/resources/LeadershipToolkit/job_aids/CreatingaCultureofTransparency.pdf [Accessed 2019, 27 September] p1-2

their area of concern. The leaders of the organization such as executive directors and senior management must ensure that they are consistently well updated with information about the organization's current and future goals, activities and responsibilities so that they can be ready to answer any questions brought to their attention in the meetings. Such meeting sessions help to uplift the corporate governance standards of the organization as leaders will often refer to the rule book of the Corporate Governance Guidelines in order to make good judgements and actions that are in the interest of the organization and its stakeholders[66] (Chen, 2017, www.mentimeter.com).

4.4.10 Clarify every decision. Interestingly, there is no simpler and more effective way an organization and its leaders can use to show everyone that it has nothing to hide than allowing people to participate in the decision-making process as this helps to boost transparency while on the other hand enabling the organization to attain its corporate governance goals. "What's even better than explaining your decision, than to involve others in the decision making process. You can do this in a number of different ways. Sometimes a quick poll on a subject can be enough to get input from others, in other cases you might want to hold a workshop or brainstorming session in order to make a collaborative decision. This approach to decision making does not only make you more transparent as a leader, but it can also help you come to better decisions for your organization"[67] (Cullen, 2017, www.mentimeter.com).

4.4.11 Introduce transparency as a company policy. An organization's board and senior executives that want to take transparency to the next level organization-wide while simultaneously showing the people they lead that transparency is an integral part of achieving good corporate governance practices will ensure that they introduce it as a new policy in the organization despite the fact that it is highlighted in the Corporate Governance Guidelines Rules Book of the organization. Thus by doing so employees, teams and senior management will more frequently discuss conversations or topics that are centered around transparency such as why it is

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[66] Chen, G. (2017) *Three Ways to Improve Transparency*. Available from: https://www.mentimeter.com/blog/transparency-at-work/three-ways-to-improve-transparency

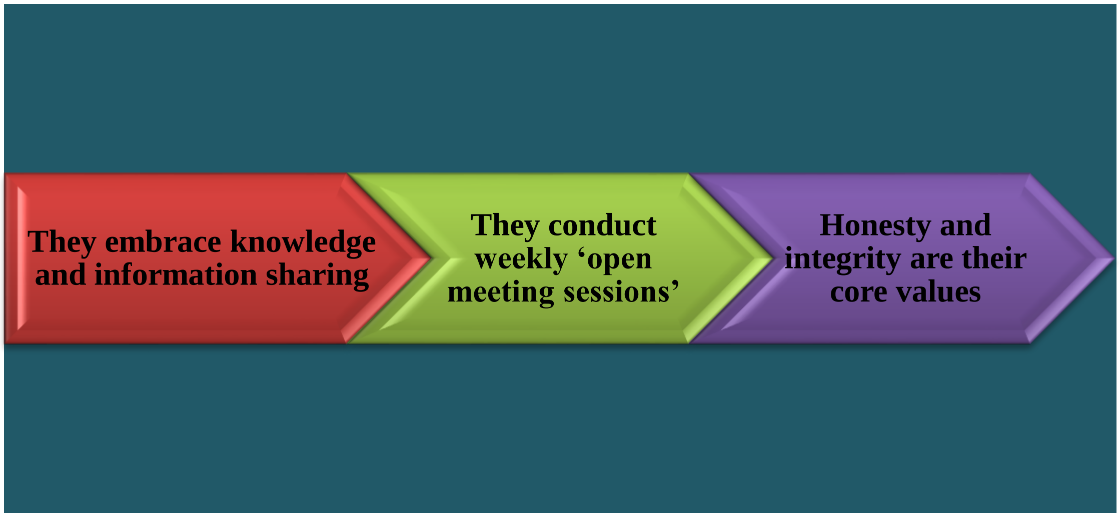
[67] Cullen, E. (2017) *6 Things that Leaders Can Do to Promote Transparency in the Workplace*. Available from: https://www.mentimeter.com/blog/transparency-at-work/6-things-that-leaders-can-do-to-promote-transparency-in-the-workplace

important, how it must be implemented, how to develop a transparency model and so on (Cullen, 2017, www.mentimeter.com). In the following section the ways that are used to identify an organization with a culture of transparency will be covered in the following section.

4.5 Ways used to identify an organization with a culture of transparency

Nowadays it has become critical for organizations to benchmark their corporate governance practices against their competitors or organizations they consider to be better than them. Thus this makes it necessary for business leaders to ensure that they become knowledgeable about the several ways that can be used to identify organizations with a culture of transparency so that they can emulate or follow in their footsteps in a ethically acceptable manner. The three ways that can be used to identify organizations with a culture of transparency will be depicted in Figure 4.3 below.

Figure 4.3 Three ways that can be used to identify organizations with a culture of transparency



Source: Modified: (Chen, 2017, www.mentimeter.com)

As depicted by Figure 4.3 above there are various ways that an organization can use to identify organizations with a culture of transparency and these include:

4.5.1 They embrace knowledge and information sharing

This oftenly starts at the actual workspaces of lower level employees then it goes all the way up to senior management level and finally the board room level. An organization with a culture of transparency often provides easy access to information to its internal and external corporate governance stakeholders on information such as financial statements, code of ethics and governance, sustainability goals, mission statement, corporate communication department contact information and they often participate on a regular basis at Trade Exhibitions or Career Exhibitions shows or conferences. In addition pro-transparency organizations tend to have open plan office workspaces for their employees in an effort to convince them that the organization has nothing to hide and also to encourage the free flow of ideas or communication from one colleague to another on a continuous basis. They often use various tools that assist in the sharing of data with everyone in the organization in order to communicate with everyone in the organization in advance in such a way that the information being communicated is clearly understood to enable everyone to easily work together in a innovative and ethical way whilst simultaneously adhering to the corporate governance practices of the organization. An organization that has a culture of transparency can easily be identified by embracing knowledge and information sharing.

4.5.2 They conduct weekly 'open meeting sessions'

This is one reliable way that can be used to identify an organization with a culture of transparency. The board of directors, executive directors, senior management and team leaders must ensure that they conduct weekly sessions where people can ask them anything they feel they have the right to know about the organization and its activities without fear. These types of meetings help to promote accountability and transparency which are the core principles of corporate governance. Therefore, organizations that conduct weekly 'open meeting sessions' can be identified as having a culture of transparency (Chen, 2017, www.mentimeter.com).

4.5.3 Honesty and integrity are their core values

A key determinant of an organization that has a culture of transparency is honesty and integrity. Nowadays there are numerous scandals in the media about misconduct, corruption or poor business leadership in organizations located across various parts of the world thus this puts intensive pressure in some organizations to resort to communicating falsehoods to the public in order to avoid negative publicity in the media about their irregular business activities. Organizations that have adopted and set honesty and integrity as their core values will consistently ensure that they inform their internal and external corporate governance stakeholders the truth of what really happened or what they believe they have the right to know the truth despite the threat of a negative media coverage or poor corporate image. It is important to note that it is more likely that there will be less negative publicity to the organization when it adopts an honesty policy focused on truthful facts and vice versa when it is caught communicating falsehood facts that were meant to hide the truth from its stakeholders. The following section will cover aspects on how an organization can practice transparency.

4.6 How to practice transparency in the organization & boardroom

"But although transparency is a necessity for the whole company, its presence is even more important at the top where strategies are planned and decisions are made. Shareholders expect that the corporate board is open about their actions; otherwise, distrust will form. And when trust breaks, shareholders tend to stay away and invest somewhere else. How transparent is your corporate board? Are directors' actions readily verifiable by internal and external audit? Is their leadership visible from the top to all the way down? Is transparency applicable to everyone? Transparency should have no exceptions, especially when your company's goals are involved. All stakeholders — from employees to investors — have the right to know about the direction your company is headed for"[68] (Roman, 2019, www.azeusconvene.com). Nowadays most of the large corporations are now implementing transparency as part of their ethics and compliance programs that encompass: (1) establishing communication channels with everyone in the organization, (2) transparency, (3) anti-bribery compliance, (4) anti-corruption compliance, (5) whistleblowing, (6) Speak Up programs and many other programs. The first step towards achieving transparency is creating effective communication channels in the organization. "Simply making information available is not sufficient to achieve transparency. Large amounts of raw information in the public domain may breed opacity rather than transparency. Information should be managed and published so that it is:

• *Relevant and accessible:* Information should be presented in plain and readily comprehensible language and formats appropriate for different stakeholders. It should retain the detail and disaggregation necessary for analysis, evaluation and participation. Information should be made available in ways appropriate to different audiences.

• *Timely and accurate:* Information should be made available in sufficient time to permit analysis, evaluation and engagement by relevant stakeholders. This means that information needs to be provided while planning as well as during and after the implementation of policies and programmes. Information should be managed so that it is up-to-date, accurate, and complete"[69] (Transparency-Initiative.org, 2019, www.transparency-initiative.org). In the following section transparency entails integrating business reporting.

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[68] Roman, A. (2019) *The Three Pillars of Corporate Governance*. Available from: https://www.azeusconvene.com/articles/three-pillars-of-corporate-governance

[69] Transparency-Initiative.org (2019) *How Do We Define Key Terms? Transparency and Accountability Glossary*. Available from: https://www.transparency-initiative.org/blog/1179/tai-definitions/

4.7 Transparency entails integrating business reporting

"Strong local capital markets are essential for a thriving private sector. In developing countries, capital markets—many still in their infancy—hold great potential to channel private capital towards priority development needs and help companies obtain long-term financing. Before capital can flow to emerging markets, however, investors need to better understand and trust these markets. They need robust information that is complete, accurate, and reliable in accordance with accepted international practices so that they can make sound investment decisions. The reason? Adhering to high standards of disclosure and transparency can mitigate some of the inherent risk in investing in emerging and frontier markets—weaker public institutions and governance, heightened social and environmental risk, and smaller companies with controlling shareholders. In turn, this can encourage more investors to consider adding well-governed emerging market companies to their investment portfolios"[70] (International Finance Corporation, 2019, www.ifc.org). [71]According to the International Corporate Governance Network (2015:5) in a fast-changing and globalising world, information material to investor decision-making is becoming increasingly diverse and dynamic. Long-term success in managing a business in today's complex economic, environmental and social landscape is increasingly dependent on factors not directly reflected in financial statements and strategic decisions will usually need to be based on a broader set of factors than those reflected in financial statements (International Corporate Governance Network, 2015:5, www.icgn.org). "The International Corporate Governance Network recognises that there is a need to balance corporate disclosure with protection of commercially sensitive information. Integrated business reporting should be both quantitative and qualitative in nature" (International Corporate Governance Network, 2015:11, www.icgn.org). The various purposes of integrated business reporting towards

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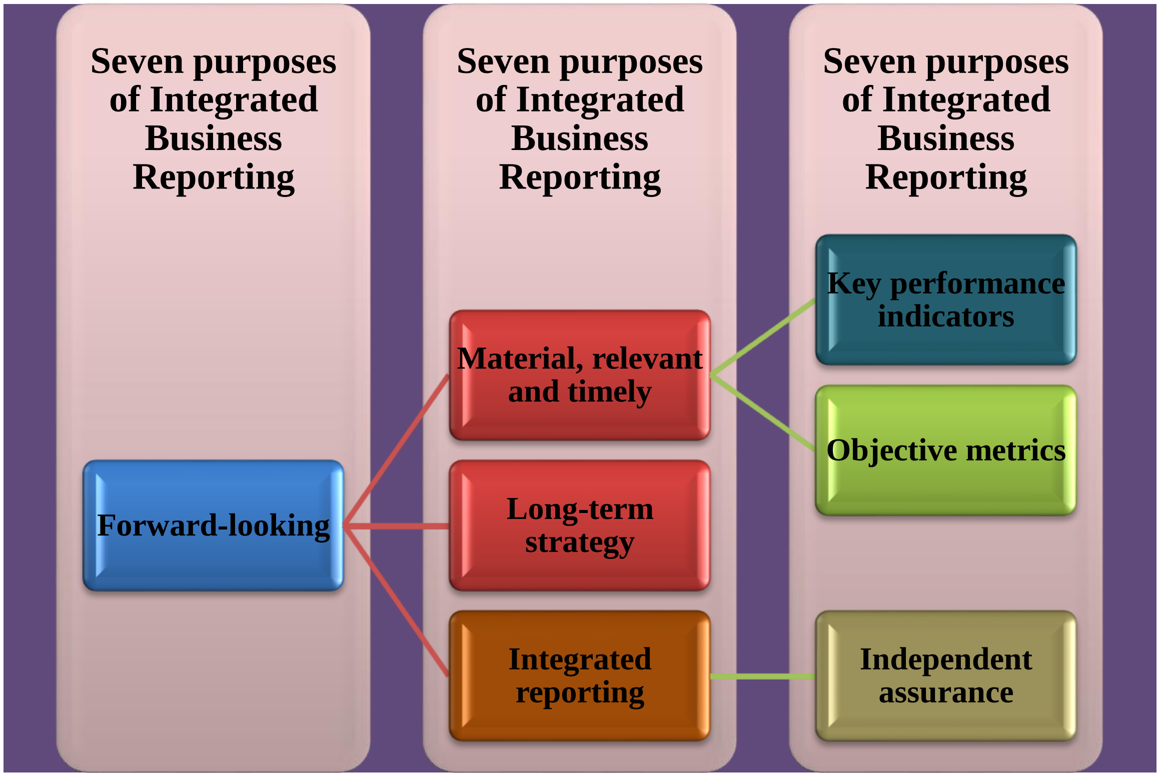
70 International Finance Corporation (2019) *IFC Unveils New Toolkit to Improve Companies' Disclosure and Transparency.* Available from: https://www.ifc.org/wps/wcm/connect/news_ext_content/ifc_external_corporate_site/news+and+events/news/ifc+unveils+new+toolkit+to+improve+companies+disclosure+and+transparency

71 International Corporate Governance Network (*ICGN*) (2015) *ICGN Guidance on Integrated Business Reporting.* Available from: https://www.icgn.org/sites/default/files/Integrated%20Business%20Reporting.pdf [Accessed 2019, 13 August] p2-15

achieving transparency and good corporate governance in an organization will be depicted in Figure 4.4 below.

Figure 4.4 The seven purposes of integrated business reporting towards achieving transparency and good corporate governance



Source: Modified: (International Corporate Governance Network, 2015:5, www.icgn.org)

[72]According to the International Corporate Governance Network (2015:5-13) the purpose of setting out guidance on integrated business reporting from an investor perspective is to indicate to companies the type of reporting that is useful and to encourage the investment community to solicit such information.

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[72] International Corporate Governance Network (*ICGN*) (2015) *ICGN Guidance on Integrated Business Reporting.* Available from: https://www.icgn.org/sites/default/files/Integrated%20Business%20Reporting.pdf [Accessed 2019, 13 August] p2-15

4.7.1 Forward-looking. *Disclosures should be genuinely informative and include forward-looking elements where this will enhance understanding*. Integrated business reporting should support and enhance information in the financial statements and explain the linkages to non-financial information. It will set historic performance in the context of a company's strategy and market conditions and will offer insight into the potential for future success. Such forward-looking elements include trend data that can help investors to assess the company's strategy and prospects. For example, do disclosures indicate significant trends that are not evident from the financial statements and, if so, how these trends are likely to affect the company?

4.7.2 Material, relevant and timely. *Disclosure should be material, relevant and timely*. Integrated business information is material if it is information whose omission or misstatement could influence the economic decisions taken by users of the information. Integrated business reporting should be timely, in particular meeting market guidelines and it should be made available as soon as reasonably possible so that investors are able to make informed decisions based on it; this diminishes the likelihood of a false or distorted market. Information should be focused in order for it to be genuinely useful. Too much information that is not relevant will dilute the message. The materiality (or not) and relevance of the issues covered will be determined by the company's circumstances and the sector within which it operates, rather than being determined by a prescriptive approach as to what should be reported. It may be helpful for the company to explain why it considers the disclosures to be material.

4.7.3 Long-term strategy. *Disclosure should describe the company's business model for generating or preserving value over the longer term and how it underpins the strategy for delivering the objectives of the company, describe the associated risks and opportunities, and explain the board's role in assessing and overseeing strategy and the management of risks and opportunities.* [73]The explanation relating to the business model and strategy should focus on the key points necessary to help investors understand not only the business model, strategy, risks and

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[73] International Corporate Governance Network (*ICGN*) (2015) *ICGN Guidance on Integrated Business Reporting.* Available from: https://www.icgn.org/sites/default/files/Integrated%20Business%20Reporting.pdf [Accessed 2019, 13 August] p2-15

opportunities but also form a view of the appropriateness and effectiveness of the governance approach adopted by the board in its oversight of these matters.

4.7.4 Integrated reporting. *Disclosure should be accessible and appropriately integrated with other information that enables investors to obtain a picture of the whole company.* Integrated business reporting should be in a form that investors can reasonably be expected to understand. For example, complicated technical terms should be explained and care should be taken to ensure that the information is clearly written and presented. Integrated reporting is a process founded on joined-up thinking that results in a periodic integrated report by an organisation about how its strategy, governance, performance and prospects, in the context of its external environment, leads to the creation of value in the short, medium and long term. Integrated reporting provides a framework within which decisions of a long-term nature can be made, unlocking financial capital for investment, as well as providing a more holistic picture of how value is created, or destroyed, over time. Critically, businesses need to recognise the linkages between improvements in non-financial areas and financial metrics, such as earnings, cash flow or share price. Such improvements can often occur after a time-lag; this can highlight the importance of relevant non-financial measures to the extent they may act as a lead indicator of future performance. It is also important to avoid measuring too many things, which might otherwise lead to an unnecessary profusion of peripheral, trivial or irrelevant disclosures. matters.

4.7.5 Key performance indicators. *Disclosure should include key performance indicators that are linked to strategy and facilitate comparisons.* An indicator is likely to be important and relevant to strategy if it is used by the board and executive management in monitoring the company's performance in achieving its strategy and is therefore likely to affect board and managerial decisions. Indicators disclosed in integrated reporting should facilitate comparisons with other companies and for the same company over time. Where sector-specific practices have emerged for indicators, companies should make use of such indicators unless they have specific reasons for considering them inappropriate. Companies should disclose indicators that are comparable over time, unless circumstances change and they cease to be appropriate matters[74].

4.7.6 Objective metrics. *Disclosure should include objective metrics where they apply and evidence based estimates where they do not.* Where objective measures of intangibles are relevant and can be obtained, such measures should be used. In the absence of relevant objective measurements, estimates and commentary should be provided. Narrative discussion and judgement can be useful in conveying information. Both metrics and judgement are valuable in integrated business reporting. Credible and verifiable measurement of non-financial business reporting is vital. However, the development of valid metrics is challenging due to a variety of factors including the measurement of intangibles, claims of proprietary information, and comparability across qualitative data elements. The metrics for non-financial business reporting will frequently be determined by the specific characteristics of a company and the sector in which it is operating matters.

4.7.7 Independent assurance. *Disclosure should be strengthened by independent assurance that is carried out having regard to established disclosure standards applicable to non-financial business reporting, such as the IASB's Practice Statement on Management Commentary.* Independent assurance about the extent to which integrated business reporting has followed established measurement and reporting standards can be useful to enhance the credibility and reliability of the reported information. Companies should adopt a clear and disclosed policy towards obtaining assurance. Importantly, the integrated report should 'tell the story' of the company. It is not helpful to investors analysing companies for the report to be 'legal boilerplate' (International Corporate Governance Network, 2015:13, https://www.icgn.org/sites/default/files/Integrated%20Business%20Reporting.pdf). The following section will cover the conclusion of this chapter in-depth.

[74] International Corporate Governance Network (*ICGN*) (2015) *ICGN Guidance on Integrated Business Reporting.* Available from: https://www.icgn.org/sites/default/files/Integrated%20Business%20Reporting.pdf [Accessed 2019, 13 August] p2-15

4.8 Conclusion

Nowadays transparency has become a critical principle of corporate governance due to the fact that it helps to create a culture of openness, easy accessibility to information and sharing in an organization. When board of directors, senior management and employees are fully knowledgeable of the fact that they are answerable to the organization's internal and external corporate stakeholders they are more likely to uphold good honest, ethical and transparent behavior at the workplace. While on the other hand a culture of transparency can help to prevent unethical conduct at the workplace such as fraud, bribery and the communication of false information to the general public or stakeholders of the organization. Transparency is one of the most effective tool an organization can use to make all the necessary information investor friendly when investors are considering to invest in the organization willingly. It can therefore be concluded that transparency is a critical ingredient in reinforcing good corporate governance standards in the organization but it is considered to be more crucial at the top hierarchy levels of the organizational structure such as the board, the executive directors and shareholders. Shareholders often make investment decisions in an organization based on the openness of the board of directors in sharing information, actions and integrity.

4.9 Review questions

1) What is the meaning of the terms: transparency and honesty?

2) Describe the importance of transparency to an organization and its board?

3) Identify how an organization can create a culture of transparency? Discuss the ways used to identify an organization with a culture of transparency?

4) Describe how an organization can effectively practice transparency in the organization and the boardroom?

5) What is integrated business reporting? Identify the seven purposes of integrating business reporting?

Chapter 5: Aligning corporate & operational governance into corporate strategy

After reading this chapter you should be able to:

- Explain the meaning of the terms: corporate strategy, goals, objectives and operational governance.
- Identify the purpose of a corporate strategy. Explain how an organization can formalize its operational governance.
- Describe how an organization can align operational governance with the business model.
- Discuss the common characteristics of organizations without operational governance. Describe the key benefits of operational governance.
- Explain the role played by boards in developing a corporate and an ethics strategy.

5.1 Introduction

One of the routine fiduciary duties of a board of director in any type and size of organization is carrying-out strategic planning in order to determine the long term goals of the organization and how to incorporate both corporate and operational governance as a strategy. Strategic plans are devised by a board in an organization and the board also determines the approach that will be used in setting both corporate and operational governance as a strategic priority. Another responsibility of a board is to ensure that both corporate and operational governance strategy is appropriately aligned to both the business and corporate strategy. One of the guaranteed ways an organization can attain strategy is via its corporate governance guidelines and practices it adopts as a whole. Today most of the board of directors and senior management in organizations now place more emphasis on adding value to the organization's market value through transparent, honest, ethical and fair corporate governance practices in a manner that protects shareholders and other stakeholders' interest in the organization. "Governance is critical to all enterprises. In small companies it may be managed in an ad hoc way and still function properly, but in larger enterprises, governance that is managed in an ad hoc manner often fails. Many enterprises identify governance as the critical area of improvement necessary to better manage the people and processes that deliver the products and services provided by the company. Governance is a straightforward concept and is practiced by all enterprises. It is the *creation of policies* regarding various aspects of the business and then *making certain that the policies are followed.* Creating the policies is not the main issue in having good governance; all successful enterprises do a good job creating policies. The hard part of governance, and where most enterprises fail, is in monitoring the policies and in knowing that the policies have been followed; in other words achieving *control and compliance"*[75] (Vitria Technology, 2008:1, www.vitria.com). The following section will cover the definition of terms.

5.2 Definition of terms

There are many definitions that have been developed by academics and industry experts in the field of business management about terms such as corporate strategy, business strategy, objectives, goals, operational governance and operational risk. "*Corporate Strategy* takes a portfolio approach to strategic decision making by looking across all of a firm's businesses to determine how to create the most value. In order to develop a corporate strategy, firms must look at how the various businesses they own fit together, how they impact each other, and how the parent company is structured in order to optimize human capital, processes, and governance. Corporate Strategy builds on top of business strategy, which is concerned with the strategic decision making for an individual business"[76] (Corporate Finance Institute, 2019, https://corporatefinanceinstitute.com). *Business strategy* focuses on determining the ways an organization can use to compete whilst corporate strategy places more emphasis on choosing from the organization's business portfolio (*such as agribusiness, mining, banking, logistics and so on*) which businesses and or industry sector the organization must compete. "*Operational Governance* allows you to state your policies as business processes, and ensures

[75] Vitria Technology (2008) *Formalizing Operational Governance: Ensuring the Well Managed Enterprise*. Available from: https://www.vitria.com/pdf/WP-Formalizing-Operational-Governance.pdf [Accessed 2019, 18 August] p1-8

[76] Corporate Finance Institute (2019) *Corporate Strategy*. Available from: https://corporatefinanceinstitute.com/resources/knowledge/strategy/corporate-strategy/

that established business policies are followed throughout all operations of the enterprise"[77] (Vitria Technology, 2008:1, www.vitria.com). In the following section the purpose of a corporate strategy will be covered.

5.3 Purpose of a corporate strategy

It is the role of the executive directors and the board to ensure that the set corporate governance guidelines are adopted and implemented in all aspects of the organization and this includes the following: the allocation of resources, when creating the organizational structure, the management of the organization's subsidiary business units and strategic tradeoffs which all fall under the corporate strategy of the organization (Corporate Finance Institute, 2019**,** https://corporatefinanceinstitute.com). When corporate and operational governance policies are established they must be categorized and followed by everyone in the organization and they must also be implemented during the organizational design process in line with the corporate strategy. "*What are the Components of Corporate Strategy?* There are several important components of corporate strategy that *leaders of organizations focus on***.** The main tasks of corporate strategy are:

• Allocation of resources

• Organizational design

• Portfolio management

• Strategic tradeoffs"[78] (Corporate Finance Institute, 2019**,** https://corporatefinanceinstitute.com)**.**

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[77] Vitria Technology (2008) *Formalizing Operational Governance: Ensuring the Well Managed Enterprise*. Available from: https://www.vitria.com/pdf/WP-Formalizing-Operational-Governance.pdf [Accessed 2019, 18 August] p1-8

[78] Corporate Finance Institute (2019) *Corporate Strategy*. Available from: https://corporatefinanceinstitute.com/resources/knowledge/strategy/corporate-strategy/

“***#1 Allocation of Resources.*** The allocation of resources at a firm focuses mostly on two resources: people and capital. In an effort to maximize the value of the entire firm, leaders must determine how to allocate these resources to the various businesses or business units to make the whole greater than the sum of the parts. Key factors related to allocation of resources are:

• **People**

- Identifying core competencies and ensuring that they are well distributed across the firm
- Moving leaders to the places they are needed most and add the most value (changes over time-based on priorities)
- Ensuring an appropriate supply of talent is available to all businesses

• **Capital**

- Allocating capital across businesses so that it earns the highest risk-adjusted return
- Analyzing external opportunities (mergers and acquisitions) and allocating capital between internal (projects) and external opportunities” (Corporate Finance Institute, 2019**,** https://corporatefinanceinstitute.com)**.**

“#2 Organizational Design. Organizational design involves ensuring that the firm has the necessary corporate structure and related systems in place to create the maximum amount of value. Factors that leaders must consider are, the role of the corporate head office (centralized vs decentralized approach and the reporting structure of individuals and business units (vertical hierarchy, matrix reporting, etc.). Key factors related to allocation of resources are:

• **Head office (centralized vs decentralized)**

- Determining how much autonomy to give business units
- Deciding whether decisions are made; top down or bottom up
- Influence on the strategy of business units

• **Organizational structure (reporting)**

- Determine how large initiatives and commitments will be divided into smaller projects
- Integrating business units and business functions such that there are no redundancies
- Allowing for the balance between risk and return to exist by separating responsibilities
- Developing centers of excellence
- Determining the appropriate delegation of authority
- Setting governance structures
- Setting reporting structures (military / top down, matrix reporting"[79] (Corporate Finance Institute, 2019, https://corporatefinanceinstitute.com).

"**#3 Portfolio Management.** Portfolio management looks at the way business units complement each other, their correlations, and decides where the firm will 'play' (i.e. what businesses it will or won't enter). Corporate Strategy related to portfolio management includes:

• Deciding what business to be in or to be out of

• Determining the extent of vertical integration the firm should have

• Managing risk through diversification and reducing the correlation of results across businesses

• Creating strategic options by seeding new opportunities that could be heavily invested in if appropriate

• Monitor the competitive landscape and ensure the portfolio is well balanced relative to trends in the market" (Corporate Finance Institute, 2019, https://corporatefinanceinstitute.com).

"**#4 Strategic Tradeoffs.** One of the most challenging aspects of corporate strategy is balancing the tradeoffs between risk and return across the firm. It's important to have a holistic view of all the businesses combined and ensure that the desired levels are risk management and return generation are being pursued" (Corporate Finance Institute, 2019, https://corporatefinanceinstitute.com). The formalization of operational governance will be covered in the following section.

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[79] Corporate Finance Institute (2019) *Corporate Strategy*. Available from: https://corporatefinanceinstitute.com/resources/knowledge/strategy/corporate-strategy/

5.4 Formalizing operational governance

In general with operational governance the organization is permitted to list its different policies as business processes while ensuring that the created business policies are implemented in the operations of the entire organization[80] (Vitria Technology, 2008:2, www.vitria.com). "Policies established by the COO, and by the heads of business units must be related to and consistent with policies executed deep in the operational infrastructure. With Operational Governance, policies are aligned from the business to the operational aspects of the enterprise, thus allowing you to control and run your business better. The crux of the issue regarding governance is that most policies are expressed only as text in a document. This simple fact makes it impossible to use your existing IT infrastructure to monitor and enforce compliance with the policies. So policies are created, but cannot be monitored automatically and may in fact conflict with other policies. The solution to this problem is simple: define the policies formally so that they may be automatically executed, and provide comprehensive analysis to managers who need to monitor and enforce them. A governance process can formally be expressed as a hierarchy of policies that are grouped together" (Vitria Technology, 2008:2, www.vitria.com). The hierarchical policy structure will be depicted by Figure 5.1 below.

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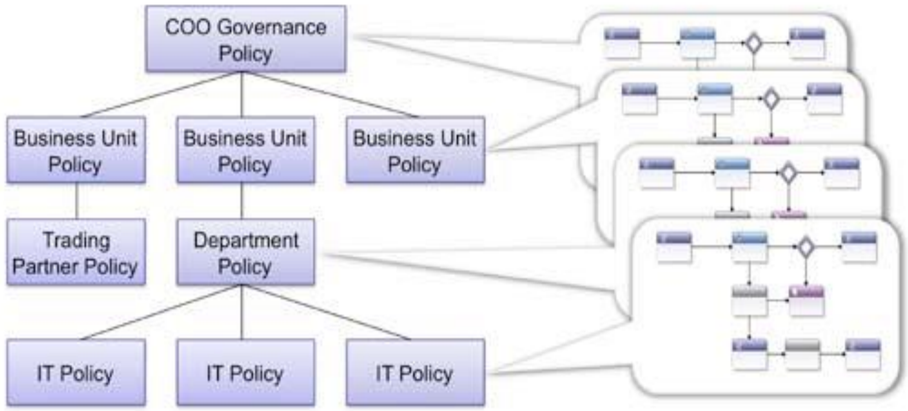
[80] Vitria Technology (2008) *Formalizing Operational Governance: Ensuring the Well Managed Enterprise*. Available from: https://www.vitria.com/pdf/WP-Formalizing-Operational-Governance.pdf [Accessed 2019, 18 August] p1-8

Figure 5.1 Hierarchical policy structure



Source: (Vitria Technology, 2008:2)

"At the top of the hierarchy are business policies that are expressed as business processes. There may be several levels of business policies. At a more granular level each step in the business processes may have a policy associated with it, usually expressed as a set of rules (see figure 5.1). This structure can be used to express the governance of any activity concerning the enterprise in a formal and automated way"[81] (Vitria Technology, 2008:2, www.vitria.com). The following section will cover how an organization can align operational governance with the business model.

