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Ethics and Governance - Lecture notes, lecture 1 - 12

Ethics and Governance (Royal Melbourne Institute of Technology)

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Ethics and Governance

Lecture 1: Introduction to ethics & governance

Main point: Ethics and Moral.

- Ethics equal common sense

What is moral?

- When you're young, you know what is right or wrong. Moral is like a seed. Ethics is like a fruit that you bear. You could be a bad apples or good apples when you grew up.

Models of management morality

Models	Explanation	Example
Immoral management (bad/wrong)	• You do wrong things intentionally • Easy for the police to catch if they have evidence • Utilitarianism and Egotism • China practice immoral management	• China food scandal, they sell expiry meat to people • China doctors sell babies
Amoral Management	• Neutral on ethics • Business 1st priority • Business is neutral • Business and ethics is different • In Hong Kong, business is money • Uncommon	• Dr Susan Lim charge unfairly
Moral Management (good/right)	▪ Unintentional ▪ Careless ▪ Casual ▪ In attention to ethics ▪ Singapore practice moral management ▪ Very serious ▪ Law (legal), schools, hospital; ▪ Service to the public (BP oil spills)	▪ Korean ships sank

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What is corporate governance?

- Governance = How an organisation is governed, which is distinct from management. Although some senior management are involved in governance.
- Governance is important to Private, Public and Not-for-profit sectors.

Definitions of corporate governance

- Corporate governance is the internal means by which corporations are operated and controlled.

Corporate governance entities

- Shareholders: own the company
- CEO& management: Run the company
- Board of director: Control the company

Example of Unethical behaviour & Poor governance

- In US: Enron and Arthur Anderson
- In Singapore: NKF and China Aviation oil

Enron	**NKF**
Failure: Massive accounting fraud **Consequence**: Collapse of US$70 billion energy trader Enron **Whistle blower**: Sherron Watkins **Penalties**: • Chairman: 45 year jail sentence • CEO: 24 year jail sentence, US$50M pay back • CFO: 10 year jail sentence • Accounting firm: Arthur Andersen dissolved	**Failure**: Misuse of funds and false declarations **Consequence**: Massive public outcry and fallout of donors **Whistle blower**: Susan leong, the straits times **Penalties**: • Chairman: 15 month jail sentence • CEO: 3 month jail sentence • Chairman, CEO and 2 board members: S$12m pay back

Why ethics and CG is important?

- Protect financial position
- Set strategic plans and measure performance
- Delegating who is responsible for what
- Ensure company complies with the law
- Protect the interests of all shareholders
- Why might E&G be important to you?

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Lecture 2: Business ethics- Normative theories (about society behaviour)

Moral Agency

- **An agent in ethical theory:**
  - Is any entity that acts and is subject to ethical rules
  - Is a rational being
  - Is not an agent for anyone or anything else (once an agent accepts an ethical theory, he will be self- governing himself and hence will act in his best interested and no one/anything will influence his actions
- The central concept of moral agency is moral responsibility e.g we can hold a moral agent morally accountable for his/her bahavipurs/actions
- Moral agent needs to be rational (know what is right and wrong) and autonomous(have the right to choose an action
- Young children are not considered moral agents (the reason advertising to children is unethical)

Moral responsibility

Morally responsible when:

- Knowingly & freely performed the act
- Knowingly & freely failed to prevent the act

Not morally responsible if:

- Did not possess all relevant information
- Were unable to prevent the act

Normative theories

- A value judgment on what a person should do rather than what they probably will do (e.g one should always be honest in business dealings)
- They serve as a criteria for judging the ethics of a situation
- They provide a philosophical approach for making ethical decisions
- Divided into consequential and non-consequential theories

Moral philosophy

What is philosophy?

