Answers to end-of-chapter questions

The questions at the end of each chapter are intended to give you an opportunity to test whether you have really grasped some of the salient features in the chapter. The answers are typically brief: they are not intended to be exam-style responses. If you find any difficulty, please refer back to the textbook.

PART 1 Principles

Chapter 1 Corporate governance: a frontier subject

 1. Corporate governance is about the exercise of power over corporate entities.

 2. The key concept of a joint-stock, limited-liability company, separate from the owners, has many of the legal property rights of a real person—to contract, to sue and be sued, to own property, and to employ. The company has a life of its own, giving continuity beyond the life of its founders, who could transfer their shares in the company. Crucially, the owners’ liability for the company’s debts is limited to their equity investment.

 3. Ownership is the basis of power over the joint-stock, limited-liability company.

 4. Berle and Means (1932) drew attention to the growing separation of power between the executive management of major public companies and their increasingly diverse and remote shareholders.

 5. The Bullock Report—The Report of the Committee of Inquiry on Industrial Democracy (1977)—proposed a continuation of the unitary board, but with worker representative directors.

 6. The Corporate Report (1975) called for all economic entities to report publicly and to accept accountability to all those whose interests were affected by the directors’ decisions.

 7. In Australia, Alan Bond, Laurie Connell of Rothwells, and the Girvan Corporation; in Japan, Nomura Securities and The Recruit Corporation; in the United States, Ivan Boesky, Michael Levine, and Michael Milken of Drexel, Burnham, Lambert; in the United Kingdom, the Guinness cases and Robert Maxwell’s companies.

 8. The first report on corporate governance in 1992 came from Sir Adrian Cadbury in the United Kingdom and was on the financial aspects of corporate governance. The committee he chaired was set up in response to various company collapses. The report called for:

● wider use of independent outside, non-executive directors;

● audit committees as a bridge between board and external auditor;

● separation of the roles of chairman of the board and chief executive.

 9. Bear Stearns, Fannie Mae and Freddie Mac, AIG (American International Group), and Lehman Brothers.

 10. The Hilmer report argued that governance is about performance as well as conformance: ‘the board’s key role is to ensure that corporate management is continuously and effectively striving for above-average performance, taking account of risk . . . (although) this is not to deny the board’s additional role with respect to shareholder protection.’

Chapter 2 Governance and management

 1. To define the rights and duties of members, and to lay down the rules about the way it is to be governed.

 2. A private company may not offer its shares for sale to the general public; a public company can.

 3. The management process runs the enterprise; the governance process oversees management and ensures that the enterprise is running in the right direction. See: the ‘governance circle and management triangle’ model.

 4. Performance (strategy formulation and policy-making) and conformance (supervising executive activities and accountability).

 5. This question tests your understanding of page 34 of the textbook .

 6. Companies House: [www.companieshouse.co.uk](http://www.companieshouse.co.uk)

 7. The great 1929 financial crash in the United States. The mission of the US Securities and Exchange Commission is to protect investors; to maintain fair, orderly, and efficient markets; and to facilitate capital formation. Among the key participants in the securities world that the SEC oversees are securities exchanges, securities brokers and dealers, investment advisers, and mutual funds.

 8. This structure can be found in many small, family firms and start-up businesses, where the company has not reached the stage at which it needs non-executive directors. The all-executive director board is also found frequently in the board structures of subsidiary companies operating in corporate groups.

 9. The typical board of a company listed in the United States has one or two executive directors—the CEO (sometimes in the combined role of chairman/CEO), the chief finance officer, and perhaps the chief operating officer—with three or four times that number of independent outside directors.

 10. In the two-tier board structure, the supervisory board, which consists entirely of non-executive members, oversees the work of the executives in the management board. Half of the supervisory board members represent capital (the shareholders) and half represent labour (the employees). In practice, members of the executive board attend meetings of the supervisory board, but have no vote. The executive members present their strategies, management plans, and budgets to the supervisory board for comment and approval. If necessary, the supervisory board refers matters back to the executives for further consideration. The supervisory board can then review and assess subsequent managerial performance. The power of the supervisory board lies in its ability to appoint to and remove members from the executive board.

Chapter 3 Theories, philosophies, and concepts of corporate governance

 1. Agency theory is based on the premise that a director will maximize his or her own personal utility (interests) and cannot be expected to act in the best interests of the shareholder. Stewardship theory follows the legal perspective that directors can be trusted to fulfil their fiduciary duty to shareholders.

 2. In essence, agency theory assumes that directors may put their own interests ahead of those of the shareholders, who have delegated responsibility for corporate governance to them. To protect shareholder interests, boards are required to report regularly to them with audited financial accounts, disclosures of directors’ interests, and various other reports.