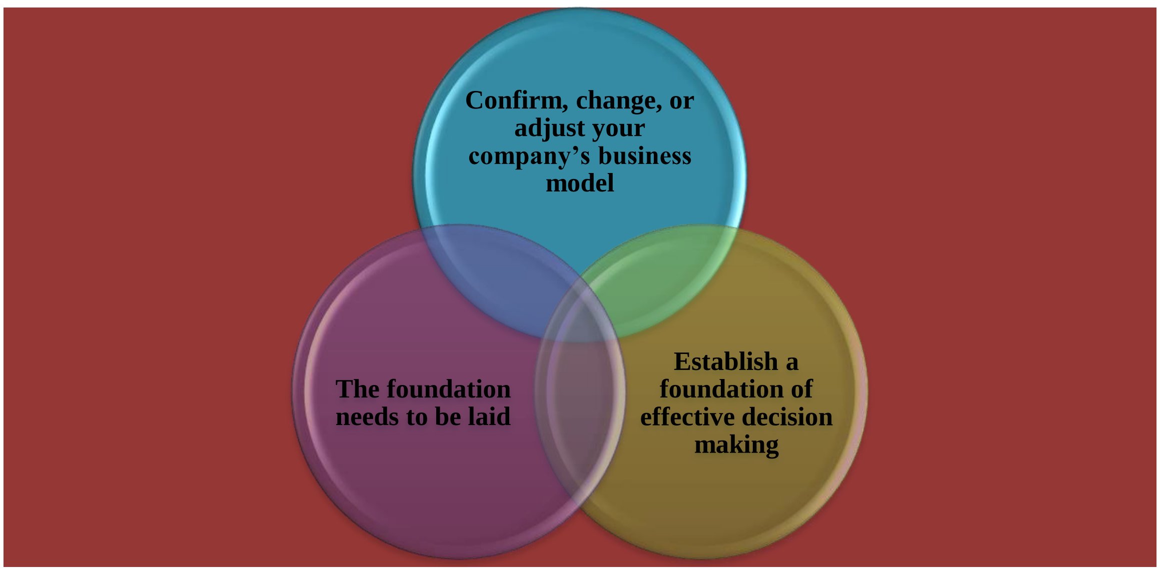
5.5 How to align operational governance with the business model

In general it is critical for the board and the executive directors of the organization to align the operational governance practices of the organization to its business model since this is one of the guaranteed ways of enabling the business to achieve its promise and set goals. One of the common mistakes that is made in organizations is the assumption that the term 'operational governance' and 'corporate governance' share the same meaning whilst they do not at all. Operational governance focuses on dealing with issues related to how decisions in an

[81] Vitria Technology (2008) *Formalizing Operational Governance: Ensuring the Well Managed Enterprise*. Available from: https://www.vitria.com/pdf/WP-Formalizing-Operational-Governance.pdf [Accessed 2019, 18 August] p1-8

organization are structured and implemented while corporate focuses on the system of rules[82] (Deloitte Consulting Pty Ltd., 2019, https://www2.deloitte.com). "Effective operational governance can provide the foundation for lasting improvements. Yet, it is the one step that companies are most likely to overlook in restructuring or making organisational changes. When corporate executives consider making organisational changes, they usually move straight to restructuring or realigning resources. However, before a single resource is redeployed, companies should consider how decisions are or will be made in the organization" (Deloitte Consulting Pty Ltd., 2019, https://www2.deloitte.com). The three steps a board and executive directors can use to align operational governance with the business model will be depicted in Figure 5.2.

Figure 5.2 Three steps used to align operational governance with the business model



Source: Modified: (Deloitte Consulting (Pty) Ltd., 2019, https://www2.deloitte.com).

[82] Deloitte Consulting (Pty) Ltd (2019) Aligning Operational Governance with the Business Model: Steps to Sustainable and Scalable Change. Available from: https://www2.deloitte.com/za/en/pages/strategy/articles/aligning-operational-governance-with-the-business-model.html#

The three steps to follow when aligning the operational governance with the business model highlighted in Figure 5.2 will be discussed in-depth. [83] "*"First*, you need to *confirm, change, or adjust your company's business model*. By business model, we mean the way a company organises or structures itself to go to market, interfaces with stakeholders, and reacts to external events. The business model should serve as the blueprint for a corporate transformation or restructuring effort. *Second*, as with a construction project, *the foundation needs to be laid*. In business, this is the operational governance – i.e. determining how decisions are made and executed – that conforms to the business model. This is the step companies are mostly likely to overlook. Yet, it is a vital step. *Lastly*, before deploying a single resource, you must *establish a foundation of effective decision making* if you want to increase your company's chances for sustained improvement. Effectively implemented, this "operational governance" can provide the means and methods for making decisions and for institutionalising them. These include: clearly defined decision making roles, a clear division of responsibilities between corporate and the business units (or other organisational entities), and a supporting infrastructure for key interactions throughout the decision process"" (Deloitte Consulting (Pty) Ltd., 2019, https://www2.deloitte.com). In the following section the common characteristics of organizations without operational governance will be covered.

5.6 Common characteristics of organizations without operational governance

"Without effective operational governance, structural inefficiency can occur, which companies can unlikely afford, in particular during an economic downturn, slow recovery or global macroeconomic challenges. Symptoms can include: confusion and conflict between corporate and individual business units, turf battles, duplication of efforts, and organisational blind spots"[84] (Deloitte Private Consulting Limited, 2019, https://www2.deloitte.com). "In every business there are differences of opinion. That is all well and good, even healthy, until those differences interfere with decision making. *In the absence of defined operational decision making, there*

[83] Deloitte Consulting (Pty) Ltd (2019) *Aligning Operational Governance with the Business Model: Steps to Sustainable and Scalable Change*. Available from: https://www2.deloitte.com/za/en/pages/strategy/articles/aligning-operational-governance-with-the-business-model.html#

[84] Deloitte Consulting (Pty) Ltd (2019) *Aligning Operational Governance with the Business Model: Steps to Sustainable and Scalable Change*. Available from: https://www2.deloitte.com/za/en/pages/strategy/articles/aligning-operational-governance-with-the-business-model.html#

tends to be significant conflict. Negative influence prevails, the loudest voice wins, meetings result in arguments, secret factions vie for control, and back stabbing is common. This is when Operational Governance is needed. In the absence of operational governance, typical arguments include:

• Disagreement over operational direction

• Fragmented control over money, resources, and priorities

• Battles over what to fund – and what not to fund

• Confusion around acceptance of deliverables and work products" (Advance Consulting, 2019, www.advanceconsulting.com). In the following section the key benefits of operational governance will be covered in the following section.

5.7 Key benefits of operational governance

"Whether the problem is at the highest level of the company (e.g., operational direction and major funding decisions) or within the lowest levels of a business process (e.g., work product review and acceptance authority), defining the rules around decision making in advance can dramatically improve operational performance and avoid wasteful conflict. *'When it is clear in advance how decisions will be made, and by whom, there is a level of congruence that brings efficiency – and even peace – to the decision making.'* All of the energy that would have been wasted in conflict can now be used to accomplish the work of the enterprise. Add that up across all of the decision points in the enterprise and you've unleashed a tremendous amount of positive and productive energy!"[85] (Advance Consulting, 2019, www.advanceconsulting.com). "Key Benefits of Operational Governance:

• Governance policies execute in existing IT infrastructure,
• Policies cannot be misinterpreted,
• Policies cannot be contradictory,
• Policies can be monitored and analyzed in real-time,

[85] Advance Consulting (2019) *Operational Governance*. Available from: https://www.advanceconsulting.com/operational-governance/

• Self-managing compliance" (Vitria Technology, 2008:2, www.vitria.com). The following section will now cover the role played by boards in developing a corporate and an ethics strategy.

5.8 Role played by boards in developing a governance and an ethics strategy

A well crafted and implemented governance strategy that is properly aligned to corporate strategy enhances the organization's performance in general. An organization's effectiveness lies in the hands of its board thus strategy plays a vital role in ensuring that the board successfully keeps the organization financially healthy and focused on achieving its set goals. A board has the fiduciary duty of establishing an effective strategy the organization must use to achieve its mission and vision. The first task a board must accomplish in order to establish and implement strategy is to clearly highlight the meaning of strategy to it and what the board intends to contribute towards strategy. One of the key roles of a board is supervision which encompasses the management and or monitoring of business performance of the top management's work ethics, compliance to the principles of corporate governance, the reduction of conflict due to the proper execution of operational governance policies, effective strategic planning and integrity. It is quite common for boards to play a critical role in formulating the strategy of the organization in collaboration with the CEO. Board of directors are usually industry experts with top notch knowledge, an advanced business network or contacts across the world thus enabling them to have an added advantage in terms of interpreting or predicting business trends in this modern-day highly dynamic business environment than senior management of the organization who often have slightly lower skills, knowledge, experience and extensive business networks or contacts. In general a board in an organization has the fiduciary duty to provide adequate support for management thereby making it the superior and authentic authority[86] (Source: Cossin and Métayer, 2019, "Board & Strategy: Does Your Board Really Add Value to Strategy?", IMD - International Institute for Management Development, **www.imd.org**).

[86] Source: Cossin and Métayer, 2019, "Board & Strategy: Does Your Board Really Add Value to Strategy?", IMD - International Institute for Management Development, **www.imd.org**

5.8.1 Questions the board of directors must ask themselves when developing a governance strategy that will be aligned to the corporate strategy

The various questions boards must ask themselves include:

• Are we really fully knowledgeable of our business model, business strategy and the principles of corporate governance the organization must adapt? Are we happy with the current corporate governance practices and transparency measures being implemented in the organization?

• Are we spending adequate time to properly analyze, plan and create conversations related to strategic issues?

• Are we currently in possession of a feasible process that we can use to oversee strategy? Are we receiving accurate information about strategy and governance?

• Are we placing more attention on long-term sustainability?

• Are we currently able to agree as a board that in the organization we now have a conducive, fair, transparent, honest and ethical good corporate governance culture that promotes constructive challenge?

• Are we collaborating with the executive management and reaching a consensus that the executive management team will consistently provide updated and accurate management information which the board can use on a regular basis to make effective decisions that are in line with the corporate governance guidelines of the organization?[87] (Chartered Institute of Management Accountants, *Incorporating Ethics into Strategy*, CIMA, 2010:6). The conclusion of this chapter will be covered in the following section.

5.9 Conclusion

In general it is the fiduciary duty of a board of director in any type and size of organization to carry-out strategic planning in order to determine the long term goals of the organization and how to incorporate both corporate and operational governance as a strategy. The board of directors' have the task of creating strategic plans in an organization and the board also determines the approach that will be used in setting both corporate and operational governance as

[87] Chartered Institute of Management Accountants (CIMA) (2010) *Incorporating Ethics into Strategy: Developing Sustainable Business Models*. Available from: https://www.cimaglobal.com/Documents/Professional%20ethics%20docs/Incorporatingethicsintostrategyweb1.pdf

a strategic priority. Nowadays the task of monitoring corporate governance and operational governance policies has become one of the key tasks that is carried-out by the board of directors' in an organization on a regular basis in collaboration with the chief governance compliance officers. Organizations that do not implement operational governance are often associated with numerous problems that include the following: high levels of conflict are rampant as people often consistently arguing over various work related issues; betrayal behaviors are consistently visible in the organization and there is regular duplication of work activities as well.

5.10 Review questions

1) Define the terms: 'corporate strategy', 'goals', 'objectives' and 'operational governance'?

2) Discuss the purpose of a corporate strategy? Describe how an organization can formalize its operational governance?

3) Explain how an organization can align operational governance with the business model?

4) Identify the common characteristics of organizations without operational governance? Explain the key benefits of operational governance?

5) Describe the questions board of directors must ask themselves when developing a governance strategy?

Chapter 6: Ethics and compliance

After reading this chapter you should be able to:

- Explain the meaning of the following terms: ethics, code of ethics and code of conduct.
- Identify the parties that are responsible of ethics & the range of job titles associated with the 'ethics ambassador' roles.
- Outline the responsibilities of an ethics ambassador in the organization.
- Explain the reasons why organizations and boards must embed ethics into their culture.
- Describe how the ethics department collaborates with the HR function? Discuss the importance of a code of conduct and a code of ethics.

6.1 Introduction

The interrelation of good corporate governance and ethics practices in an organization is unquestionable and inevitable. Each and every organization that has the following: a highly successful corporate social responsibility program, good corporate image, high customer satisfaction rates, enhanced innovation rates, high business performance and a highly motivated workforce is often fueled by good corporate governance and ethical practices. Good corporate governance practices can only interrelate with ethics practices if the organization strives to have a better understanding of the ethics cultures or activities in the organization. [88]"Workplaces can provide many challenges that test our ability and willingness to act with courage. If you see someone doing something wrong – i.e., steal from the employer; take credit for someone else's work; falsify data and records, it takes a person of courage to inform higher-ups in the organization about the misdeeds even if it means you will be retaliated against. Doing what is right is not always easy but it is moral behavior. In today's society it has become more difficult than ever, it seems, for people to act courageously" (Mintz, 2018, www.ethicssage.com). Most of the organizations around the world operating in this modern day business environment have well crafted code of ethics and codes of conduct guidelines they have adopted and provided to their board of directors, business executives, managers and employees in the form handbooks or

[88] Mintz, S. (2018) *Are You Courageous and Is It A Good Thing*. Available from: https://www.ethicssage.com/2018/12/are-you-courageous-and-is-it-a-good-thing.html

downloadable emailed attachment files. The ability to know what is right or wrong in the form a handbook is the greatest gift an organization can provide its board of directors, business executives, managers and employees since it enables them to avoid engaging in activities such as indiscipline, corruption, fraud and so on at the workplace. The following section will help provide clear definitions of the terms used in this chapter.

6.2 Definition of terms

In general the field of ethics is broad therefore numerous definitions have been developed by academics, experts and authors in the field over the past number of years. The term *'ethics'* refers to a set of principles that help to shape an individual's or organization's culture, thinking or mindset towards their behavior, morality, conscience and ethos on what they believe is right or wrong in general (Rudolph. Patrick. T. Muteswa, 2019). *"Ethics* defines the best option as the one which best achieves what is good, right and consistent with the nature of the things in question"[89] (The Ethics Centre, 2019, https://ethics.org.au/why-were-here/what-is-ethics/). In this chapter the term 'ethics ambassador' and 'ethics champion' are some of the terms that will be used more often. "*Ethics ambassadors* can be defined as employees that assist senior management in promoting an ethical culture based on shared core values within the organization"[90] (Institute of Business Ethics, 2017:1, https://www.ibe.org.uk/). [91]"A *code of ethics* is a written set of guidelines issued by a company to its management and staff to help them conduct their behaviour and actions in accordance with its values and ethical standards" (Duffy, 2017, www.charteredaccountants.ie/). *"Code of Conduct* can refer to a listing of required behaviors, the violation of which would result in disciplinary action. In practice, used

[89] The Ethics Centre (2019) *What is Ethics?* Available from: https://ethics.org.au/why-were-here/what-is-ethics/

[90] Institute of Business Ethics (IBE) (2017) Ethics Ambassadors: Promoting Ethics on the Front Line. *Business Ethics Briefing, Issue 57*. Available from: https://www.ibe.org.uk/userassets/briefings/ibe_briefing_57_ethics_ambassadors.pdf [Accessed 2019, 02 August] p1-6

[91] Duffy, D. (2017) *Ethics and the Role of the Board*. Available from: https://www.charteredaccountants.ie/Accountancy-Ireland/Articles2/Spotlight/Latest-News/ethics-and-the-role-of-the-board

interchangeably with Code of Ethics"[92] (Ethics & Compliance Initiative, 2019, https://www.ethics.org/resources/free-toolkit/toolkit-glossary/). In the next section the individuals who are responsible of ethics in the organization will be clearly highlighted.

6.3 Who is responsible of ethics & the range of job titles associated with the 'ethics ambassador' roles

The task of overseeing that all matters related to ethics and compliance in an organization is conducted by ethics officers in the organization. One of the most common mistake the board of directors, senior management and employees often make is assuming that the responsibility of ethics lies with the ethics ambassadors only whilst in actual fact the responsibility lies with everyone in the organization and they all have a role to play in ensuring that the ethics standards and policies of the organization are maintained or improved on a regular basis. The modern day term that is similar to the term 'ethics officers' which is more popular nowadays in organizations is 'ethical ambassadors'. The job titles that are linked to the role of an ethics ambassador depend on the type, size and operations of the organization. In some organizations these different titles simply refer to the role of an ethics ambassador. *"What are ethics ambassadors?* Ethics ambassadors are employees selected to formally assist senior management in promoting and embedding the ethics policies, codes of conduct, business principles, statements of values or other similar policies of their organisations. In this Guide we use the term 'ethics policy' to represent all similar initiatives. The post of ethics ambassador may be full-time or may be taken on in addition to an employee's day-to-day job. Ethics ambassadors will normally be positioned throughout the company; across business units, geographical locations, and the hierarchy of an organisation and may comprise an informal 'network' of diverse employees with similar responsibilities. In practice ethics ambassadors have a range of different job titles depending on the organisation and the scope of their responsibilities within it. Examples include:

• Ethics Champion

• Ethics Advisor

[92] Ethics & Compliance Initiative (2019) *Ethics and Compliance Glossary: Home/Resources/Free Ethics & Compliance Toolkit/*Ethics and Compliance Glossary. Available from: https://www.ethics.org/resources/free-toolkit/toolkit-glossary/ *"© 2019 Ethics & Compliance Initiative. Used with permission of the Ethics Research Center, 2650 Park Tower Drive, Vienna, VA 22180, www.ethics.org".*

• Ethics Point of Contact

• Ethics Coordinator

• Ethics Officer

• Ethics and Compliance Focal Point

• Compliance and Ethics Leader

• Ethics Liaison

• Business Compliance Representative

• Business Conduct Officer

• Compliance and Ethics Ambassadors

• Operating Company Compliance Officer

• Ethics Star"[93] [94] (Institute of Business Ethics, Steinholtz, R. and Irwin, J., 2010, https://www.ibe.org.uk). In the following section the responsibilities associated with ethics ambassadors in the organization will be discussed.

6.4 Responsibilities of an ethics ambassador

There are numerous responsibilities that are associated with the job title of an ethics ambassador. "Care needs to be taken to ensure that the responsibility allocated to an ethics ambassador is commensurate with his/her skills, experience and motivation. This may include:

• localising global ethics material and initiatives,

• acting as a point of contact for employees,

• acting as an advocate for the ethics programme, the values of the organization and communicating and disseminating information from the ethics office;

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[93] Steinholtz, R.N. and Irwin, J. (2010) *GOOD PRACTICE GUIDE: Ethics Ambassadors*. London: Institute of Business Ethics, p4-10.

[94] Institute of Business Ethics (IBE) (2017) Ethics Ambassadors: Promoting Ethics on the Front Line. *Business Ethics Briefing, Issue 57*. Available from: https://www.ibe.org.uk/userassets/briefings/ibe_briefing_57_ethics_ambassadors.pdf [Accessed 2019, 02 August] p1-6

• delivering training; recording, reporting and investigating suspected unethical conduct;

• investigating reports of misconduct;

• keeping the ethics programme top of mind with leaders" (IBE Good Practice, Steinholtz, R.N. and Irwin, J., 2010, *Ethics Ambassadors* cited in Institute of Business Ethics, 2017, https://www.ibe.org.uk/userassets/briefings/ibe_briefing_57_ethics_ambassadors.pdf). The following section will cover in detail how the ethics department collaborates with the human resources department.

6.5 How the Ethics Department collaborates with the HR department

[95]"It is difficult to provide a general definition of the role and scope of the ethics function that would be applicable to all organisations. The operation of each organisation's ethics function differs according to its internal structure and the sector in which it operates. Therefore, when considering the effective management of an ethics function, the foremost priority is to define a clear mandate, spelling out the function's key responsibilities specific to a particular organisation. This is important as there is no one-size-fits-all approach to business ethics. Generally, it is recognised that the ethics function holds a vital role in ensuring that ethics is part of all business operations and that the core values are embedded and reflected in the organisation's culture" (Institute of Business Ethics, 2016:1-5, https://www.ibe.org.uk/userassets/briefings/b54_ethicsfunction.pdf). [96]Furthermore, according to the Institute of Business Ethics (2014:1) *Collaboration Between the Ethics Function and HR*. When embedding ethical values into organisational culture, the roles of the company Ethics and HR functions can frequently overlap. It is important therefore that they work together effectively to ensure this happens. This Briefing identifies the areas where HR and the Ethics department can work together and looks at ways in which effective partnerships can be formed.

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[95] Institute of Business Ethics (IBE) (2016) Enhancing the Effectiveness of the Ethics Function. *Business Ethics Briefing, Issue 54*. Available from: https://www.ibe.org.uk/userassets/briefings/b54_ethicsfunction.pdf [Accessed 2019, 04 August] p1-5

[96] Institute of Business Ethics (2014) Collaboration Between the Ethics Function and HR. *Business Ethics Briefing, Issue 40 (April)*, p1-2

6.5.1 Recruitment and exit interviews[97]: Job applicants are increasingly concerned about the ethical conduct and reputation of an organisation. HR are often the first interaction that a potential employee has with the company and where they get their initial impression of the organisational culture. The Ethics function can inform HR about how the company approaches its corporate responsibility and ethical commitments so that they are able to effectively answer interviewee's questions. This, as well as including ethics issues, questions and dilemmas at the interview stages of recruitment can help HR ensure new employees are aware of, and accept, the behaviours expected of them by an organisation. Including questions around the company values, expected behaviours and organisational culture in exit interviews can also provide useful information for monitoring the effectiveness of the ethics programme. HR and the Ethics function can work together to identify what to ask to assess whether ethical concerns were a reason for an employee leaving[98].

6.5.2 Induction: Often overseen by HR**,** induction is an opportunity to provide new employees with an objective view of the company, organisational culture, work ethic and expected behaviours. Therefore, to support this process effectively and assist employees with their integration into the workforce, the Ethics function can provide HR with relevant materials.

6.5.3 Training: Ensuring *all* training sessions include a focus on expected behaviours is a key way to ensure that ethical values are understood and applied by employees and ethical conduct is not viewed as an 'add on'. Learning and Development experts are often positioned in HR and can deliver training together with the Ethics team where possible, thus allowing the functions to utilise shared knowledge and expertise. HR can also use employee records to help monitor which employees have or have not completed training or 'refresher' training.

6.5.4 Speak Up: Ownership of the Speak Up process can vary from company to company but HR and the Ethics function commonly both play a role. There are many issues that stakeholders may

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[97] IBE Business Ethics Briefing 17 (2010) *Ethical Due Diligence in Recruitment*. Available http://www.ibe.org.uk/userassets/briefings/ibe_briefing_17_ethical_due_diligence_in_recruitment.pdf

[98] Institute of Business Ethics (2014) Collaboration Between the Ethics Function and HR. *Business Ethics Briefing, Issue 40 (April),* p1-2

speak up about including: bullying, harassment, discrimination, violence etc. that are relevant to both functions. Although typically the domain of HR, consequent investigations to resolve issues might include the involvement of the Ethics team too. Rather than come through other official Speak Up channels, employee concerns may also be handed directly to either HR or the Ethics department. Both teams can then liaise about the logging and management of these cases as well as any training or awareness actions that may be required[99].

6.5.5 Performance management and appraisals: Assessing employees' application of ethical values through appraisals can encourage them to behave ethically. Developing a rewards system for ethical behaviour, such as remuneration, promotion or ethics 'awards', are ways of encouraging and reinforcing the expected ethical behaviour of employees. HR and the Ethics function can work together to develop an employee incentive system for their organisation to reward employees who demonstrate ethical behaviours. HR could provide the Ethics function with (anonymous) results from staff appraisals. These would help towards monitoring the effectiveness of the ethics programme or help to see where further training should be focused. In disciplinary matters there is often an ethical element. The Ethics function could be consulted by HR on whether a particular behaviour is acceptable and HR can then implement corrective action when it is not.

6.5.6 Staff survey: One way of taking the 'ethical temperature' of a business is to survey employees about their experiences, perceptions and awareness of the organisation's ethical values and business practices. HR may oversee the surveying but the Ethics function can provide insight regarding ethical challenges the company is facing and input into the questions that are asked. Findings can then inform future training needs[100].

6.5.7 Ethics Ambassadors: The Ethics function might approach HR to help identify employees to act as 'ethics ambassadors' (EAs, also sometimes called 'ethics champions'). HR may be well

[99] Institute of Business Ethics (2014) Collaboration Between the Ethics Function and HR. *Business Ethics Briefing, Issue 40 (April)*, p1-2

[100] IBE (2008) *Surveying Staff on Ethical Matters*. Available to order from http://www.ibe.org.uk/list-of-publications/67/47

positioned to do this because of the information they hold on employees including job descriptions, appraisal results and accountabilities. HR can also help the Ethics function to communicate what and who EAs are within the organisation[101].

6.5.8 Reporting to the Board: Most Boards are interested in whether a company is operating ethically and in line with corporate values or not.

6.5.9 Internal Communications: HR are often the owner or champion of the internal communications process in which multiple channels of information that can directly reinforce the messages around ethical culture and expected behaviours exist. These include newsletters, intranet, social media etc. and provide opportunities for ethics messages to be cascaded internally. HR can be invaluable to the Ethics team in terms of communications when new programs are being implemented locally. They can provide expertise on labour relations issues as well as reviewing translations so that they fit with the local culture but at the same time still mean the same in legal terms (Institute of Business Ethics, 2014:1-4, https://www.ibe.org.uk/userassets/briefings/b40_hr.pdf). In the following section the reasons why organizations and boards must embed ethics into their culture will be discussed in detail.

6.6 Reasons why organizations and boards must embed ethics into their culture

There are numerous reasons why an organization and its board must embed ethics into its corporate culture. Generally there are a few certain questions both independent and non-independent directors of the organization must ask first themselves in-depth in order to have adequate reasons for embedding ethics into the organization's corporate culture and these include the following:

• Does the organization have any possible areas that make it highly vulnerable to risk?

• Do we have a clear idea or a well drafted list of the different types of risks that may affect the organization both in the short-and-long term of its operational life?

• Do we have a clear idea of the exact financial figures of all the lost income revenue or cashflow as a result of being vulnerable to all the different forms of risk?

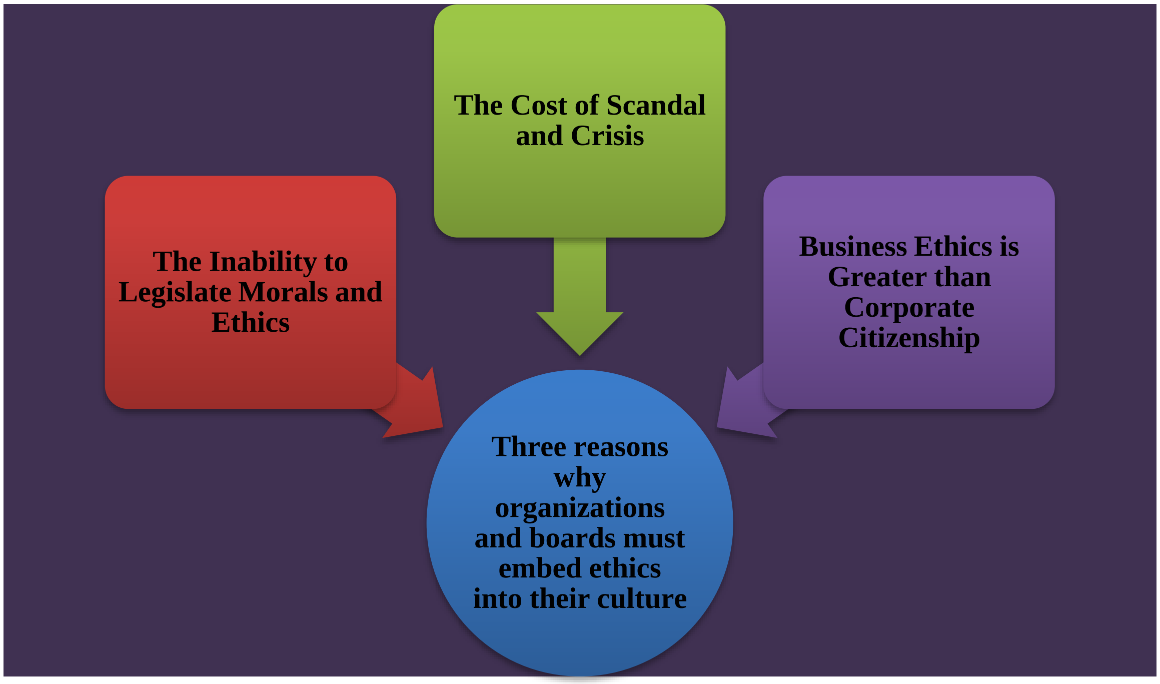
[101] IBE (2010) *Ethics Ambassadors.* Available to order from http://www.ibe.org.uk/list-of-publications/67/47

• Do we have the required brainpower and an ethics-driven skills base that can be fully utilized to boost value creation, intellectual honesty, employee wellness, high productivity levels, efficiency and gain a sustainable competitive advantage?

• Do we have a good corporate governance statement and an 'ethical values' statement that helps to guide employees, management, executive directors and the board directors in their day-to-day fiduciary duties and roles so that they put the interests of the organization, shareholders and stakeholders first instead of their own personal interests?[102] (Valls, 2019, https://ethicalboardroom.com/why-boards-should-care-about-creating-an-ethical-work-culture/). The three reasons why organizations and boards must embed ethics into their culture will be depicted by Figure 6.1 below.

[102] Valls, J. (2019) *Why Boards Should Care About Creating An Ethical Work Culture*. Available from: https://ethicalboardroom.com/why-boards-should-care-about-creating-an-ethical-work-culture/

Figure 6.1 Three reasons why organizations and boards must embed ethics into their culture



Source: Modified: (NEDonBoard, 2019, www.nedonboard.com/)

[103]According to NEDonBoard (2019):

6.6.1 The Inability to Legislate Morals and Ethics

There are a significant number of people who believe that more regulations are needed to help improve business ethics; however, history has proven that ethics cannot be regulated, it must be adopted as a part of a company's primary culture. The trust that has been lost in business, must be rebuilt through the directors who create business cultures that are capable and willing to recognize and engage ethical risk.

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[103] NEDonBoard (2019) *Culture and Ethics in the Boardroom the Ethical Compass of the Company*. Available from: https://www.nedonboard.com/culture-and-ethics-in-the-board-room-the-ethical-compass-of-the-company/ [Accessed 2019, 29 July] ***NEDonBoard is the UK professional body for non-executive directors and board members.***

6.6.2 The Cost of Scandal and Crisis

In recent years, there has been no shortage of business scandals and corporate collapses associated with poor ethics. The actions of many of the key executives, and the mute attitudes of their directors, have come under public scrutiny. There have been allegations of fraudulent management, corruption and bribery, just to name a few. These cases, and many others like them, have created cause for concern in relation to business ethics. These are all issues that the non-executive directors of any corporation must grapple with. While the director is expected to be a team player, they are faced with the challenge of being able to effectively engage the enigmatic issues that are facing the company. Ethics should be high on the priority list, because without a culture that is built on ethical superiority, it will be impossible to maintain the trust of the public. Losing the support and trust of the public is the precursor to corporate collapse.