- From your thinking hat of what happen to your whole universe

Consequence based or teleological (actionable)

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- Ethical egoism (selfish people/self-interest/ bad people)
- Utilitarianism (everybody/majority)
- Virtue ethics (good people)

Non-consequential, duty based or deontological (non-actionable)

- Kantian ethics (rightful)
- Justice ethics (fairness)

Theories	Adv & Disadvanatge	Limitations	Example
Egoism (selfish): • an act is morally right if and only if it best promotes an agent's self-interests. • People should make decisions that maximize their self-interest • Is a form of selfishness you take action at the expense of the other person	-	-	• A CEO (agent) may recommend a "lousy" director with the self-interests that the latter will give him some benefits in the long term (e.g pay rises)
Utilitarianism: • Concerned with making decisions that promote greatest overall amount of good in the world • An ethical decisions is one that maximises good consequences over bad consequences for the greatest number of people • Consequences include happiness(pleasure, health and satisfaction) and pain (sadness, sickness and disappointment) • Best decision is one that yields greatest net benefit • Utility concerns" greatest good for the greatest	• Cost-benefit analysis fits with business decision making • Provides an objective and attractive way of resolving conflict of self-interest • Fits into people's intuitive criteria for deciding moral problem • Making ethical decisions based on the greatest good for the greatest number of people seems to have a logical basis	• The nature of the consequences: bias. Need to retrench 20% randomly so that 80% of staff are kept. So as to satisfy the shareholders. Is a financial outcome the best? Too much focus on ethical ends can lead to ignoring moral consideration of the means.	• School, government, legal company • Taking action for the benefit of majority

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number". The emphasis is "majority"			
Virtue ethics: • Self-sacrifice for the benefit of others • Focuses on the integrity of the moral actor rather than the act • Opposite of ego	**-**	• May be limited agreement about standards • Community may be wrong	• Mother Teresa
Kantianism • The society the people you mixed with around you • You react according to the society you live in and take action according to heart • Focus on doing what is "right" rather than doing what will maximize societal welfare-what is good (as in utilitarianism)	**Disadvantage:** Motive is always taken to be more important than outcome. At times, this is debatable. E.g bribery to get job done. But what if everyone starts bribing to get job done? Often involves emotions, which can be wrong at times	Difficult to determine which rule, principle, right to follow/takes precedence. E.g Kantianism may indicate that free speech rights is "good" but privacy of others is also "good"	**-**
Justice Fair treatment and due reward in accordance with ethical or legal standards Managers adopting this theory will provide the same rate of pay to workers who are similar in level of skills, responsibility instead of gender, personality, favoritism Protects the interests of stakeholders who may be under-represented or lack power What is right? What is legal/illegal? Take action according to your mind	**Advantage** • Useful as it protects those who lack/voice influence • Benefits/burdens can be hard to define/quantity	The rights of some may have to be sacrificed in order to ensure a more equitable distribution of benefits Need to be highly trained (e.g judges)	**-**

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Application of theories

Sam, a sales representative, is preparing a sales presentation for his firm, Midwest hardware, which manufactures nuts and bolts. Sam hopes to obtain a large sales order from a construction firm that is building a bridge across the Missis river. The bolts produced by Midwest have a 3% defect rate, which, although acceptable in the industry, makes it unacceptable for certain projects, such as those subject to sudden, severe stress. The new bridge is located near to the Centre of a great earthquake zone. If Sam wins the contract, he will earn a commission of $25,000. But, if Sam tells the construction firm about the defect rate, the construction firm may award the job to a competitor whose bolts are more reliable. Sam is thus in a dilemma on whether to report the bolts 3% defect rate to the construction firm

Egoism

- Sam will probably choose the choice that maximises his self-interest.
- If his self-interest is personal wealth, value the $25,000 commission than the collapse of the bridge. Sam will likely keep quiet about the defect rate.

Utilitarianism

- Sam will conduct a cost benefit analysis to determine which alternative generate the most utility.
- Building the bridge- improve roadways, transportation across the river, create hundreds of new jobs; boost the local economy; increase revenue for Midwest.
- In contrast, bridge collapse kill or injure hundreds/thousands of people
- But, bolts only 3% defect rate; earthquake may not occur; few cars/people at time of disaster
- Seems that building the bridge creates greater utility than not building. Sam will not report the defect rate

Virtue ethics

- Sam will probably tell the construction firm about the defect rate (honesty)-right thing to do because of the outcome of the potential loss of lives with the bridge collapse
- This action will contribute the most positively to his virtue/integrity as a decision maker.

