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The Chartered
Governance
Institute

Advanced Certificate in Corporate Governance

Qualification Discovery Pack

Overview

This discovery pack has been created to give you an in-depth understanding of what is involved in studying for the Advanced Certificate in Corporate Governance.

Whether you are looking to progress your own career or looking to develop your team, this certificate is ideal for those who want to lead good governance in the heart of the organisation.

The pack is divided into six sections:

Introduction
The introduction tells you, at a glance, what the certificate involves. It provides key details such as entry requirements, ways to study, content and benefits of the certificate.

The short syllabus
The short syllabus provides more details about the certificate: topics explored and qualification structure.

Study text sample
We have included a sample from the study text to give you a taster of the subject matter and format of the material that we provide to support your learning.

Tuition options
We recommend our students take tuition and have a number of partners who are registered to provide tuition in person and through distance learning. We provide a list of our partners who deliver tuition for the certificate here.

Sample exam paper
An exam paper adapted from the November 2019 session is included in this pack. This will give you an accurate example of what could be asked in the exam and how it is structured.

How to register
The final section of this pack explains how you can register for the Advanced Certificate in Corporate Governance.

INTRODUCTION

Advanced Certificate in Corporate Governance

Become an effective advisor on governance

Experience/qualifications: No prior qualifications required, experience recommended
Ways to study: Tuition from one of our partners is highly recommended, but you can also self-study using the text
Support: We provide a study text and support resources such as examiner reports and past papers. Students are also very welcome at Institute events
Cost: £1,530
Dates: Register anytime, exams are in June and November
Web: icsa.org.uk/discoveradvcertcorpgov

This internationally-recognised qualification will give you the knowledge and skills needed to embed good governance practice at the heart of your organisation, whether that be a company in the private sector, a voluntary organisation or a public sector body.

The course is designed to give an in-depth understanding of key concepts in the area of corporate governance, among them leadership and the role of the board, risk management and internal controls, and shareholder relations. If you are working in a relevant role in governance, compliance or risk, this course will provide you with a comprehensive understanding of what effective governance means.

Content
The course requires 200 hours' study time over six to nine months. Topics covered include:

- General principles of corporate governance
- The board of directors and leadership
- Remuneration of directors and senior executives
- Relations with shareholders
- Risk management and internal control
- Corporate social responsibility

Benefits
You will develop and reinforce your understanding of:

- frameworks of governance in a national and international context;
- how to advise on governance issues while pursuing strategic objectives;
- the solutions-led analysis and evaluation of governance problems;
- principles of risk management for good governance; and
- responsibilities to stakeholders and how to advise on ethical conduct.

THE SHORT SYLLABUS

Corporate Governance

Total hours study time: 200

Introduction
The aim of this module is to provide advanced knowledge and key skills necessary for the company secretary or governance professional to act as chief adviser to the board and other stakeholders on best practice in corporate governance, and as the facilitator for systematic application across a wide range of organisations.

Section	Total hours study time	Weighting percentage	Topic area explored
Section A: Corporate governance – principles and issues	50 hours	25%	Definitions and issues in corporate governance Corporate governance in the UK Role of the company secretary/governance professional in governance Other governance issues
Section B: The board of directors and leadership	60 hours	30%	Directors' duties and powers Role and membership of the board Balance, composition and succession planning Board effectiveness
Section C: Disclosure	40 hours	20%	Financial reporting to shareholders and external audit Corporate social responsibility, sustainability and business ethics Corporate responsibility and reporting on non-financial issues
Section D: Risk management and internal control	20 hours	10%	Systems of risk management and internal control Risk structures, policies, procedures and compliance
Section E: Corporate governance systems, controls and issues	30 hours	15%	Shareholders rights and engagement Board engagement with shareholders and other stakeholders Remuneration of directors and senior executives

STUDY TEXT SAMPLE

ICSA Study Text

Corporate Governance

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Andrew Hamer

Chapter one

Definitions and issues in corporate governance

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1. Introduction
2. Origins of the term corporate governance
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4. Theories of corporate governance
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6. Principles of corporate governance
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9. Implementation of a governance framework
10. The importance of adopting good corporate governance practices
11. Consequences of weak governance practices
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1. Introduction

corporate governance
The system by which a company is directed, so as to achieve its overall objectives. It is concerned with relationship, structures, processes, information flows, controls, decision-making and accountability to the highest level in a company.

This chapter introduces you to **corporate governance**, what it is and what it is not, why it is important and the consequences of not practising good governance. It discusses the different approaches to, and theoretical frameworks of, corporate governance and how they have developed over the years. It looks at what makes up a corporate governance framework and how this might be implemented in an organisation.

2. The origins of the term corporate governance

English dictionaries define 'governance' as the way that organisations or countries are managed at the highest level, and the system for doing this. Bob Tricker first used the term 'corporate governance' in an article, 'Perspectives

on corporate governance: Intellectual influences in the exercise of corporate governance', which was published in a 1983 collection of essays edited by Michael Earl. Tricker had realised in the 1970s that 'governance' was different from 'management' – a topic which had been written about extensively.