6.6.3 Business Ethics is Greater than Corporate Citizenship

Despite the fact that a significant number of regulators, business school professors, and business commentators advocate a higher standard of corporate citizenship, business ethics cannot be viewed as an optional exercise in corporate citizenship, meaning that they must be viewed as being fundamental to the governance and efficacious management of every company. Decisions at every level of a company have ethical implications, whether in the boardroom or at managerial levels. This is why the culture has to flow freely from the top. If you wish to change a culture of a company, you must begin in the boardroom (NEDonBoard, 2019, https://www.nedonboard.com/culture-and-ethics-in-the-board-room-the-ethical-compass-of-the-company/). The following section will cover the importance of a code of ethics and a code of conduct.

6.7 Importance of a code of ethics and code of conduct

Nowadays most of the organizations are enjoying several advantages associated with good corporate governance and a strong ethics culture as a result of drafting effective codes of ethics and codes of conduct statements or documents. ""Regardless of whether your organization is legally mandated to have a code of conduct (as public companies are), every organization ***should*** have one. A code has value as both an internal guideline and an external statement of corporate values and commitments. A well-written code of conduct **clarifies an**

organization's mission, values and principles, linking them with standards of professional conduct. The code articulates the values the organization wishes to foster in leaders and employees and, in doing so, defines desired behavior. As a result, written codes of conduct or ethics can become **benchmarks** against which individual and organizational performance can be measured. Additionally, a code is a **central guide and reference for employees** to support day-to-day decision making. A code encourages discussions of ethics and compliance, empowering employees to handle ethical dilemmas they encounter in everyday work. It can also serve as a valuable reference, helping employees locate relevant documents, services and other resources related to ethics within the organization. Externally, a code serves several important purposes:

• *Compliance*: Legislation (i.e., the Sarbanes-Oxley Act of 2002) requires individuals serving on boards and organizational leaders of public companies to implement codes or clearly explain why they have not.

• *Marketing*: A code serves as a public statement of what the company stands for and its commitment to high standards and right conduct.

• *Risk Mitigation*: Organizations with codes of ethics, and who follow other defined steps in the U.S. Sentencing Commission's Federal Sentencing Guidelines, can reduce the financial risks associated with government fines for ethical misconduct by demonstrating they have made a "good faith effort" to prevent illegal acts"" (Ethics & Compliance Initiative, 2019, https://www.ethics.org/resources/free-toolkit/code-of-conduct/). *"© 2019 Ethics & Compliance Initiative. Used with permission of the Ethics Research Center, 2650 Park Tower Drive, Vienna, VA 22180, www.ethics.org". "What a Code Can Help to Accomplish*. A quality code of conduct can go a long way in improving a company's success. Companies that view a code merely as a way to communicate legal rules miss much of the value that a code can provide. A well-developed code can help a company to:

• Prevent legal and regulatory violations. This is the first objective that most companies attach to a code of conduct. When violations do occur, a code can help to detect them and mitigate their effects.

• Foster greater employee loyalty and retention. When employees feel included and engaged in the company's culture and success, they feel more committed.

• Encourage greater customer loyalty and retention. When customers learn about and then experience in practice a company's high standards of conduct, customers are more likely to show their appreciation.

• Build stronger relationships with suppliers and other business partners. As with employees, the more that they understand what the company expects of them – and what they can expect from the company – the stronger the alliance.

• Strengthen trust and respect of other stakeholders, such as local communities, regulators, NGOs, even from competitors. As codes become publicly available publications, more outside stakeholders are reviewing them and setting their expectations of the company partly based on its code. The more that a company lives up to the expectations that it has established, the greater goodwill it engenders.

• Build a stronger reputation for integrity by helping the company to do what it says it will do"[104] (Lunday, 2018, www.corporatecomplianceinsights.com). The following section will cover the different examples of leading global organizations with remarkable code of ethics and code of conduct.

6.7.1 Examples of leading global organizations with remarkable code of ethics and code of conduct

There are numerous organizations in the world with exemplary leadership and unique ethics practices they implement in their day-to-day business operations. Some of the various examples of leading global organizations with good-to-great leaders and unique ethics practices are depicted in Figure 6.2 below.

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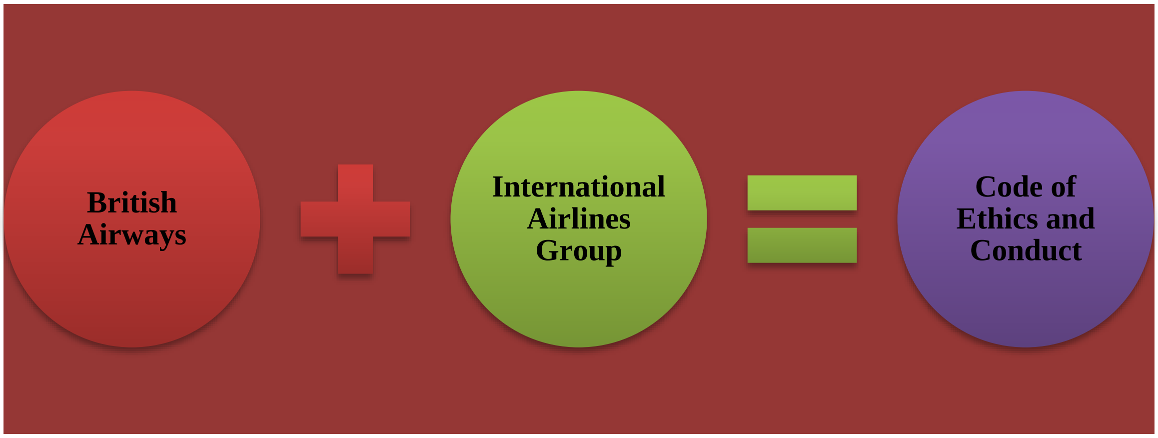
[104] Lunday, J. (2018) *Creating An Effective Code of Conduct and Code Program*. Available from: https://www.corporatecomplianceinsights.com/creating-an-effective-code-of-conduct-and-code-program/

Figure 6.2 Two examples of global organizations with a remarkable code of ethics and conduct



Source: Modified: (British Airways, 2019, www.britishairways.com; International Airlines Group - IAG, 2019, www.iairgroup.com).

6.7.1.1 British Airways

A good example of an organization that has achieved milestones and a good corporate image as a result of its ethics practices is Harmondsworth, United Kingdom-based leading airline company called 'British Airways' the flag carrier airline of the nation of the United Kingdom which is now owned by the Spanish firm the 'International Airlines Group' (*IAG*). The current Chief Executive of British Airways is Mr. Alex Cruz[105] (British Airways, 2019, www.britishairways.com). *"Celebrating 99 years of flying with pride*. British Airways can trace its origins back to the birth of civil aviation, the pioneering days following World War I. In the 99 years that have passed since the world's first schedule air service on 25 August 1919, air travel has changed beyond all recognition. Each decade saw new developments and challenges, which shaped the path for the future,.. On 25 August 1919 Aircraft Transport and Travel Limited (AT&T), a forerunner company of today's British Airways, launched the world's first daily international scheduled air service, between London and Paris. That first flight, which took off from Hounslow Heath, close to today's Heathrow Airport, carried a single passenger and cargo that included newspapers, Devonshire cream, jam and grouse" (British Airways, 2019,

[105] British Airways (2019) *Explore Our Past*. Available from: https://www.britishairways.com/en-zw/information/about-ba/history-and-heritage/explore-our-past

www.britishairways.com). Table 6.3 will help depict the corporate responsibility practices of British Airways. [106]According to the British Airways (2019):

Table 6.3 Corporate Responsibility of British Airways
British Airways: *Corporate Responsibility* "At British Airways, we work hard to manage our business responsibly, be a good neighbour, reduce our environmental impact and celebrate diversity. We are committed to fight human and wildlife trafficking. We operate our aircraft with sensitivity to noise and air quality and engage with the community on these issues. To tackle climate change we are investing in sustainable fuel solutions, flying efficiently to reduce fuel consumption, supporting global regulation, modernising our fleet and reducing waste and increasing recycling. We ensure we run a safe and comfortable operation for our customers, continually invest in our aircraft and facilities and offer additional help to those who require it. We look after our colleagues, encouraging their physical and mental well-being, creating an inclusive culture and developing initiatives to create a more diverse workforce. Our Community Investment programme has helped more than 600,000 people since 2010, in the UK and overseas, and provided much needed support and funding to charities during humanitarian crises. We offer hundreds of work experience placements and apprenticeships every year" (British Airways, 2019). *"Conducting business responsibly:* We are committed to operating our business in a responsible manner. *Ethics and Integrity* - Everyone working for us is expected to act with integrity, in accordance with company policies and in compliance of the laws of the countries where they work. Our suppliers are bound by the terms of the IAG Supplier Code of Conduct which requires them to: • Act with honest and integrity. • Provide a safe working environment where employees are treated with dignity and respect.

[106] British Airways (2019) *Corporate Responsibility*. Available from: https://www.britishairways.com/en-us/information/about-ba/csr/corporate-responsibility

• Seek to minimise and reduce our impact on the environment.

• Provide supply chain transparency and improve supply chain standards.

Human Trafficking and Modern Slavery: British Airways supports tackling human trafficking. Our cabin and flight crew have the most exposure to potential trafficking situations and are trained to spot incidents. British Airways has a zero-tolerance approach to Modern Slavery. **Our full statement on Modern Slavery and Human Trafficking**" (British Airways, 2019, https://www.britishairways.com/en-us/information/about-ba/csr/corporate-responsibility).

Source: Modified: (British Airways, 2019, www.britishairways.com)

6.7.1.2 International Airlines Group (IAG)

One of the leading global organizations with unique ethics practices and standards is the International Airlines Group. The current Chief Executive of IAG is Mr. Willie Walsh. The International Airlines Group was launched in 2011 (International Airlines Group - IAG, 2019, www.iairgroup.com). "International Airlines Group (IAG) is one of the world's largest airline groups with 573 aircraft flying to 268 destinations and carrying around 113 million passengers each year. It is a Spanish registered company with shares traded on the London Stock Exchange and Spanish Stock Exchanges. Our vision is to be the world's leading airline group, maximizing sustainable value creation for our shareholders and customers. Our business model makes us well-positioned to achieve this in an increasingly competitive and fast-paced environment" (International Airlines Group - IAG, 2019, www.iairgroup.com). [107]IAG brands portfolio includes: **Aer Lingus** (is the national airline of Ireland, founded in 1936), **British Airways** (is the number one carrier in London, the world's largest international aviation market, and the number one European carrier across the North Atlantic), **Iberia** (founded in 1927, Iberia is Spain's largest airline and its flag carrier), **LEVEL** (is IAG's new low-cost airline brand, built on the belief that the world is a better place when we all get out and experience it), **Vueling** (is one of Europe's leading low-cost airlines and is number one in connecting Spain and Continental Europe), **Avios** (is transforming its loyalty programmes, diversifying its partnerships and leveraging data to become the loyalty partner of choice and a centre of loyalty excellence for the

[107] International Airlines Group (IAG) (2019) *Our Brands*. Available from: https://www.iairgroup.com/en/our-brands

International Airlines Group), **IAG CARGO** (Five IAG airlines – one cargo carrier. IAG Cargo is the trusted cargo partner of more than 10,000 businesses), **IAG Global Business Services (GBS)** (since launching in 2014, IAG GBS has transferred and restructured services, implemented new technology, created new ways of working and delivered unprecedented cost savings – establishing IAG GBS as a strategic platform for growth as well as IAG itself) (International Airlines Group, 2019, https://www.iairgroup.com/en/our-brands). [108]A portion of the IAG Code of Conduct that covers the issues related about ethical business practice will be highlighted in Table 6.4 below.

Table 6.4 International Airlines Group
"*CEO Statement* - Our vision is to be the world's leading airline group and we will only achieve that if we conduct our business in a way which is not only safe, but ethical. We have worked hard over many years to establish the reputation of our businesses across the globe and it is important that we continue to work to protect that reputation" (International Airlines Group, 2019:2, https://www.iairgroup.com/~/media/Files/I/IAG/documents/iag-code-of-conduct-april-2019.pdf). According to the International Airlines Group (2019:5): **Our principles** In the following section, you will find the principles we must all work by every day at IAG, wherever we are in the world. **Our People and Workplace** *Health, Safety and Security* Health, safety and security is fundamental to our business, whether in the air or on the ground. It is our highest priority. We must work and operate in a healthy, safe and secure way in compliance with all applicable laws, regulations, company policies and industry standards.

[108] International Airlines Group (2019) *International Airlines Group: Our Code of Conduct*. Available from: https://www.iairgroup.com/~/media/Files/I/IAG/documents/iag-code-of-conduct-april-2019.pdf [Accessed 2019, 03 August] p1-7

Fairness and Respect

[109]Safe and ethical behaviour depends on all of us as individuals and, fundamental to that, is how we treat each other. We must treat all employees with dignity and respect and we should never engage in bullying or harassment. We must ensure that everyone who works for or with the Group is treated fairly and not unlawfully discriminated against. It is our collective responsibility to promote and provide a work environment that is free from intimidation and harassment and allows people to raise concerns freely and without fear of retaliation.

Our Customers and Stakeholders

Our Customers

We are a customer service business. We aim to provide good value and service to our customers and to look after them, or their cargo, properly in many different circumstances. We must treat our customers with fairness, care, respect and dignity and in a professional and non-discriminatory way.

Environment

Our planet is a precious place. We are aware of our impact on the environment and we work to mitigate that impact, both on the ground and in the air, while responding to the demand for passenger and cargo air transport in the 21st century.

Suppliers and Business Partners

We promote and maintain relationships with suppliers and business partners that are cooperative and based on trust, fairness and transparency. We engage with suppliers and business partners in accordance with this Code. Though we cannot control the behaviour of others, it is our expectation that our suppliers and business partners will carry out their business in a way that is consistent with our Code.

Local Community

Companies can have a positive impact in the communities they serve and the social good they do is recognised by employees, customers and investors. We are committed to supporting positive engagement with those communities local to our operations in a manner that aligns with the values and objectives of our operating companies.

Political Engagement

We do not allow the use of company funds or resources, including any company brands, to support any political party or candidate.

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[109] International Airlines Group (2019) *International Airlines Group: Our Code of Conduct*. Available from: https://www.iairgroup.com/~/media/Files/I/IAG/documents/iag-code-of-conduct-april-2019.pdf [Accessed 2019, 03 August] p1-7

Our Business Dealings

Compliance with Laws

[110]We must act in compliance with the applicable laws, rules and regulations of the countries in which we operate.

Competing Fairly

We conduct our business in an open and honest manner and must carry out our business in compliance with competition laws.

Anti-bribery

We must never offer, pay, request or accept anything of value to obtain an improper advantage, or improperly influence any kind of decision or action, whether directly or through a third party.

Avoiding Conflicts of Interest

We must act in the best interests of the Group. This means we should avoid situations where personal interests, such as family or financial interests, conflict with those of the Group (or may be perceived as such). If we encounter an actual, potential or perceived conflict of interest, we must report it to ensure it is managed appropriately.

Securities Law Compliance

We must comply with securities laws and never engage in any insider dealing.

Tax Compliance

We understand and comply with our tax obligations in the countries in which we operate and we must never engage in tax evasion or facilitate the tax evasion of others.

Trade Compliance

We abide by all relevant international trade laws, including export control, sanctions and customs laws.

Respecting Human Rights

We carry out our work in a manner that respects the human rights of others. This means we do not accept any form of forced or involuntary labour, human trafficking and modern slavery anywhere in our business (International Airlines Group, 2019:7, https://www.iairgroup.com/~/media/Files/I/IAG/documents/iag-code-of-conduct-april-

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[110] International Airlines Group (2019) *International Airlines Group: Our Code of Conduct*. Available from: https://www.iairgroup.com/~/media/Files/I/IAG/documents/iag-code-of-conduct-april-2019.pdf [Accessed 2019, 03 August] p1-7

2019.pdf).

Source: Modified: (International Airlines Group, 2019:1-7, www.iairgroup.com)

The conclusion of this chapter will be covered in the following section.

6.8 Conclusion

In our society nowadays ethics helps to guide people or entities on what must be considered to be moral or immoral. Ethics is a broad field and one of its sub-elements is business ethics. Trustworthiness and respect are some of the key parts of business ethics. Organizations that create and adopt codes of ethics often create working environments where their board of directors, managers and employees adhere to good corporate guidance rules and standards on a day-to-day basis. Ethics and compliance is now an important topic in organizations across the world due to the fact that the performance of any organization in this modern-day business environment is now determined by good corporate governance and ethical practices of the organization. It can therefore be concluded that good corporate governance practices in collaboration with the ethics function or ethics programme play a significant role in ensuring that an organization adopts ethical practices.

6.9 Review questions

1) What is the meaning of the following terms: 'ethics', 'code of ethics' and 'code of conduct'?

2) Identify the parties that are responsible of ethics & the range of job titles associated with the 'ethics ambassador' roles?

3) List the responsibilities associated with an ethics ambassador's job title in the organization?

4) Describe how the ethics department collaborates with the HR function?

5) Discuss the reasons why organizations and boards must embed ethics into their culture? Discuss the importance of a code of conduct and a code of ethics?

Chapter 7: Leadership and board committees influence good corporate governance standards

After reading this chapter you should be able to:

- Define the meaning of the following terms: leadership, board committee and a leader.
- Highlight the advantages of good leadership and the disadvantages of poor leadership in an organization. Discuss at least three examples of leading global organizations with good-to-great leaders.
- Describe in-depth why organizations tend to rely on board committees to deal with various issues in the organizations.
- Explain in detail the two types of board committees and give relevant details of the various committees associated with the two types of board committees.

7.1 Introduction

Today the world's most powerful and well governed corporations share one thing in common that is 'effective leadership'. The key ingredient that is used in the modern day highly volatile business environment to achieve good corporate governance is 'leadership'. Every organization despite its size, type and or physical geographical location often thrives when it is being well led while on the other hand one of the characteristics of effective business leaders is that they often practice the adopted fundamental corporate governance principles of the organization in their day-to-day functional activities. "Whatever the type of your organisation, good governance and leadership sets you apart from your competition, adding an ethical dimension beyond simple good management. Good governance describes the high-water mark for arriving at decisions which are transparent, accountable, responsive, participatory and effective"[111] (Haddleton Legal, 2019, https://haddletonlegal.com/). "The principle of leadership relates to the ability of the organisation to set the tone from the top by clearly communicating the company strategy, culture, values and behaviours, and by demonstrating how these are embedded throughout the

[111] Haddleton Legal (2019) *Good Governance and Effective Leadership.* Available from: https://haddletonlegal.com/services/good-governance-and-effective-leadership/

organization"[112] (Bell, 2019, https://www.grantthornton.co.uk/). The definition of terms will be covered in the following section.

7.2 Definition of terms

Numerous publications such as journals, newspapers, magazines, websites and textbooks have highlighted the definition of leadership over the past number of years. In general the terms 'leader' and leadership' are often used when discussing any topic that is related to leadership. A *leader* is an individual with an inner ability to unite or persuade others to walk towards a certain path through inspiring their morale and gaining their trust (Rudolph. Patrick. T. Muteswa, 2019). "A *board committee* is a group of people to whom some specific role has been delegated (by the main board). Established to build expertise and lessen the workload of the full board, the role of committees is usually to research, review and make recommendations, and advise the board on specific matters. Generally made up of board members, committees can also have independent members (*i.e. non-board members*). Committees have limited authority, power, and responsibilities, and each committee should operate under its own charter or terms of reference. The board retains ultimate responsibility for any actions made by the committee"[113] (Cook, L. cited in Get on Board Australia, 2019, https://getonboardaustralia.com.au/). The following section will cover the advantages of good leadership.

7.3 Advantages of good leadership

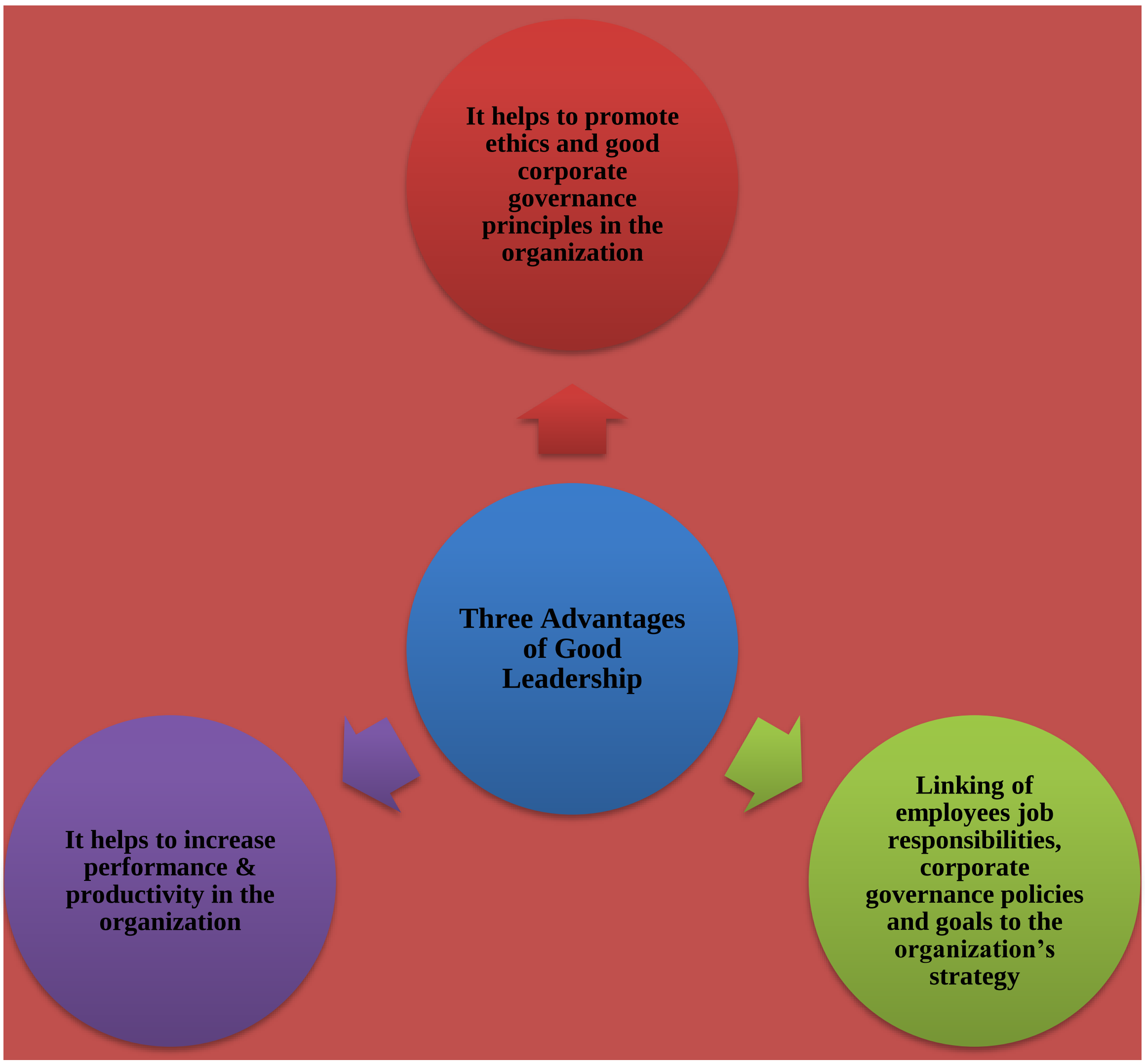
An outstanding business leader understands the importance of corporate governance and what it aims to achieve in the organization. "Effective leadership doesn't just involve making decisions and setting a course, but communicating this well with employees and investors, in a way that equips and empowers them to achieve it. *From compliance to good governance.* Good corporate governance is not about dotting every 'i' and crossing every 't'. Far too many people place emphasis on compliance and ignore the beneficial role that governance plays in supporting the

[112] Bell, S. (2019) *You Need Effective Leadership for Good Governance*. Available from: https://www.grantthornton.co.uk/insights/five-principles-of-good-governance--leadership/

[113] Cook, L. cited in Get on Board Australia (2019) *Board of Directors Advisory Board Management Committee Board Committee Where Do You Sit?* Available from: https://getonboardaustralia.com.au/board-of-directors-management-committee-advisory-board-or-board-committee-where-are-you-sitting/

execution of strategy. The art of good governance is about working smarter, not harder, by taking a principles-based approach to achieving your objectives and aligning your business model to the interests of all stakeholders in the organisation. A one-size-fits-all approach, while compliant, is likely to be counterproductive to value enhancement" (Bell, 2019, https://www.grantthornton.co.uk/). The three advantages of good leadership in organization are depicted by Figure 7.1 below.

Figure 7.1 Three advantages of good leadership



The various advantages identified by Figure 7.1 that are enjoyed by an organization with effective leadership are further discussed as follows:

7.3.1 It helps to promote ethics and good corporate governance principles in the organization

A good leader leads by example and will do anything to ensure that moral values, principles and ethics of the organization are maintained by his or her followers to protect the employees from losing focus on the organization's mission and vision. Great leaders ensure that they create a long lasting exemplary way of doing things by upholding ethical behavior on a daily basis with the aim of encouraging their followers to do the same as this helps to build and maintain a good image of the organization. Most ethical leaders consistently ensure that they take into consideration the positive and negative opinions of the people they are leading before making a decision that affects them and they also ensure that all their decisions adhere to the organization's codes of ethics[114] (Kay, 2016, https://aboutleaders.com/).

7.3.2 It helps the organization to link employees' job responsibilities, corporate governance policies and goals to the organization's strategy

Leaders help to ensure that they properly inform and educate all the organization's stakeholders in particular its employees about what the organization intends to accomplish (*purpose*) and the strategies it will implement to attain its purpose. Corporate governance guidelines adopted by an organization must enable everyone in the organization to align their routine tasks on the job towards achieving the organizational strategy. One of the qualities of a true business leader is that they continuously guide the actions of their followers towards attaining the organization's vision, mission and strategy. Therefore, by doing so the employees become accustomed to the idea of aligning their behavior, personal goals, work responsibilities to the overall organizational strategy. This helps to increase the pace at which an organization can accomplish its planned goals and objectives.

7.3.3 It helps to increase performance and productivity in the organization

The upholding of the principles of corporate governance such as fairness, ethics, respect, accountability, transparency and the disclosure of information often results in the adoption and

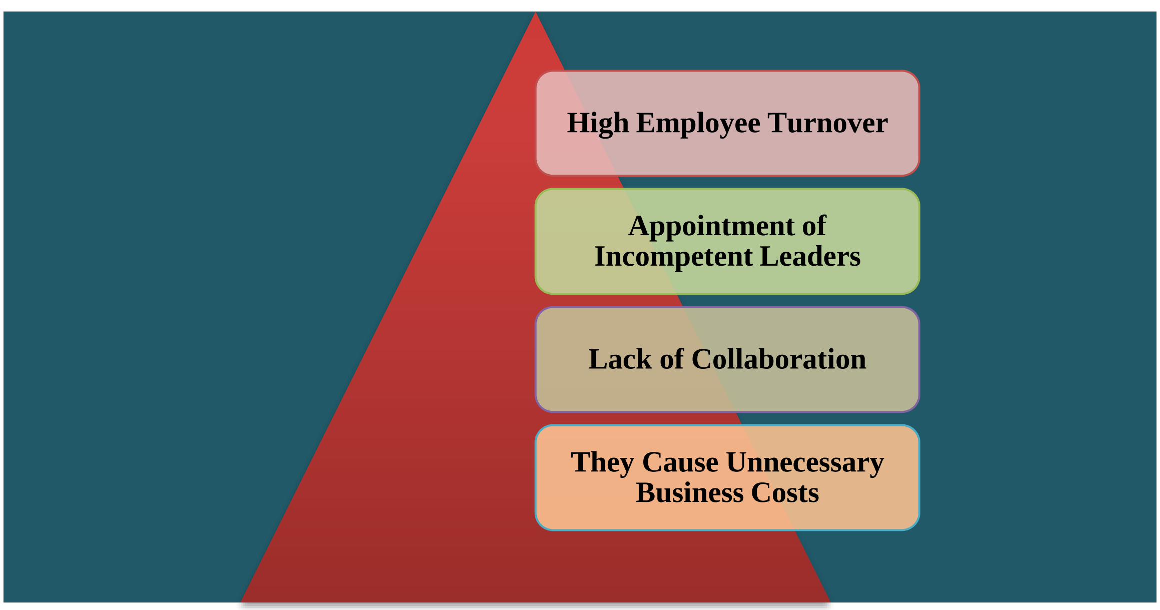
[114] Kay, M. (2016) *Leadership Skills #7: Great Leaders Have Ethics*. Available from: https://aboutleaders.com/leadership-skills-7-great-leaders-have-ethics/

implementation of effective leadership styles by the board of directors, executive directors and senior management. Employees are human beings therefore the style of leadership a leader uses at the workplace plays a great role in influencing their motivation, work performance and organizational commitment. Organizations with great leaders often perform exceptionally well in the market and at their maximum capacity. Generally organizations that invest in leadership training tend to have better qualified board of directors, executive directors and senior managers who can lead the employees more effectively. In the following section the disadvantages of poor leadership will be discussed in-depth.

7.4 Disadvantages of poor leadership

In general several billions of dollars are lost globally on a daily basis as a result of poor leadership and failure to adhere to good corporate governance practices in organizations by the board of directors, executive directors and senior management. Some of the disadvantages that are experienced by organizations with poor leadership will be depicted in Figure 7.2 below.

Figure 7.2 Four disadvantages of poor leadership



Source: Modified: (Riggio, 2019; DeRosa, 2019; Veldsman, 2016).

As depicted by Figure 7.2 above the four disadvantages of poor leadership in organizations will be discussed further as follows:

7.4.1 High Employee Turnover. One of the quickest way to identify a poorly led organization is employee turnover. [115]"*The (Good) Rats are Leaving the Ship*. High rates of turnover, particularly if those leaving are talented and experienced employees, is a key indicator of a failing organization. The causes of turnover can be many—a toxic organizational culture, poor leadership, non-competitive compensation, and other factors"[116] (Riggio, 2019, https://www.psychologytoday.com/intl/blog/cutting-edge-leadership/201902/4-warning-signs-your-organization-is-failing).

7.4.2 The appointment of incompetent leaders. Another quick way of identifying poor leaders is the appointment of incompetent leaders to oversee the affairs of the operational activities of the organization. ""*The (Bad) Rats are Running the Ship*. What do I mean by "bad rats?" This is when an organization allows abusive supervisors and bullies to go unchecked. Why would they do this? Often it is because either the "rats" have some sort of control or have the support of higher-level leadership. Leaders all too often overlook abusive and bullying behaviors in employees because they are viewed (rightly or wrongly) as contributing to the bottom line. Meeting departmental or organizational goals by abusing employees to get there is a sign of a deteriorating organization"" (Riggio, 2019, https://www.psychologytoday.com/intl/blog/cutting-edge-leadership/201902/4-warning-signs-your-organization-is-failing).