Kantianism (rightful)

- Sam will be morally responsible to inform the construction firm about the defect rate. The motive of moral action is more important than the potential loss of commission.

Justice (fairness)

- Sam will conduct a benefit-burden analysis for the various stakeholders

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(Midwest construction firm, local community, government, and competitor) and judge whether the benefits/burdens are fairly distributed among the stakeholders.

- It is unlikely that with the construction of the bridge will lead to fairness. E.g a better qualified competitor should be more suitable for the job; Lives may be lost for those using the bridge at the time of the disaster if Midwest's bolts are used.
- Sam will probably inform the construction firm on the bolts defect rate.

Lecture 3: Business ethics- Psychological (cognitive) theories (how human behave/react)

Moral awareness

- ➢ The initial step in the ethical decision making process
- ➢ The situation or issue is interpreted as a moral issue
- ➢ Leads to moral judgment

Summary of the six stages of moral reasoning

Level	Focus	Stage	Orientation
Post-conventional	Universal principles	6	Self-chosen ethical principles (virtue)
		5	Just rules determined by consensus (utilitarianism)
Conventional	Community	4	Rule-follower (Justice)
		3	Pleasing others (Kantianism)
Pre-conventional	Self-centered	2	Self-interest (egoism)
		1	Avoiding punishment (Morality) Do what is right, avoid what is wrong

Moral intensity

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- Strength/seriousness of the moral issue
- Affects the recognition of the moral issue, the making of moral judgment, the establishment of moral intent and the engagement in moral behaviour.
- Managers' ethical decision making is a function of the moral intensity of the encountered dilemma.
- Focuses on the moral issue, not on the moral agent or the organizational context.

Moral approbation

- Individuals consider four factors when determining their own or someone else's level of moral responsibility in a given situation:

1. The severity of the act's consequences
2. The certainty that the act is moral or immoral
3. The actor's degree of complicity in the act
4. The extent of pressure the actor feels to behave unethically. Desire of moral agents to be seen as moral by themselves and others

Fulfilment of roles- deindividuation process

- **Conflicting roles may lead to unethical behaviour**
  - The Zimbardo prison experiment
- **People do what they are told-obedience to authority**
  - The milgram experiments
  - Obedience to authority at work

Diffusion of responsibility:

- Individuals encouraged to push responsibility up the organizational hierarchy
- Diffusion of responsibility in groups

Ethical decision in business

- Gather the facts
- Define ethical issues (moral awareness)
- Identify the affected parties (stakeholder analysis)
- Identify the consequences (teleology)
- Identify the obligations (deontology)
- Consider your character and integrity (virtue ethics)
- Think creatively about potential actions (moral imagination)
- Check your gut feeling (intuition)

Lecture 4: Creating an Ethical Organisation

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Ethics of value or Ethics of compliance

- **Value approach:** is proactive and inspirational; emphasizes expected behaviour, high standards
    - Automatic
- **Compliance approach:** is reactive and punitive; emphasizes required behaviour, obeying the law
    - Company believes you need discipline to be good

Organisational Culture

- Organisational culture affects people in organisations
    - When you get into friendly culture you become friendly
- The organizational culture includes the basic assumptions concerning what is right, proper and fair
- Expresses shared assumptions, values and beliefs and is the social glue that holds the organisation together. It's how we do things around here (Kantianism apply here)

Ethical formal cultural systems

- **Leadership**
    - Creates, maintains and changes culture. Most important aspect of an organisation's ethical culture.

- **Selection and Reward systems**
    - Getting the right fit (selection)
    - They reward for performance e.g pay $300 for punctuality
    - Punish for discipline
    - Reward system can encourage unethical behaviour
    - People do what's rewarded
    - Rewards don't have to be explicit
    - Think about how attempts to motivate can backfire e.g backstabbing (when everyone wants it and does not encourage team building)
    - Set goals for ethical conduct
- **Structure**
    - Authority, responsibility and ethical culture
- **Policies and codes**
    - Their effectiveness depends on other formal and informal systems. Ethics must be in the blood line of the organisation.
- **Orientation and training programs**
- **Decision making processes assumptions and scripts**

Formulating a code of ethics (why code of ethics is important?)

