**DQ 1: With appropriate examples, compare and contrast rules-based and principles-based approaches to corporate governance.**

Corporate governance can be viewed as the structure of rules, practices and processes used to direct and manage a company or country’s financial system. It would essentially involve the balancing the interests of a company’s shareholders, senior management executives, customers, suppliers, financiers, government and the community (Solomon, 2013).

Rules based approach to corporate governance refers to the view that companies must be required by law (or a governing body) to comply with some established rules or principles of good corporate governance (Broshko & Li, 2006). For example in the USA Nasdaq and the NYSE have set rules on how they operate. This has the inherent benefit for precise application in a given situation at the time of implementation. The downside is that rules can become outdated as situations will keep changing.

Principles based approach is where the rules can be different for each company given that circumstances may change over time. The companies are expected to comply with the best practices for corporate governance (Broshko & Li, 2006). In the UK and Canada, this approach is used and is also termed as comply or explain. The benefit is that a firm can be allowed to tailor its corporate governance practices to its specific situation, and providing investors information relevant to evaluate these practices. The downside is that the approach can be considered weak in addressing corporate governance failures. For instance, the investors may not have the time or resources to evaluate if a firms corporate governance practices are good enough, and thus the investment is lost in a failure (Broshko & Li, 2006).

It can be shown that countries with principle based corporate governance such as Canada, UK, and Nigeria have more of family owned small enterprises listed on the stock exchange since this approach allows for smaller boards as opposed to rules based approach where the rules are more stringent and thus limiting (Howell & Sorour, 2016).

References

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