7.4.3 "Lack of Collaboration. Effective managers coordinate tasks within their departments, promoting an encouraging atmosphere for idea sharing and cooperation. Poor management

[115] Riggio, R. (2019) *4 Warning Signs Your Organization is Failing*. Available from: https://www.psychologytoday.com/intl/blog/cutting-edge-leadership/201902/4-warning-signs-your-organization-is-failing "Copyright Sussex Publishers, LLC. Except as otherwise expressly permitted under copyright law, no copying, redistribution, retransmission, publication or commercial exploitation of downloaded material will be permitted without the express written permission of Sussex Publishers, LLC."

[116] Riggio, R. (2019) *4 Warning Signs Your Organization is Failing*. Available from: https://www.psychologytoday.com/intl/blog/cutting-edge-leadership/201902/4-warning-signs-your-organization-is-failing "Copyright Sussex Publishers, LLC. Except as otherwise expressly permitted under copyright law, no copying, redistribution, retransmission, publication or commercial exploitation of downloaded material will be permitted without the express written permission of Sussex Publishers, LLC."

inhibits collaboration and causes employees to focus inwardly on their own roles or departments at the expense of the company's larger goals. Many leaders are promoted because they are high achievers, but only one-in-seven of them actually possess the characteristics of high-potential leaders. This makes it difficult for them to facilitate effective collaboration"[117] (DeRosa, 2019, https://www.onpointconsultingllc.com/blog/the-real-consequences-of-poor-leadership-development).

7.4.4 They cause unnecessary business costs. A leader who is inappropriately qualified often lacks the managerial knowledge that is needed to successfully lead the employees. In addition a leader who is inappropriately qualified is more likely to make the organization to lose money (*sales revenue*) on a daily basis as a result of his/her bad management decisions instead of generating cash inflows for the business (Veldsman, 2016). The hiring of inexperienced business managers leads to organizations achieving lower sales revenues, whilst simultaneously incurring higher operating costs which results in the reduction of profits made by the business[118] (Veldsman, 2016, www.theconversation.com/how-toxic-leaders-destroy-people-as-well-as-organisations-51951). In the following section examples of organizations with great leaders will be discussed in-depth.

7.5 Examples of organizations with good-to-great leaders

Today there are several leading organizations operating in different parts of the world that have become global powerful corporate brands and that are well known for their high corporate governance standards as a result of their good-to-great leaders. Some of the leading organizations with good-to-great leaders that will be covered in this chapter are depicted in Figure 7.3 below.

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[117] DeRosa, D. (2019) *The Real Consequences of Poor Leadership Development*. Available from: https://www.onpointconsultingllc.com/blog/the-real-consequences-of-poor-leadership-development

[118] Veldsman, T. (2016) *How Toxic Leaders destroy People As Well As Organizations.* Available from: www.theconversation.com/how-toxic-leaders-destroy-people-as-well-as-organisations-51951

Figure 7.3 Three examples of organizations with good-to-great leaders

Source: Modified: (LafargeHolcim, 2019; Airbus SE, 2019 & Boeing Inc., 2019)

7.5.1 LafargeHolcim

A typical good example of a remarkable leading global organization with a powerful employer brand with a board that is comprised of good-to-great leaders with a strong innovation orientated culture is LafargeHolcim, headquartered in Jona, Switzerland. The current Chairman of LafargeHolcim is Mr. Beat Hess and the Vice Chairman is Mr. Oscar Fanjul. The other board of directors of LafargeHolcim include: Mr. Paul Desmarais Jr., Mr. Patrick Kron, Mr. Adrian Loader, Mr. Jürg Oleas, Ms. Hanne Birgitte Breinbjerg Sørensen, Dr. Dieter Spälti, Mr. Colin Hall, Ms. Naina Lal Kidwai and Ms. Claudia Sender Ramirez[119] (LafargeHolcim, 2019, https://www.lafargeholcim.com/board-directors). "LafargeHolcim is the global leader in building

[119] LafargeHolcim (2019) *Board of Directors*. Available from: https://www.lafargeholcim.com/board-directors

materials and solutions. We are active in four business segments: Cement, Aggregates, Ready-Mix Concrete and Solutions & Products. With leading positions in all regions of the world and a balanced portfolio between developing and mature markets, LafargeHolcim offers a broad range of high-quality building materials and solutions. LafargeHolcim experts solve the challenges that customers face around the world, whether they are building individual homes or major infrastructure projects. Demand for LafargeHolcim materials is driven by global population growth, urbanization, improved living standards and sustainable solutions construction. Around 75,000 people work for the company in around 80 countries"[120] (LafargeHolcim, 2019, https://www.lafargeholcim.com/our-strategy). "*Board of Directors*. The Board is comprised of eleven Board members, all of who are independent according to the Swiss Code of Best Practice for Corporate Governance and the criteria laid out by the DJSI. Furthermore, the company has a set policy that the majority of Directors on the Board shall be independent. Board members are expected to attend all regular meetings. With regard to Board composition, the Nomination, Compensation and Governance Committee considers diversity (including but not limited to: origin, domicile, gender, age and professional background) as well as such other factors necessary to address current and anticipated needs of the Company" (LafargeHolcim, 2019, https://www.lafargeholcim.com/board-directors).

7.5.2 Airbus SE

One of the organizations that have managed to set the pace of exemplary leadership and effective corporate branding as a result of its highly functional board of directors is the leading commercial aircraft manufacturer 'Airbus SE' which is headquartered in Leiden in the Netherlands. "The Board of Directors is responsible for the management of the Company and consists of a maximum of 12 members, appointed and removed at the *Shareholders' Meeting*. The Board is responsible for the overall conduct of the Company, the management, direction and performance of the Company and its business. The *Board Rules* specify that in addition to the Board of Directors' responsibilities under applicable law and the Articles of Association, the Board of Directors is responsible for certain enumerated categories of decisions. Under the Articles of Association, the Board of Directors is responsible for the management of the Company. Under the Board Rules, the Board of Directors delegates day-to-day management

[120] LafargeHolcim (2019) *Our Strategy*. Available from: https://www.lafargeholcim.com/our-strategy

of the Company to the CEO, who, supported by the *Executive Committee*, makes decisions with respect to the management of the Company. However, the CEO may not enter into transactions that form part of the key responsibilities of the Board of Directors unless these transactions have been approved by the Board of Directors"[121] (Airbus, 2019, https://www.airbus.com/company/corporate-governance/board-and-board-committees.html). The current Chairman of the Board at Airbus SE is Denis Ranque and the CEO of Airbus SE is Guillaume Fury (*who is also a current Board Member*). The list of other current board of directors at Airbus SE includes: Victor Chu, Jean-Pierre Clamadieu, Ralph D. Crosby, Jr., Lord Paul Drayson, Catherine Guillouard, Hermann Josef-Lamberti, Amparo Moraleda, Claudi Nemat, Carlos Tavares (Airbus, 2019, https://www.airbus.com/company/corporate-governance/board-and-board-committees.html).

7.5.3 Boeing Inc.

Today one of the world's leading aircraft manufacturer and innovation centered organization is the Illinois, Chicago, United States of America headquartered Boeing Corporation (Boeing, 2018). [122]"Since July 15, 1916, we've been making the impossible, possible. From producing a single canvas-and-wood airplane to transforming how we fly over oceans and into the stars, The Boeing Company has become the world's largest aerospace company. And we're just getting started. Thank you for making 2016 unforgettable with events, activities and commemorations that celebrated not only our first century of innovation, but also the people and moments that inspire us to live by our founder Bill Boeing's philosophy – *'build something better.'"* (Boeing Inc., 2019, https://www.boeing.com/history/). [123]"*Boeing Overview*. Boeing is the world's largest aerospace company and leading manufacturer of commercial jetliners, defense, space and security systems, and service provider of aftermarket support. As America's biggest

[121] Airbus (2019) *Board and Board Committees*. Available from: https://www.airbus.com/company/corporate-governance/board-and-board-committees.html

[122] Boeing Inc., *History: Thank You for Celebrating Our Centennial with Us!*, [Website], 2019, https://www.boeing.com/history/, (accessed 12 October 2019).

[123] Boeing Corporation, *Overview*, [Website], 2019, https://www.boeing.com/company/general-info/index.page#/overview, (accessed 12 October 2019).

manufacturing exporter, the company supports airlines and U.S. and allied government customers in more than 150 countries. Boeing products and tailored services include commercial and military aircraft, satellites, weapons, electronic and defense systems, launch systems, advanced information and communication systems, and performance-based logistics and training. Boeing has a long tradition of aerospace leadership and innovation. The company continues to expand its product line and services to meet emerging customer needs. Its broad range of capabilities includes creating new, more efficient members of its commercial airplane family; designing, building and integrating military platforms and defense systems; creating advanced technology solutions; and arranging innovative financing and service options for customers. With corporate offices in Chicago, Boeing employs more than 153,000 people across the United States and in more than 65 countries. This represents one of the most diverse, talented and innovative workforces anywhere. Our enterprise also leverages the talents of hundreds of thousands more skilled people working for Boeing suppliers worldwide. Boeing is organized into three business units: Commercial Airplanes; Defense, Space & Security; and Boeing Global Services, which began operations July 1, 2017. Supporting these units is Boeing Capital Corporation, a global provider of financing solutions. In addition, functional organizations working across the company focus on engineering and program management; technology and development-program execution; advanced design and manufacturing systems; safety, finance, quality and productivity improvement and information technology"[124] (Boeing Corporation, 2019, https://www.boeing.com/company/general-info/index.page#/overview). [125] "*Overview:* At Boeing, ethical business conduct isn't just a part of what we do—it's at the very core of how we operate. Doing the right thing for our employees, customers, stakeholders and communities has helped us earn trust and build partnerships that will drive us forward in our next century, and beyond. Each year, Boeing's chairman hosts a live, company-wide broadcast event with employees across the globe to underscore the importance of intentional and ethical decision-making in everything we do. While each employee is accountable for upholding the Boeing

[124] Boeing Corporation, *Overview*, [Website], 2019, https://www.boeing.com/company/general-info/index.page#/overview, (accessed 12 October 2019).

[125] Boeing Inc., *Ethics and Compliance*, [Website], 2019, https://www.boeing.com/principles/ethics-and-compliance.page, (accessed 12 October 2019).

Code of Conduct, ensuring that our enduring values remain foundational to our work, and following all applicable laws, regulations and company policies, Boeing advances its unified approach to ethics and compliance through the integration of key functions: Corporate Audit, Ethics and Business Conduct, Global Trade Controls, Security & Fire Protection, and other enterprise-wide services. These functions and operating groups constitute the Boeing Office of Internal Governance and Administration and represent approximately 1,700 employees worldwide. This office reports significant investigations, audit findings, or escapes to the Board of Directors and will disclose criminal conduct to appropriate regulators with the guidance and assistance of the Law Department. This structure creates a sustainable advantage for Boeing by enabling compliant company performance across all geographic locations—while also building on our legacy of integrity, transparency and an unwavering commitment to fair and ethical business practices. [126]***Leadership Matters: Ethical Business Conduct Guidelines***. Leadership Matters is a companywide initiative that focuses on enabling a culture of openness and accountability in order to sustain an ethical and compliant work environment and enhance business performance. The intent is to embed ethical decision-making into all aspects of business, and equip managers and employees with tools to confidently address ethics-related matters, and to raise questions without fear of retaliation. Boeing asks teammates around the world to provide answers to questions in a formal, confidential survey about their perceptions of the company, its direction, the quality of our managers, our shared values and ethics along with other important dimensions of corporate culture. Boeing specifically asks about employees' perceptions of retaliation for reporting wrongdoing and of their management's support of ethical decision-making to ensure a culture of openness and accountability. Focused surveys are also deployed to collect further details about employees' perceptions of the Boeing culture. Managers use the feedback to initiate conversations with their team, identify actions to improve the employee experience and fully engage the team to contribute their best every day. Company leaders take the results and supporting managers seriously, providing them the needed resources to change the company for the better. The ethics and compliance groups provide a range of tools and resources to help managers and employees discuss ethics issues and regularly practice

[126] Boeing Inc., *Ethics and Compliance*, [Website], 2019, https://www.boeing.com/principles/ethics-and-compliance.page, (accessed 12 October 2019).

ethical decision-making skills. The tools and resources include: • **Ethical Business Conduct Guidelines** (PDF). Please note: This document for Boeing employees is being provided for reference to stakeholders outside the company. However, it contains links to material accessible only from inside the Boeing computing network. • Workplace case studies based on actual events • Staff meeting materials that drive openness, trust, and personal accountability, and encourage speaking up without fear of retaliation. Additional topics are provided to help employees respond ethically when faced with normal business pressures, such as workforce shifts, and cost or schedule constraints. • Training refreshers on company procedures and policies"[127] (Boeing Inc., 2019, https://www.boeing.com/principles/ethics-and-compliance.page). The various reasons why corporate governance relies on board committees will be covered in the following section.

7.6 Why organizations rely on board committees

"When established, charged and composed effectively, board committees can be a valuable asset to both your board and your management team by helping to:

• identify and examine key issues, concerns and questions ahead of board meetings.

• give laser focus to a project delegated by the board and/or helping to get things done more quickly and efficiently than would be possible for the full board.

• more equitably distribute the board's work, since committee assignments can be dispersed among board members.

• facilitate trust-building between board members and management through their combined efforts. (It's always a good idea to include relevant members of your management team on your board committees, too!)

[127] Boeing Inc., *Ethics and Compliance*, [Website], 2019, https://www.boeing.com/principles/ethics-and-compliance.page, (accessed 12 October 2019).

• increase engagement among individual board members and help them make a more meaningful contribution to the board and to the credit union"[128] (Daigneault and Boden, 2016, https://www.cumanagement.com/articles/2016/11/benefits-board-committees). [129]According to Jo Iwasaki cited in Acca Global (2019) *What are board committees and their functions? Boards may assign specific tasks to committees to help them fulfill their diverse range of responsibilities*. Committees can deal with specific tasks for which the board is responsible, but which it does not necessarily have enough time and resource to manage. By delegating tasks to committees, boards can spend their time more efficiently. Board committees meet according to their task, and as specified in their terms of reference. This might be at a specific time of the year (eg coinciding with the financial reporting and audit cycle for the company's audit committee) or at certain intervals. It is important that prospective board members consider whether they have sufficient time to dedicate not only to the work of the board, but also to that of a committee or committees because board committees are usually made up of a sub-selection of board members. While it is not mandatory to have board committees, particularly in companies that are not listed, many corporate governance codes, recommend as a best practice that companies set up an audit committee and, particularly in the case of large companies, remuneration and nomination committees. Many companies, especially in the financial services sector, also have ethics and risk committees (Jo Iwasaki cited in Acca Global, 2019, https://careers.accaglobal.com/careers-advice/sectors-and-specialisms/neds-and-trustees-advice/what-are-board-committees-and-their-functions.html). The various types of board committees will be discussed in-depth in the following section.

7.7 Types of board committees

"From standing and ad hoc committees to task forces and advisory councils, a board accomplishes its work through a variety of smaller groups. Associations need to regularly evaluate their existing committee structure and be ready to adjust it based on the organization's

[128] Daigneault, M.G. and Boden, J. (2016) *Benefits of Board Committees.* Available from: https://www.cumanagement.com/articles/2016/11/benefits-board-committees

[129] Jo Iwasaki cited in Acca Global (2019) *Sectors and Specialisms: NED and Trustee Advice*. Available from: https://careers.accaglobal.com/careers-advice/sectors-and-specialisms/neds-and-trustees-advice/what-are-board-committees-and-their-functions.html

changing governance needs. Just as every board is unique, every board's committee structure is unique too. Most organizations have the same committee structure from year to year with little thought given as to what the committees do or whether they are still relevant to the organization. As a result, the committees have vague objectives, committee meetings are often endless discussions with no work achieved, and the members of the committees become bored or frustrated. Organizations should avoid the temptation to form too many committees. To be effective (and to avoid burnout), board members should generally not serve on more than two committees. There are generally two types of board committees:

• *Standing committees* (also called operating committees) are those committees that an organization uses on a continual basis. They can be set forth in the organization's bylaws or in its board operations and policy manual, or they may be established by custom.

• *Ad hoc committees* are formed for a limited period of time to address a specific need. When the work of the ad hoc committee is completed, the committee is dissolved. An ad hoc committee may exist for less than a year or for a year or more depending on the extent of the work assigned to it"[130] (Johnson, 2015, https://www.asaecenter.org/resources/articles/an_plus/2015/december/the-basics-of-board-committee-structure).

"The bulk of the board's work should be done through its standing committees. Some boards have board development plans where members rotate through the different committees to gain a broad understanding of the organization. Others allow members to stay with the same committee each year to develop a deeper knowledge of the subject area to provide greater service to the organization. A balance of the two strategies allows board members to gain experience with different committees and to develop some expertise with the work of one or two committees. Ad hoc committees are often formed to amend the bylaws, recruit a new CEO, develop a strategic plan, relocate the organization, form a new subsidiary, launch a new division, or work with other organizations or coalitions. An ad hoc committee could also be formed to study and find creative solutions to a particular challenge an organization is facing, such as falling membership levels or

[130] Johnson, E. (2015) *The Basics of Board Committee Structure*. Available from: https://www.asaecenter.org/resources/articles/an_plus/2015/december/the-basics-of-board-committee-structure

poor communications. A board does not always need to add new committees to get its work done, nor must committee members always be members of the board. A *task force* can be formed if there is an objective that can be achieved in a relatively short period of time. Special events planning or analyzing a proposed merger are examples of work that can be handled by task forces. *Advisory councils* assist boards in carrying out their work by providing expertise and advice in selected areas. [131]Advisory councils do not have any governance responsibilities and are a good way to include former board members, potential board members, subject matter experts, and others in the work of the board without placing them on the board. Not every volunteer makes a good board member. Sometimes a task force or advisory council is a better use of the volunteer's talent, experience and time. Ad hoc committees and task forces are a good way to involve non-board members in the board's work. Committees should perform regular self-assessments to determine if they are working effectively, achieving their established goals, and providing value to the organization. This can be done at the end of each committee meeting or on an annual or more frequent basis. Committee chairs and vice chairs should provide actual leadership to the committee. These are not empty titles but require real work in terms of translating the board's goals for the committee into meeting agendas and work plans. Committee chairs also report on the work of their committee to the Executive Committee and the full board. Committees with no work can be abolished, and committees with overlapping work can be merged. Committees should not take on a life of their own, nor should they overshadow the board itself" (Johnson, 2015, https://www.asaecenter.org/resources/articles/an_plus/2015/december/the-basics-of-board-committee-structure). The different types of standing committees that are often found in organizations will be covered in the following section.

7.7.1 Standing committees

Several standing committees exist nowadays in organizations and these help organizations to maintain their corporate governance standards on a regular basis. In general standing committees

[131] Johnson, E. (2015) *The Basics of Board Committee Structure*. Available from: https://www.asaecenter.org/resources/articles/an_plus/2015/december/the-basics-of-board-committee-structure

are the commonly used forms of committees in organizations. The different types of standing committees include the following:

7.7.1.1 "Audit committee - The primary task of the audit committee is to oversee the relationship with external auditors to ensure the quality of the company's financial statements. The audit committee's role includes making recommendations on the appointment and reappointment of the external auditors, their remuneration, and their terms of engagement. For this task, it is essential that you keep up to date on the relevant professional and regulatory requirements within your jurisdiction. It is often the case that the audit committee membership must have relevant financial (and possibly auditing) expertise and experience. This is because the audit committee will be reviewing, and reporting to the board on, the most critical accounting policies, which are the basis for the financial reports. Another important task for the audit committee is to provide the link between the internal and external auditors. On behalf of the board, the audit committee receives reports from the internal auditors and, through its relationship with the external auditors, it is then well placed to advise the board on the necessary next steps. This is why the audit committee is often an integral part of a company's risk management and internal control systems" (Jo Iwasaki cited in Acca Global, 2019, https://careers.accaglobal.com/careers-advice/sectors-and-specialisms/neds-and-trustees-advice/what-are-board-committees-and-their-functions.html). *""The role of the Audit Committee.* The audit committee's primary task is to monitor the integrity of the company's *financial reporting.* It also has a role in checking the company's internal financial controls, reviewing them and their operation and ensuring that necessary risk management systems are in place. It is responsible for overseeing the company's *external audit process* and relations with the external auditor. This includes making recommendations on the appointment, reappointment and removal of the external auditors. It must also keep a close check on the external auditors' independence and objectivity. The audit committee has a role in *fraud prevention.* It needs to be confident that there are opportunities throughout the company for employees to act as "whistleblowers" and report improprieties and abuses. The committee should ensure that arrangements are in place for the proportionate and independent investigation of such matters and for appropriate follow-up action. The UK Corporate Governance Code recommends that the audit committee should be comprised of at least three, or in the case of smaller companies two, independent non-executive directors, one of whom should have recent and relevant financial experience''"[132] (Institute of Directors, 2019, www.iod.com). "Audit Committee**.** It is usually a small committee of three to five members. Its work is often seasonal, tied to the end of the organization's fiscal year. The Audit Committee selects the outside auditor, meets with the auditor to receive the audit report and management letter, and discusses the management letter with the full board and the senior staff. The Audit Committee may also be charged with auditing the expenses of the board and the chief executive officer. Members of the Audit Committee should be financially literate and at least one (and preferably more) should be financial professionals. While there may be some overlap in membership with the Finance Committee, the chair of the Finance Committee and the treasurer should not be on the Audit Committee. Likewise, the chair of the board and the CEO should not be on the Audit Committee" (Johnson, 2015, https://www.asaecenter.org/).

7.7.1.2 Ethics & Compliance Committees are established in an organization to help enforce compliance with the organization's rules and practices that are concerned with upholding ethical conduct and integrity amongst board members including the organization. A good example of an organization that uses Ethics & Compliance Committees is the leading commercial aircraft manufacturer 'Airbus SE' which is headquartered in Leiden in the Netherlands. [133]According to Airbus (2019) *The Ethics and Compliance Committee* assists the Board in overseeing Airbus' culture and commitment to ethical business and integrity. It oversees the Company's ethics and compliance programme, organisation and framework for the effective governance of ethics and compliance, including all associated internal policies, procedures and controls (Airbus, 2019, www.airbus.com).

7.7.1.3 "Health, safety & sustainability committee - This committee supports and advises the Board of Directors on the development and promotion of a healthy and safe environment for employees and contractors as well as on sustainable development and social responsibility. It is also responsible for the following:

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[132] Institute of Directors (2019) *The Role of Board Committees*. Available from: https://www.iod.com/news/news/articles/The-roles-of-board-committees

[133] Airbus (2019) *Board and Board Committees*. Available from: https://www.airbus.com/company/corporate-governance/board-and-board-committees.html

• Overseeing the resources and processes to be employed to minimize or eliminate risks to health and safety

• Overseeing health and safety performance of the Company, its employees and contractors

• Reviewing compliance with relevant health and safety legal and regulatory requirements, and internal policies and procedures

• Assessing performance and use of resources through reviews and audits, including periodic formal reviews of the Company's health and safety performance"[134] (LafargeHolcim, 2019, https://www.lafargeholcim.com/committees).

7.7.1.4 "*Executive Committee***.** Depending on the size of the board, it may be advantageous to form a small (three- to seven- member) Executive Committee that is authorized to meet and take action between board meetings when it is impractical to get the full board together for a special board meeting. The Executive Committee can also serve as an advisor to the chief executive officer and a liaison between the CEO and the full board. The Executive Committee is usually charged with oversight of the organization's chief executive officer. While there may be a separate CEO search committee or a compensation committee, the Executive Committee will often hire the CEO and work with the CEO in establishing goals for the year, evaluating performance, and setting compensation. The Executive Committee reports on these activities to the full board. The members of the Executive Committee are often on that committee due to the position they hold within the organization. The chair and any vice chairs are normally on the Executive Committee" (Johnson, 2015, https://www.asaecenter.org/).

7.7.1.5 "Governance Committee. The Governance Committee is charged with the care and feeding of the board itself. The responsibilities assigned to this committee vary with each organization. As a general rule, the Governance Committee would be responsible for board recruitment, orientation, self-assessment, continuing education, and board management. Recruitment involves identifying current and projected vacancies on the board, assessing the composition of the current board and identifying gaps in competencies or demographics, and

[134] LafargeHolcim (2019) *Committees*. Available from: https://www.lafargeholcim.com/committees

finding and recruiting potential board members. The Governance Committee is charged with developing a position description for board membership to inform prospective candidates of qualifications in terms of their experience and background and what will be expected of them if they join the board. The Governance Committee can also serve as the Nominating Committee for new board members and officers"[135] (Johnson, 2015, https://www.asaecenter.org/).

7.7.1.6 Remuneration committee. "The role of the Remuneration Committee. Devising the appropriate *remuneration packages* for the executive directors can be one of the most contentious issues a board faces - not least because of the publicity executive pay has attracted in recent years. Levels of remuneration should be sufficient to attract and retain the executive directors needed to run the company, but companies should avoid paying more than necessary. It is vital that decisions on executive remuneration, benefits and bonuses are seen to be taken by those who do not stand to benefit directly from them. In listed companies and some larger private companies therefore, policy on executive remuneration is usually decided by a committee of non-executive directors. As a matter of good practice, executive directors should not be responsible for determining their own remuneration. The UK Corporate Governance Code recommends that this should be the remit of a remuneration committee made up of at least three or in the case of smaller companies two, independent non-executive directors" (Institute of Directors, 2019, www.iod.com).

7.7.1.7 Nomination committee. "The role of the Nomination Committee. One of the board's most crucial functions is to decide on *new appointments* to the board and to other senior positions in the company. Again, in some cases, this is done within a committee, composed of executive and non-executive directors, whose task it is to ensure that appointments are made according to agreed specifications. Where implemented, the appraisal of directors is often tied directly into the selection and nomination process. As a matter of good practice, the *selection process* of directors should be carried out by the nomination committee, which then makes recommendations to the full board. Non-executive directors should form a majority of this committee. The nomination committee will typically also ensure that *succession plans* are in

[135] Johnson, E. (2015) *The Basics of Board Committee Structure*. Available from: https://www.asaecenter.org/resources/articles/an_plus/2015/december/the-basics-of-board-committee-structure

place for the board and the executive level immediately below it" (Institute of Directors, 2019, www.iod.com).

7.7.2 Adhoc committees

Today numerous adhoc committees are used in organizations once in a while. "By their nature, ad hoc committees are formed when they are needed and dissolved when their work is done. Below are some examples of ad hoc committees"[136] (Johnson, 2015, https://www.asaecenter.org/).

7.7.2.1 "Bylaws Committee. The Bylaws Committee is charged with reviewing the organization's bylaws and current practices to ensure that they are synchronized. Over time, it is not uncommon for an organization's practices to evolve so that they no longer follow the bylaws. The Bylaws Committee assesses why this has happened and recommends changes to either the organization's practices or the bylaws. This group can also be used to review current best practices and governance trends and make recommendations on those the organization should consider adopting. A Bylaws Committee may work with the Governance Committee or Membership Committee. Since a review of the organization's bylaws and practices is usually only done every few years, this does not need to be a standing committee" (Johnson, 2015, https://www.asaecenter.org/).

7.7.2.2 "Strategic Planning Committee. Since it should take less than a year to develop or update an existing strategic plan, this task can be assigned to an ad hoc committee or a task force. Many organizations will choose to make it an ad hoc committee. Members of the Strategic Planning Committee are responsible for developing or updating an existing strategic plan for the full board's approval. They may also monitor the implementation of the plan and report on its progress to the full board. This ad hoc committee may work closely with the Finance Committee, the Membership Committee, and the Program Committee" (Johnson, 2015, https://www.asaecenter.org/). In the next section the conclusion of this chapter will be covered.

[136] Johnson, E. (2015) *The Basics of Board Committee Structure*. Available from: https://www.asaecenter.org/resources/articles/an_plus/2015/december/the-basics-of-board-committee-structure

7.8 Conclusion

Effective leadership is the glue that keeps together all the activities in the organization to work harmoniously such as the ethics & compliance policy, corporate governance guidelines and organizational strategy. Effective leaders have the ability to execute strategy whilst thinking strategically. Poor leadership in an organization leads to the board of directors and executive management appointing incompetent people to manage the day-to-day activities of the organization while on the other hand it leads to high employee turnover of talented employees in the organization which ultimately reduces the productivity levels of the organization. The basic traits that are associated with leadership that upholds corporate governance on a continuous basis include: justice, integrity, courage and so on. It can therefore be concluded that board committees are divided into two namely: standing and adhoc committees. Generally committees enable the board to allocate tasks to board members based on their career field of specialization and they also help the board to solve some of its key challenges it might be facing at a particular time period due to inadequate time to use to properly address these challenges.

7.9 Review questions

1) What is the meaning of the following terms: ‘leadership’, ‘board committee’ and a ‘leader’?

2) List the advantages of good leadership and the disadvantages of poor leadership in an organization?

3) Describe at least four examples of leading global organizations with good-to-great leaders?

4) Explain in-depth why organizations tend to rely on board committees to deal with various issues in the organizations?

5) Discuss in detail the two types of board committees and give relevant details of the various committees associated with the two types of board committees?

Chapter 8: Diversity and Inclusion

After reading this chapter you should be able to:

- Describe the meaning of the terms diversity, inclusion, recruitment and training. Discuss the interrelation between diversity & inclusion.
- Describe the advantages of board diversity. Explain the current global efforts being used by organizations to regulate board diversity.
- Highlight how an inclusive workplace culture makes diversity work. Identify the role played by the recruitment activity in achieving board diversity and inclusion in the organization.
- Describe the different types of disabilities to be aware of during the board recruitment process. Explain the four key drivers of diversity and inclusion at the workplace nowadays. Outline the various topics covered in general disability awareness training programs and the disability awareness training programs for leaders of an organization.
- Explain the five ways an organization can use to improve its board diversity. Discuss the common reasons why diversity & inclusion efforts fail.

8.1 Introduction

In general human beings are different in their own unique ways and the good part about these differences amongst them is that they enable all the human beings in society or communities to effectively work together. [137]"The board of directors forms one of the pillars of a robust corporate governance framework. Recent academic literature suggests that one of the ways to enhance corporate governance, arguably, is to diversify the board. Over the years, regulators have placed great emphasis on addressing different matters relating to the board of directors. In short, board diversity aims to cultivate a broad spectrum of demographic attributes and characteristics in the boardroom. A simple and common measure to promote heterogeneity in the

[137] Source: Eric YW Leung, P1 article for ACCA, 2019 at https://www.accaglobal.com/lk/en/student/exam-support-resources/professional-exams-study-resources/strategic-business-leader/technical-articles/diversifying-the-board.html

boardroom – commonly known as gender diversity – is to include female representation on the board" (Source: Eric YW Leung cited in Acca Global, 2019, www.accaglobal.com). Boardroom diversity has become the new buzz word in the ethics and corporate governance field nowadays. "Way back when, it all made sense. Having people on your board of directors who were reliable, likeminded and known entities was the most logical strategy to build a board. After all, the purpose of the board was to support the chief executive officer's (CEO) plan and assure the shareholders that experienced, intelligent people were looking out for their interests. Even if this strategy was well-intentioned, it came with a number of significant downsides. First, it created an environment in which directors were beholden to the CEO for their seat—something that clearly undermined board independence. Second, a board built on a handful of relationships has the inherent risk of insularity. This homogeneity can be a hindrance in an increasingly dynamic environment. As globalization, the rapid deployment of technology, an increasing need for risk management and the shifting demographics of workforces made businesses much more complex, boards began to broaden their composition. But diversity for its own sake falls short of both the need and the opportunity. An evolution is under way, and boards now are beginning to realize that it is the breadth of perspective, not the mere inclusion of various diverse traits, that benefits the organization"[138] (Russell Reynolds Associates Inc., 2009:1, https://www.russellreynolds.com). The definitions of terms used in this chapter will be covered in the following section.