The term corporate governance was picked up and used by Sir Adrian Cadbury when he was asked to **chair** a committee established in May 1991 by the Financial Reporting Council (FRC), the London Stock Exchange, and the accountancy profession due to an increasing lack of investor confidence in the honesty and accountability of listed companies. This followed the sudden financial collapses of two companies, Coloroll and Polly Peck, both of which had apparently healthy published accounts. While the committee was in session, there were two further scandals at the Bank of Credit and Commerce International (BCCI) and the Mirror Group News International.

The recommendations from the Committee were published in 1992 in 'The Report of the Committee on the Financial Aspects of Corporate Governance: The Code of Best Practice' (the Cadbury Report) and underpin many of the corporate governance laws, regulations, standards and codes adopted globally today. The topics covered by the Cadbury Report included: board effectiveness, the roles of the chair and the **non-executive directors**, access to independent professional advice, **directors**' training, board structures and procedures, the role of the company secretary, directors' responsibilities, internal **financial controls** and internal audit. We will see later in this book that each of these topics has, over the years since 1992, been developed further as best practice and thinking on the subject has evolved in response to subsequent events to where we are today.

chair
Leader of the board of directors often referred to as the 'company chair' in companies and 'chair' in public bodies and voluntary organisations.

non-executive directors
A director who is not an employee of the company and who does have any responsibilities for executive management in the company.

executive director
A director who also has executive responsibilities in the management structure. Usually a full-time employee with a contract of employment.

financial controls
Internal controls to prevent or detect errors resulting from financial risks.

Case study 1.1

Polly Peck was a UK listed company which was placed into administration in October 1990. Its share price fell 75% from the beginning of August 1990 to 20 September 1990 when its shares were suspended from trading on the London Stock Exchange. The chair and chief executive of Polly Peck was Asil Nadir, a charismatic and hard-working businessman. It is argued that the fact that Nadir was chair and CEO of Polly Peck meant that the concentration of too much power in the hands of one individual may have meant that important decisions were not fully discussed by the board of directors.

Nadir had acquired 58% of Polly Peck in 1980 at a cost of £270,000. Under his management Polly Peck experienced unprecedented growth, with Nadir's investment valued at just over £1 billion by 1990. The growth was achieved through diversification into other product lines and expansion internationally, both of which were deemed to be high-risk strategies by market analysts.

In August 1990, Nadir – frustrated with Polly Peck's low price-earnings ratio, i.e. the relationship between its share price and reported profits

chief executive officer (CEO)
The person who is the head of the executive management team in an organisation.

before dividends (earnings) – announced that he was to bid for the company and take it private.

Five days later he abruptly changed his mind and dropped the plan. This caused the share price to fall substantially. As the company went into administration, it issued a statement stating that a combination of the fall in share price and negative publicity associated with it, had caused the company's liquidity problems.

Nadir had claimed that he could shore up the company with his own personal wealth, which at the time was thought to be about £1 billion. However, it turned out that he and his other companies were in substantial debt. Unfortunately, many of the banks were holding Polly Peck shares as collateral against these loans. Following the collapse, Nadir was charged with theft and false accounting.

3. Definitions of corporate governance

There is no one definition of corporate governance.

In 1984 Bob Tricker stated: 'If management is about running business, governance is about seeing that it is run properly. All companies need governing as well as managing.' Since then corporate governance has been defined in many ways. For example:

- The Cadbury Committee (1992) defined corporate governance as 'the system by which companies are directed and controlled'.
- The Organisation for Economic Co-operation and Development (OECD) published its Corporate Governance Principles in 1999 (revised in 2004) and defined corporate governance as involving 'a set of relationships between a company's management, its board, its shareholders and other **stakeholders** … also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined'.
- In 2004, The New Partnership for African Development (NEPAD) Declaration on Democracy, Political, Economic and Corporate Governance defined corporate governance as being 'concerned with ethical principles, values and practices that facilitate the balance between economic and social goals and between individual and communal goals. The aim is to align as nearly as possible the interests of individuals, corporations and society within the framework of sound governance and the common good.'
- In 2015, the G20/OECD issued a new set of corporate governance principles which stated that corporate governance practices should 'help build an environment of trust, transparency and accountability necessary for fostering long-term investment, financial stability and business integrity, thereby supporting stronger growth and more inclusive societies'.

stakeholder
A stakeholder group is an identifiable group of individuals or organisations with vested interest. Stakeholder groups in a company include the shareholders, the directors, senior executive management and other employees, customers, suppliers, the general public and (in the case of many companies) the government. Stakeholders maybe categorised as financial or non-financial stakeholders and as an external or internal stakeholders (depending on whether The in the company) the nature of their interest differs between stakeholder group.