3. ‘’Agency theory involves a contract under which one or more persons (the shareholders) engage other persons (the directors) to perform some service on their behalf which includes delegating some decision-making authority to the agent. If both parties to the relationship are utility maximizers there is good reason to believe the agent will not always act in the best interests of the principal.’

4. Critics of agency theory argue that:

* It has a relatively narrow theoretical scope.
* To see relationships in terms of contracts between principals and agents is naïve.
* To focus purely on published quantitative metrics is mechanical.
* Board behaviour does not consist of sets of contractual relationships.
* The subtle and complex dynamics of board behaviour cannot be quantified.
* The shareholder/director agency model is simplistic, assuming all investors are long term.
* The short-term outlook of stock markets in the UK and USA may produce different agency relationships.
* Agency theory makes philosophical, moral assumption about the nature of man; assuming that people are self-interested, not altruistic; they cannot be expected to look after the interests of others.
* Agency theory has been erected on a single, questionable abstraction that governance involves a contract between two parties, and is based on a dubious conjectural morality that people maximize their personal utility.

5. Stewardship theory follows the legal requirement for directors to act solely in the interests of the shareholders. Stakeholder philosophy believes that companies should be accountable to a wide range of stakeholders affected by its activities.

6. Stewardship theory is based on a nineteenth-century model of joint-stock limited-liability companies, which were owned by a handful of individual shareholders.

Modern listed companies, particularly in liquid markets, are typically held by a highly diversified and, sometimes, volatile set of shareholders, including holdings concentrated in the hands of a few large institutional investors.

7. The view taken of the nature of man.

8. Culture can be thought of as the beliefs, expectations, and values that people share. Like the skins of an onion, culture has many layers—national cultures, regional cultures, the culture of a company, and the culture of each boardroom in which it is practised.

9 . Culture is influenced by law, is reflected in the language, and is passed on by experience in families, schools, and organizations. It is culture that determines values: what is thought of as acceptable, important, and right or wrong. Culture affects how people think and act. It is fundamental to understanding corporate governance.

10. A systems theoretical approach enables any situation to be perceived in terms of its boundaries (what is in the system; what is in its environment, the level of the system; the degree of abstraction needed to define that system’s component parts) and the inputs and outputs to the system.

Chapter 4 The governance partnership: ­Investors, companies, and directors

 1. To define the rights and duties of members (shareholders), and to lay down the rules about the way the company is to be governed. Shareholder rights are determined by the company’s articles of association and company law, predominantly the Companies Acts.

 2. Basically, no. Having elected directors to govern the company, shareholders do not have the right to be involved in the day-to-day management of the business, nor to inspect company records or management accounts. Of course, if directors or senior executives of that company also own shares, they have the right to information and inspection, but not because they are shareholders

3. The company must answer any questions relating to the business put by a member, unless it can be shown that it is not in the interests of the company or the question has already been answered on the company’s website. Shareholders have the right to have matters included on the agenda of the annual general meeting, if they hold 5% of the voting shares or have the support of 100 members entitled to vote.

4. Institutional investors should have a clear policy on voting and disclosure of their voting activity. They should seek to vote all shares held. They should not automatically support the board. If they have been unable to reach a satisfactory outcome through active dialogue, they should register an abstention or vote against the resolution.

5. An independent non-executive director (INED) is a director with no affiliation or other relationship with the company, other than the directorship, that could affect, or be seen to affect, the exercise of objective, independent judgement. A connected non-executive director (CNED) is an outside director who does have some relationship with the company.

6. An outside director is another word for non-executive director. Mainly used in the United States, it is often taken to refer to an independent director. A shadow director is a person who, although not formally a member of a board, is able to exert pressure on the decisions of that board.

7. In most jurisdictions ‘yes’. They are sometimes referred to as associate directors.

8. The ‘chair is legally the chair of the board of directors, elected to that office by the other directors, not the shareholders.

9. While arguments can be advanced to support the appointment of a retiring CEO to the chair (experience, contacts, continuity), most authorities and some corporate governance codes discourage the practice because the incoming CEO may find the newly appointed chair interfering with the day-to-day running of the company, which is the new CEO’s responsibility.

10. In company law, every director is equally responsible, as a member of the board, for the governance of the company. Executive directors have additional responsibilities as executives of the company, according to their contract of employment and, sometimes, the company’s articles of association.

Chapter 5 The regulatory framework

 1. The Cadbury Report called for:

● the wider use of independent non-executive directors;

● the introduction of an audit committee of the board with a minimum of three non-executive directors with a majority of them independent;

● the division of responsibilities between the chairman of the board and the chief executive—but, should the roles be combined, the board should have a strong independent element;

● the use of a remuneration committee of the board to oversee executive rewards;

● the introduction of a nomination committee with independent directors to propose new board members; and

● adherence to a detailed code of best practice.

2. a. On professional development:

● All directors should receive induction ­training.