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- A code of ethics is, in essence, a formalization of moral principles and responsibilities.
- The need for a code of ethics
    - Requirement by law e.g U.S.
    - Safeguarding reputation
    - Improving customer service (and thus sales)
    - Seeking like-minded partners and suppliers
    - Attracting and retaining the best employees
    - Responding to internal and/or external pressure

Ethical informal cultural systems

- **Informal cultural systems**
    - Informal norms
    - Heroes and role models
    - Rituals
    - Myths and stories
    - Language
- **Developing and changing the ethical culture**

Organisational culture and leadership

- **Leaders affect culture through:**
    - Attention
    - Critical incidents and crises
    - Role modeling/teaching/coaching
    - Criteria for scarce resources, rewards status, recruitment, selection, promotion, retirement, excommunication
    - Others: formal statements, structure, systems, processes, physical setting, rituals, stories etc.

Responsibility of managers

- Managers have responsibility for ethical behaviour in organisations because they affect culture, policies and practices
    - Begin with clear standards
    - Design a plan to continually communicate your standards
    - Managers are role models

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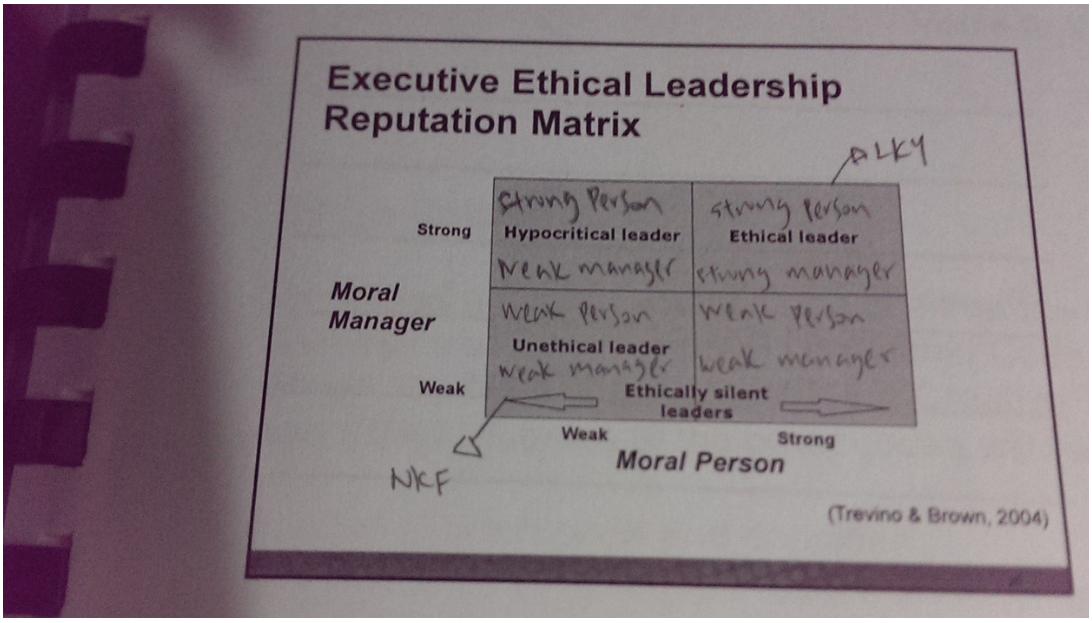
Executive ethical leadership reputation matrix



Guidelines for effective ethics management

- Understand existing ethics culture
- Communicate importance of ethical standards
- Focus on reward systems
- Promote ethical leadership in the organisation

Lecture 5: Corporate social responsibility (the company responsibility to the society)

Corporate moral responsibility: Behave morally

Corporate moral responsibility (CMR)

CMR has two meanings

1. CMR refers to the quality of corporate behaviour; is the behaviour moral, good right?
2. CMR refers to holding corporations morally responsible for their behaviour as we hold individuals responsible for their actions
   - E.g Haze in Singapore. When the Indonesia rebuke saying "Singaporeans why are you so childish?" is an example of bad moral corporate behaviour.
   - Months later he take ownership to apologise in the news and send army to clear forest. (example of good moral behaviour) In this case, corporate represents Indonesia as a nation.