- In 2016, the King IV Report on Corporate Governance for South Africa defined corporate governance as: 'The exercise of ethical and effective leadership by the governing body towards achievement of the following governance outcomes:
  - ethical cultures
  - good performance
  - effective control
  - legitimacy

The UK Corporate Governance Code 2016 stated that 'the purpose of corporate governance is to facilitate effective, entrepreneurial and prudent management that can deliver the long-term success of the company'. It refers back to the definition of corporate governance from the Cadbury Report, and states that the 2016 Code is still set within the context of this definition: 'Corporate governance is therefore about what the board of a company does and how it sets the values of the company. It is to be distinguished from the day to day operational management of the company by full-time executives.' The 2018 UK Corporate Governance Code expands the definition, recognising that companies do not exist in isolation: 'To succeed in the long-term, directors and the companies they lead need to build and maintain successful relationships with a wide range of stakeholders.'

Originally referring to the governance in large listed companies, evidence is growing that corporate governance can deliver benefits to other types of organisations of all sizes across all three sectors, public, private and not for profit. As we will see in Chapter 4, codes of best practice have been developed for the public, voluntary and health sectors, for sports bodies, and for academy schools, among others.

4. Theories of corporate governance

There are two main theories that form the basis for corporate governance practices. These are the shareholder primacy theory (and related to this, **agency theory**), which forms the basis of the shareholder value approach to corporate governance, and the **stakeholder theory**, which forms the basis of the stakeholder approach to corporate governance. These two approaches to corporate governance are discussed later in this chapter.

agency theory
A theory based on the separation of ownership from control in a large organisation and the conflict of interests between the individuals who direct the organisation and the people who own it. In a company, the directors act as agents for shareholders, and the conflict of interests between them should be controlled.

stakeholder theory
The view that the purpose of corporate governance should be to satisfy, as far as possible, the objectives of all key stakeholders.

4.1 Shareholder primacy theory

The shareholder primacy theory of corporate governance focuses on maximising the value to shareholders before considering other corporate stakeholders, such as employees, customers, suppliers and society as a whole. It was developed in the 1960s by economists, such as Milton Friedman and Henry Manne, out of the legal arguments propounded by Berle and Means in agency theory.
The shareholder primacy theory is based on the premise that shareholders own companies and that directors, managers and employees are engaged by the company for the purpose of maximising shareholder wealth.

The contrary view advocated by supporters of the stakeholder approach to corporate governance is that shareholders don't actually own the company as the company is a separate legal entity in and of itself. Companies, like individuals, are therefore citizens of the countries in which they operate and should therefore comply with societal norms for that country, which includes complying with all laws and regulations and taking into consideration how they impact other citizens and the environment.

Since the 2008 global financial crisis, the focus by many companies on shareholder primacy as a governance model has come under criticism for the following reasons:

- Inappropriate stewardship. It is argued that changes in shareholder structure from direct investment by individual shareholders to wealth invested under management (asset managers, pensions, insurance) has led to what are often referred to as 'ownerless companies', where no single investor has a large enough stake in the company to act as the responsible owner, checking the performance and behaviour of the board and management of the company. Even where the asset managers, pensions and insurance companies group together under shareholder representative bodies such as the Investment Management Association and the Pensions and Lifetime Savings Association (formerly National Association of Pension Funds), their focus tends to be on issues such as executive pay and board composition rather than the decision making of the board and management team.
- **Short termism**, defined by the Kay Report (2012) as both 'a tendency to under-investment, whether in physical assets or in intangibles such as product development, employee skills and reputation with customers, and as a hyperactive behaviour by executives whose corporate strategy focuses on restructuring, financial re-engineering or mergers and acquisitions at the expense of developing the fundamental operational capabilities of the business'. A report in 2016 from Tomorrow's Company, an independent non-profit think tank, found that UK companies were not allocating capital to tackle the major challenges faced by the UK in infrastructure and research and development. Instead companies are choosing to pay out more of their cash to shareholders by way of dividends or share buy-back programmes.

short termism
This refers to the tendency for company management to take actions that maximise short-term earnings and stock prices at the expanse of the shareholders' objectives of long-term company performance.

Furthermore, there is evidence that there has been a decline in the average holding periods of shares in both the UK and the US from around six years in 1950 to six months in 2010 (Haldane 2010). It is argued that this demonstrates that shareholders are investing in shares more often as a tradable commodity for short-term gain, with investment in the business itself of secondary importance.

4.1.1 Agency theory

Agency theory was developed in 1932 by Berle and Means, although it has been argued by Letza, Sun and Kirkbride (2004) that Adam Smith in his book the Wealth of Nations (1772) first pointed out the principal–agent relationship between shareholders and directors when he argued that company directors

were not likely to be as careful with other people's money as their own. Further work to understand how the relationship between agents and principals played out in corporates was carried out by Jensen and Meckling (1976).