● All directors should have regular updates on relevant skills, knowledge, and familiarity with the company.

b. On boards’ performance evaluation:

● Boards should undertake an annual evaluation of their own performance.

● There should also be an annual assessment of the performance of individual directors and of the main board committees.

 3. The OECD has produced sets of principles that are intended to assist governments in their efforts to evaluate and improve the legal, international, and regulatory framework for corporate governance in their countries, and to provide guidance and suggestions to stock exchanges, investors, corporations, and others that have a role in the process of developing good corporate governance.

 4. Companies should manage effectively relationships with their employees, suppliers, and customers, and with others who have a legitimate interest in the company’s activities. Companies should behave ethically and have regard for the environment and society as a whole. (Principle 9)

 5. Section 404 of the Act requires management to produce an ‘internal control report’ as part of each annual Exchange Act report. The report is required to affirm ‘the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting’.

 6. Principle 7: Companies should have and continue to develop coherent strategies for each business unit. These should ideally be expressed in terms of market prospects and of the competitive advantage the business has in exploiting these prospects. The company should understand the factors that drive market growth, and the particular strengths that underpin the competitive position.

Principle 8: Companies should be able to explain why they are the ‘best parent’ of the businesses they run. Where they are not best parent, they should be developing plans to resolve the issue.

 7. No director qualifies as ‘independent’ unless the board of directors affirmatively determines that the director has no material relationship with the listed company (either directly or as a partner, shareholder, or officer of an organization that has a relationship with the company).

 8. The audit committee must have a minimum of three members. Each member of the audit committee must be financially literate, as such qualification is interpreted by the company’s board in its business judgement, or must become financially literate within a reasonable period of time after his or her appointment to the audit committee. In addition, at least one member of the audit committee must have accounting or related financial management expertise, as the company’s board interprets such qualification in its business judgement.

 9. Listed companies must adopt and disclose a code of business conduct and ethics for directors, officers, and employees, and promptly disclose any waivers of the code for directors or executive officers.

 10. The responsibilities of the board include the strategic guidance of the company, the effective monitoring of management by the board, and the board’s accountability to the company and the shareholders.

Chapter 6 Models of corporate governance

 1. There are many differences, but the principal distinction is that the Anglo-American model has a unitary board with both executive and non-executive directors, while the two-tier board separates the roles of corporate supervision (the supervisory board) from the responsibility for corporate management (the management board).

|  |  |  |  |
| --- | --- | --- | --- |
| <2. | **Country** | **Individuals** | **Institutional investors** |
|  | UK | 19% | 58% |
|  | USA | 51% | 41% |

 3. The *keiretsu* typically has:

* a network of connected companies, often including a financial institution;
* a large board of, predominantly, the upper tiers of management, although the recent corporate governance rules call for independent non-executive directors;
* very formal meetings of the main, large board, with much influence coming from a smaller group of the top executives.

 4. Studies suggest that overseas Chinese firms:

● are family-centric with close family control;

● in listed companies, keep the public in a minority with a controlling equity stake kept within the family, sometimes causing problems of family-related transactions;

● are entrepreneurial, often with a dominant entrepreneur, centralized decision-making, with close personal links emphasizing trust and control;

● have a paternalistic management style, in a social fabric dependent on relationships and social harmony, avoiding confrontation and the risk of loss of ‘face’;

● see an intuitive strategy formulation in which business is seen as more of a succession of contracts or ventures, relying on intuition, superstition, and tough-minded bargaining rather than quantitative analysis.

 5. The *ringi* approach to decision-making, with widespread participation within the organization.

6.

* A reliable legal system
* Stock market with liquidity
* Financial institutions
* Regulatory authorities
* A companies registry
* Accounting and legal professions
* Auditing firms that are professional
* Professional organizations
* Educational institutions
* Consulting organizations
* Financial and corporate governance training, continuous professional development
* Corporate governance research with academic and professional publications.

7.

* Corporate governance codes of good practice
* Securities regulations
* International accounting standards
* Global concentration of audit practices
* Raising capital on overseas stock exchanges
* International institutional investors
* Research publications, international conferences, and professional journals.

8.

* Legal differences
* Standards in the legal process
* Stock market differences
* Ownership structures
* History, culture, and ethnic.

 9. Trust.

PART 2 Policies

Chapter 7 Functions of the board

 1. Strategy formulation is the process of generating and reviewing alternative longer-term directions for the firm that lead towards the achievement of its purpose.

 2. A mission statement is a concrete statement of the company’s purpose, aims, and direction, which can inspire employees and inform customers and other stakeholders.

 3. In long-range planning, the planner is, conceptually, inside the organization looking out. The approach fails to take a strategic perspective, perpetuating the existing business, rather than recognizing strategic changes in technology, markets, and competition, and ignoring the economic and social context.

 4. 1. Who is currently competing in our market?