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Corporate social responsibility (CSR)

- Corporate social responsibility assumes that we hold organisations morally responsible for their actions. E.g we attribute moral agency to the organisation.
- CSR goes a step further, It assumes that we hold organisations morally responsible for their actions
- Gained more prominence(reputation) with an emphasis on the company's board for its responsibility for relations with its stakeholders. Henceforth, stakeholder theory.
- The continued existence of companies is based on an implied agreement between business and society.

Corporate governance and CSR

- CSR and its related concepts (accountability, sustainability, citizenship, responsiveness and stakeholder management) pertain to the external legitimacy of the corporation because they address the impact corporations have on society
- Corporate governance relates to internal legitimacy, concerned with questions such as who runs the corporation, for whom and by what means.

Classical view to CSR- Friedman

- Business is amoral because economy is different from business. Business is business, moral is moral. Their ultimate goal is profit.
- Business executives do not have the rights to further social interested by spending shareholders customers or employees money.
    - CSR is economic profit and legal, if business makes money, you can pay your employees and that is CSR. With salary, employees are able to send their kids to school.
- Only people can have responsibilities. A corporation is an artificial person and in this sense may have artificial responsibilities, but "business" as a whole cannot be said to have responsibilities
- Business executives have the responsibility to conduct the business in accordance with the desires of the owners of the business…make as much money as possible while conforming to the basic rules of the society, both those embodied in law and those embodied in ethical custom.
- E.g Developing countries can use friedman's theory (India, Myanmar, Bangkok, Cambodia.)

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Corporate social responsibility- Carroll's pyramid/4 faces

- Agree with friedman with additional values: philanthropic responsibilities and ethical responsibilities.

Philanthropic (charitable) responsibilities: • How the company treat the society • Promote human welfare and goodwill • endeavor	**Example:** ○ Contributing scholarship for students from the company. ○ UOB raise 200K for charity at calligraphy auction
Ethical responsibilities: • As you employ, do use cheap labours, the company needs to know how to take care of their employees • Ethics go beyond legal code to include behaviour morally acceptable to stakeholders • Business ethics is concerned with knowing ethics and doing ethics	Being a family friendly company ○ SIM have childcare for SIM employee kids.
Legal responsibilities • Business expected to carry out its work lawfully. The law is at the floor of acceptable behaviour ○ Law reflects minimum standards of behaviour ○ Law are not always up to date ○ Law may not address all relevant social issues ○ Law may lag behind ethical thinking	-
Economic responsibilities • Business produces goods and services, while making an acceptable profit. Without financial viability other responsibilities are dubious.	-

Stakeholder theory

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- Corporations ought to be operated for the benefit of all those who have a stake in them
    - The unit of analysis of stakeholder theory is the organisation not the individual manager.
    - Stakeholder theory is a theory of organizational strategy and ethics
    - All strategic management theories have moral content

<u>**Primary stakeholders**</u>	<u>**Secondary stakeholders**</u>
• Employees • Customers • Communities • Financiers • Suppliers``	• Government • Competitors • Media • Special interest groups • Consumer advocate groups

Stakeholder Management

- Any group or individual who can affect or is affected by the achievement of the organisation's purpose.
    - Identification of stakeholder and claims
    - Treatment of stakeholders
    - Assessment of the impact
        - **E.g BP oil spills→sea creatures die → tourism decrease → employee lose their job**

Normative stakeholder theory

- Addresses morals and values as a central feature of managing organisations.
- If examines the ends of corporate activity and the means of achieving those ends

Distribution of value

- Stakeholder theory is concerned with distributive and procedural justice
- Benefits are distributed based on relative contribution to the organisation
- Owing shares is not riskier than losing a job, product failure, environment damage.
- Not about making money but key ethical issue is employees losing their jobs.