The agent–principal relationship exists when an agent represents the principal in a particular transaction and is expected to represent the best interests of the principal above their own. Jensen and Meckling argued that the agent–principal relationship existed in companies where there was a separation of ownership and control, the shareholders playing the part of the principal and the directors and managers playing the part of the agent. Where separation of ownership and control in a company exists, the challenges associated with the agent–principal relationship also occur. These relate to conflicts of interest and the costs associated with avoiding/managing those conflicts.

Agency conflict

Conflict arises in an agent–principal relationship when agents and principals have differing interests. The main conflict between shareholders and managers is as follows:

- Shareholders usually want to see their income and wealth grow over the long term so will be looking for long-term year-on-year increases in dividends and share prices.
- Directors and managers, on the other hand, will be looking more short-term to annual increases in their **remuneration** and bonuses.

remuneration
The payment packages offered to top company executives and all executive directors.

Jensen and Meckling identified four areas of conflict:

- Moral hazard. A manager has an interest in receiving benefits from his or her position in the company. These include all the benefits that come from status, such as a company car, use of a company plane, a company house or flat, attendance at sponsored sporting events and so on. Jensen and Meckling suggested that a manager's incentive to obtain these benefits is higher when they have no shares, or only a few shares, in the company. For example, senior managers may pursue a strategy of growth through acquisitions, in order to gain more power and 'earn' higher remuneration, even though takeovers might not be in the best interests of the company and its shareholders.
- Level of effort. Managers may work less hard than they would if they were the owners of the company. The effect of this lack of effort could be smaller profits and a lower share price.
- Earnings retention. The remuneration of directors and senior managers is often related to the size of the company (measured by annual sales revenue and value of assets) rather than its profits. This gives managers an incentive to increase the size of the company, rather than to increase the returns to the company's shareholders. Management are more likely to want to reinvest profits in order to expand the company, rather than pay out the profits as dividends. When this happens, companies might invest in capital investment projects where the expected profitability is quite small, or propose high-priced takeover bids for other companies in order to build a bigger corporate empire.

- Time horizon. Shareholders are concerned about the long-term financial prospects of their company, because the value of their shares depends on expectations for the long-term future. In contrast, managers might only be interested in the short term. This is partly because they might receive annual bonuses based on short-term performance, and partly because they might not expect to be with the company for more than a few years.

total shareholder return
The total returns in a period earned by the company's shareholders, consisting normally of the dividends received and the gain (or minus the fall) in the share price during the period. The returns might be expressed as a percentage of the share value, e.g. the share price at the start of the period.

related party transaction
A transaction by a company with a 'related party' such as a major shareholder, director, a company in which a director has a major interest or a member of a director's family.

general meeting
A meeting of the equity shareholders of a company.

Agency theory says that companies should use corporate governance practices to avoid or manage these conflicts. Examples of how companies can achieve this are as follows:

- The use of long-term incentive share award or stock option schemes based on **total shareholder return** to align the interests of shareholders and management.
- Adoption of conflict of interest and **related party transaction** policies.

Agency costs

Agency costs are the costs associated with maintaining the agent–principal relationship. In companies, these costs are:

- Bonding costs – the cost of paying directors and executive management.
- The costs of monitoring the performance of the board and executive management. These will include the cost of **general meetings** and of the production and distribution of shareholder information such as annual reports and financial statements. It could be argued with the introduction of electronic communications that the cost of the latter has been reduced in recent years.
- Residual loss relates to the costs to shareholders associated with actions by the directors and executives which in the long run turn out not to be in the interests of the shareholders, for example a major acquisition or disposal, fraud or foray into a new business line.

Evidence shows that applying good corporate governance practices helps to minimise both the potential for conflict and the costs associated with the separation of ownership and control in corporates.

It is argued that agency theory appears to focus exclusively on maintaining value for the shareholders and this in turn has led to short-termism at the expense of long-term performance as many shareholders are looking for short-term gains. Blair (1995) goes on to argue that 'what is optimal for shareholders often is not optimal for the rest of society. That is, the corporate policies that generate the most wealth for shareholders may not be policies that generate the greatest total social wealth'.

4.2 Stakeholder theory

Stakeholder theory, in direct contrast to shareholder primacy theory, states that the purpose of corporate governance should be to meet the objectives of everyone that has an interest in the company. Individuals and groups that have

an interest in a company are known as stakeholders. Key stakeholder groups are investors, employees (often represented by unions), suppliers, customers, government, regulators, creditors, local communities and the general public. When making decisions, boards should balance the interests of these different stakeholder groups, deciding on a case-by-case basis which interests should take priority in a particular circumstance. This means that non-financial objectives, such as employee relations or limiting environmental impact, should be considered equal to the financial objectives, such as the return on investment, usually associated with maximising shareholder value.

Stakeholder theory also states that companies should act as good **corporate citizens** when making decisions and carrying out their activities, taking into account the impact these will have on society and the environment. Companies should be accountable to society and should conduct their activities to the benefit of society. This aspect of the stakeholder theory forms the basis for arguments in favour of **corporate social and environmental responsibility** discussed in more detail in Chapter 11.

corporate citizen
A company acting with due regard for its responsibilities as a member of the society in which it operates. Corporate citizenship is demonstrated through CSR policies.

corporate social responsibility (CSR)
Responsibility shown by a company or organisation for matters of general concern to the society in which it operates, such as protection of the environment, health and safety and social welfare.