2. What strategic powers do our upstream suppliers of goods and services have?

3. What strategic powers do our downstream distributors and ultimate customers have?

4. Could our customers’ needs be met in other ways—with substitute goods or services?

5. Could other firms enter the market?

 5. Resource-based strategic theory sees a firm as a collection of resources and capabilities that need to be utilized to create a winning strategy. The resources could include access to capital, employee skills, unique products or services, managerial talent and experience, equipment and buildings, or goodwill. This resource-based perspective seeks to find a fit between a firm’s internal capabilities and its external market situation that will produce a competitive advantage.

 6. Corporate policies can be thought of as the rules, systems, and procedures that are laid down by the board to guide and constrain executive management.

 7.

* Financial accounts—profit and loss account and balance sheet
* Budgetary control with cost centres
* Profit performance with profit or profitability centres
* Multiple performance measures and control systems.

 8. When, in a management control system, organizational units are held responsible for various performance criteria, in seeking to meet their required performance each unit will tend to take action that is beneficial to achieving its own objectives, even though they are detrimental to the organization as a whole.

 9. Universally, the answer is: the shareholder members. In the case of a joint-stock, limited-liability company the members are those shareholders with voting rights. In a co-operative society, the members are those with voting rights under the constitution. In a professional body, the members are those who are paid-up and qualified to vote under the rules of that association.

10. To reduce the reports presented to directors, some firms rely on exception reporting in which only significant variations from planned performance have occurred for board-level consideration and action if necessary.

Chapter 8 The governance of corporate risk

 1. The UK Corporate Governance Code, the Sarbanes-Oxley Act, the Basel II agreement.

 2. Audit committees tend to be orientated towards the past, involved with audit outcomes, and approving accountability information for publication, while risk assessment needs a pro-active, forward-looking orientation.

 3. Form a risk assessment or risk management committee as a distinct standing committee of the board.

 4. Such a risk management committee might have four or five members, wholly or mainly INEDs with appropriate business experience, meeting, perhaps, four times a year, and reporting to the board as a whole. Members of senior management and external experts in risk might be invited to attend meetings to inform and give advice.

 5. In a management-based risk management committee, which might include the CEO, the CFO, profit-responsible division or unit heads, and the CRO, with external experts invited to attend to give advice.

6. In every organization risk arises at various levels:

* corporate strategic risks—exposure to threats from outside the organization;
* management-level risks—exposure to risks arising from the firm’s activities;
* operational risks—exposure to hazards within the enterprise.

 7. An enterprise risk management system (ERMS) should provide information routinely and regularly for management to take executive decisions and for the board to carry out its monitoring and supervisory function. The ERMS should also generate information to enable the company to communicate externally to auditors, regulators, shareholders, and other legitimate stakeholders, as well as its insurers and brokers.

 8.

* Risk recognition
* Risk assessment
* Risk evaluation
* Risk management policies
* Risk monitoring
* Risk transfer (buying insurance, creating a derivative, or just self-insuring).

 9.

* A simple tabular approach
* A questionnaire designed to identify risks and hazards
* Mind mapping
* Risk benchmarking by industry, country, or other company
* Software programs and systems.

10.

* Avoid the risk. Do not commit to the planned action. Abandon the project.
* Mitigate the risk by making capital investment or incurring ongoing expenditure.
* Transfer the risk. Enter derivative agreements. Insure against the risk.
* Risk retention. Accept the risk. Self-insure.

Chapter 9 The board and business ethics

1. All organizations develop their own culture, reflecting the way people in that organization are expected to behave; in other words it reflects the ethos and the ethics of the enterprise. ethics are implicit, undeclared but evident to all who deal with that enterprise.

 2. Societal, strategy-driven, stakeholder, ethical, political, philanthropic.

 3. A firm’s ‘socially responsible activities’ might include:

● the contributions of facilities or staff time to local and other organizations;

● educational and academic contributions;

– support for local and other academic institutions;

– contributions to research and similar activities;

● aesthetic and arts contributions:

– expenditure on building and landscape design;

– sponsorship of arts, crafts, and similar activities;

● sports and leisure contributions.

 4. Boards adopting an enlightened shareholder value (ESV) approach believe that the satisfaction of the needs of stakeholders is crucial to corporate success and essential to creating value for shareholders. The ESV concept of corporate governance attempts to overcome apparent conflicts between the shareholder and the stakeholder-focused perspectives.

Profits can be generated, shareholder value created, and society’s wealth increased by satisfying stakeholder interests, rather than through the classical attempts of shareholder theory to maximize shareholder wealth.

 5. To be effective, a company’s CSR efforts need to be led by the directors. A primary duty of the board is to identify the aims of the company, establish its mission, and set its values. A company’s attitude to CSR should be embedded in its corporate strategy.