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- E.g NTUC (nation trade union) anything under NTUC, NTUC staff goes through training so that they can be re-employed (benefit of stakeholder)

Arguments for managing for stakeholders

- **Consequences**
  - Stakeholder management leads to best consequences for all because it recognizes that stakeholder interests are joint.
- **Rights**
  - Stakeholders have rights based on their stake and their basic humanity
- **Character**
  - Business virtues such as efficiency, fairness, respect, integrity etc. are necessary to create stakeholder value

Shareholder and stakeholder views of the firm

- **Shareholder view**
  - To maximize shareholder value, wealth
- **Stakeholder view**
  - To create sustainable value, not wealth, for all stakeholders

Lecture 6: Global financial crisis (consequence of GFC because of unethical leadership; solution is ethical leadership- utilitarianism & virtue)

- **Triple bottom line (3BL)**

1. **Financial (or economic) – profit**
   - Freeman theory
   - Economic growth
   - Cost (reduce cost)
   - Revenue
   - According to stakeholder theory, business entity should be used as a vehicle for coordinating stakeholders interest profit (instead of maximizing shareholder lower)
2. **Social – people**
   - Carroll's theory
   - People
   - Employee welfare
   - Fair trade
3. **Environmental – planet**
   - Consumption use and waste mangement

Organisational sustainability

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- Not just about the environment
- Focus on long-term rather than short-term
- Broader approach to performance measurement-not just money
- **Closely linked to:**
    - Business ethics (particularly virtue ethics and utilitarianism)
    - Corporate social responsibility
    - Stakeholder approaches to organizational governance and management

- **Factors that lead to failure in Greece (turn it around with ask about Singapore)**

Greece	**Singapore**
• Excessive expenditure by government • Mismanagement • Unregulated labour market • Obsolete(out dated) pension system • Rising unemployment • Insufficient bureaucracy • Tax evasion • Corruption	• Good management • Regulated labour market • Updated pension system • Low unemployment rate 2% • Sufficient bureaucracy • No corruption

✓ **Causes of the GFC**

Inflated housing bubble

- Over-inflated housing bubble-'fuelled by low interest rates, easy and available credit, scant regulation, and toxic mortgages. Was the spark that ignited a string of events, which lead to a full blown crisis in the US autumn of 2008 and its devastation impacted worldwide.
- They thought property will always increase as a result it over - inflated.

Sub- Prime mortgages(for deregulate)

- A type of loan granted to individuals with poor credit histories
- Deregulation + increased competition = lower standards of lending – the race to the bottom
- Prime people who have mortgage are people who are employed
- Toxic mortgage are people who are unemployed because you cannot honour your mortgage as such property goes on auction and it is sold cheap as a result property value decrease is called toxic mortgage.

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Securitisation risky mortgage

- Took out the entire mortgage and give it to the investment bank.
- Financial sector over time accrued trillions of dollars in dangerous mortgages thus embedding risk right the way through the global financial system, as mortgage related securities were packaged, repackaged and sold to investors around the world
- Housing bubble in the US burst ‘hundreds of billions of dollars in losses in mortgages and mortgage-related securities shook markets as well as financial institutions that has significant exposures to those mortgages and had borrowed heavily against them. This happen not just in the United States but around the world.

Asleep at their posts (leaders sleeping in their jobs)

- Senior executives and major decision makers as well as the “public stewards” (regulators) ignored warnings and failed to question, understand, and manage evolving risks within a system essential to the well-being of citizens not only in the US but also in Europe and to a lesser extent the pacific region.
- Captains and stewards of the financial system exhibited a catastrophic error of judgment
- E.g you are in parliament house, you supposed to be listening to the issues and everything. However, the minister was checking stock (asleep at their posts)
- Whistle blower voiced it out but the leaders were sleeping at their job.