Test yourself 1.1

1. **What is the main difference between the agency and stakeholder theories?**
2. **How do they affect the objectives of companies?**
3. **How can a company manage conflicts of interest between shareholders and directors and managers?**

5. Approaches to corporate governance

There are four main approaches to corporate governance, the first two of which have as their basis the theoretical frameworks discussed above. These are:

- shareholder value approach;
- stakeholder approach;
- inclusive stakeholder approach; and
- enlightened shareholder value approach

5.1 Shareholder value approach

The shareholder value approach to corporate governance states that the board of directors should govern their company in the best interests of its owners, the shareholders. The main objective is to maximise the wealth of a company's shareholders through share price growth and dividend payments, while conforming to the rules of society as embedded in laws and customs. The directors should only be accountable to the shareholders, who should have the power to appoint them and remove them from office if their performance is inadequate. This approach focuses on protecting investors and the value of their

shareholding in the company. It was historically adopted in listed companies where there was a separation of ownership and control. However, private companies are now also adopting this approach.

Non-corporates can also adopt an investor value approach to their governance. Investors in not-for-profit and public sector organisations can expect a 'social impact' as value for their investment. For example, in developing economies an investor in private sector agribusiness will expect value for money from the activities undertaken by the organisations in which they invest.

It is argued that a pure shareholder value approach is not sustainable in the long term as companies are not islands and have to interact with different stakeholder groups, the interests of which they will have to consider if they are going to be successful and sustainable in the long run.

5.2 Stakeholder approach

The stakeholder or pluralist approach to corporate governance states that companies should have regard to the views of all stakeholders, not just shareholders. This would include the public at large. When taking decisions, boards of companies should try to balance the interests of all the company's stakeholders.

The stakeholder approach to corporate governance is predominantly adopted in civil law countries, such as France and Germany, and in Japan and China where companies are often required to take account of the social and financial interests of employees, creditors and consumers in their decision-making. This approach is also reflected in the New Partnership for Africa's Development's definition of corporate governance, which states that corporate governance is concerned with achieving a balance between economic and social goals and between individual and communal goals.

Opponents of the stakeholder approach argue that if companies were to take into account all stakeholders' conflicting views, they would never come to a decision. However, there is no direct evidence that one approach is superior to the other in terms of the success of the organisation.

5.3 Inclusive stakeholder approach

The South African King Reports, developed by the Institute of Directors in South Africa, introduced a third approach to corporate governance, the inclusive stakeholder approach. This approach differs in its emphasis from the shareholder value and stakeholder approaches in that its supporters believe that the board of directors should consider the legitimate interests and expectations of key stakeholders on the basis that this is in the best interests of the company. The legitimate interests and expectations of key stakeholders should be included in the board's decision-making process and traded off against each other on a case-by-case basis in the best interests of the company.

In the inclusive approach, the shareholder does not have any predetermined precedence over other stakeholders. The best interests of the company are defined by the Institute of Directors for Southern Africa, King Code

of Governance for South Africa 2009, King IV, not in terms of maximising shareholder value, but 'within the parameters of the company as a sustainable enterprise and the company as a corporate citizen'.

The inclusive stakeholder approach reflects African needs and culture. It incorporates the concepts of **sustainability** and 'good citizenship' (**ethics** and corporate social responsibility) into the definition of corporate governance as part of the fight against corruption, poverty and health issues such as TB, malaria and HIV/AIDS. The concepts of ethics and corporate social responsibility are often seen in the shareholder value approach as complementary disciplines.

sustainability
Conducting business operations in a way that can be continued into the foreseeable future, without using natural resources at such a rate or creating such environmental damage that continuation of the business will eventually become impossible.

corporate ethics
Standards of business behaviour, sometimes set out by companies in a code of corporate ethics.

5.4 Enlightened shareholder value approach

The **enlightened shareholder value approach** proposes that boards, when considering actions to maximise shareholder value, should look to the long term as well as the short term, and consider the views of and impact on other stakeholders in the company, not just shareholders. The views of other stakeholders are, however, only considered in so far as it would be in the interests of shareholders to do so. This differs from the stakeholder and stakeholder inclusive approaches where boards balance the conflicting interests of stakeholders in the best interests of the company.

enlightened shareholder approach
Approach to corporate governance based on the view that the objective of its directors should be to meet the needs of shareholders, while also showing concern for other major stakeholders.

The enlightened shareholder value approach was introduced in the UK by the Companies Act 2006 (CA2006), which imposed a statutory duty on directors to 'promote the success of the company for the benefit of its members as a whole, and in doing so have regard (among other matters) to:

- the likely consequences of any decision in the long term;
- the interests of the company's employees;
- the need to foster the company's business relationships with suppliers, customers and others;the impact of the company's operations on the community and the environment;
- the desirability of the company maintaining a reputation for high standards of business conduct; and
- the need to act fairly as between members of the company.