 6. A CSR policy is a summary of the firm’s attitudes to relationships with its business stakeholders and the communities in which it operates, and the impact it wants to have on them. To be effective, CSR policies need to be understood, accepted, and applied throughout the organization.

 7. A clear CSR policy can influence potential investors looking for socially responsible, ethical, or environmentally friendly enterprises in which to invest.

 8. The United Nations Brundtland Report defines sustainable development as ‘development that meets the needs of the present without compromising the ability of future generations to meet their own needs’.

 9. The Global Reporting Initiative (GRI) is a world-wide, multi-stakeholder network to create and develop the Sustainability Reporting Framework, in which business, civil society, labour, investors, accountants, and others collaborate.

 10. The GRI is based on the underlying belief that reporting on economic, environmental, and social performance by all organizations should be as routine and comparable as financial reporting. The principles and guidance section of the GRI framework provides guidance and principles for defining the report content, which helps to determine what should be covered by the sustainability report and where its boundaries should be drawn.

Chapter 10 The governance of listed companies

1. ● A holding company is a company that holds all or a dominant share of the voting rights in another company.

 ● A subsidiary company is a company in which another company (its holding company) holds all of its voting shares (a wholly owned subsidiary) or a majority of its voting shares (a partially owned subsidiary).

 ● An associate company is a company over which another company exercises dominant power, even though it does not hold a majority of the voting rights in that company, for example where the other shareholdings are widely spread.

 2. The primary reason is, typically, low taxation with some businesses exempt from profits tax, and no capital gains or wealth taxes. Additionally, an off-shore jurisdiction might have good communications, political and economic stability, no exchange controls, and offer companies registered there flexibility, corporate privacy and confidentiality, a pool of professional service providers, sound company law, and regulation that is reasonable, but not bureaucratic.

 3. Not unless they are managers of the company as well as shareholders.

 4. Principally to leverage financial power gained from the gearing. By investing in a chain, the head of the chain is able to exercise more influence over the companies in the chain than would be available by investing in individual companies in the chain.

 5. The creation of two or more classes of voting shares in which one class enjoys greater voting rights than the other class.

 6. A nominated adviser authorized by the UK AIM market, which all AIM companies are required to appoint. The Nomad’s experience provides a quality control mechanism by checking the company’s plans and certifying to the Exchange that the company is suitable and ready for listing.

 7. A dual-listed company is a group structure in which two listed companies merge but both companies continue to exist and share ownership of a single, operational business. The group then has two stock exchange listings, with different bodies of shareholders, usually in different countries.

 8. Many companies use joint ventures with another company to enter markets, transfer technology, procure supplies, obtain finance, share management skills, manufacture products around the world, or share risk on an international scale.

 9. Shareholder activism can include communication and negotiation direct with management, but also media campaigns or blogging to change corporate practices, proxy battles advancing shareholder resolutions to force change, calling shareholder meetings, or litigation against companies or their directors. Some shareholder activists use their shareholding to advance their own social, environmental, or other agenda and influence corporate behaviour.

 10. Only in some company law jurisdictions. In other jurisdictions, companies are prohibited from investing in themselves through group networks.

Chapter 11 The governance of non-listed corporate entities

 1. If disagreements arise that were not envisaged in the initial joint venture (JV) agreement, directors of the JV company can face conflicts between their responsibilities to the JV company and to the JV partner company that employs them. Although many JV companies do appoint the managing director or CEO of the JV to the board, others now appoint only representative directors from the partner companies and have the JV managing director attend meetings in a non-voting, non-partisan way.

 2. Basically, in a partnership, the partners are responsible for governing the firm. In a firm with few partners, governance is by a meeting of all of the partners. In larger firms, the partnership may decide to appoint a managing partner and a governing body, perhaps called an executive or management committee, which meets regularly to manage partnership affairs, with a periodic, perhaps annual, meeting of the entire partnership to accept the accounts, to transact business reserved to the meeting and appoint members to the governing body.

 3. Some countries have a form of limited-liability partnerships (LLP). This governance vehicle gives the benefits of limited liability to the members, but allows the flexibility of organizing as a traditional partnership. The governance of an LLP is similar to that of a partnership: members provide the capital, contribute personally, and share profits and losses, to give some protection to those dealing with a limited partnership. However, the disclosure requirements tend to be more stringent than those for a traditional partnership, and similar to those of a company.

4. ● A holding company is the company at the head of the group pyramid. Its board of directors is often called the ‘main board’.

 ● A subsidiary company is one in which the holding or parent company holds all or a majority of the voting shares in that company.

 ● An associated company is one in which the holding company, although not holding a majority of the shares, has sufficient interests to control it and determine its actions.

 5. 1. Subsidiary company self-governance, allowing each company in the group to govern itself and manage its own affairs, subject to overall group-wide policies and resource allocation.

2. Group-wide governance, treating the group companies as divisions or departments of the holding company.

 6. The opportunity for cross-group coordination; the sharing of expertise, training, and development of future main board directors; management development; and the building of group norms and culture.