Credit Rating agencies

- Only for investment companies/industry
- Moody’s standard & Poor’s and Fitch, which were responsible for giving financial sector AAA or AA or A or B or BB rating
- Have existed for many decades. No longer government organisation.
  - Is best to be under government
- What’s much less well known even than the fact that the rating agencies were being paid to rate (should all services be privatized?)
  - Privatize will go around chopping rating when they receive bribery for companies.
- In the position to demand that payment is protected by the Securities and Exchange Commission regulations since 1975 very difficult for anybody to compete with them. So they were pretty much free to do whatever they wanted to
  - Regulation is no good
- What a mess they made of it all.

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- ✓ **Lesson learnt GFC**

Removal of the glass-steagall act in 1999 in the United States

- Commercial banks couldn't be investment banks
    - Consumer banks cannot be investment bank as conflict may arise.

- **Conclusion from the GFC (result from unethical leadership)**

- Enormous impact (economic & social) on many people lives (social aspects of sustainability e.g jobs ability to pay for food, shelter and generate health & well-being, retirement funds etc.
- Investment in housing- the housing bubble
- Fatal combination of increased competition and decreased regulation lead to sub-prime mortgages
- Securitisation- dispersed the bubble through the financial system
- Panice trading once bubbles began popping
- Failures of senior executive teams (bad boys of business) and corporate governance to manage risk appropriately

What is fiscal cliff?

- The term fiscal cliff refers to a combination of dramatic spending cuts and tax increases mandated to come into effect in January.
    - Reduce in budget/spending (government spending), increase tax (tax payer, the only way government make money)
- To avoid the cliff, US president barack Obama has to strike an agreement with Republicans who control the US house of representatives by the end of the year

Why?

- The budget control act of 2011 codified in law a grudging political compromise forcing the government to slash spending by $US1.2 trillion over 10 years from January 1.
- Next year's cuts, called sequestration, $US109billion
- Taxes will also rise significantly for most Americans

Lecture 7: Theories of Corporate governance

Corporate governance definitions

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- Corporate governance is the internal means by which corporations are operated and controlled

Agency theory

- The principle-agent problem occurs when one person or entity (the agent) is able to make decisions that impact, or on behalf of, another person or entity: the principal. The dilemma exists because sometimes the agent is motivated to act in his own best interests rather than those of the principal.

- the 'principal' who employs an 'agent' to act on his or her behalf. As applied to corporate governance the theory suggests a fundamental problem for absent or distant owners/shareholders who employ professional executives to act on their behalf. In line with neo-classical economics, the root assumption informing this theory is that the agent is likely to be self-interested and opportunistic. (The assumption of owner/shareholder property rights obviates any need to think about the principal's motives.) This raises the prospect that the executive, as agent, will serve their own interests rather than those of the owner principal. To counter such problems the principal will have to incur 'agency costs'; costs that arise from the necessity of creating incentives that align the interests of the executive with those of the shareholder, and costs incurred by the necessity of monitoring executive conduct to prevent the abuse of owner interests.

- Principal (shareholders); Agent (CEO/management)
    - E.g a dental patient (the principal) wondering whether his dentist (the agent) is recommending expensive treatment because it is truly necessary for the patient's dental health, or because it will generate income for the dentist. In fact the problem potentially arises in almost any context where one party is being paid by another to do something, whether in formal employment or a negotiated deal such as paying for household jobs or car repairs.
- The problem arises where the two parties have different interests and asymmetric information (the agent having more information), such that the principal cannot directly ensure that the agent is always acting in its (the principal's) best interests,[2] particularly when activities that are useful to the principal are costly to the agent, and where elements of what the agent does are costly for the principal to observe.

Agency costs: the costs generated in the principal-agent relationship

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- **Monitoring costs** (auditing, Auditor)
  incurred when the principals attempt to monitor or restrict the actions of agents. For example, the board of directors at a company acts on behalf of shareholders to monitor and restrict the activities of management to ensure behavior that maximizes shareholder value. The cost of having a board of directors is therefore, at least to some extent, considered an agency monitoring cost. Costs associated with issuing financial statements and employee stock options are also monitoring costs.
- **Bonding costs** (fixing contracts, HR)
  incurred by the agent. An agent may commit to contractual obligations that limit or restrict the agent's activity. For example, a manager may agree to stay with a company even if the company is acquired. The manager must forego other potential employment opportunities. That implicit cost would be considered an agency bonding cost.
- **Residual loss** (managers defrauding shareholders)
  the costs incurred from divergent(develop in different directions) principal and agent interests despite the use of monitoring and bonding.