Interestingly, the interests of creditors are not included within this list. CA2006 specifically states that the duty imposed on directors to promote the success of the company overrides any laws or regulations requiring the director to act in the interests of creditors of the company.

There are two main challenges in practice with how the enlightened shareholder value approach has been adopted in the UK. Although directors now have a duty to consider the interests of a wider stakeholder group, there is:

1. No provision in CA2006 to enforce the duty. The only stakeholder with enforcement rights within CA2006 are those for members through a **derivative action**. It could be argued, however, that there is redress for non-shareholder stakeholders through other aspects of law, e.g. employment law, health and safety legislation and environmental law.

derivative action
Legal action taken against a director by shareholders in the company, alleging negligence or breach of duty.

2. No guidance as to how directors should take other stakeholder interests into account, particularly conflicting ones. Boards, therefore, in reality still focus on shareholder interests only, perhaps as these are the only enforceable ones.

The Companies (Miscellaneous Reporting) Regulations 2018 seek to address these challenges by providing guidance and reporting requirements on how directors are taking into account in their decision making the interests of employees and fostering relationships with customers, suppliers and others. More information on this is provided in Chapter 2.

5.5 Convergence of approaches to corporate governance

Proponents of each of the approaches to corporate governance have traditionally been very protective of their approach, seeing the shareholder value and stakeholder approaches as being diametrically opposed.

However, trends today seem to support convergence of the two main approaches to corporate governance: the shareholder value approach and the stakeholder approach. As we saw in Africa, where many countries follow the common law system, 'in the best interests of the shareholders' is being redefined as 'the long-term sustainability of the company', which appears to resemble more closely the stakeholder approach, rather than being 'in the best interests of shareholders'. This is not seen as at odds with being in the shareholders' best interests.

In civil law countries, pressure is being exerted to give priority to the interests of shareholders. For example, in France, the Marini Report criticised the concept of company interest, since it brought the danger of having management act primarily in its own interests. In Japan, corporate governance principles suggest on the one hand that a balance of various interests must be drawn, but on the other hand that the providers of capital are at the core of corporate governance.

Whichever approach to corporate governance is adopted, one of the underlying issues corporate governance attempts to deal with is conflicts of interest (potential or actual) between shareholders, members of the board as a whole, or as individual members and stakeholders. Directors may be tempted to take risks for short-term benefit whereas shareholders and many stakeholders will be looking to the long term. If a company gets into financial difficulty, directors can usually move on to another company with limited or no financial loss, leaving the shareholders and other stakeholders to suffer the fallout and loss.

Test yourself 1.2

1. **What is the difference between the enlightened shareholder value and inclusive stakeholder approaches to corporate governance?**
2. **Which approaches see boards taking a longer-term view in decision-making?**
3. **Which approaches put shareholders first?**

6. Principles of corporate governance

Despite there being no agreed definition of corporate governance, there are four agreed principles underlying the development of corporate governance. These principles can be found operating to different degrees in all types of organisations whichever sector they are in: private, public or not-for-profit. These principles are:

- responsibility;
- accountability;
- transparency; and
- fairness.

6.1 Responsibility

This refers to a person or group of people having authority over something, and who are, therefore, liable to be held accountable for the exercise or lack of exercise of that authority. Those given authorities should accept full responsibility for the powers that they have been given and the authority they exercise. They should understand what their responsibilities are, and should carry them out ethically with honesty, probity and integrity.

Organisations should ensure that procedures and structures are in place so that people know what they are responsible for and thus liable to account for. This will help people to minimise, or avoid completely, potential conflicts of interest that could arise in the exercise or lack of exercise of their authority. Mismanagement of authority should be penalised, and therefore responsibility goes hand in hand with accountability.

6.2 Accountability

accountability
The requirement for a person in a position of responsibility to justify, explain or account for the exercise of their authority and their performance or actions.

This refers to the requirement for a person or group of people in a position of responsibility to account for the exercise (or not) of the authority they have been given. Accountability should be to the person or group of people from whom the authority is derived.

Those providing accountability should provide 'honest' information and not manipulate facts or 'spin' them to their or their organisation's advantage.

Accountability applies to all the different 'players' within an organisation, whether they are the owners of the organisation, the governing body, the management or the employees. The challenge is in deciding how the person or group of people should be made accountable, and over what time period.

Corporate governance best practice requires an organisation to set out clearly who is accountable for what and over what time period so that an organisation's stakeholders are clear whom they should hold responsible for what. The sophistication of how this is set out will again depend on the size and complexity of the organisation and can range from a few lines to a large manual as the organisation becomes more complex.

SAMPLE
EXAM PAPER

Advanced Certificate in Corporate Governance

Sample assessment material 2019

Section A

*Answer **all** the questions in this section.*

1. The UK Corporate Governance Code 2018 states that FTSE 350 companies should carry out an externally facilitated board evaluation annually.