 7. A family council, consisting of the family members who own shares (management and non-management), meets prior to meetings of the shareholders and the directors to identify issues that affect family members and to resolve them in the best interests of the family.

8.

* Their primary purpose is to provide a public service.
* Their source of funds can include membership subscriptions, donations and legacies, charitable events and collections, public appeals, and charges for services provided.
* Although executives may be remunerated, much of the activity is supported by unpaid volunteers.
* Because of the diversity of charities, both in scale and purpose, many countries recognize the need to regulate them comprehensively.

9. A Sovereign Wealth Fund is an investment fund that invests a country’s financial surpluses in the shares of companies in other countries. Sovereign Wealth Funds are typically found in countries with surplus wealth, often derived from oil.

Chapter 12 Corporate governance around the world

1. CSRC, the China Securities Regulatory Commission of the State Council, is the Chinese Government’s corporate regulator. SASAC, the State-owned Assets Supervision and Administration Commission of the State Council, holds the Chinese Government’s shareholding in all China’s listed companies (other than those in the finance sector).
2. None. Hong Kong has its own corporate governance code, enshrined in the Hong Kong Stock Exchange listing rules. Under the Joint Agreement between Britain and China, the Hong Kong SAR (Special Administrative Region) kept its law, law courts, and currency.
3. Companies in India, both in the public and private sectors including multinationals, are dominated by majority shareholders, with pre-emption rights for minority shareholders frequently ignored. A corporate governance rating by the Asian Corporate Governance Association assessed India’s corporate governance as ‘fair to poor’.
4. The role of the state has expanded and government influence over some companies has increased. Some ownership has been transferred back to the state by expropriation or by acquisition in the market, as in the case of Yukos.
5. The International Finance Corporation, working with the World Bank, also produced a corporate governance manual for Russia, including drafts for a corporate charter, director contracts, and bylaws on shareholder meetings, the corporate secretary, proxy voting, and the board of directors.
6. Brazilian company law and the code have three unusual corporate governance features—the ­fiscal council, the family council, and the advisory board.
7. No, unless they own companies in mainland China.
8. Listed *chaebol* companies are often still controlled by the dominant owner-family interests. Even though companies attract outside capital, family domination is maintained through insider boards and cross-ownership with subsidiary companies.
* Concentrated ownership, with strong family ownership of both private and listed companies or state ownership.
* Dominant family oversight and control, with leadership from the head of the family, entrepreneurial decision-making, opaque communications, and relationship-based trading.
* Debt financing in which bank financing is often more than shareholders’ equity.

 10. Islamic shariah law introducing religious rules and interpretations.

PART 3 Practices

Chapter 13 Board membership: directors’ ­appointment, roles, and remuneration

 1. The remuneration committee is a subcommittee of the main board, consisting wholly or mainly of independent outside directors, which is set up with responsibility for overseeing the remuneration packages of board members, particularly the executive directors and, possibly, members of senior management.

 2. Integrity means being able to distinguish right from wrong and judge corporate behaviour accordingly. It means being able to recognize and declare a conflict of interest. It means acting in the company interest, not self-interest, and resisting the temptation to make an unacceptable personal gain. Essentially, integrity means acting honestly.

 3. Integrity and honesty, passion for customers, for our partners, and for technology, openness and respectfulness, taking on big challenges and seeing them through, constructive self-criticism, self-improvement, and personal excellence, and accountability to customers, shareholders, partners, and employees for commitments, results, and quality.

 4. They can be summarized as intellect, character, and personality.

 5. The essential director-level skills include:

– strategic reasoning, perception, and vision;

– a critical faculty capable of quantitative and qualitative analysis and financial interpretation;

– planning and decision-making capabilities;

– communication and interpersonal skills;

– networking and political abilities.

 6. Character traits, what some call ‘strength of character’, include being independently minded, objective, and impartial. A director needs to be capable of moving towards consensus. Yet, from time to time, a director needs to be tough-minded, tenacious, and resilient, with the courage to make a stand. Further, a director needs to have a balanced approach to risk, be results-orientated—neither risk-averse nor rash.

 7. – A duty of trust—to exercise a fiduciary responsibility to the shareholders.

– A duty of care—to exercise reasonable care, diligence, and skill.

 8. Related-party transactions provide a good example of the requirement to disclose personal interests. The listing rules of most stock exchanges and securities regulators require related-party transactions to be disclosed and, often, approved by the other shareholders.

9. The main duty of a remuneration committee is to establish a formal and transparent procedure for developing policy on executive director and top management remuneration. The challenge is to provide sufficient incentive to attract and retain top management in a competitive market for talent, rewarding success, while avoiding excesses and apparently rewarding failure. The remuneration committee is a standing committee of the main board, is appointed by the board, and reports to it.