8.2 Definition of terms

"Until recently, there has been an urge for diversifying the board. Intuitively, *diversity* means having a range of many people that are different from each other. There is, however, no uniform definition of board diversity. Traditionally speaking, one can consider factors like age, race, gender, educational background and professional qualifications of the directors to make the board less homogenous. Some may interpret board diversity by taking into account such less tangible factors as life experience and personal attitudes" (Source: Eric YW Leung cited in Acca

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[138] Russell Reynolds Associates Inc. (2009) *Different is Better – Why Diversity is Better in the Boardroom.* Available from: https://www.russellreynolds.com/en/Insights/thought-leadership/Documents/different-is-better_0.pdf [Accessed 2019, 04 September] p1-8

Global, 2019, www.accaglobal.com). *"Diversity* is the range of human differences, including but not limited to race, ethnicity, gender, gender identity, sexual orientation, age, social class, physical ability or attributes, religious or ethical values system, national origin, and political beliefs. *Inclusion* is involvement and empowerment, where the inherent worth and dignity of all people are recognized"[139] (Ferris State University, 2019, https://www.ferris.edu/). "*Diversity* means all the ways we differ. Some of these differences we are born with and cannot change. Anything that makes us unique is part of this definition of diversity. *Inclusion* involves bringing together and harnessing these diverse forces and resources, in a way that is beneficial. Inclusion puts the concept and practice of diversity into action by creating an environment of involvement, respect and connection - where the richness of ideas, backgrounds, and perspectives are harnessed to create business value. Organizations need both diversity and inclusion to be successful"[140] (Jordan, 2011, www.diversityjournal.com). ""There's some confusion regarding the definition of an inclusive culture. Just because your company has some racial and gender diversity doesn't mean you can check the inclusion box. "In an *inclusive culture*, everyone has the opportunity to do their best work no matter who they are, what they do or where they work," says Simma Lieberman, an inclusion expert who is the author of "110 Ways to Champion Diversity and Build Inclusion" and who recently launched a podcast, Every Day Conversations on Race for Every Day People"" [141] (Simma Lieberman cited in TalentCulture, 2018, https://talentculture.com/). According to Hunter (2002:83) *recruitment* is the process of encouraging people to apply for jobs in an organisation and its objective is to have a pool of suitably qualified and experienced applicants from whom one or more employees can be selected[142] (Hunter, 2002:83). The interrelation that exists between diversity and inclusion will be covered in the following section.

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[139] Ferris State University (2019) *Diversity and Inclusion Definitions*. Available from: https://www.ferris.edu/HTMLS/administration/president/DiversityOffice/Definitions.htm

[140] Jordan, T. H. (2011) Moving from Diversity to Inclusion. *Profiles in Diversity Journal*. Available from: www.diversityjournal.com/1471-moving-from-diversity-to-inclusion/

[141] TalentCulture (2018) *How to Intentionally Create a More Inclusive Culture*. Available from: https://talentculture.com/how-to-intentionally-create-a-more-inclusive-culture/

[142] Hunter, C. (2002) *Managing People in South Africa: a Systematic Approach to Human Resources Management*. Pietermaritzburg: Bytes Document Solutions.

8.3 Interrelation between ‘diversity’ & ‘inclusion’

There are several differences and interlinks that exist between diversity and inclusion in general. The interlinks that exist between diversity and inclusion are depicted in greater detail by Table 8.1 below.

Table 8.1 Interrelation between 'diversity' and 'inclusion'

Diversity	**Inclusion**
"Diversity is a fact"[143] (Anna Beninger cited in TalentCulture, 2018, https://talentculture.com/).	"Inclusion is a choice" (Anna Beninger cited in TalentCulture, 2018, https://talentculture.com/).
"Beninger says diversity refers to the demographic makeup of an organization's workforce" (Anna Beninger cited in TalentCulture, 2018, https://talentculture.com/).	"You must have a diverse workforce in order to be inclusive"[144] (Anna Beninger cited in TalentCulture, 2018, https://talentculture.com/).
The benefit of diverse groups is that they bring a variety of viewpoints, experiences, backgrounds and interests to the table (Anna Beninger cited in TalentCulture, 2018, https://talentculture.com/).	"On the other hand, she says, inclusion can be invisible and difficult to grasp. 'Catalyst research shows that when individuals feel that they belong to the group and are valued for their unique perspective and skills, they are more cooperative and innovative," (Anna Beninger cited in TalentCulture, 2018, https://talentculture.com/).
'"Diverse teams inherently create more unique ideas because individuals have had different experiences and view problems in different ways,' Beninger says. 'They challenge one another and ultimately develop stronger solutions.'" (Anna Beninger cited in TalentCulture, 2018, https://talentculture.com/).	"However, when companies have diversity without inclusion, the results are much different. Lieberman says that without inclusion, you just have employees from different backgrounds. 'Diversity alone may look good in the company photo, but without inclusion employees end up in racial, cultural, gender and other types of silos — and they will leave if they are underutilized, underestimated or feel invisible.' She says companies will not benefit from diversity unless they make

[143] TalentCulture (2018) *How to Intentionally Create a More Inclusive Culture*. Available from: https://talentculture.com/how-to-intentionally-create-a-more-inclusive-culture/

[144] Anna Beninger, Senior Director, Research, Catalyst, as quoted in "How to Intentionally Create a More Inclusive Culture" (TalentCulture, August 14, 2018)

	employees feel welcome and can bring them together to interact and solve problems using the unique talents and experiences from their backgrounds" (Simma Lieberman, an inclusion expert who is the author of '110 Ways to Champion Diversity and Build Inclusion' cited in TalentCulture, 2018, https://talentculture.com/).

Source: Modified: (Anna Beninger and Simma Lieberman cited in TalentCulture, 2018, https://talentculture.com/).

The following section will help to highlight how diversity and inclusion is a process in-depth.

8.3.1 Diversity & inclusion is a process

The organization's board, executive directors and senior managers must fully be knowledgeable of the fact that diversity and inclusion must consistently be implemented in the entire organization. [145]"*Realize That D&I Is a Process, Not a Program*. Inclusion isn't something that you do one time and then check it off your list. '*Too many people see it as a one-time event with training or an hour lunch-and-learn, but inclusion has to be embedded in the culture in every business system and process*,' Lieberman says, adding that this doesn't just happen by chance. '*It has to be intentional and aligned with recruiting, hiring and retaining people*,' she says. Another issue is the tendency to focus too much on policies and programs. When developing a D&I strategy, Beninger says it's important to pay attention to the human side of change. 'Catalyst research shows that an organization's formal efforts to promote inclusion may be effective, but if there is a disconnect with the informal culture, exclusion can persist.' For example, she says, an employee may be excited about the company's leadership development program, but at the same time dreading interactions with team members who constantly dismiss his or her ideas at meetings. '*To overcome this challenge, organizations should promote inclusive leadership behaviors among all employees and visibly and explicitly reward these behaviors*,' Beninger says. 'When exclusionary behavior does happen, interrupt these behaviors — and, importantly, leaders should validate employees' experiences of exclusion by transparently acknowledging barriers and setbacks, and highlighting efforts to amplify inclusion.'" (Anna Beninger and Simma Lieberman cited in TalentCulture, 2018, https://talentculture.com/).

[145] TalentCulture (2018) *How to Intentionally Create a More Inclusive Culture*. Available from: https://talentculture.com/how-to-intentionally-create-a-more-inclusive-culture/

8.4 Key drivers of diversity & inclusion at workplaces

Today there are several factors that are driving the adoption of diversity and inclusion at the workplace across all the organizational hierarchical structures. In general all change initiatives start at the top including diversity and inclusion programs in the organization. "What is driving your organization to integrate inclusion and diversity as part of its overall strategy? While laws and demographics are powerful drivers toward change, it's the positive impacts of a more diverse workforce that are driving new organizational practices. Recruiting a diverse workforce and then retaining those workers within an inclusive environment offers organizations a classic win-win situation"[146] (The Conference Board of Canada, 2019, www.conferenceboard.ca/). Some of the top drivers of diversity in the organization were identified by The Conference Board of Canada (2019) *Top 4 Drivers of Workplace Inclusion* via www.conferenceboard.ca/. According to The Conference Board of Canada (2019) organizations are starting to realize that building a diverse and inclusive workplace is no longer a nice to have – it's a critical business imperative. Here is a snapshot of four main drivers behind this new thinking:

8.4.1 Aging population and the need to fill skills shortages. With an aging population, the demand for workers to replace retirees will only continue to increase in Canada. By 2035, those 65 and older will represent nearly a quarter of the total population. This demographic change is pushing employers to look outside of their traditional talent pools to consider under-used groups to address labour shortages and fill critical skills gaps.

8.4.2 Under-accessed talent groups. Women, immigrants, people with disabilities and Indigenous people are groups of under-represented workers that have the potential to help fill the gaps in Canada's shrinking labour pool. Research shows that homogeneity at the top of organizations can create a behavioural barrier to both diversity and inclusion at all levels.

[146] Source: The Conference Board of Canada (2019) *Top 4 Drivers of Workplace Inclusion*. Available from: https://www.conferenceboard.ca/insights/blogs/top-4-drivers-of-workplace-inclusion

Organizations must be more deliberate in their efforts to hire, retain and promote people from these diversity groups, especially at the leadership level[147].

8.4.3 Meeting regulatory compliance. Legislation requires many Canadian organizations to track the diversity of their workforce and/or report on how they address barriers and provide accommodation. Organizations that report know exactly how diverse their current workforces are—or are not. Businesses need to step up unless they wish to see regulatory bodies take further legislative action to drive greater impact and change on inclusion and diversity efforts.

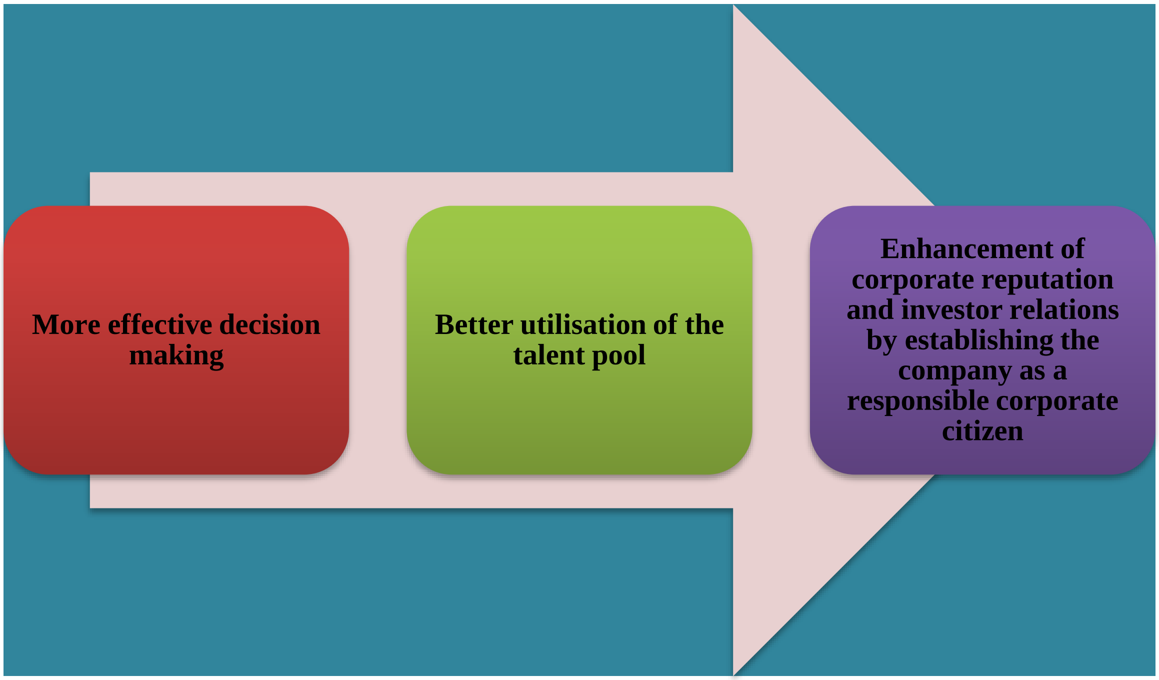
8.4.4 Understanding the competitive advantages of a diverse workforce. There is a strong business case for the benefits of a diverse workforce, supported by a growing body of evidence. Ethnic and cultural diversity has been associated with increased revenue and productivity. There is a strong correlation between corporate financial performance and women's representation on boards. Organizations that hire persons with disabilities have shown improvements in profitability and competitive advantage (Source: The Conference Board of Canada, 2019, https://www.conferenceboard.ca/insights/blogs/top-4-drivers-of-workplace-inclusion). The advantages of board diversity will be discussed in-depth in the next section.

8.5 Advantages of board diversity

Nowadays there are several advantages that are enjoyed by organizations that embrace board diversity. Some of the advantages of board diversity are depicted in Figure 8.1 below.

[147] Source: The Conference Board of Canada (2019) *Top 4 Drivers of Workplace Inclusion*. Available from: https://www.conferenceboard.ca/insights/blogs/top-4-drivers-of-workplace-inclusion

Figure 8.1 Three advantages of board diversity



Source: Modified: (Eric YW Leung cited in Acca Global, 2019, www.accaglobal.com)

[148]As previously depicted by Figure 8.1 the three advantages of board diversity are discussed in-depth as follows:

8.5.1 "More effective decision making. It is believed that a diverse board is able to make decisions more effectively by reducing the risk of 'groupthink', paying more attention to managing and controlling risks as well as having a better understanding of the company's consumers. These benefits are further elaborated below. Directors are responsible, as mentioned previously, for devising strategies through critical analysis and effective problem solving. One of the pitfalls behind the decision-making process in the boardroom is 'groupthink', which is described as a psychological behaviour of minimising conflicts and reaching a consensus decision without critically evaluating alternative ideas in a cohesive in-group environment. Combining contributions of a group of people with different skills, backgrounds and experiences is assumed to be able to approach problems from a greater range of perspectives, to raise

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[148] Source: Eric YW Leung, P1 article for ACCA, 2019 at https://www.accaglobal.com/lk/en/student/exam-support-resources/professional-exams-study-resources/strategic-business-leader/technical-articles/diversifying-the-board.html

challenging questions and to debate more vigorously within top management groups. Such a multiple-perspective analysis of problems can change the boardroom dynamics and is more likely to be of higher quality than decisions made under a 'groupthink' environment. Diversified board members are more likely to possess different personal characteristics, which lead to dissimilar leadership, thinking, emotional styles and even risk preferences and behaviours. Not only may this foster creativity in delivering solutions to problems, but also provide a more comprehensive oversight to the operations of the organisation through a further enhancement of the company's sensitivity to a wider range of possible risks such as reputation and compliance risks. This may then support a greater supervision on the boards in its performance evaluation and in the decision-making process. Further, companies are competing in a global environment nowadays. In order to achieve organisational goals and objectives, directors need to understand diverse stakeholders' claims – in particular the needs of customers – well. A balanced board will have more representatives of users and customers of its products in the boardroom to make informed judgment. This may be especially important for consumer-facing industries to have female directors and for multinational companies to include foreign nationals on the board. Dissimilar backgrounds, experience and social networks in the boardroom may therefore improve their understanding of the stakeholders, provide diverse connections with the external environment and help address stakeholders' claims in a more responsive manner"[149] (Source: Eric YW Leung, P1 article for ACCA, 2019 at https://www.accaglobal.com/lk/en/student/exam-support-resources/professional-exams-study-resources/strategic-business-leader/technical-articles/diversifying-the-board.html).

8.5.2 "Better utilisation of talent pool. Stakeholders are demanding more from directors, in particular from non-executive directors (NEDs). Having NEDs on the board has already been a common requirement across countries. NEDs are, however, often criticised for having insufficient devotion of time and effort in understanding the business and representing stakeholders to scrutinise executive directors in making appropriate decisions. One of the problems of searching for suitable directors lies on the limited number of candidates – there is

[149] Source: Eric YW Leung, P1 article for ACCA, 2019 at https://www.accaglobal.com/lk/en/student/exam-support-resources/professional-exams-study-resources/strategic-business-leader/technical-articles/diversifying-the-board.html

especially a tendency to search for board members with typical characteristics, such as male directors. If directors expand the pool of potential candidates by considering more diversified attributes, like women and ethnic minorities to be included in the boardroom, it will alleviate the problem of 'director shortage' and therefore better utilise the talent pool. It is therefore vital for companies to initiate tapping into the under-utilised pool of talent through board diversity"[150] (Source: Eric YW Leung, P1 article for ACCA, 2019 at https://www.accaglobal.com/lk/en/student/exam-support-resources/professional-exams-study-resources/strategic-business-leader/technical-articles/diversifying-the-board.html).

8.5.3 "Enhancement of reputation and investor relations by establishing the company as a responsible corporate citizen. Having a heterogeneous board can enhance corporate reputation through signalling positively to the internal and external stakeholders that the organisation emphasises diverse constituencies and does not discriminate against minorities in climbing the corporate ladder. This may somehow indicate an equal opportunity of employment and the management's eagerness in positioning the organisation as a socially responsible citizen. It is also argued that board diversity reflects the diversity of the society and community served by the organisation. This reflection strengthens the social contract between a business and its stakeholders, which, in turn, improves its strategic fit that the business has with its environment. As a result, it is suggested that a diverse board can help a company build its reputation as a responsible corporate citizen that understands its community and deserves its trust. Further, more institutional investors have taken into account board diversity as a factor for investment evaluation due to the reasons that: (i) a number of academic research papers indicated the positive correlation between firm value and board diversity; and (ii) institutional investors are placing greater emphasis on corporate social responsibility. Board diversity can, therefore, to a certain extent, improve its investor relations" (Source: Eric YW Leung, P1 article for ACCA, 2019 at https://www.accaglobal.com/lk/en/student/exam-support-resources/professional-exams-study-resources/strategic-business-leader/technical-articles/diversifying-the-board.html). The next section will cover issues related to the global efforts to regulate board diversity.

[150] Source: Eric YW Leung, P1 article for ACCA, 2019 at https://www.accaglobal.com/lk/en/student/exam-support-resources/professional-exams-study-resources/strategic-business-leader/technical-articles/diversifying-the-board.html

8.6 Global efforts to regulate board diversity

[151] *"Regulatory initiatives of board diversity*. Board diversity can be promoted by a number of methods. Measures currently adopted by different regulatory bodies are generally classified into the following approaches: (i) through imposing quotas on the board; and (ii) enhancing disclosures using the 'comply or explain' approach. Imposing quotas refers to mandatory requirement in appointing a minimum number of directors with different attributes on the board. This legislation enactment mainly deals with gender diversity to tackle the relative underrepresentation of women in the boardroom. For example, since 2008, each listed company in Norway has had to ensure that women fill at least 40% of directorship positions. Spain and France are implementing similar mandatory requirements for gender diversity. This approach increases the number of women on the board at a faster rate and forces companies to follow the legislation. Another measure to enhance board diversity is through transparency and disclosure. Companies, under corporate governance codes, are required to disclose their diversity policy in appointing directors so that investors and stakeholders can make proper evaluation. Those who fail to implement such measures have to explain their non-compliance in the corporate governance report or equivalent. The Corporate Governance Code (2010) of the United Kingdom, for example, stipulates that companies are required to: (i) incorporate diversity as a consideration in making board appointments; and (ii) disclose in their annual reports describing the board's policy on diversity, as well as its progress in achieving the objectives of that policy. Australia and Hong Kong are promoting diversity using a similar 'comply or explain' approach. Supporters of this approach believe that board appointments should be made on the basis of business needs, skills and ability instead of legislative requirements, which may sometimes be considered excessive in the market" (Source: Eric YW Leung, P1 article for ACCA, 2019 at https://www.accaglobal.com/lk/en/student/exam-support-resources/professional-exams-study-resources/strategic-business-leader/technical-articles/diversifying-the-board.html). How being inclusive empowers diversity workplace culture to achieve the intended results will be discussed in the following section.

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[151] Source: Eric YW Leung, P1 article for ACCA, 2019 at https://www.accaglobal.com/lk/en/student/exam-support-resources/professional-exams-study-resources/strategic-business-leader/technical-articles/diversifying-the-board.html

8.7 An inclusive workplace culture makes diversity work

"On gender, for example, whether you believe in quotas or not, the almost undeniable truth is that companies with women on their boards outperform companies with all-male boards. Similarly, on age diversity, our research indicates that a wide range of age representation on a board is a positive indicator of a company's performance. A number of leading companies have already stepped up their efforts to recruit women proactively. The numbers look a bit more promising in Europe, with 41% of new independent director seats filled by women in Germany in 2017, 42% in France, and 39% in the UK. [152]Both Germany and France have introduced regulatory requirements that have had a significant influence on the numbers. [153]In Australia, 39% of new director seats in 2017 were filled by women"[154] (Hibbert and Gwin, 2019, https://www.weforum.org/agenda/2019/01/diverse-boards-outperform-their-peers-so-how-do-you-build-one/). [155] "*Does Gender Diversity on Boards Really Boost Company Performance? Many commentators suggest that gender diversity in the corporate boardroom improves company performance because of the different points of view and experience it offers. However, rigorous, peer-reviewed academic research paints a different picture. Despite the intuitive appeal of the argument that gender diversity on the board improves company performance, research suggests otherwise. Results of numerous academic studies of the topic suggest that the presence of more female board members does not much improve — or worsen — a firm's performance. In this opinion piece, Wharton management professor Katherine Klein summarizes academic research on the topic and discusses the possible reasons and implications for these*

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[152] Heidrick & Struggles (2018) *Board Monitor Europe 2018*. Available from: https://www.heidrick.com/Knowledge-Center/Publication/Board-Monitor-Europe-2018

[153] Heidrick & Struggles (2018) *Board Monitor Asia Pacific*. Available from: https://www.heidrick.com/Knowledge-Center/Publication/Board-Monitor-Asia-Pacific

[154] Hibbert, J. and Gwin, B. (2019) *Diverse Boards Outperform their Peers So How Do You Build One*. Available from: https://www.weforum.org/agenda/2019/01/diverse-boards-outperform-their-peers-so-how-do-you-build-one/

[155] Knowledge@Wharton, *Wharton School University of Pennsylvania* (2017) *Does Gender Diversity on Boards Really Boost Company Performance?* Available from: https://knowledge.wharton.upenn.edu/article/will-gender-diversity-boards-really-boost-company-performance/

surprising findings. Klein is also the vice dean of the Wharton Social Impact Initiative. Do companies with women on the board perform better than companies whose boards are all-male? But research conducted by consulting firms and financial institutions is not as rigorous as peer-reviewed academic research. Here, I dig into the findings of rigorous, peer-reviewed studies of the relationship between board gender diversity and company performance. **'Rigorous, peer-reviewed studies suggest that companies do not perform better when they have women on the board. Nor do they perform worse.'** Spoiler alert: Rigorous, peer-reviewed studies suggest that companies do not perform better when they have women on the board. Nor do they perform worse. Depending on which meta-analysis you read, board gender diversity either has a very weak relationship with board performance or no relationship at all"[156] (Wharton School University of Pennsylvania, 2017, https://knowledge.wharton.upenn.edu/article/will-gender-diversity-boards-really-boost-company-performance/). [157] *"There is no doubt that in this multidimensional and complex society, focusing on maximizing the value of a diverse workforce has almost become a business imperative. While we are extensively focused on hiring for diversity, there's one part of the equation that we do not often talk about; namely - fostering an inclusive workplace culture***.** There cannot be any doubt about the enormous benefits diversity can bring to organisations. Our own research has pointed out that companies with a *diverse leadership perform better financially*, are more creative and *are better at fostering strong business relationships*. But, does this mean that all organizations hiring for a diverse workforce can harvest these benefits? *An inclusive culture indicates a climate* in which respect, equity, and positive recognition of differences are all cultivated, and the social and institutional response to disability poses no barrier to a positive employment experience. Nevertheless, truly inclusive cultures extend beyond basic or token presence of workers who have disabilities. They are

[156] Knowledge@Wharton, *Wharton School University of Pennsylvania* (2017) *Does Gender Diversity on Boards Really Boost Company Performance?* Available from: https://knowledge.wharton.upenn.edu/article/will-gender-diversity-boards-really-boost-company-performance/

[157] Service Futures (2019) *Diversity is Nothing without Inclusive Workplace Culture*. Available from: https://www.servicefutures.com/diversity-nothing-without-inclusive-workplace-culture [Accessed 2019, 04 September]

instead built on formal, informal policies and practices that involve the following three values: *The beauty lies in valuing people's abilities instead of limitations.* Fostering an inclusive workplace culture – the real emphasis should be placed on valuing people's abilities instead of limitations" (Service Futures, 2019, https://www.servicefutures.com/diversity-nothing-without-inclusive-workplace-culture). In an inclusive workplace culture all the people from different backgrounds and abilities are embraced. The critical part that is played by the recruitment activity in achieving board diversity and inclusion in the organization will be discussed in-depth.

8.8 Role of recruitment in board diversity & inclusion

An organization's human resources are the most valuable resource due to the fact that the success or failure of an organization is determined by the type of human resources it employs. One of the simplest and reliable way organizations can use nowadays to accomplish their set vision and goals is hiring appropriately qualified people with strong work ethics. Every organization in the world today is fiercely competing for its most valued asset: '*skilled, talented and knowledgeable board of directors'*. The role of recruitment is to produce an adequate number of job applicants to help secure the availability of adequate people with the prerequisite skills and requirements who will fill up board vacancies that may arise in the organization. [158]"When board recruitment comes up on the agendas of most boards, the discussion usually starts with the question, '*Who do we know*?' There may not be a worse way to begin. By limiting ourselves to people that board members already know, we establish a very small field from which to recruit. And of course, we are more likely to know people like ourselves than people with genuinely different backgrounds and perspectives. The second worst way to begin a recruitment discussion is to talk about what prospective board members have the ability to do rather than what they *will* do. For example, it's common for a board to say, '*We need a CPA*,' rather than '*We need someone who can and will work with the staff on better budgeting*.' ***Four principles to follow when recruiting a more diverse board.*** (1) Focus on what people *will* do, rather than on what they are, or on what their skills are. Just because a person is wealthy doesn't mean he will make a large donation,…. Too often individuals are recruited because we believe

[158] Masaoka, J. (2009) *Recruiting for Board Diversity: Part 3 in Diversity Series*. Available from: https://blueavocado.org/board-of-directors/recruiting-for-board-diversity-part-3-in-diversity-series/

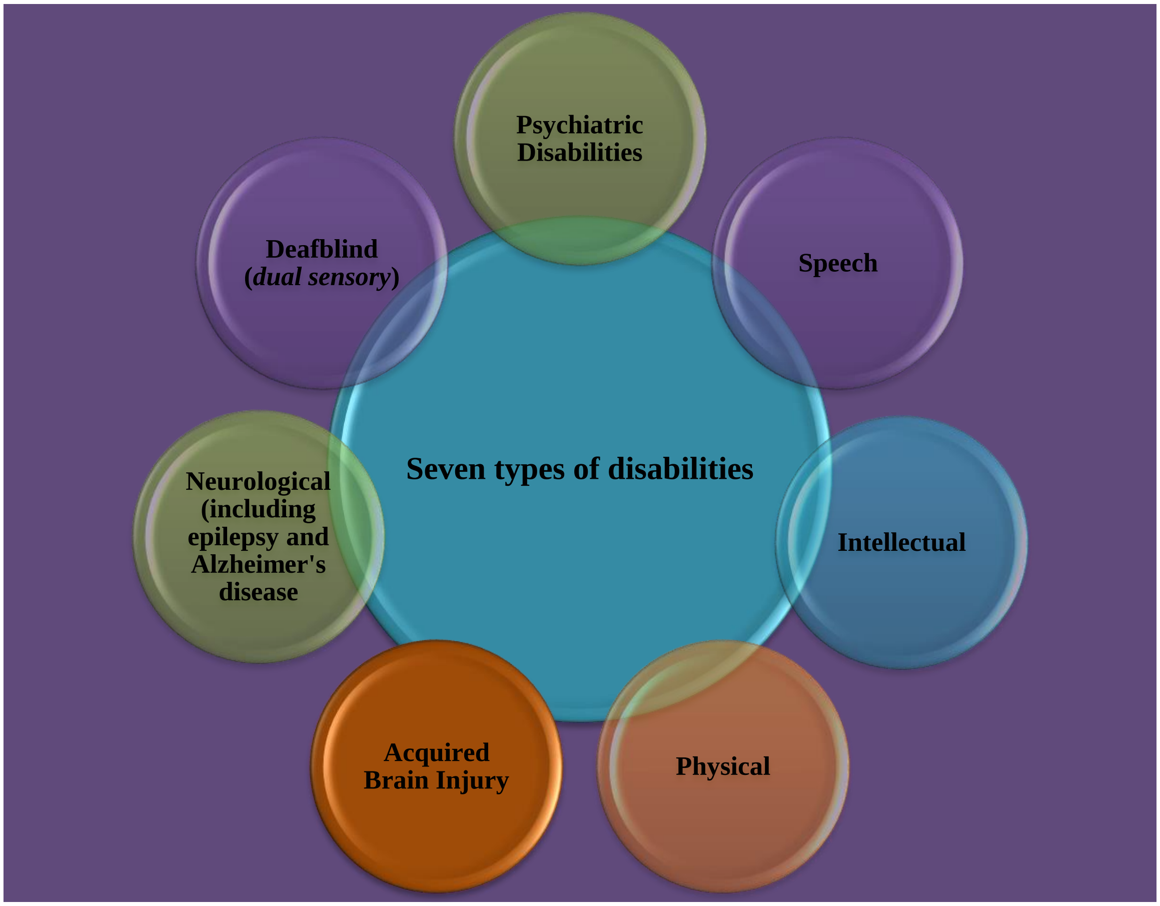
they will do something, but we consider it rude to ask them to commit to it as part of the recruitment discussions. Afterwards we then wonder why they aren't doing whatever it is we refrained from asking them to do in the first place. (2) When changing the diversity on the board, bring on two or three new people at once. (3) Recruit for a path of stepping stones, rather than two opposite shores. At an art center, for instance, if all the artists are poor, and all the non-artists are wealthy, the board ends up in two camps. Try to recruit some well-to-do artists and some non-artists who are low-income. (4) If you have board requirements that act to exclude people you want to recruit, rather than making exceptions for 'diverse board members,' change the requirements"[159] (Masaoka, 2009, https://blueavocado.org/). The hiring process of any type and size of an organization must implement its set diversity and inclusion policies including national legislation that often clearly stipulates that organizations must hire people with disabilities on a regular basis. The next section will cover the different types of disabilities to be aware of during the board recruitment process.

8.9 Types of disabilities to be aware of during the board recruitment process

"A less visible, but equally important issue is that of people with disabilities. Thirty percent of white-collar professionals in the US have a disability. As more and more people retire later, those figures will only rise" (Hibbert and Gwin, 2019, https://www.weforum.org/agenda/2019/01/diverse-boards-outperform-their-peers-so-how-do-you-build-one/). In general it is illegal for an organization to discriminate job applicants based on factors that include: disability, race, gender, marital status and so on. On the other hand in most of the countries located around the world some of the previously mentioned discrimination factors differ according to each specific country's labour legislation. The different types of disabilities are many and these are highlighted by Figure 8.2 below.