   Is this **true** or **false?**

   *(Tick **one** box only)*

   ☐ True

   ☐ False

   (1 mark)

2. Explain the purpose of the Equator Principles.

   (3 marks)

3. Give any **two** examples of the ways in which a new Company Secretary can check whether the Board is focused on the company conducting its business ethically.

   (2 marks)

4. Which of the following responsibilities should be included in the statement of responsibilities of a Senior Independent Director?

   *(Tick **one** box only)*

   A. ☐ Acting as interim Chair in the event of the unexpected resignation of the current Chair.

   B. ☐ Arranging to meet with the other non-executive directors without the Chair being present.

   C. ☐ Agreeing the level of directors' fees payable to the Chair.

   D. ☐ Leading the process for appointment of a new Chair.

   (1 mark)

5. Describe the purpose **and** benefits of integrated reporting.

   (5 marks)

6. Explain the agency theory in the context of the shareholder value approach to corporate governance.

   (4 marks)

7. Outline **four** key features of an effective induction programme for a new director.

(4 marks)

8. Describe the directors' duty of skill and care under section 174 of the Companies Act 2006.

(5 marks)

TOTAL FOR SECTION A = 25 MARKS

Section B

*Answer **three** questions only.*

[This has been produced for sample purposes, adequate spacing for answers will be included in the examinations.]

9. Beta Group plc (Beta) has its shares listed on the London Stock Exchange and has a wide shareholder base including institutional shareholders, large private shareholders and small private shareholders.

   Beta's registrars have recently alerted Beta's Company Secretary to the fact that an activist shareholder, Druid Partners LLP (Druid), has recently been building a stake in the company and is now the registered holder of around 6% of the shares. Druid has not had any dialogue with the Board of Beta but has recently been making public statements which are critical of the Board and its strategy, in particular criticising the track record of Beta's CEO. The media has also been running stories suggesting that other shareholders are unhappy with the company's strategy following a drop in the share price.

   Beta is currently preparing its annual report and AGM notice which will be despatched ready for the next AGM, which is due to take place in around four months' time. One of the items on the agenda at the AGM will be the approval of a new directors' remuneration policy, in the form to be set out in the annual report. The remuneration committee is in the process of finalising the policy and in particular is considering amendments to the nature and level of the targets to be met by the executive directors in relation to their Long-Term Incentive Plan (LTIP). This follows criticism by shareholders of the targets under the current remuneration policy which led to an 18% vote against the remuneration implementation report at last year's AGM. The remuneration committee is also considering how to exercise the discretion available to the company under the existing remuneration policy as regards the directors LTIP awards for the current year.

   (a) Discuss how the Board of Beta should go about understanding the views of Beta's shareholders. Include in your answer how it should engage with them in relation to the finalisation of its remuneration policy and in relation to any other issues of concern to shareholders.

   (13 marks)

   (b) Prepare a briefing paper for the Board of Beta explaining the term 'shareholder activism'. Your answer should consider the context of the shareholding built up by Druid, its shareholder rights and the tactics Druid might employ in the lead up to or at the AGM.

   (12 marks)

[Total for Question 9 = 25 marks]

10. You are the new Company Secretary of Roadplan plc (Roadplan), a road transportation and logistics company. Roadplan was originally founded by Adam Peat over 25 years ago and he is still the CEO. The company was listed in 2007 and at that time Robert Hill, who had no previous connections with the company, became non-executive Chair. The current Finance Director, Anthony Smith, has also been with the company since it was founded and was promoted to Finance Director at the time of the listing.

In addition to the Chair, there are four non-executive directors: John Harris and David Young, who were appointed in 2008 as independent directors, and Simon Dale and Jane Court, who were appointed in 2015 as independent directors. Simon has recently joined the Board of a private company that Robert is also on the Board of. Jane, who is the chair of the remuneration committee, has indicated to the Board that she would like to step down from the Board after the next AGM.

The company has expanded rapidly over the last three years and in particular has expanded its business into new types of logistics operations which are heavily IT dependent. The Board members have recently completed a skills audit which showed that none of them have any significant IT experience or skills.

(a) Analyse the corporate governance weaknesses of the current Roadplan Board composition.
(15 marks)

(b) Describe the process that should be followed, and issues that should be considered, when appointing a new non-executive director. (Note: you are not required to refer to the Beta scenario in your answer.)
(10 marks)

[Total for Question 10 = 25 marks]

11. You are the Company Secretary of Prime Plastics plc (Prime), a large global company with plastics manufacturing operations in a range of countries. It has over 500 employees in the UK. Prime is a private, family owned company which is a large company for the purposes of the Companies Act 2006.

Three years ago, Prime suffered a chemical leak at one of its factories in Europe leading to fines and a significant environmental clean-up operation. As a consequence, a sustainability committee of the board was formed to focus on corporate social responsibility (CSR) issues and in particular on environmental issues. Prime has updated its environmental policies and has also increased its reporting in its annual report in relation to environmental issues.