10. If you are challenged by this question, please refer back to the textbook.

Chapter 14 Board leadership: the reality of the boardroom

 1. The fundamental power of the board is derived from the shareholders who have delegated the running of the company to the directors. This power is reinforced by authority derived from the company’s constitution backed up by company law.

 2. ● By a majority or dominant shareholder putting pressure on the board

● From the threat of a potential takeover

● By the prospect of litigation

● Through the influence of the auditors

● From the effects of legislation and regulation

● From media pressure and other external exhortation

● By a dominant or charismatic leader

● And, obviously, through the changing business circumstances.

 3. Knowledge power is power derived from access to information, skills, or experiences not available to the other directors (e.g. the influence on board discussions about international currency rates by the INED who is also a director of an international bank).

 4. ● Personality power

● Knowledge power

● Sanction power

● Interpersonal power

● Networking power

● Ownership power

● Representative power.

 5. Professional, representative, rubber-stamp, and country club.

 6. The style and culture of a board can be influenced by:

* Board traditions
* Corporate vision
* Innovation
* Control
* Decision taking
* Leadership
* Commitment
* Adaptability
* Collaboration
* Conflict
* Relationships
* Communication
* Status
* Conformity
* Trust

 7. To manage the board.

8.

* Management of the board
* Management of meetings
* Strategic leadership
* Linking the board with management
* Arbitration
* Figurehead or public face of the company.

9. The chair of the board has a fundamental leadership role. The chair’s personality, leadership style, and overall ability can be significant. This question calls for a personal interpretation, based on the textbook and, perhaps influenced by the very different styles of the two chairs in the NHS Foundation Trust case series.

10. The chair could be called on to represent the company to the shareholders, to make public statements about the company, to appear at public inquiries, and to be the face of the company to the media.

 **Chapter 15 Board activities: corporate governance in practice**

 1. The remuneration committee is responsible for recommending to the board the remuneration packages of executive directors, and sometimes other top management, including their salary, fees, pension arrangements, options to acquire shares in the company, and other benefits.

 2. The role of the nomination committee is to suggest names for board membership, in an attempt to introduce different experience, personalities, and diversity to the board, and to avoid domination of the nomination process by the chairman, CEO, or any other dominant directors.

 3. The primary role of the audit committee is to liaise between the board and the independent external auditors.

 4. Liaising between the board and the independent external auditors might include:

● making recommendations to the board on their appointment, re-appointment, or removal and replacement;

● reviewing and approving their terms of engagement;

● ensuring their objectivity and independence from the company, confirming that no conflicts of interest exist that could affect the auditor’s ability to issue an unbiased opinion on the company’s financial statements;

● developing and implementing a policy for their engagement on non-audit work;

● approving their remuneration;

● working with them on audit procedures and plans, receiving the auditor’s report and management letter about issues that have arisen during the audit, and reviewing and acting on these issues.

 5. See the 17 items listed in the main text.

 6. Some boards expect their audit committee to be responsible for the internal audit function, with the head of internal audit reporting to the audit committee, rather than the chief finance officer, as is the case in many other companies.

 7. The directors are responsible for the preparation and presentation of the financial statements. The auditor’s responsibility is to audit the financial records and to express an opinion to shareholders whether they give a true and fair view of the state of the company’s affairs, also confirming that hat they are in accordance with the requirements of company law and International Auditing Standards.

 8. The PCAOB standards require auditors to:

● obtain reasonable assurance that effective internal control over financial reporting has been maintained;

● assess the risk that a material weakness exists, testing and evaluating the design, and operating effectiveness of internal control based on the assessed risk;

● perform such other procedures as are considered necessary in the circumstances.

9. In the United States, the company secretary is typically known as the corporate secretary, and the role is frequently carried out by the corporate lawyer.

10. The duties of the company secretary typically include:

* advising the chair on legal rules and regulations affecting the company;
* convening board, board committee, and company (shareholder) meetings;
* advising on and guiding board and board committee procedures.

Chapter 16 Board effectiveness: building better boards

 1. Commitment, character, collaboration, competence, creativity, contribution.

2. The fundamental areas in which the new director needs to be fully informed are knowledge of the company, of its business, and of its financial situation. This should include knowledge of the company’s products or services, its markets, and its competitors. An appreciation of the state of key functions or divisions in the organization and any current issues are important, including operations, marketing, human resource management, information systems, research and development, and any other key areas.

 3. Confidentiality, security, integrity, availability, assurance, cost-effectiveness, flexibility, simplicity, and ease of use.

 4. Why, what, when, where, and who.

 5. No. A director cannot opt out of certain items because he or she lacks appropriate knowledge, although he or she may rely on information received and the opinions of fellow directors, given in good faith, unless he or she has any reason to doubt—in which case he or she must pursue the issue to its root.