[159] Masaoka, J. (2009) *Recruiting for Board Diversity: Part 3 in Diversity Series*. Available from: https://blueavocado.org/board-of-directors/recruiting-for-board-diversity-part-3-in-diversity-series/

Figure 8.2 Seven types of disabilities



Source: Modified: (National Disability Services, 2019, https://www.nds.org.au/)

The various types of disabilities that were previously highlighted by Figure 8.2 that organizations must be aware of when carrying-out the hiring process of the board include the following:

8.9.1 Psychiatric disabilities. According to the National Disability Services (NDS) (2019) psychiatric disability includes recognisable symptoms and behaviour patterns, frequently associated with distress, which may impair personal functioning in normal social activity. Includes the typical effects of conditions such as schizophrenia, affective disorders, anxiety disorders, addictive behaviours, personality disorders, stress, psychosis, depression and adjustment disorders. For psychiatric disability one would normally expect there to be a diagnosis. General issues with behaviour (where there is no specific diagnosis) should be reflected in the support needs data (for example, support needs in relation to 'interpersonal interactions and relationships') rather than here in 'disability group'. Includes: schizophrenia, affective disorders, anxiety disorders, addictive behaviours, personality disorders, stress, psychosis, depression and adjustment disorders[160] (National Disability Services, 2019, https://www.nds.org.au/disability-types-and-descriptions).

8.9.2 "Speech. Encompasses speech loss, impairment and/or difficulty in being understood" (National Disability Services, 2019, https://www.nds.org.au/disability-types-and-descriptions).

8.9.3 "Intellectual. Applies to conditions appearing in the developmental period (age 0–18 years) associated with impairments of mental functions, difficulties in learning and performing certain daily life skills and limitations of adaptive skills in the context of community environments compared to others of the same age. Includes: Down syndrome, tuberous sclerosis, cri-du-chat syndrome. Specific learning/Attention Deficit Disorder (ADD) (other than intellectual)—learning disability is a general term referring to a group of disabilities, presumed due to central nervous system dysfunction rather than an intellectual disability, covering significant difficulties in the acquisition and use of organisational skills, listening, speaking, reading, writing, reasoning or mathematical skills. Autism (including Asperger's syndrome and Pervasive Developmental Delay)—Autism is used to describe pervasive developmental disorders involving disturbances in cognition, interpersonal communication, social interactions and behaviour (in particular obsessive, ritualistic, stereotyped and rigid behaviours)" (National Disability Services, 2019, https://www.nds.org.au/disability-types-and-descriptions).

8.9.4 "Physical. Used to describe conditions that are attributable to a physical cause or impact on the ability to perform physical activities, such as mobility. Physical disability often includes impairments of the neuromusculoskeletal systems including, for example, the effects of paraplegia, quadriplegia, muscular dystrophy, motor neurone disease, neuromuscular disorders, cerebral palsy, absence or deformities of limbs, spina bifida, arthritis, back disorders, ataxia, bone formation or degeneration, scoliosis. Includes: impairments of the neuromusculoskeletal systems including, for example, the effects of paraplegia, quadriplegia, muscular dystrophy, motor neurone disease, neuromuscular disorders, cerebral palsy, absence or deformities of limbs,

[160] National Disability Services (NDS) (2019) *Disability Types and Prescriptions*. Available from: https://www.nds.org.au/disability-types-and-descriptions

spina bifida, arthritis, back disorders, ataxia, bone formation or degeneration, scoliosis" (National Disability Services, 2019, https://www.nds.org.au/disability-types-and-descriptions).

8.9.5 "*Acquired brain injury*. Acquired brain injury is used to describe multiple disabilities arising from damage to the brain acquired after birth. Results in deterioration in cognitive, physical, emotional or independent functioning. May be as a result of accidents, stroke, brain tumours, infection, poisoning, lack of oxygen or degenerative neurological disease"[161] (National Disability Services, 2019, https://www.nds.org.au/disability-types-and-descriptions).

8.9.6 "Neurological (including epilepsy and Alzheimer's disease). Applies to impairments of the nervous system occurring after birth, includes epilepsy and organic dementias (for example, Alzheimer's disease) as well as such conditions as multiple sclerosis and Parkinson's disease" (National Disability Services, 2019, https://www.nds.org.au/disability-types-and-descriptions).

8.9.7"Deafblind (dual sensory) refers to dual sensory impairments associated with severe restrictions in communication, and participation in community life. Deafblindness is not just vision impairment with a hearing loss, or a hearing loss with a vision impairment. Deafblindness is a unique disability of its own requiring distinct communication and teaching practices" (National Disability Services, 2019, https://www.nds.org.au/disability-types-and-descriptions). Issues related to disability awareness training will be covered in the next section.

8.10 Disability awareness training is part of ethics and corporate governance that helps the organization to become more inclusive

Training can be defined as an instructor-led human resources management activity that focuses on the sharing of knowledge, skills and character to an individual or group of people in order to assist them to enhance their job performance and productivity levels at the workplace[162] [163]

[161] National Disability Services (NDS) (2019) *Disability Types and Prescriptions*. Available from: https://www.nds.org.au/disability-types-and-descriptions

[162] Masadeh, M. (2012) Training, Education, Development and Learning: What is the Difference? *European Scientific Journal Vol 8(10),* p63-65.

[164](Manpower Services Commission, 1981; Masadeh, 2012:63). In general organization development uses training as a strategy to help facilitate change in the organization's processes, products, quality, systems, strategies, planning, decision-making, culture and so on to enhance its efficiency. In addition for the past several decades' organizations have based their strength and success on training since it helps their human resources to continuously learn and grow their skills in order to maintain good work and corporate governance standards. The main aim of disability training workshops is to help the board, executive directors and functional department managers to become more knowledgeable on aspects that are related to building a diverse workforce in order for them to easily provide adequate support to their subordinates or colleagues with disabilities on a regular basis at the workplace. The organization can carry-out customizable training programs to help boost the confidence of staff towards supporting disability. In addition the various topics that can be covered by the customized training programs include: the meaning of disability and types, common misconceptions about disability, terminology that is linked to disability, discrimination of persons with disabilities and so on. The human resources function in liaison with the Chairperson of the board of directors and the CEO can effectively devise training programs that focus on improving the disability awareness of the organization's leaders and such disability training programs for leaders often cover topics that include the following: disability discrimination laws, disability action plans, diversity & inclusion hiring strategies, how to establish a disability confident organization or board and so on[165] (Epic Employment Service Inc., 2019, https://epicassist.org/training/diversity-and-inclusion-training/disability-awareness-workshops/). *"Disability awareness can help your business*. Disability-confident businesses ensure that they are opening their doors to all customers and potential employees – including the 20% of Australians that have a disability. When you consider this often under-serviced group, you will discover capable, motivated, and

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[163] Manpower Services Commission (1981) Glossary of Training Terms. London: HMSO

[164] Manpower Services Commission (1981) *Glossary of Training Terms.* London: Department of Employment now the Department for Work and Pensions. Available from: https://www.gov.uk/government/ © Legislation.gov.uk, 2018. This information is licensed under the Open Government Licence v3.0. To view this licence, visit http://www.nationalarchives.gov.uk/doc/open-government-licence/ OGL v3.0

[165] Epic Employment Service Inc. (2019) *Disability Awareness Workshops*. Available from: https://epicassist.org/training/diversity-and-inclusion-training/disability-awareness-workshops/

loyal job seekers and customers. *Businesses who are well-informed and capable of employing people with disability are often rewarded with*:

• increased tenure and fewer absences

• competitiveness in tender processes, as many tenders now require businesses to demonstrate their commitment to diversity and inclusion

• existing staff gaining confidence to disclose disability

• improved staff morale, with a diverse workforce resulting in greater teamwork and cohesiveness

• market differentiation

• a better reputation and customer base, as employees and customers show loyalty to organisations that value diversity and inclusion" (Epic Employment Service Inc., 2019, https://epicassist.org/training/diversity-and-inclusion-training/disability-awareness-workshops/). The various tips on how the organization can be more disability inclusive will be covered in the following section.

8.10.1 Tips to the board and executive directors on how to be a more disability inclusive organization

[166]According to Epic Employment Service Inc. (2019) *Top tips on how to be a more disability inclusive business.* Becoming more disability inclusive will not only help you build a business that better represents our society (1 in 5 Australians live with disability), it will also help you realise a range of other business benefits. Here are four tips from local disability employment specialists, EPIC Assist, to help your business build a more disability inclusive workforce.

8.10.1.1 Start with your staff. Because so many businesses are not disability-friendly, customers with disability tend to become loyal, long-standing customers to businesses that are. A great way

[166] Epic Employment Service Inc. (2019) *Tips On How to be a More Disability Inclusive Business*. Available from: https://epicassist.org/top-tips-on-how-to-be-a-more-disability-inclusive-business/

to build a disability-friendly business is to start by building a disability inclusive workforce. Who better to provide guidance on how to make improvements from a disability perspective, than a person with disability?

8.10.1.2 Invest in diversity training. Disability and mental health awareness training can help develop practical strategies and tools that encourage your business to create a more supportive, positive, and productive environment. An investment in disability and mental health awareness is an investment in your team's wellbeing.

8.10.1.3 Foster a safe environment. Employees should feel comfortable asking for reasonable adjustments and safe disclosing a disability or mental health condition. Positive workplace culture encourages the creation of spaces where people feel supported and good about coming to work.

8.10.1.4 Get advice from the experts. If you've never hired someone with disability you may be unsure where to start. Specialist disability employment services, like EPIC Assist, can work with you to help you to break down the barriers around hiring people with disability, and help you to connect with suitable candidates (Epic Employment Service Inc., 2019, https://epicassist.org/top-tips-on-how-to-be-a-more-disability-inclusive-business/). The various ways an organization can use to improve board diversity will be covered in the following section.

8.11 How to improve board diversity

There are several ways that can be used by an organization to improve its board diversity. According to Hibbert and Gwin (2019) *five simple steps to bolster board diversity:*

8.11.1 Lead, don't follow. Companies that act quickly will not only reap the business advantages of board diversity sooner rather than later, but also set the gold standard among their peers and send a strong message to their clients or customers and their employees that diversity matters. In European boardrooms, shifts in approach and targets for boards and how they are assembled has been at the forefront for several years, encouraging both diversity and performance.

8.11.2 Drive board diversity from the top. Although the decision making falls to the Nominating Committee, the push for diversity must also come from the Chair or a strong Lead Director or

CEO who keeps it front and centre. Without strong support from one or more key members of the board, efforts to add diversity can often get sidelined. One leadership team in an industry notorious for its lack of diversity found success by expressing their commitment to diversity not as pressure, but as enthusiasm – an enthusiasm that spread infectiously to the entire Nominating Committee and resulted in one of the most diverse boards in the industry[167].

8.11.3 Look beyond the usual candidate pool. The ideal candidate does not have to be a CEO. [168]We have seen a clear shift in companies' efforts to bring new perspectives: 36% of new board appointees in 2017 in the US had no previous board experience; and almost three-quarters of new directors had international experience. [169]In *Asia-Pacific*, 22% had no previous board experience and in Europe the figure is 34%. And, notably, new proprietary research shows that 46% of all CEOs have previous experience as either CFOs or COOs. In addition to those executives, consider general managers, division heads, presidents of universities, retired public servants who have led large government agencies, and retired career military officers who have led complex commands. Consider also functional leaders whose expertise is relevant to a key area of your company's strategy or entrepreneurs who have scaled a business. Executives who are earlier in their career often bring sharp new insights into the boardroom, especially on technology and industry disruption.

8.11.4 Develop a game plan. The most effective boards build a recruiting plan and methodically tackle it. Often they get to know candidates before they can take a board role – investing in and developing a relationship. They think creatively about their most strategic needs and keep a focus on identifying diverse candidates, even when they are not in active recruiting mode. They

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[167] Hibbert, J. and Gwin, B. (2019) *Diverse Boards Outperform their Peers So How Do You Build One*. Available from: https://www.weforum.org/agenda/2019/01/diverse-boards-outperform-their-peers-so-how-do-you-build-one/

[168] Heidrick & Struggles (2018) *Board Monitor Europe 2018*. Available from: https://www.heidrick.com/Knowledge-Center/Publication/Board-Monitor-Europe-2018

[169] Heidrick & Struggles (2018) *Board Monitor Asia Pacific*. Available from: https://www.heidrick.com/Knowledge-Center/Publication/Board-Monitor-Asia-Pacific

ask major organizations like Catalyst for ideas. And they execute a disciplined recruiting strategy.

8.11.5 Stay the course. It is hard work to build a board. Recruiting the right person takes time. Insist on being presented with a diverse slate that includes women, people of different races and ages, and those with disabilities. [170]Think about building a pipeline of ideas that enhances the culture of a board, not just recruiting one person today but, if you identify several great candidates for the long-term health of a board, consider adding them sooner than you might have planned. Indeed, some companies expand the size of their boards particularly to ensure long-term diversity by being able to add people when they become available (Hibbert and Gwin, 2019, https://www.weforum.org/agenda/2019/01/diverse-boards-outperform-their-peers-so-how-do-you-build-one/). The various reasons why diversity efforts in organizations fail will be covered in greater detail in the next section.

8.12 Common reasons why diversity & inclusion efforts fail

[171]According to Brazen (2016) *5 Reasons Why Diversity Initiatives Fail (+ How to Save Yours).* It's widely acknowledged that most successful organizations have explicit diversity policies in place. So where does the disconnect come from? If leaders know that diversity is good for business, why do they fail to create diverse workforces? How do these carefully designed diversity initiatives fail? After more than 20 years working with human resources executives at Fortune 50 companies all over the globe, I've found that these five common issues are usually at the root of why diversity initiatives fail.

8.12.1 A Misunderstanding of What Diversity Is. Any diversity initiative that functions solely to meet specific metrics is doomed to fail from the start. Yes, workplaces thrive when you bring in a wide variety of people with different life experiences and ideas, but diversity is more than just who you hire — it also encompasses how you integrate employees within their team and the

[170] Hibbert, J. cited in Heidrick & Struggles (2017) *Cultures Seat in the Boardroom*. Available from: https://www.heidrick.com/Knowledge-Center/Video/Cultures-seat-in-the-boardroom

[171] Brazen (2016) *5 Reasons Why Diversity Initiatives Fail (+ How to Save Yours)*. Available from: https://www.brazen.com/blog/recruiting-hr/why-diversity-initiatives-fail-5-reasons/

company culture as a whole. When workers feel like they don't belong, they lose job satisfaction. Diversity initiatives should seek to make every employee feel heard, valued, and included.

8.12.2 Believing There Are No Issues. The downfall of many a diversity initiative is the assumption that because a policy is in place, it must be working. The existence of a diversity initiative is a very different thing than the implementation of a diversity initiative. Human resources and diversity leaders need to make sure that every member of the organization understands what diversity is, why it's valuable, and how to foster it. You should always be looking for opportunities to create a more diverse and inclusive workplace. As you probably already know, creating a diverse and inclusive workplace is hard!

8.12.3 Lack of Organizational Buy-In. If you don't have the support of your colleagues in your diversity initiatives, it's going to be very hard to enact any meaningful culture change in your organization. Leaders need education to understand that diversity is more than a buzzword or a perfunctory corporate duty — it's a vital part of the success of any organization. A real commitment to diversity and inclusion is sometimes at odds with the expectations of management, because it necessitates a slowdown of things they want to be easy — hiring, communication, decision making, etc. However, an intentional focus on managing differences or diversity helps leaders optimize the talent on their teams and, hopefully, in turn optimize their results.

8.12.4 Unexplored Bias. As you move your corporation from a quota-based understanding of diversity to an inclusion-based understanding, you'll likely unearth new, unexplored biases that are holding back your talent from reaching its full potential. Assumptions about temperament, personality, and leadership style may prevent you from uncovering amazing leaders.

8.12.5 A Lack of Support. This is one of those problems that goes back to organizational buy-in. If a company really cares about diversity, high-level executives have to be involved and it needs to be promoted from the top down, through both words and actions. If you're met with pushback, remind them why they hired a diversity leader to begin with (Brazen, 2016, https://www.brazen.com/blog/recruiting-hr/why-diversity-initiatives-fail-5-reasons/). The conclusion of this chapter will be covered in the following section.

8.13 Conclusion

The existence of differences amongst human beings has traditionally been inevitable and generally one of the key tasks of the board in relation to corporate governance is to ensure that fair or impactive diversity and inclusion policies are devised on a regular basis. Diversity and inclusion helps to enhance the quality and performance of the board. Nowadays the global rise of women directors in the corporate world is rapidly increasing thus the implementation of effective diversity and inclusion policies helps organizations to achieve gender diversity initiatives in their boards. It can therefore be concluded that board diversity is propelled by carrying out consistent board training workshops that cover topics related to the recruitment of persons with disabilities; how to avoid misconceptions towards persons with disabilities; balancing gender diversity; discrimination legislation; ethics and corporate governance guidelines. Board diversity is easily attained when the board nominations committee working in liaison with the CEO, Chairman and the human resources department successfully manages to identify all the unique characteristics of job applicants to use in creating effective supportive structures, policies or leadership roles that help the board to create value.

8.14 Review questions

1) Define the following terms: ‘diversity’, ‘inclusion’, ‘recruitment’ and ‘training’? Describe the interrelation between ‘diversity’ & ‘inclusion’?

2) Explain the differences that exist between diversity and inclusion? Discuss the advantages of board diversity? Identify the global efforts to regulate board diversity?

3) Explain in greater detail how an inclusive workplace culture makes diversity work? Describe the role played by the recruitment activity in achieving board diversity and inclusion in the organization?

4) Explain the four key drivers of diversity and inclusion at the workplace nowadays? Identify the various topics that are covered in a general disability awareness training program and also in a disability awareness training program for the leaders of the organization?

5) Discuss the five ways an organization can use to improve its board diversity? Describe the common reasons why diversity & inclusion efforts fail?

Chapter 9: Corporate governance codes & value creation

After reading this chapter you should be able to:

- Describe the meaning of the terms corporate governance code and value creation.
- Explain the history of corporate governance codes. Describe a typical example of an organization with a corporate governance statement.
- Discuss the principal uses and key design characteristics of a corporate governance code.
- Describe how corporate governance codes drive international harmonization. Provide an example of a corporate governance code in particular the United Kingdom Corporate Governance Code.
- Explain the contribution of the board of directors towards 'value creation'.

9.1 Introduction

"Corporate governance is commonly referred to as the way in which companies are directed and controlled. Companies play a significant role in society by creating wealth, providing employment, paying taxes and generating investment returns. Some of the world's biggest companies have market capitalisations larger than the gross domestic product of entire economies. The enterprise and accountability of such companies are therefore highly important as reflected in the words of Anne Simpson, Executive Officer of the International Corporate Governance Network. *'Corporate governance ...is the meeting of the private interest and the public good: shareholders rely upon effective governance for the investment returns which fund pensions and insurance and protect savings; for companies it underpins both enterprise and accountability; for the wider community transparency and accountability in governance is vital for ensuring prosperity and the contribution to the public purse upon which social welfare relies*.' All countries have their own unique system of corporate governance reflecting different economic, cultural and legal circumstances"[172] (International Corporate Governance Network

[172] Introduction to the International Corporate Governance Network Yearbook 2005, Anne Simpson, ICGN

Yearbook, 2005 cited in Institute of Chartered Accountants in England and Wales – ICAEW, 2006:4, www.icaew.com). One of the critical elements that propel business prosperity in general is 'creating value' through innovation, adopting a strong ethics culture and adhering to the corporate governance code. The business world has taken a new dramatic shift of moving towards a 'corruption, bribery, unethical conduct and dishonesty' free ecosystem with the aim of gaining customer confidence or support by developing effective corporate governance guidelines in order to easily build long term customer relationships while simultaneously strengthening the value of the organization. A corporate governance code is one of the modern-day tool that is being used by customers, shareholders and other stakeholders of the organization to hold the board of directors, executive management and employees in organizations accountable for their performance, actions, ethics culture and so on. According to Integrated Reporting <IR> (2015:18) the modern corporate is increasingly seen as having a wider purpose in society beyond delivering value to shareholders. As the board's governance role expands accordingly, so <IR> is increasingly being used as a tool to understand and communicate value creation in its broadest context[173] (Integrated Reporting, 2015:18, http://integratedreporting.org). *'Used with permission from the International Integrated Reporting Council ©'.* "*'If businesses are not making, and seen to be making, a positive contribution to the societies of which they are a part then they will lose trust and value as a result'* - Tomorrow's Business Success, Tomorrow's Company, CIMA and the IIRC" (Integrated Reporting, 2015:7, http://integratedreporting.org). "*Transparency:* This is probably the most important value driver of corporate governance codes, at least when it comes to developed capital markets. An issuer must disclose whether it complies with the code and, if not, why not. In Europe, this mandatory disclosure requirement in an annual corporate governance report has recently been enshrined with changes in the Fourth Company Law Directive" (Simon .C.Y. Wong cited in the International Finance Corporation, 2008:2, https://openknowledge.worldbank.org/). The following section will cover the definition of terms.

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[173] Integrated Reporting (2015) *Creating Value: Value to the Board*. Available from: http://integratedreporting.org/wp-content/uploads/2015/04/Value-to-the-Board.pdf *'Used with permission from the International Integrated Reporting Council ©'.* [Accessed 2019, 29 August] p3-18

9.2 Definition of terms

Today there are several definitions that have been published by authors, academics and industry experts to help simplify the terms used in the field of corporate governance and compliance in order to promote greater understanding of the critical subject of 'corporate governance'. The term 'corporate governance code' is broad in scope in general. [174]"The *UK Corporate Governance Code* (formerly known as the Combined Code) sets out standards of good practice for listed companies on board composition and development, remuneration, shareholder relations, accountability and audit. The code is published by the Financial Reporting Council (FRC)" (Institute of Chartered Accountants in England and Wales – ICAEW, 2019, www.icaew.com). A *corporate governance code* can be defined as carefully devised guidelines of implementing transparency, accountability, honesty, disclosure of information, value creation and ethical conduct on an on-going basis in various areas of the organization such as all board committees (*namely: ethics, audit, remuneration, nominations, workplace health & safety and so on*), risk management, the executive directors' operational management activities and they also unquestionably advance the interests of the organization's shareholders and stakeholders (Rudolph. Patrick. T. Muteswa, 2019). *Value creation* can be defined as the critical actions, decisions, plans, systems and processes that are devised and implemented by an organization with the main aim of: (1) innovating its products/services, (2) boosting business performance (*in particular profits, market prices, market share and so on*), (3) maintaining its competitive advantage in the long run (Rudolph. Patrick. T. Muteswa, 2019). The history of corporate governance codes will be discussed in-depth in the next section.

9.3 History of corporate governance codes

The various major corporate scandals that occurred in the global economy many decades ago in certain parts of North America and Western Europe led to the creation of corporate governance codes that were devised in such a way that made them to be part of Company Laws in these respective countries. However, over the recent past years these corporate governance codes were

[174] Institute of Chartered Accountants in England and Wales (ICAEW) (2019) *UK Corporate Governance Code.* Available from: https://www.icaew.com/technical/corporate-governance/codes-and-reports/uk-corporate-governance-code

further refined in such a way that everything they stipulated became mandatory for all the organizations that 'intended to list' or 'those that were already listed' on the stock exchange. ""It is relatively straightforward to develop corporate governance codes. *The challenge lies in ensuring their effective implementation and enforcement*, as evidenced by the complaints heard in some countries that governance codes have not lived up to their promise to spur enduring improvements in corporate practices. The concerns voiced range from poorly written guidelines to inadequate levels of compliance by companies to "box-ticking" by investors""[175] (Simon .C.Y. Wong cited in the International Finance Corporation, 2008:3, https://openknowledge.worldbank.org/). Some of the many countries that have taken the lead in crafting effective corporate governance codes include: Germany, Belgium, The Netherlands, the United States of America, Australia and the United Kingdom while on the continent of Africa several countries in the Southern Africa region have already pioneered the way in crafting effective corporate governance codes. In general the compliance screws for listed organizations on issues related to corporate governance codes keep being tightened on a regular basis to entrench ethical and transparent operational activities in the board room and senior management level. The United Kingdom is one of the few countries with a clearly outlined history of corporate governance in the world. "The Committee on the Financial Aspects of Corporate Governance was set up in May 1991 by the Financial Reporting Council, the Stock Exchange and the accountancy profession in response to continuing concern about standards of financial reporting and accountability, particularly in light of the BCCI and Maxwell cases. Its subsequent report (published in 1992), which became known as the Cadbury Report after Sir Adrian Cadbury who Chaired the Committee, developed a set of principles of good corporate governance which were incorporated into the LSE's Listing Rules. It also introduced the principle of 'comply or explain'. It made the following three basic recommendations:

• the CEO and Chair of companies should be separated;

[175] Simon .C.Y. Wong cited in the International Finance Corporation (2008) Developing and Implementing Corporate Governance Codes. *Private Sector Opinion Issue 10*: *A Global Corporate Governance Forum Publication.* Available from: https://openknowledge.worldbank.org/bitstream/handle/10986/11132/472770BRI0Box31SO1issue11001PUBLIC1.pdf?sequence=5&isAllowed=y p1-12

• boards should have at least three non-executive directors, two of whom should have no financial or personal ties to executives; and

• each board should have an audit committee composed of non-executive directors"[176] (Financial Reporting Council - *FRC*, 2019, www.frc.org.uk).

9.3.1 Revising of corporate governance codes

Corporate governance codes are devised to enable and facilitate the long term success and attractiveness of capital markets in an economy for instance the new revised UK corporate governance code. Nowadays most of the governments' around the world that are revising their corporate governance codes are now placing more emphasis on improving the integrity, disclosure of information and value creation processes of organizations and their boards with the aim of gaining the public's confidence or approval of business for instance the United Kingdom government when it recently revised its UK corporate governance code[177] (Source: Steve Giles, CPD article for ACCA, 1 November 2018 at https://www.accaglobal.com/gb/en/member/discover/cpd-articles/governance-risk-control/corpgov-cpdnov18.html). ""It forms part of the government's 'world-leading package' of reform to 'enhance the public's trust in business', and is based on greater accountability and transparency. The reform package includes changes to legislation. [178]The Companies (Miscellaneous Reporting) Regulations 2018 requires businesses to disclose in the annual report arrangements for engaging with stakeholders. Large companies now need to produce a corporate

[176] Financial Reporting Council (FRC) (2019) *History of the UK Corporate Governance Code*. Available from: https://www.frc.org.uk/directors/corporate-governance-and-stewardship/uk-corporate-governance-code/history-of-the-uk-corporate-governance-code

[177] Source: Steve Giles, CPD article for ACCA, 1 November 2018 at https://www.accaglobal.com/gb/en/member/discover/cpd-articles/governance-risk-control/corpgov-cpdnov18.html.

[178] United Kingdom Legislation.gov.uk (2018) *The Companies (Miscellaneous Reporting) Regulations 2018*. Available from; https://www.legislation.gov.uk/ukdsi/2018/9780111170298 [Accessed 2018, 25 November] © Legislation.gov.uk, 2018. This information is licensed under the Open Government Licence v3.0. To view this licence, visit http://www.nationalarchives.gov.uk/doc/open-government-licence/ OGL v3.0

governance statement. The Wates Principles, which align with the code, are designed to provide a framework to report against on an 'apply or explain' basis. The revised code retains many elements of 2016's code but is adapted to reflect the changing economic and social climate. In addition to being shorter and differently structured, it has an important new societal dimension. It aims to build trust through strong relationships between companies, shareholders and key stakeholders, thereby engendering sustainable growth in the UK economy. Previous codes concentrated on the company-shareholder relationship. [179]The word 'stakeholder' appears rarely in the 2016 version – now it is highly visible. The introduction states that directors 'need to build and maintain successful relationships with a wide range of stakeholders'. [180]Boards now must describe how they consider the interests of stakeholders when performing their duty under section 172 of the Companies Act 2006. The importance of engaging the workforce is highlighted. Provision 5 sets out three potential mechanisms:

• a director appointed from the workforce

• a formal workforce advisory council

• a designated non-executive director

If the board does not choose one or more of these methods, it must explain what alternative arrangements are in place. The revised code also promotes more effective communication with shareholders. For example, where 20% or more votes are cast against a board resolution, the board should explain what actions it proposes to take to consult shareholders, and provide an update after six months, with a final summary in the annual report. Details of significant votes

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[179] Source: Steve Giles, CPD article for ACCA, 1 November 2018 at https://www.accaglobal.com/gb/en/member/discover/cpd-articles/governance-risk-control/corpgov-cpdnov18.html**.**

[180] United Kingdom Legislation.gov.uk (2018) *Companies Act 2006*. Available from; www.legislation.gov.uk/ukpga/2006/46/pdfs/ukpga_20060046_en.pdf [Accessed 2018, 25 November] © Legislation.gov.uk, 2018. This information is licensed under the Open Government Licence v3.0. To view this licence, visit http://www.nationalarchives.gov.uk/doc/open-government-licence/ OGL v3.0

against will be available on a public register maintained by the Investment Association. Next, the board is asked to assess and monitor culture. For the first time the company's purpose must be established. The board should ensure that its company's purpose, values, strategy and culture are aligned, based on integrity, 'generating value for shareholders and contributing to wider society'. In addition, the code strengthens significantly the role of the nominations committee in promoting effective succession planning and diversity. There is a small but important change regarding the chairman. Provision 19 states that boards should consider the length of time that chairs remain in post beyond nine years. There are key changes to remuneration too. Provision 40 establishes guidelines for executive director remuneration policy and practices. Remuneration committees should consider workforce pay and related policies when setting director remuneration. They should 'exercise independent judgment and discretion', especially when the outcomes from formulaic calculations of performance-related pay are not justified. The aim, as with many of the code changes, is to address public concern"" (Source: Steve Giles, CPD article for ACCA, 1 November 2018 at https://www.accaglobal.com/gb/en/member/discover/cpd-articles/governance-risk-control/corpgov-cpdnov18.html). The following section will cover examples of organizations with corporate governance codes.

9.4 A typical example of an organization with a corporate governance statement

Nowadays there are several leading global organizations that have adopted and implemented corporate governance guidelines. A typical good example of a leading, successful and well led organization that has successfully managed to adopt and effectively execute its corporate governance responsibility is Qantas Airways. [181]"Founded in the Queensland outback in 1920, Qantas has grown to be Australia's largest domestic and international airline. Registered originally as the Queensland and Northern Territory Aerial Services Limited (QANTAS), Qantas is widely regarded as the world's leading long distance airline and one of the strongest brands in Australia. We've built a reputation for excellence in safety, operational reliability, engineering and maintenance, and customer service. The Qantas Group's main business is the transportation of customers using two complementary airline brands - Qantas and Jetstar" (Qantas, 2019, https://www.qantas.com/au/en/about-us.html). Therefore, it is important to point-out that the

[181] Qantas (2019) *About Us*. Available from: https://www.qantas.com/au/en/about-us.html

overview and the sub-headings of the corporate governance statement (2018) of Qantas will be depicted in this chapter 9 below.