The company has recently been the subject of adverse publicity in relation to an employment dispute at one of its UK operations, with suggestions that employee morale is very low following the imposition of new employment contracts. In addition, the company's suppliers have been complaining in private to the Finance Director about the time it is taking Prime to pay their invoices.

The CEO of Prime would prefer not to have to go public in the company's next annual report about the employee and supplier disputes and would prefer to continue to concentrate on the company's improvement in environmental standards and policies in the CSR section of the annual report. He wants advice on whether this approach is acceptable and he is concerned about how the recent regulatory focus on stakeholders fits with the board's duty to its shareholders.

(a) Prepare a briefing note for the CEO of Prime discussing the statutory reporting requirements the company must comply with (and the guidance available to assist it) in relation to how the Board has engaged with its stakeholders.

Your answer should also include how it has considered the application of the stakeholder factors listed in section 172 of the Companies Act 2006.
(15 marks)

(b) Discuss what is meant by “enlightened shareholder value” and how section 172 of the Companies Act 2006 encapsulates that concept in a way which reduces the concern raised by the CEO.

(10 marks)

[Total for Question 11 = 25 marks]

12. Exmoor Technologies plc (Exmoor) is a UK listed company in the telecoms sector. It is heavily reliant on its database of customer information.

The sector that Exmoor works in is highly competitive and is frequently affected by the emergence of new technologies.

About 12 months ago, the regulators in one of the European jurisdictions in which Exmoor operates announced that it had begun an investigation into the activities of Exmoor’s sales representatives. This was following allegations that they were offering bribes to retailers to promote Exmoor’s products.

There has also recently been a social media campaign run by a campaign group in relation to the environmental impact of the methods used to create telecoms products. Exmoor was listed in one of the group’s campaign documents as one of the companies that had failed to mitigate that impact.

Exmoor’s current loan facilities expire in the next calendar year and so Exmoor is about to start the process of renegotiating its loan facilities with its main lenders.

(a) Discuss the reputational risks that Exmoor faces, or may face in future, and why it is important for the Exmoor Board to assess and manage them.

(9 marks)

(b) Describe the viability statement that the UK Corporate Governance Code requires Exmoor to include in its annual report and the challenges that the Exmoor Board has in making that statement.

(8 marks)

(c) Explain the role that a Company Secretary can play in assisting a Board with risk and risk management issues.

(8 marks)

[Total for Question 12 = 25 marks]

TOTAL FOR SECTION B = 75 MARKS

TOTAL FOR PAPER = 100 MARKS

END

TUITION OPTIONS

Tuition partners for the Advanced Certificate in Corporate Governance

While the Advanced Certificate in Corporate Governance can be obtained through independent study, we recommend that you take up tuition to help you to achieve your qualification.

Our partners provide tuition through face-to-face and online/ distance learning. Our recommended tuition partners are required to regularly demonstrate that they meet the Institute's expectations with regards to enrolment and exam performance.

Find further details and links to these providers at icsa.org.uk/discover-rtps

Recommended tuition partners

BPP Professional Education, Jersey

Tuition type:
Face-to-face: ✔
Online: ✔
Revision: ✔

Contact: Emma Williams
Phone: 01534 711 800
Email: jerseyenquiries@bpp.com
Website: bppci.com

Campbell's College

Tuition type:
Face-to-face (London revision classes only): ✔
Distance learning: ✔
Revision: ✔

Contact: Jane Hamilton
Phone: 01322 665 589
Email: enquiries@campbellscollege.com
Website: campbellscollege.co.uk

Tuition partner

Governance Gurus

Tuition type:
Face-to-face: ✔
Online: ✔

Contact: Robert Ford
Phone: 00 971 558 034 055
Email: rob@governance-gurus.ae
Website: governance-gurus.ae

HOW TO REGISTER

Applying for the Advanced Certificate in Corporate Governance

Students need to first register with The Chartered Governance Institute to start the Advanced Certificate in Corporate Governance. To do so, visit **icsa.org.uk/discoveradvcertcorpgov** and apply online.

Throughout the process, you will be asked to provide your personal details, employment details and where you plan to sit your exam.

On becoming a student, you will be asked for your commitment to follow our student rules and regulations and our Code of Professional Ethics and Conduct. These undertakings help to ensure that you observe high professional standards from the very start of your career in governance. You will also gain access to your MyCG account and the learning materials.

Once your student membership has been confirmed and the Advanced Certificate in Corporate Governance application approved, we recommend students take up tuition to help to achieve the qualification. Students will need to contact the tuition provider directly to register for tuition.

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Discover how qualifying in corporate governance, or training those in your organisation, can help embed good governance practice at the heart of your organisation.

If you would like more information, or want to talk to someone about your options at The Chartered Governance Institute, contact our Membership team at enquiries@icsa.org.uk or +44 (0)20 7580 4741.

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