 6. No. Although, subject to the articles, there are no specific rules governing the content or format of minutes of board or board subcommittee meetings; they should provide a competent and complete record of what transpired, what was decided, and what actions are to be taken by whom and when.

 7. A good report with high-quality information is:

* understandable
* reliable
* relevant
* comprehensive
* concise
* timely
* cost-effective.

 8. A newly appointed director needs a proper induction programme to reduce the learning time taken before beginning to make significant contributions to board deliberations.

 9. Directors’ and officers’ insurance.

 10. No. Actions can be brought against the company, the board, and/or individual directors. Claims for unlimited amounts can put directors’ personal assets at risk.

Chapter 17 Board evaluation: reviewing directors and boards

1.

* Chair initiates and board approves
* Determine methodology
* Informal or formalized director performance review
* Establish criteria to be used for the review
* Confidential briefing to directors on what the appraisal will involve
* Gather relevant performance data
* Draw conclusions
* Discussion with the director reviewed
* Identify courses of action for each director, e.g. knowledge needed, attendance improved, personal attitudes or style need changing etc.

 2. In many cases at the moment, director appraisals are being conducted in an informal way, with the chairman personally assessing the performance and commenting privately to the director involved.

 3. Yes, the pressure is on for director appraisals to be more formalized. To set up such a process needs a board policy decision, with the full support of all the directors.

 4. Typically, the output of an individual director performance assessment will be a confidential report to the chairman and, possibly, the chairman of the board’s nomination committee, if involved in the review process. Given the personal nature of the report, most chairmen will not table it at a board meeting, but discuss the relevant portion with each director.

 5. The UK Corporate Governance Code calls on the non-executive directors, led by the senior independent director, to be responsible for performance evaluation of the chairman, taking into account the views of executive directors. But in most cases, the chairman’s performance is reflected in the performance of the company as a whole. Continued poor performance will bring calls for a change of chairman from major investors, the media, or occasionally from fellow directors who are dissatisfied.

 6. Yes and yes.

 7. The chairman often assumes the role of:

* an experienced INED, perhaps the senior INED;
* an executive director, such as the CEO or the CFO;
* the internal auditor;
* the audit committee;
* a past chairman;
* a respected chairman or INED from the board of another company not in competition;
* an independent organization or firm of ­consultants.

8. The stages of a board review project are:

* Review the overall governance structure
* Review the board structure
* Profile board members
* Review board style, efficiency, and effectiveness
* Determine a strategy for board development.

 9.

* Ownership structure and external influences
* Shareholder rights and relations
* Transparency, disclosure, and audit
* Board structure and effectiveness.

 10.

* The World Bank and International Monetary Fund Reports on the Observance of Standards and Codes (ROSC) programme;
* The European Bank for Reconstruction and Development (2003) (EBRD) corporate governance assessment project;
* The FTSE ISS CGI company ratings

Chapter 18 Corporate governance: the next thirty years

1. Drivers of change include:
* To end corruption, corporate collapse, and economic catastrophe
* Efforts by reformers and interest groups
* Corporate governance research and development
* Social, political, and economic changes
* Society’s changing expectations.

 2. The Commission supports the NYSE’s listing requirements generally providing for a majority of independent directors, but also believes that companies can have additional non-independent directors so that there is an appropriate range and mix of expertise, diversity, and knowledge on the board.

 3. American concepts of corporate governance rely on rules, and the British on principles.

 4. The question is which is preferable: a dominant leader, who can provide single-minded leadership and enhance performance, or shared responsibility, which reduces risk?

 5. Recognize that good corporate governance is about the effectiveness of the governing body not about compliance with codes.

 6. Society today is not satisfied with corporate behaviour. Evidence is widespread. Scepticism abounds about business which is seen to lead to greed, excessive remuneration that erodes shareholder wealth, retirement awards and performance bonuses not linked to performance, and growing disparity of wealth in society. Around the world corruption seems rife at every level. Too many cases are reported of top management domination, arrogance, and abuse of power.

 7. Board-level information systems that enable directors to search for the information they feel they want, perhaps applying other tools and simulations to explore possible outcomes, while communicating their ideas to other board colleagues online.

8. Some of the developments in the future that could affect corporate governance include:

* The development of new organizational forms;
* The reinforcement of the right of owners to nominate directors;
* Institutional investors exercising more power over their investments;
* The drive for gender diversity on boards;
* The demand for genuine independence of external auditors;
* New theories of corporate governance.

 9. Basically, in China the state sees corporate governance as a means of developing the economy and society in the service of the people, rather than a means of corporate regulation and control.

1. Given logical reasoning, a philosophy of corporate governance could be developed that would integrate corporate governance with its societal, economic, and political context. Such theory would embrace every corporate entity, whatever its size, purpose, or domicile; distinguish governance from management; and clarify its relationships with its societal, economic, and political reality.