Qantas Corporate Governance Statement 2018

Corporate Governance Statement FOR THE YEAR ENDED 30 JUNE 2018

As at 31 August 2018

Overview

[182]"The Board is responsible for the overall corporate governance of Qantas Airways Limited (Qantas) and its controlled entities (Qantas Group), including adopting appropriate policies and procedures designed to ensure that Qantas is properly managed to protect and enhance shareholder interests. The Board monitors the operational and financial position and performance of Qantas and agrees its business strategy, including approving the strategic goals of Qantas and considering and approving a business plan and annual budget. The Board is committed to maximising performance, generating appropriate levels of shareholder value and financial return, and sustaining the growth and success of Qantas. Corporate governance is core to ensuring the creation, protection and enhancement of shareholder value. The Board maintains, and requires that Qantas Management maintains, the highest level of corporate ethics. The Board comprises a majority of Independent Non-Executive Directors who, together with the Chief Executive Officer (CEO) as Executive Director, have an appropriate balance of skills, knowledge, experience, independence and diversity. Throughout 2017/2018 and at the date of this Statement, the Board has endorsed the ASX Corporate Governance Principles and Recommendations 3rd Edition (ASX Principles)" (Qantas, 2019:1, www.qantas.com). The sub-headings of the Qantas corporate governance statement are depicted in Table 9.1 below whilst the full corporate governance statement can be viewed on the Qantas website link:

[182] Qantas (2019) *Qantas Corporate Governance*. Available from: https://www.qantas.com/content/dam/qantas/pdfs/about-us/corporate-governance/qantas-corporate-governance.pdf [Accessed 2019, 27 August] p1-13

https://www.qantas.com/content/dam/qantas/pdfs/about-us/corporate-governance/qantas-corporate-governance.pdf (Qantas, 2019, www.qantas.com).

Table 9.1 Qantas Corporate Governance Statement (*Sub-headings only*)

THE BOARD LAYS SOLID FOUNDATIONS FOR MANAGEMENT AND OVERSIGHT Board Meetings Australian Provisions THE BOARD IS STRUCTURED TO ADD VALUE Independence Nominations Committee Diversity Leadership – Group Inclusion and Diversity Council THE BOARD PROMOTES ETHICAL AND RESPONSIBLE BEHAVIOUR Qantas' Employee Share Trading Policy Whistleblower Policy Other Policies THE BOARD SAFEGUARDS THE INTEGRITY OF CORPORATE REPORTING Audit Committee CEO and CFO Declaration THE BOARD MAKES TIMELY AND BALANCED DISCLOSURE THE BOARD RESPECTS THE RIGHTS OF SECURITYHOLDERS Auditor at AGM THE BOARD RECOGNISES AND MANAGES RISK Safety, Health, Environment and Security Committee

Internal Audit THE BOARD REMUNERATES FAIRLY AND RESPONSIBLY Remuneration Committee

Source: Modified (Qantas, 2019:4-13, www.qantas.com)

In the following section all aspects related to the principal uses and the key design characteristics of a corporate governance code will be discussed in-depth.

9.5 Principal uses and the key design characteristics of a corporate governance code

[183]"""Governance codes have proved popular because they are seen as **flexible instruments that rely on market mechanisms** for their development, implementation, enforcement, and subsequent evolution. In contrast to the more rigid and prescriptive nature of mandatory legislation and regulation, corporate governance codes not only accommodate—but in fact expect—some degree of non-compliance with their provisions. Moreover, codes can be amended to reflect changing needs and circumstances much more quickly than legislation can. Consistent with the trend in many countries to reduce government involvement in the economic arena, **a popular use of corporate governance codes is as a substitute for regulation**. For instance, the Cadbury Code, issued in the wake of corporate scandals in the UK in the early 1990s, was developed by the business community in response to the British government's threat to impose regulation if the private sector failed to take adequate steps to regain the trust of the broader public. Moreover, legislation, with the attendant possibility of civil and criminal sanctions, is not appropriate for many corporate governance issues, such as director appointment processes and the induction/ on-going training of non-executive directors. In addition, the inherent flexibility of

[183] Simon .C.Y. Wong cited in the International Finance Corporation (2008) Developing and Implementing Corporate Governance Codes. *Private Sector Opinion Issue 10*: *A Global Corporate Governance Forum Publication.* Available from: https://openknowledge.worldbank.org/bitstream/handle/10986/11132/472770BRI0Box31SO1issue11001PUBLIC1.pdf?sequence=5&isAllowed=y p1-12

codes has made them a popular instrument— particularly in emerging markets—to build awareness of corporate governance best practices among companies, investors, and other relevant parties. Due to differences in ownership structures, legal and regulatory frameworks, and the nature of agency issues confronted, the specific provisions of a corporate governance code will vary from one country to the next. Most, however, focus on the same overarching principles:

1. ***Fairness*** to all shareholders, whose rights must be respected;
2. Clear ***accountability*** by the board and management;
3. ***Transparency***, or accurate, timely, and comprehensive financial and nonfinancial reporting; and
4. ***Responsibility*** for the interests of minority shareholders and other stakeholders, and for abiding by the letter and spirit of the law"" (Simon .C.Y. Wong cited in the International Finance Corporation, 2008:3-6, https://openknowledge.worldbank.org/bitstream/handle/10986/11132/472770BRI0Box31SO1issue11001PUBLIC1.pdf?sequence=5&isAllowed=y).

[184]""In the UK, where ownership of listed companies is diffused but where institutional investors collectively hold substantial stakes in them, the Combined Code focuses principally on the functioning of the board of directors, structure of executive remuneration arrangements, and responsibilities of institutional investors. Meanwhile, reflecting the prevalence of family ownership, the South Korean corporate governance code understandably emphasizes minority shareholder rights and responsibilities of controlling shareholders. **While codes can be used in place of regulation to address many issues, they do not supplant the law on all governance matters**. Even in the UK, where a tradition of self-regulation provides broad scope for a corporate governance code, topics such as voting rights, pre-emption rights, and approval of

[184] Simon .C.Y. Wong cited in the International Finance Corporation (2008) Developing and Implementing Corporate Governance Codes. *Private Sector Opinion Issue 10*: *A Global Corporate Governance Forum Publication.* Available from: https://openknowledge.worldbank.org/bitstream/handle/10986/11132/472770BRI0Box31SO1issue11001PUBLIC1.pdf?sequence=5&isAllowed=y p1-12

related-party transactions are enshrined in the company law or listing regulations. [185]Yet, deciding where to draw the boundary between voluntary codes and mandatory law is not as straightforward as it may appear. This is due to, among other things, the contrasting approaches of countries on similar issues. In the UK and a number of other countries, board committee structure is a matter addressed in the local governance code, compliance with which is not mandatory. Such divergence of approach extends to other areas, such as board independence, board processes, and disclosure of voting records. Given this disparity, how should policymakers define the dividing line between code and law? In general, **deciding between statutory prescriptions and voluntary codes requires balancing several considerations**"" (Simon .C.Y. Wong cited in the International Finance Corporation, 2008:3-6, https://openknowledge.worldbank.org/bitstream/handle/10986/11132/472770BRI0Box31SO1issue11001PUBLIC1.pdf?sequence=5&isAllowed=y).

"“In all countries, the most important *“core”* rules—such as voting rights, fiduciary duties of directors, and financial reporting standards—are established through laws and regulations while "*secondary*" matters—such as the separation of chairman and CEO roles and board appointment processes—are usually addressed in a code. Similarly, regulations can be used to lay down the minimum requirements while codes set loftier, aspirational targets. Of course, **minimum requirements—and aspirational standards—vary from one country to the next**, and recent reforms have raised the baseline on many issues. Level of detail is yet another way in which laws and codes can complement one another. Under this approach, laws will set forth core rights and responsibilities (such as fiduciary duties and pre-emption rights) while codes elaborate on how companies and other affected parties can fulfill them. The UK Combined Code, for instance, provides guidance on how boards can discharge their fiduciary obligations to shareholders. Likewise, the UK Pre-Emption Guidelines spell out circumstances when a waiver of pre-emption rights may be appropriate. A further consideration is the desirability or feasibility of uniform

[185] Simon .C.Y. Wong cited in the International Finance Corporation (2008) Developing and Implementing Corporate Governance Codes. *Private Sector Opinion Issue 10*: *A Global Corporate Governance Forum Publication.* Available from: https://openknowledge.worldbank.org/bitstream/handle/10986/11132/472770BRI0Box31SO1issue11001PUBLIC1.pdf?sequence=5&isAllowed=y p1-12

practice around a particular topic. If there is legitimate scope for differences among companies, a code might be the better instrument. On matters where a "one-size-fits-all" approach or uniform application is warranted, law may be more suitable than codes. In other words, **legislation is suited to areas the gravity of which outweighs all other considerations and where variance in practice among affected firms is deemed unacceptable**. As an example, it may be entirely appropriate for firms to adopt different processes on director nomination to fit their particular circumstances. But on issues such as disclosure of executive remuneration on an individualized basis or CEO certification of the integrity of financial statements, the choice is largely binary. Either a matter is considered to be sufficiently important, in which case a uniform standard will apply to all companies, or it is not, in which case no obligation is imposed on any firm. There appears no legitimate justification to introduce regulations that will permit variance among firms on these matters. In Canada, which applies the principle of proportionality to its corporate governance regulations, the government has decided that all companies, regardless of size, must have their financial statements certified by the CEO and CFO"" (Simon .C.Y. Wong cited in the International Finance Corporation, 2008:3-6, https://openknowledge.worldbank.org/bitstream/handle/10986/11132/472770BRI0Box31SO1issue11001PUBLIC1.pdf?sequence=5&isAllowed=y). The following section will help to clearly outline how corporate governance codes drive international harmonization.

9.6 Corporate governance codes drive international harmonization

The modern day business world has become a single economy as a result of globalization, international-continental investment treaties and international trade. In addition one of the key drivers of international harmonization are corporate governance codes adopted by different countries and organizations nowadays. "The increasingly international nature of business and investment, coupled with regulatory responses to corporate scandals, are encouraging demands from companies and investors for consistency in corporate governance practices across borders. Establishing comparable standards and harmonising them, where possible, is important in areas such as shareholder rights, board responsibilities and disclosure. Comparability can provide real benefits to business and investment by helping to reduce complexity and potential confusion. While one system of corporate governance cannot apply to all countries, there are opportunities for commonly accepted practices to encourage more efficient global capital markets. For example the European Commission's Company Law and Corporate Governance Action Plan with its variety of directives and other measures is aimed at harmonising, where possible, key aspects of company law and corporate governance in all Member States. Corporate scandals on both sides of the Atlantic accentuated the need for governments and regulators to reinforce business integrity and instill market confidence"[186] (European Commission, 2003 cited in Institute of Chartered Accountants in England and Wales – ICAEW, 2006:6, www.icaew.com). "In Europe in 2003, a number of high profile scandals, including in the Netherlands and in Italy damaged market confidence. At the same time in the UK the Higgs and the Smith reports examined the role of non-executive directors and audit committees respectively. The UK response was to strengthen the Combined Code on Corporate Governance by refining existing recommendations and introducing new ones in 2003. The European Commission also acted to help instill market confidence, the importance of which was stressed by Alexander Schaub, Director-General of DG Internal Market and Services at the European Commission: *'Good corporate governance is an essential prerequisite for the integrity and the credibility of financial institutions, stock exchanges, individual companies, and indeed the whole market economy. By ensuring greater transparency, fairness and accountability with respect to shareholders and other stakeholders, good corporate governance builds economic confidence and trust. It facilitates access to external financing and plays a critical role in channelling savings to productive investment. In today's integrated markets, failure to deal with the regulatory issues associated with corporate governance can have strong repercussions on global financial markets and jeopardise financial stability'. Shareholder engagement and co-operation across borders*. Increased co-operation between shareholders around the world can encourage greater understanding of fundamental corporate governance principles. Shareholders are becoming more attuned to differences in areas such as shareholder rights and are encouraging the harmonisation of standards in the countries in which they invest. More investors are buying shares in companies outside their home market. *Increasing international regulatory co-operation*. In the face of

[186] Institute of Chartered Accountants in England and Wales (ICAEW) (2006) *Effective Corporate Governance Frameworks: Encouraging Enterprise & Market Confidence.* Available from: https://www.icaew.com/-/media/corporate/files/technical/corporate-governance/dialogue-in-corporate-governance/effective-corporate-governance-frameworks.ashx [Accessed 2019, 26 August] p3-38

corporate scandals, policy makers have been challenged with adapting national laws and practices to mitigate problems while facilitating the adoption of internationally accepted standards" (United Kingdom Government Department of Trade & Industry, 2003; Financial Reporting Council, 2003 - *Audit Committees Combined Code Guidance*; Financial Reporting Council, 2003 - *Combined Code on Corporate Governance* and the American Law Institute, 2005 cited in Institute of Chartered Accountants in England and Wales – ICAEW, 2006:6-9, www.icaew.com). The following section will specifically cover the corporate governance code of the United Kingdom (UK).

9.7 Example of a corporate governance code (*the United Kingdom*)

[187]"""In recent years, *voluntary codes have been increasingly employed across the globe to drive corporate governance reform*. These guidelines, which emanate from stock exchanges, securities commissions, investors and investor associations, and supra-national organizations, set forth "best practice" recommendations across a range of topics that listed companies, shareholders, and other relevant parties are encouraged—but not obliged—to follow. Today, corporate governance codes are found in over 70 countries""" (Simon .C.Y. Wong cited in the International Finance Corporation, 2008:3, https://openknowledge.worldbank.org/). There are several examples of corporate government codes that are being implemented across numerous countries. """Simon Wong's extensive experience informs his paper on developing and implementing corporate governance codes. His commentary begins by reviewing the UK Combined Code, the Rolls-Royce *of* corporate governance regulation, as an example for exploring the conditions that determine whether a code succeeds. He cautions against code "transplanting" from developed to emerging economies without regard for the specific ownership and control structures and for the economic environment that shapes firm structure and behavior. He also underlines the need for "walking the walk." Sadly, many codes sit on the shelves of their drafters because no local institutions have assumed any leadership role in promoting implementation. And, he clearly

[187] Simon .C.Y. Wong cited in the International Finance Corporation (2008) Developing and Implementing Corporate Governance Codes. *Private Sector Opinion Issue 10*: *A Global Corporate Governance Forum Publication.* Available from: https://openknowledge.worldbank.org/bitstream/handle/10986/11132/472770BRI0Box31SO1issue11001PUBLIC1.pdf?sequence=5&isAllowed=y p1-12

draws the line between legislation and code provisions. Pernicious behavior by management or board members must be prohibited by law"" (Stilpon Nestor cited in the International Finance Corporation, 2008:1, https://openknowledge.worldbank.org/). The various reasons why corporate governance codes have yielded positive results in the United Kingdom will be covered in-depth below.

9.7.1 Reasons why corporate governance codes have yielded a positive results in the United Kingdom

[188] "*Essential attributes for effective implementation and enforcement of a corporate governance code—the UK experience.* In the UK, a collection of codes—with the Combined Code the most well-known— govern such matters as board composition, executive remuneration, voting disclosure, and institutional shareholder responsibilities. Since their introduction in 1992, these codes have sparked real improvements in UK governance practices. **The increasing independence and professionalism in British boardrooms, for one, can be attributed to the influence of the Cadbury Code and its progenies**. Take the splitting of chairman and CEO roles, which was practiced by 50% of large UK companies when the Cadbury Code was issued in 1992. Today, 95% of the FTSE 100 companies have different individuals occupying these posts. Moreover, reflecting the heightened focus on board independence, the previously common practice of elevating the CEO to chairman is now a rare occurrence. Equally important, these codes have facilitated constructive dialogue between companies and their shareholders. Today, chairmen and CEOs meet regularly with their companies' largest shareholders to discuss strategy, performance, corporate governance, and other important matters. While UK governance codes do not work perfectly, they are generally perceived to be effective and enjoy broad support. So, why have corporate governance codes worked comparatively well in the UK?" (Simon .C.Y. Wong cited in the International Finance Corporation, 2008:7-8, https://openknowledge.worldbank.org/). The five reasons why the UK Corporate Governance

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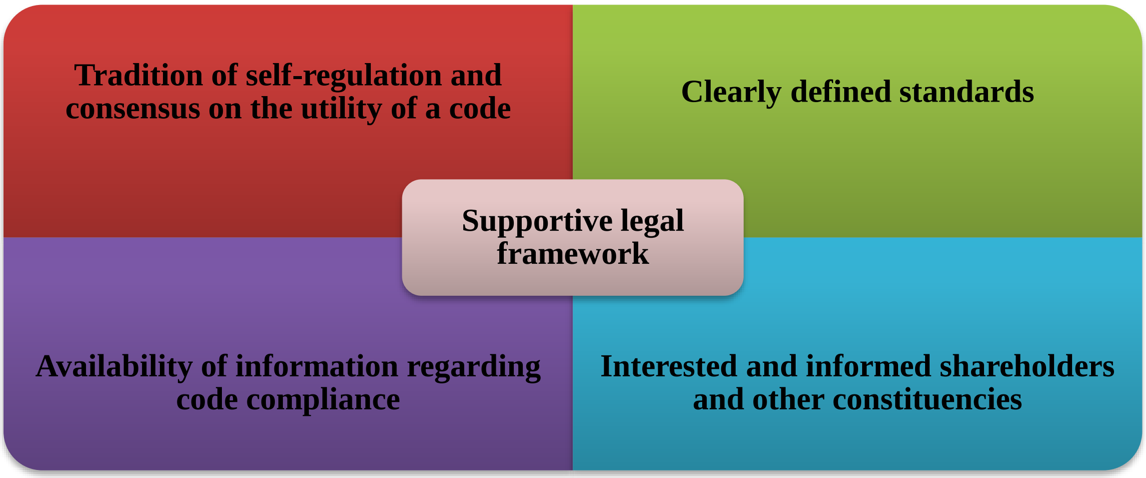
[188] Simon .C.Y. Wong cited in the International Finance Corporation (2008) Developing and Implementing Corporate Governance Codes. *Private Sector Opinion Issue 10*: *A Global Corporate Governance Forum Publication.* Available from: https://openknowledge.worldbank.org/bitstream/handle/10986/11132/472770BRI0Box31SO1issue11001PUBLIC1.pdf?sequence=5&isAllowed=y p1-12

Codes have yielded positive results over the past years that were identified by Simon .C.Y. Wong cited in the International Finance Corporation (2008) will be depicted in Figure 9.1 below.

Figure 9.1 Reasons why corporate governance codes have worked well in the UK



Source: Modified (Simon .C.Y. Wong cited in the International Finance Corporation, 2008:8, https://openknowledge.worldbank.org/).

As depicted in Figure 9.1 there are many reasons why the UK corporate governance codes have managed to produce good results in the business sector over the past number of years. [189]According to Simon .C.Y. Wong cited in the International Finance Corporation (2008:8) in essence, a handful of attributes have contributed to their success, namely:

9.7.1.1 Tradition of self-regulation and consensus on the utility of a code. Self-regulatory instruments are ubiquitous in the UK capital market, covering matters from corporate governance to takeovers to dealings among market participants. With a tradition of self-regulation stretching back hundreds of years, **the UK provides a highly conducive environment for voluntary codes**. Within both the government and the private sector, there is a general preference for economic activities to be governed, where feasible, through industry-

[189] Simon .C.Y. Wong cited in the International Finance Corporation (2008) Developing and Implementing Corporate Governance Codes. *Private Sector Opinion Issue 10*: *A Global Corporate Governance Forum Publication.* Available from: https://openknowledge.worldbank.org/bitstream/handle/10986/11132/472770BRI0Box31SO1issue11001PUBLIC1.pdf?sequence=5&isAllowed=y p1-12

based tools rather than statutory and regulatory instruments. With respect to governance-related matters, companies value the flexibility of the Combined Code on such issues as the separation of chairman and CEO roles, composition of the board and its committees, and director appointment processes. At the same time, notwithstanding the additional responsibilities imposed on them, institutional investors prefer codes on these matters because they believe they are generally better positioned than the government to assess the most appropriate governance arrangements for each company[190].

9.7.1.2 Clearly defined standards. **For a governance code to be effective, the standards and behaviors expected of companies, shareholders, and other relevant parties must be clearly defined**. This encompasses not only written guidance but also exemplary practices in the local market that others in the same community can emulate. As a document that encapsulates best practice, the Combined Code is drawn from actual examples at leading British companies. On matters ranging from the role of the senior independent director to the appropriate structure of executive remuneration arrangements, the "gold standard" can usually be found within the UK.

9.7.1.3 Availability of information regarding code compliance. **Effective monitoring and enforcement of a code begins with the availability of information on the corporate governance practices at individual companies**. In this regard, the real innovation of the Cadbury Code rested less in its substantive recommendations—which reflected governance practices at large UK companies at the time—but more in the mechanism proposed to ensure adequate disclosure of compliance to the public. In its report, the Cadbury Committee asked the London Stock Exchange to require listed companies to reveal in their annual reports whether they were complying with it—and, if not, why**.** The ensuing LSE rule of mandatory disclosure—called "comply or explain"—has made the corporate governance practices of British companies much more transparent and has forced companies to think about them carefully, since **any departure from the code has to be publicly justified**.

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[190] Simon .C.Y. Wong cited in the International Finance Corporation (2008) Developing and Implementing Corporate Governance Codes. *Private Sector Opinion Issue 10*: *A Global Corporate Governance Forum Publication.* Available from: https://openknowledge.worldbank.org/bitstream/handle/10986/11132/472770BRI0Box31SO1issue11001PUBLIC1.pdf?sequence=5&isAllowed=y p1-12

9.7.1.4 Interested and informed shareholders and other constituencies. **Most countries rely on shareholders to monitor and enforce compliance with the corporate governance code.** In the UK, this task is undertaken principally by large institutional shareholders—pension funds, insurance companies, and asset management firms—with assistance from the media and proxy voting research providers. **Institutional investors all over the world have been accused of excessive passivity** on voting and other corporate governance matters, choosing instead to sell their stakes when they have concerns or relying on others to take action when problems arise[191]**.**

9.7.1.4 Supportive legal framework. The final essential attribute of the UK system is a supportive legal framework. In the UK, short of running afoul of concert party rules that would require shareholders holding a collective stake of 30% or more to make an offer for the targeted company, shareholders are normally allowed to communicate with each other on corporate governance matters. This not only facilitates discussions between individual shareholders but permits industry bodies and other collective forums to openly deliberate on matters of mutual interest and concern. **Allowing shareholders to communicate helps them to stay informed** and potentially gives them greater leverage in discussions with companies. Finally, the Companies Act endows shareholders in UK-incorporated companies with substantial powers, enabling them to act decisively when necessary**.** For example, 100 shareholders with an average par value holding of £100 and those with a collective stake of 5% or more are able to requisition an extraordinary general meeting to appoint or remove directors. In addition, shareholders have at their disposal other levers of influence, such as an advisory vote on the remuneration report (Simon .C.Y. Wong cited in the International Finance Corporation, 2008:12, https://openknowledge.worldbank.org/bitstream/handle/10986/11132/472770BRI0Box31SO1issue11001PUBLIC1.pdf?sequence=5&isAllowed=y). The following section will cover brief parts of the Corporate Governance Code of the United Kingdom.

[191] Simon .C.Y. Wong cited in the International Finance Corporation (2008) Developing and Implementing Corporate Governance Codes. *Private Sector Opinion Issue 10*: *A Global Corporate Governance Forum Publication.* Available from: https://openknowledge.worldbank.org/bitstream/handle/10986/11132/472770BRI0Box31SO1issue11001PUBLIC1.pdf?sequence=5&isAllowed=y p1-12

9.7.2 The United Kingdom Corporate Governance Code

In this chapter the Table of Contents and the principles of all the chapters in the United Kingdom Corporate Governance Code will be presented in Table 9.2 below while the full Corporate Governance Code can also be found on the following website link: https://www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.PDF (Financial Reporting Council Limited, 2019, www.frc.org.uk). [192]According to the Financial Reporting Council Limited (2018:1-12):

Table 9.2 The UK Corporate Governance Code July 2018
CONTENTS Introduction 1. Board Leadership and Company Purpose 2. Division of Responsibilities 3. Composition, Succession and Evaluation 4. Audit, Risk and Internal Control 5. Remuneration ***Introduction.*** The first version of the UK Corporate Governance Code (the Code) was published in 1992 by the Cadbury Committee. Over the years the Code has been revised and expanded to take account of the increasing demands on the UK's corporate governance framework. At the heart of this Code is an updated set of Principles that emphasise the value of good corporate governance to long-term sustainable success. By applying the Principles, following the more detailed Provisions and using the associated guidance, companies can demonstrate throughout their reporting how the governance of the company contributes to its long term sustainable success and achieves wider objectives. Achieving this depends crucially on the way boards and companies apply the spirit of the Principles. The Code does not set out a rigid set of rules; instead it offers flexibility through the application of Principles and through 'comply or explain' Provisions and supporting guidance. It is the responsibility of boards to use this flexibility wisely

[192] Financial Reporting Council Limited (2018) *The UK Corporate Governance Code*. Available from: https://www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.PDF [Accessed 2019, 30 August] p1-12

and of investors and their advisors to assess differing company approaches thoughtfully.

Reporting on the Code. The 2018 Code focuses on the application of the Principles. The Listing Rules require companies to make a statement of how they have applied the Principles, in a manner that would enable shareholders to evaluate how the Principles have been applied. The ability of investors to evaluate the approach to governance is important. Reporting should cover the application of the Principles in the context of the particular circumstances of the company and how the board has set the company's purpose and strategy, met objectives and achieved outcomes through the decisions it has taken. It is important to report meaningfully when discussing the application of the Principles and to avoid boilerplate reporting. The focus should be on how these have been applied, articulating what action has been taken and the resulting outcomes. High-quality reporting will include signposting and cross-referencing to those parts of the annual report that describe how the Principles have been applied. This will help investors with their evaluation of company practices.

Application. The Code is applicable to all companies with a premium listing, whether incorporated in the UK or elsewhere. The new Code applies to accounting periods beginning on or after 1 January 2019. For parent companies with a premium listing, the board should ensure that there is adequate co-operation within the group to enable it to discharge its governance responsibilities under the Code effectively. This includes the communication of the parent company's purpose, values and strategy. Externally managed investment companies (which typically have a different board and company structure that may affect the relevance of particular Principles) may wish to use the Association of Investment Companies' Corporate Governance Code to meet their obligations under the Code. In addition, the Association of Financial Mutuals produces an annotated version of the Code for mutual insurers to use.

1 BOARD LEADERSHIP AND COMPANY PURPOSE

Principles

A. A successful company is led by an effective and entrepreneurial board, whose role is to promote the long-term sustainable success of the company, generating value for shareholders and contributing to wider society.

B. The board should establish the company's purpose, values and strategy, and satisfy itself that these and its culture are aligned. All directors must act with integrity, lead by example and promote the desired culture.

C. The board should ensure that the necessary resources are in place for the company to meet its objectives and measure performance against them. The board should also establish a framework of prudent and effective controls, which enable risk to be assessed and managed.

D. In order for the company to meet its responsibilities to shareholders and stakeholders, the board should ensure effective engagement with, and encourage participation from, these parties.

E. The board should ensure that workforce policies and practices are consistent with the company's values and support its long-term sustainable success. The workforce should be able to raise any matters of concern.

2 DIVISION OF RESPONSIBILITIES

Principles

F. The chair leads the board and is responsible for its overall effectiveness in directing the company. They should demonstrate objective judgement throughout their tenure and promote a culture of openness and debate. In addition, the chair facilitates constructive board relations and the effective contribution of all non-executive directors, and ensures that directors receive accurate, timely and clear information.

G. The board should include an appropriate combination of executive and non-executive (and, in particular, independent non-executive) directors, such that no one individual or small group of individuals dominates the board's decision-making. There should be a clear division of responsibilities between the leadership of the board and the executive leadership of the company's business.

H. Non-executive directors should have sufficient time to meet their board responsibilities. They should provide constructive challenge, strategic guidance, offer specialist advice and hold management to account.

I. The board, supported by the company secretary, should ensure that it has the policies, processes, information, time and resources it needs in order to function effectively and efficiently.

3 COMPOSITION, SUCCESSION AND EVALUATION

Principles

J. Appointments to the board should be subject to a formal, rigorous and transparent procedure, and an effective succession plan should be maintained for board and senior management. Both appointments and succession plans should be based on merit and objective criteria and, within this context, should promote diversity of gender, social and ethnic backgrounds, cognitive and personal strengths.

K. The board and its committees should have a combination of skills, experience and knowledge. Consideration should be given to the length of service of the board as a whole and membership regularly refreshed.

L. Annual evaluation of the board should consider its composition, diversity and how effectively members work together to achieve objectives. Individual evaluation should demonstrate whether each director continues to contribute effectively.

4 AUDIT, RISK AND INTERNAL CONTROL

Principles

M. The board should establish formal and transparent policies and procedures to ensure the independence and effectiveness of internal and external audit functions and satisfy itself on the integrity of financial and narrative statements.

N. The board should present a fair, balanced and understandable assessment of the company's position and prospects.

O. The board should establish procedures to manage risk, oversee the internal control framework, and determine the nature and extent of the principal risks the company is willing to take in order to achieve its long-term strategic objectives.

5 REMUNERATION

Principles

P. Remuneration policies and practices should be designed to support strategy and promote long-term sustainable success. Executive remuneration should be aligned to company purpose and values, and be clearly linked to the successful delivery of the company's long-term strategy.

Q. A formal and transparent procedure for developing policy on executive remuneration and

determining director and senior management remuneration should be established. No director should be involved in deciding their own remuneration outcome. R. Directors should exercise independent judgement and discretion when authorising remuneration outcomes, taking account of company and individual performance, and wider circumstances (Financial Reporting Council Limited, 2018:1-12, https://www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.PDF).

Source: Modified: (Financial Reporting Council Limited, 2018:1-12, https://www.frc.org.uk/).

In the following section the contribution of the board of directors towards value creation will be discussed in-depth.

9.8 Contribution of the board of directors towards 'value creation'

[193]"Corporate governance-the system by which a company's board of directors and management executives align themselves with shareholders' interests in order to make strategic decisions-can be a catalyst (or constraint) to value creation. Value creation is a product of business fundamentals (what the company actually does and how it performs) and investor perceptions (how the market prices the company's expected future performance). Effective corporate governance enhances these two elements, primarily through greater transparency and more effective decision-making, and thus generates more value for shareholders. Today well-functioning board of directors play an increasingly important part in shaping corporate performance and investor perception. In addition to their checks-and-balances roles, boards' strategic guidance, oversight, and effective decision making can provide invaluable direction and support to companies as they grapple with the challenge of globalization, enhanced business volatility, and intensifying levels of competition. Yet these are not roles that typically come to mind when one thinks about best practices for board governance. Instead, people tend to focus

[193] Orglmeister, C., Aquiar, M. and Azevedo, D. cited in Boston Consulting Group (2012) *Value-Focused Corporate Governance: How to Engage Boards and Enhance Decision Making.* Available from: http://imagesrc.bcg.com/Images/Value_Focused_Corp_Governance_Dec_2012_tcm9-101231.pdf [Accessed 2019, 30 August] p2-14

on standard guide-lines for everything from directors' roles and responsibilities to information disclosure" (Orglmeister, C., Aquiar, M. and Azevedo, D. cited in Boston Consulting Group, 2012:3, http://imagesrc.bcg.com/Images/Value_Focused_Corp_Governance_Dec_2012_tcm9-101231.pdf).

[194]Furthermore, according to a report authored by Orglmeister, C., Aquiar, M. and Azevedo, D. cited in Boston Consulting Group titled ***'Value-Focused Corporate Governance: How to Engage Boards and Enhance Decision Making'*** (2012:5-14) **The Devil in the Details: Four Hidden Factors**. The real key to effective governance lies in its 'hidden' side, practices and processes that are often overlooked precisely because they appear to be mere details. In fact, these details - individually and collectively - have a tremendous impact on governance. Consider the following:

• How well does the board operate as a team, from its interpersonal dynamics to its decision-making capability?

• Do its often-invisible processes and workings create a culture that promotes cooperation and efficiency?

• How can boards foster and sustain engagement, positive team dynamics, and an unwavering focus on the issues that matter most?

Addressing the 'hidden' factors can create an environment that facilitates proper flow of information, preparation of members, and setting of priorities. In such an environment, boards can fulfill their overarching purpose: better decision making and improved investor perception, which are the catalysts to superior value creation. Consider our pyramid of four hidden factors - the preconditions for achieving corporate governance success:

• Senior leaders' engagement

• A disciplined approach to decision making

[194] Orglmeister, C., Aquiar, M. and Azevedo, D. cited in Boston Consulting Group (2012) *Value-Focused Corporate Governance: How to Engage Boards and Enhance Decision Making.* Available from: http://imagesrc.bcg.com/Images/Value_Focused_Corp_Governance_Dec_2012_tcm9-101231.pdf [Accessed 2019, 30 August] p2-14

• Clear, carefully crafted mechanisms and protocols

• A robust information infrastructure

These four factors won't apply to all companies in the same way; there is no one-size-fits-all approach. In implementing them, each company must consider its own particular characteristics and circumstances: its industry, ownership structure, organization, operations, and culture. It's equally important to weigh the balance of power between the board and the CEO and how evolved the company's governance policies and practices are[195].

Factor 1: Senior Leaders Engagement

Clearly, the different operating models of board call for different degrees of board engagement. In addition, engagement levels aren't always static: special circumstances call for heightened levels. What we're talking about is achieving optimal engagement on the basis of what's appropriate for any given model. Sometimes, inadequate engagement is simply a function of having individual directors who are passive or lack commitment. More often, though, it stems from any number of factors, such as the following:

• The lack (or unbalanced mix) of capabilities among directors

• An ambiguous or undisciplined decision-making approach

• Differing views of the board's role

• Members' limited access to crucial information

• A poorly established relationship between directors and controlling shareholders or management

[195] Orglmeister, C., Aquiar, M. and Azevedo, D. cited in Boston Consulting Group (2012) *Value-Focused Corporate Governance: How to Engage Boards and Enhance Decision Making.* Available from: http://imagesrc.bcg.com/Images/Value_Focused_Corp_Governance_Dec_2012_tcm9-101231.pdf [Accessed 2019, 30 August] p2-14

Whatever the cause, weak engagement can damage board morale and fuel divisiveness. At the extreme, it can result in a board that is either bureaucratic and inflexible or unable to fully utilize board members' capabilities. It can lead to management without checks and balances and with ineffective, if not unhealthy, board-management interactions. Companies can use many strategies to strengthen board members' engagement. It's worth remembering that engagement starts at the top. Board chairs can play an active role in engaging members simply by being model board members. One chairman we know devotes 50 percent of his time to his governance role. He personally revises the board meeting's agenda, prioritizes the order of topics for discussion, and even allocates specific time slots for each topic. He closes every board meeting with an around-the-table check, asking directors how they might improve the dynamics for the next meeting[196] (Orglmeister, C., Aquiar, M. and Azevedo, D. cited in Boston Consulting Group, 2012:5-14, http://imagesrc.bcg.com/Images/Value_Focused_Corp_Governance_Dec_2012_tcm9-101231.pdf). Furthermore, according to Orglmeister, C., Aquiar, M. and Azevedo, D. cited in Boston Consulting Group (2012:5-14):

Factor 2: A Disciplined Approach to Decision Making

No board can be expected to make sound decisions without the right information in hand, without open lines of communication, or without clear governance processes and protocols. Yet for many boards, these elements are often missing. Important but nonstrategic matters that should fall within management's jurisdiction sometimes land in the board's lap, while truly strategic issues that merit the board's deliberation are dealt with by company management. Complex issues that merit preliminary analysis by a committee sometimes end up on the main board agenda prematurely analysis by a committee sometimes end up on the main board agenda prematurely, crowding by a committee sometimes end up on the main board agenda prematurely, crowding out other matters that are ready for deliberation. A host of other inefficiencies can impede the decision-making process, from less-than ideal approval flows to poor meeting

[196] Orglmeister, C., Aquiar, M. and Azevedo, D. cited in Boston Consulting Group (2012) *Value-Focused Corporate Governance: How to Engage Boards and Enhance Decision Making.* Available from: http://imagesrc.bcg.com/Images/Value_Focused_Corp_Governance_Dec_2012_tcm9-101231.pdf [Accessed 2019, 30 August] p2-14

dynamics that distract members from the most essential issues. Underutilized or ineffective committees, ambiguous deadlines that create confusion, the absence of confidentiality protocols or guidelines on appropriate deliberation times - all can hamper decision making. Many of these inefficiencies cannot only block the board's ability to respond swiftly to critical company challenges but also undermine the quality of its decisions. Boards can adopt any of a number of measures to orchestrate, streamline, inform, and improve their decision making.

Review managements' approval levels-and segment decision flows-by topic. The goal here is to ensure that the right parties are dealing with the right types of decisions in the right order. Which decisions should be delegated to management? Which ones might require advanced consultation and alignment with controlling shareholders? Segmenting approval flows by topic facilitates in-depth analysis (clarifying when certain committees or other types of expertise are warranted)[197].

Leverage committees to maximize their impact on board effectiveness. Many boards fail to capitalize on the analyses their committees produce. That means they also fail to take advantage of the other benefit that committees provide: alleviating the load of nonurgent issues for the board. To ensure that committee work is integrated into board decisions, the board should review and if, necessary, redefine how its committees are structured. It should look at their activities, their timelines, and the roles of their individual members.

Create a fast track for urgent decisions. Boards should define in advance the types of issues that justify rapid approval and establish procedures that will facilitate speedy decision-making. They must consider ways to get the necessary information to decision makers quickly and determine which communication channels (videoconference, phone conference, or email, for example) are the most appropriate.

Modify the organization of board meetings. Agenda management may seem minor, but it can have a tremendous impact on effective decision making. Typically, agendas are developed in a

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[197] Orglmeister, C., Aquiar, M. and Azevedo, D. cited in Boston Consulting Group (2012) *Value-Focused Corporate Governance: How to Engage Boards and Enhance Decision Making.* Available from: http://imagesrc.bcg.com/Images/Value_Focused_Corp_Governance_Dec_2012_tcm9-101231.pdf [Accessed 2019, 30 August] p2-14

way that presumes equal importance for each item by allocating equal time. That approach almost ensures that critical issues, especially those that aren't at the top of the schedule, will be shortchanged (Orglmeister, C., Aquiar, M. and Azevedo, D. cited in Boston Consulting Group, 2012:5-14,http://imagesrc.bcg.com/Images/Value_Focused_Corp_Governance_Dec_2012_tcm9-101231.pdf). Furthermore, according to Orglmeister, C., Aquiar, M. and Azevedo, D. cited in Boston Consulting Group (2012:5-14):

Factor 3: Clear, Carefully Crafted Mechanisms and Protocols

[198]Clearly defined governance mechanisms and protocols are essential for supporting the board's mission and for carrying out the many activities that constitute corporate governance. The notion that well-thought through processes support higher-level activities is hardly rocket science. Nonetheless, it is surprisingly absent among many boards. So interactions between board and management are sometimes marred by poor information flow. Some boards spend more time trying to schedule meetings than they do framing the strategic agenda. Others don't establish adequate transparency in their dealings with 'related parties', in which conflicts of interest may exist. Still others overlook the need to educate new directors about the company, its strategic challenges, and their role as directors. What can boards do to shore up their governance mechanisms and protocols?

Develop a calendar of yearly meetings, with key themes predefined on each meeting agenda. By planning when important things will be covered in meetings and committees, boards can highlight and anticipate issues, allowing participants time to prepare. An annual meeting calendar should include recurring annual decisions (such as approving the budget and strategic plan) and key strategic topics (such as the industry landscape, the macroeconomic environment, and competitors' activities), while leaving room for ad hoc items (such as M&A opportunities).

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[198] Orglmeister, C., Aquiar, M. and Azevedo, D. cited in Boston Consulting Group (2012) *Value-Focused Corporate Governance: How to Engage Boards and Enhance Decision Making.* Available from: http://imagesrc.bcg.com/Images/Value_Focused_Corp_Governance_Dec_2012_tcm9-101231.pdf [Accessed 2019, 30 August] p2-14

Set rules for handling transactions that potentially involve conflicts-of-interests. Many guidelines, both statutory and best practice, address the appropriate means of dealing with related parties that potentially represent conflicts of interests. But it's important for boards to use the available guidelines to create their own clear-cut rules outlining behaviour for related-party transactions. Well-crafted rules should define types of related parties, describe potential conflict-of-interest situations, and establish disclosure policies and controls.

Create an induction program for new directors. Such a program can shorten new directors' learning curve and help them get quickly integrated into the board's work. The induction program should introduce them to the company's operations, strategy, and significant challenges.

Establish a governance office (with an appointed officer) to orchestrate the organization's corporate-governance processes. A governance office is more than just the official record for the board and its committees; it is the orchestrator of the four factors in this report. It ensures that all the processes, players, and tools are in place, aligned, functioning well, and always being improved. From overseeing information flow among directors and between the board and management to coordinating strategic and legal matters, the governance office is in effect the board's administration and execution arm. Some boards might prefer a governance officer with a business background; others, one with a legal background[199] (Orglmeister, C., Aquiar, M. and Azevedo, D. cited in Boston Consulting Group, 2012:5-14, http://imagesrc.bcg.com/Images/Value_Focused_Corp_Governance_Dec_2012_tcm9-101231.pdf). Furthermore, according to Orglmeister, C., Aquiar, M. and Azevedo, D. cited in Boston Consulting Group (2012:5-14):

Factor 4: A Robust Information Infrastructure

A robust information infrastructure helps support the flow of information that board members need in order to exercise their role. It involves facilitating both access to information and flow of

[199] Orglmeister, C., Aquiar, M. and Azevedo, D. cited in Boston Consulting Group (2012) *Value-Focused Corporate Governance: How to Engage Boards and Enhance Decision Making.* Available from: http://imagesrc.bcg.com/Images/Value_Focused_Corp_Governance_Dec_2012_tcm9-101231.pdf [Accessed 2019, 30 August] p2-14

information between and among governance parties, documenting decisions and actions, and providing tools for unfettered communication. Its importance seems self-evident and fundamental, yet many boards make do without one. Inevitably, the other three essential factors are impaired: processes are weak or broken, engagement suffers, and decision making falters. Directors at many boards frequently have trouble obtaining or accessing important information, such as current performance indicators, documentation of important deals, and the status of decisions already implemented. Without such crucial information, it is difficult for boards to make decisions or follow up on past decisions to evaluate outcomes. Directors risk facing a bottleneck, having to redo work, or worse-if there's not enough time-being forced to make decisions on the basis of a partial or inaccurate picture. Fortunately, many elements of a sound information infrastructure are relatively straightforward to implement[200].

Create a corporate governance portal. A portal promotes focus, agility, and transparency between board members and management. Typical content comprises board documents, supporting material for meetings, documentation of past decisions (including assumptions used), implementation reports, company performance (past, present, and targeted), industry reports (focusing, for example, on markets, competition, and trends), and relevant information from public sources-basically, the full set of information that supports board resolutions. Overseeing the corporate governance portal is one of the primary responsibilities of the governance officer in his or her orchestrating capacity. A portal manager should be appointed to coordinate, centralize, and publish content. Interestingly, some companies encourage the use of the portal by providing directors with electronic tablets, for easy, secure portal access.

Develop standard approval templates to get information to members promptly. Whether the board is pondering an acquisition or a major capital-improvement project, templates for information approvals (to assess valuation assumptions and financial data, for instance) help ensure that members get the information they need in a timely manner. Introduce systematic

[200] Orglmeister, C., Aquiar, M. and Azevedo, D. cited in Boston Consulting Group (2012) *Value-Focused Corporate Governance: How to Engage Boards and Enhance Decision Making.* Available from: http://imagesrc.bcg.com/Images/Value_Focused_Corp_Governance_Dec_2012_tcm9-101231.pdf [Accessed 2019, 30 August] p2-14

follow-up reporting. Boards should, but don't always, know the outcome of their decisions. Follow-up reporting provides an objective record to help them monitor their resolutions. A variety of approaches can be used, with varying degrees of detail, from exception reporting to a continuous log that details activities.

Create standard presentation formats. Quality and consistency in presentation formats (whether for quarterly financial reports or updates on HR programs, for example) help board members absorb information more readily, avoid distraction, and adhere to meeting schedules (Orglmeister, C., Aquiar, M. and Azevedo, D. cited in Boston Consulting Group, 2012:5-14, http://imagesrc.bcg.com/Images/Value_Focused_Corp_Governance_Dec_2012_tcm9-101231.pdf). The conclusion of this chapter will be covered in the following section.

9.9 Conclusion

In general corporate governance helps to entrench a culture of transparency, accountability and compliance in the organization and its board of directors. Several corporate governance codes are currently being implemented in Asia, Europe, Africa, North America, Oceania and Latin America and most of the corporate governance codes are consistently revised to enhance investor confidence in the economy and information disclosure. Corporate governance empowers organizations to create value for their internal and external stakeholders by taking actions that strengthens the organization's market price, corporate brand and competitive advantages. One of the highlighted unique aspects about corporate governance codes is that they are based on market systems when they are devised and applied therefore this enables them to offer organizations some free room for non-compliance while on the other hand with local laws organizations are legally required to comply thus making legislation inflexible. It can be concluded that the United Kingdom's Corporate Governance Code is one of the best in the world.

9.10 Review questions

1) Explain what is the meaning of the terms 'corporate governance code' and 'value creation'?

2) Discuss the history of corporate governance codes? Explain a typical example of an organization with a corporate governance statement?

3) Identify the principal uses and key design characteristics of a corporate governance code?

4) Explain how corporate governance codes drive international harmonization? Describe an example of a corporate governance code in particular the United Kingdom Corporate Governance Code?

5) Explain the contribution of the board of directors towards ‘value creation’?

Chapter 10: Governance, risk, compliance & operational risk management

After reading this chapter you should be able to:

- Define the terms: operational risk and risk management. Describe the meaning of the abbreviation 'GRC'.
- Identify some of the benefits of GRC. Explain the roles played by people in the organization when conducting GRC.
- Explain the theories of operational risk management. Discuss how an organization can assess and measure risk.
- Describe the different types of operational risk management. Outline the various ways an organization can manage operational risk.
- Outline the key benefits of operational risk management by an organization. Discuss the eight practices that are used to align strategy, planning and risk.

10.1 Introduction

Corporate governance is not only about transparency, accountability, integrity and ethics but it also encompasses issues related to managing risk in the organization. Nowadays organizations that adopt good corporate governance guidelines and practices are often in a better position to conduct transparent, honest, accountable and ethical operational activities that ultimately play a critical role in reducing the risk of loss or failure by the organization. Good corporate governance entails having well devised effective operational risk management policies in the organization that have been effectively communicated to everyone in the organization on a continuous basis about their contents, benefits and application. The market value of the organization is often increased when effective decisions are made by the board and the executive directors in a manner that represents the shareholders interests in good faith. Risk is one inevitable element each and every organization must be able to carefully deal with despite its size, type and goals due to the fact that the business environment is highly dynamic. Change is generally inevitable in the current global business environment and this makes the operating conditions of an organization to keep shifting from one position to another thus this keeps exposing the organization to risk as these varying shifts may either have negative or positive impacts to the success of the organization. As a result the management of risk has become a major concern for most of the board of directors and their executive directors in organizations located around the world. Risk management is one of the activities that help organizations to operate in a more reliable way without fear of failure or high exposure to the consequences of risk. “Every business faces circumstances or fundamental changes in their situation that can be seen as presenting varying levels of risk to that business, from minor inconveniences to potentially putting its very existence in jeopardy”[201] [202] (Amit Kothari, 2019, https://tallyfy.com/). Generally almost each and every part of an organization is exposed to risk of some sort or kind on a daily basis that can affect its leadership, products, services, brand value, market position, strategy, revenue, workplace health and safety, ethics culture, integrity, corporate governance guidelines and so on. The following section will cover the definition of terms.

10.2 Definition of terms

Several definitions have been published by academics, industry experts and so on over the past years in the field of ‘operational risk’ and ‘risk management’. ‘“What is business/operational risk? ‘*Business/operational risk* relates to activities carried out within an entity, arising from structure, systems, people, products or processes.’ *CIMA Official Terminology, 2005. Operational risk* has also been defined as: ‘The risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events.’ *Basel Committee on Banking Supervision, 2004. Risk management* is: ‘A process of understanding and managing the risks that the entity is inevitably subject to in attempting to achieve its corporate objectives. For management purposes, risks are usually divided into categories such as operational, financial, legal compliance, information and personnel. One example of an integrated solution to risk management is enterprise risk management’”[203] (Source: Chartered Institute of Management

[201] Amit Kothari (2019) *What is Operational Risk Management – Definition and Core Concepts*. Available from: https://tallyfy.com/operational-risk-management/

[202] Amit Kothari (2019) *The Essential Guide to Governance, Risk Management and Compliance (GRC)*. Available from: https://tallyfy.com/guides/governance-risk-management-compliance-grc/

[203] Chartered Institute of Management Accountants (CIMA) (2008) *Operational Risk: Topic Gateway Series No. 51*. Available from: www.cimaglobal.com/Documents/ImportedDocuments/51_Operational_Risk.pdf [Accessed 2019, 18 August] p1-14

Accountants – CIMA, 2008:3, *Operational Risk: Topic Gateway Series No. 51*.). *"Governance, Risk Management and Compliance*, also known as GRC, is an umbrella term for the way organisations deal with three areas that help them achieve their objectives" (Amit Kothari, 2019, https://tallyfy.com/). The theory of operational risk management will be covered in the next section.

10.3 Governance, Risk Management and Compliance,

[204]"The main purpose of GRC as a business practice is to create a synchronized approach to these areas, avoiding repetition of tasks and ensuring that the approaches used are effective and efficient. *Governance.* As the name suggests, this looks at the way companies are managed at the highest levels, including the mechanisms, processes and relations that allow for smooth allocation and understanding of the rights and responsibilities of the various decision makers within the business. *Risk management.* Every aspect of every business has the potential for risk, whether it's a risk to reputation, health & safety, financial security, etc. It's nearly impossible to avoid risks and certainly very difficult to do so whilst also achieving successes, so risk management is the set of processes that identify, analyze and respond appropriately to each potential risk. *Compliance.* Managing risks is one thing but it's possible for multiple conflicting risks to occur, leaving a business having to decide between minimizing the risk to safety or minimizing the risk to profits, so it's necessary to ensure that the right decisions are always made. This is where compliance comes in, with businesses needing to comply with various standards, laws, regulations, etc, to avoid the penalties that result from non-compliance"[205] (Amit Kothari, 2019, https://tallyfy.com/).

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[204] Amit Kothari (2019) *The Essential Guide to Governance, Risk Management and Compliance (GRC)*. Available from: https://tallyfy.com/guides/governance-risk-management-compliance-grc/

[205] Amit Kothari (2019) *What is Operational Risk Management – Definition and Core Concepts*. Available from: https://tallyfy.com/operational-risk-management/

10.4 Governance, Risk Management and Compliance (GRC) Benefits

[206]"However, GRC isn't about adding to the complexity of already-overstuffed processes, but to help condense and clarify them to enable smooth running. But what are the main benefits of starting to utilise GRC capabilities?

• *Cutting costs* – The integrated approach of GRC often brings real financial benefits as unnecessary spending can be cut, while the clearer focus can help boost revenue at the same time. The bigger the business, the more likely it is that there will be plenty of areas where there is crossover and wastage, so a process like this can transform efficiency.

• *Less duplicated work* – This is where most of the cost-cutting can be made, but it's about more than just the money. Having similar processes duplicated across a business is a hugely inefficient way to operate and GRC can free up whole teams to work on other projects.

• *Less negative impact* – Having too many procedures, especially ones that aren't working in a logical manner, can waste a lot of time for staff across a business. Tying everything together in an GRC strategy cuts down on the paperwork and bureaucracy, which will boost your staff's productivity, not to mention their morale.

• *Greater information quality* – A more centralized and consistent approach to governance, risk management and compliance helps to not only speed up the processes for gathering the necessary information, but also improve the quality of what is gathered, helping decisions be made more rapidly and with greater confidence[207].

• *More ability to repeat processes* – Another huge benefit is that processes can be standardised across these areas, allowing for them to be repeated more easily and with greater consistency and efficiency.

• *Reputation security* – Risk management and compliance are both essential parts of any attempts to secure your business's reputation, so it goes without saying that managing these aspects more efficiently provides a more effective method of reputation security.

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[206] Amit Kothari (2019) *What is Operational Risk Management – Definition and Core Concepts*. Available from: https://tallyfy.com/operational-risk-management/

[207] Amit Kothari (2019) *The Essential Guide to Governance, Risk Management and Compliance (GRC)*. Available from: https://tallyfy.com/guides/governance-risk-management-compliance-grc/

• *Better allocation of resources* – Getting more information and understanding more about areas that are duplicating work can help determine the most effective directions for your business to go in.

• *No more silos* – Any large business has numerous issues with staff working in 'silos' where information doesn't flow in or out in a productive manner. GRC won't completely eradicate these issues, but it will certainly minimise their potential impact on key areas"[208] [209] (Amit Kothari, 2019, https://tallyfy.com/).

10.5 GRC Guide: The Roles

"Here are the main roles that each category of staff member needs to undertake to be involved with GRC:

• ***CEO/Board level*** – Anyone in a role at this level needs to be able to provide strategic oversight and decision-making capacities along with timely and clear communication down the chain to enable colleagues to fulfil their roles effectively.

• ***Finance chiefs*** – Whoever has overall responsibility for the financial operations of a business has a large part to play in GRC implementation, not least when it comes to spelling out the financial drivers for the changes.

• ***Risk managers*** – Any large organisation should already have people at managerial level who are responsible for risk management and their roles in GRC are extensive. They need to identify threats (and opportunities) and come up with strategic responses to minimize the risks to the business, as well as being responsible for the ongoing monitoring.

• ***Compliance officers*** – Similarly, anyone with responsibility for compliance need to be involved in all planning decisions, driving forward strategies that help the business meet the requirements needed for standards, laws, etc.

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[208] Amit Kothari (2019) *The Essential Guide to Governance, Risk Management and Compliance (GRC)*. Available from: https://tallyfy.com/guides/governance-risk-management-compliance-grc/

[209] Amit Kothari (2019) *What is Operational Risk Management – Definition and Core Concepts*. Available from: https://tallyfy.com/operational-risk-management/

• ***HR managers*** – When it comes to how GRC is implemented across the business and communicated to staff to ensure buy-in, much of this responsibility lands within the remit of human resources. Without an effective HR department, any kind of major strategic overhaul like this is doomed to fail.

• ***IT managers*** – They are responsible for whatever technological solution is bought in or developed to meet the needs of the GRC strategy and will certainly need to be involved in the decision-making process. They will also be responsible for the way information is gathered across the business and how is it delivered where it is needed"[210] [211] (Amit Kothari, 2019, https://tallyfy.com/).

10.6 Theories of operational risk management

"Operational risks range from the very small, for example, the risk of loss due to minor human mistakes, to the very large, such as the risk of bankruptcy due to serious fraud. Operational risk can occur at every level in an organisation. The type of risks associated with business and operation risk relate to:

• business interruption

• errors or omissions by employees

• product failure

• health and safety

• failure of IT systems

• fraud

• loss of key people

• litigation

• loss of suppliers.

[210] Amit Kothari (2019) *What is Operational Risk Management – Definition and Core Concepts*. Available from: https://tallyfy.com/operational-risk-management/

[211] Amit Kothari (2019) *The Essential Guide to Governance, Risk Management and Compliance (GRC)*. Available from: https://tallyfy.com/guides/governance-risk-management-compliance-grc/

Operational risks are generally within the control of the organisation through risk assessment and risk management practices, including internal control and insurance"[212] (Source: Chartered Institute of Management Accountants – CIMA, 2008:4, *Operational Risk: Topic Gateway Series No. 51*.). In the following section the ways an organization can use to assess and measure risk will be highlighted in-depth.

10.7 How to assess and measure risk

"Various methods may be used to assess the severity of each risk once it has been identified. One of the reasons for measuring risk is that it allows the most significant risks to be prioritised. The result or impact of a risk occurring may be financial loss, damage to reputation, process change or a combination of these. One of the simplest ways to measure risks is to apply an impact and likelihood matrix which provides an overall risk rating. One of the issues with measuring risk is that there are objective or subjective risks. Many risks are subjective and qualitative, rather than objectively identifiable and measurable. For example, the risks of litigation, economic downturn, loss of key employees, natural disasters and loss of reputation are all subjective judgements. There is an important distinction between objective, measurable risks and subjective, perceived risks. Some of the factors that influence this distinction are:

• how recently the risk has occurred
• how visible the risk is
• how management perceives the risk
• how the organisation establishes formal or informal ways of dealing with the risk.

The analysis can be either quantitative or qualitative, but it should allow for comparison and trend analysis. One of the issues with risk assessment is that traditional risk assessment techniques often focus on those elements that can be quantified easily. Such techniques fail to address all critical drivers of successful risk management" (Source: Chartered Institute of Management Accountants – CIMA, 2008:5, *Operational Risk: Topic Gateway Series No. 51*.). In

[212] Chartered Institute of Management Accountants (CIMA) (2008) *Operational Risk: Topic Gateway Series No. 51*. Available from: www.cimaglobal.com/Documents/ImportedDocuments/51_Operational_Risk.pdf [Accessed 2019, 18 August] p1-14

the following section the key benefits an organization can enjoy as a result of operational risk management will be highlighted in-depth.

10.8 Key benefits of operational risk management

"Before you decide whether or not you want to investigate how Operational Risk Management works and what you need to do to implement it. These will help to convince those with sign-off on the decision that it is the right move for your organization, so here are the main benefits of Operational Risk Management:

• Improving the reliability of business operations

• Improving the effectiveness of the risk management operations

• Strengthening the decision-making process where risks are involved

• Reduction in losses caused by poorly-identified risks

• Early identification of unlawful activities

• Lower compliance costs

• Reduction in potential damage from future risks

There are plenty more benefits as well as a few challenges, as with any major *business process*, but Operational Risk Management is an essential step for every company that is looking to avoid potentially damaging issues" (Amit Kothari, 2019, https://tallyfy.com/). In the following section the different types of operational risk management will be covered in-depth.

10.9 Types of operational risk management

In general there are various types of risk that can be found in an organization. "Risks can be categorised in a number of ways. A popular way is to use one of four main categories, namely operational risk, financial risk, environmental risk and reputational risk" (Source: Chartered Institute of Management Accountants – CIMA, 2008:5, *Operational Risk: Topic Gateway Series*

No. 51.). [213]Some of the types of risk that were identified by Grant Thornton (2017:7) in an article titled: '*Managing Operational Risk'* and these types of risk will be highlighted in Table 10.1 below.

Table 10.1 Types of risk

Risk Types	**Risk Types**
"Internal Fraud. Events intended to defraud, misappropriate property, or circumvent regulations or company policy, involving at least one internal party, categorised into unauthorized activity and internal theft and fraud" (Grant Thornton, 2017:7, www.grantthornton.co.uk).	*"Clients, Products and Business Practices*. Events due to failures to comply with a professional obligation to clients, or arising from the nature or design of a product, which include disclosure and fiduciary rules, improper business and market practices, product laws, and advisory activities" (Grant Thornton, 2017:7, www.grantthornton.co.uk).
"External Fraud. Events intended to defraud, misappropriate property, or circumvent the law, by a third party, categorised into theft, fraud, and breach of system security" (Grant Thornton, 2017:7, www.grantthornton.co.uk).	*"Execution, Delivery and Process Management.* Events due to failed transaction processing or process management that occur from relations with trade counterparties and vendors, classified into categories such as transaction execution and maintenance, customer intake and documentation and account management" (Grant Thornton, 2017:7, www.grantthornton.co.uk).
"Employment Practices & Workplace Safety. Acts inconsistent with employment, health and safety laws or agreements, categorised into employee relations, safety of the environment, and diversity and discrimination" (Grant Thornton, 2017:7, www.grantthornton.co.uk).	*"Damage to Physical Assets.* Events leading to loss or damage to physical assets from natural disasters or other events such as terrorism" (Grant Thornton, 2017:7, www.grantthornton.co.uk).
"Business Disruption and System Failures. Events causing disruption of business or system failures" (Grant	

[213] Grant Thornton (2017) *Managing Operational Risk*. Available from: https://www.grantthornton.co.uk/globalassets/1.-member-firms/unitedkingdom/pdf/documents/managing-operational-risk.pdf [Accessed 2019, 23 August] p1-11

Thornton, 2017:7, www.grantthornton.co.uk).	

Source: Modified: (Grant Thornton, 2017:7, www.grantthornton.co.uk).

The following section will cover how an organization can effectively manage operational risk.

10.10 How to effectively manage operational risk

“Risk evaluation is used to make decisions about the significance of the risks to the organisation and whether each specific risk should be accepted or treated. When looking at operational risk management, it is important to align it with the organisation’s risk appetite. The risk appetite will be influenced by the size and type of organisation, its capacity for risk and its ability to exploit opportunities and withstand setbacks. Once the severity of the risk has been established, one or more of the following methods of controlling risk can be applied:

• accepting the risk

• sharing or transferring the risk

• risk reduction

• risk avoidance” (Source: Chartered Institute of Management Accountants – CIMA, 2008:8, *Operational Risk: Topic Gateway Series No. 51*.). In the following section the conclusion of the chapter will discussed.

10.11 Conclusion

The scope of corporate governance in an organization also entails ensuring that the organization is able to craft effective operational risk management policies which must be effectively communicated to everyone on a continuous basis about their contents, benefits and application. All the basic principles of corporate governance such as transparency, accountability, integrity and ethics must be aligned to the management of risk in the organization on a continuous basis. Risk management is one of the critical activities that is consistently conducted by the board of directors and the executive directors to uphold the interests of the organizations’ shareholders and other stakeholders in good faith. It can therefore be concluded that change in the business environment is one of the main reasons why organizations are exposed to risk nowadays on a daily basis.

10.12 Review questions

1) What is the definition of the terms: operational risk and risk management? Explain the meaning of the abbreviation 'GRC'?

2) Identify some of the benefits of GRC? Explain the roles played by people in the organization when conducting GRC?

3) Discuss the theories of operational risk management? Explain how an organization can assess and measure risk?

4) Discuss the different types of operational risk management? Identify the various ways that can be used by an organization to manage operational risk?

5) Highlight the key benefits of operational risk management by an organization? Describe the eight practices that are used to align strategy, planning and risk?

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