Agency theory- governance mechanisms

- **External: Market for corporate control (takeovers)**
  - A bidder makes an offer to the dispersed shareholders of a target firm, and if they accept this offer, the bidder acquires control of the target firm and so can replace, or at least control management.
- **Internal: Strong, independent boards of directors**
  - The fundamental function of the board of directors is to control managerial behaviour and ensure that senior managers act in the best interests of shareholders

Agency theory and its implications for governance

- CEO and board chairman to be different persons
- Outside directors advocated
- Non-executive directors advocated
- Important role for audit and remuneration committees

Limitations of agency theory

- The theory's view of individuals as opportunistic and self –seeking may be too simplified

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- Thus recommended that the agency theory be used with other theories because the agency perspective" presents a partial view of the world that, although it is valid, also ignores a good bit of the complexity of organisations. Additional, perspectives can help to capture the greater complexity. These include the stewardship and stakeholder theories.
- While monitoring is the main function of agency theory, service and strategic roles are also advocated (supported). On the other hand, there is lack of empirical (realistic/observed) evidence on the latter two roles.

Stewardship theory *** impt

- Psychology & sociology
- Managers are good stewards (agents) of the corporations and diligently work to attain high levels of corporate profit and shareholders' returns
- Different perception of human behaviour, different corporate governance approach
- Managers should be empowered to perform to their maximum potential.
- Managers are motivated primarily by achievement and responsibility needs
- Empowering managers to exercise authority and responsibility will facilitate the maximization of organizational financial performance and shareholder value.
- Manager prerogative
    - Managers are responsible stewards of the firm working diligently to serve the interest of shareholders
- Governance structures should effectively facilitate and empower stewards rather than monitor and control them.

Google stewardship theory:

- Stewardship theory assumes that managers are stewards whose behaviors are aligned with the objectives of their principals. The theory argues and looks at a different form of motivation for managers drawn from organizational theory. Managers are viewed as loyal to the company and interested in achieving high performance. The dominant motive, which directs managers to accomplish their job, is their desire to perform excellently. Specifically, managers are conceived as being motivated by a need to achieve, to gain intrinsic satisfaction through successfully performing inherently challenging work, to exercise responsibility and authority, and thereby to gain recognition from peers and bosses. Therefore, there are non-financial motivators for managers.

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The theory also argues that an organization requires a structure that allows harmonization to be achieved most efficiently between managers and owners. In the context of firm's leadership, this situation is attained more readily if the CEO is also the chairman of the board. This leadership structure will assist them to attain superior performance to the extent that the CEO exercises complete authority over the corporation and that their role is unambiguous and unchallenged. In this situation, power and authority are concentrated in a single person. Hence, the expectations about corporate leadership will be clearer and more consistent both for subordinate managers and for other members of the corporate board. Thus, there is no room for uncertainty as to who has authority or responsibility over a particular matter. The organization will enjoy the benefits of unity of direction and of strong command and control.

- **Stewardship theory** is a theory that managers, left on their own, will indeed act as responsible stewards of the assets they control.
- This theory is an alternative view of agency theory, in which managers are assumed to act in their own self interests at the expense ofshareholders.[1] It specifies certain mechanisms which reduces agency loss including tie executive compensation, levels of benefits and also managers incentive schemes by rewarding them financially or offering shares that aligns financial interest of executives to motivate them for better performance.[2]
- In American politics, an example of the stewardship theory is where a president practices a governing style based on belief they have the duty to do whatever is necessary in national interest, unless prohibited by theConstitution

Stewardship theory and its implications for governance

- CEO and chairman to be same person
- Often prevalent in family firms
- Inside directors advocated (supported/backed/encouraged)
- Board members act as advisors to management
- Has the corporate world moved away from stewardship to agency post corporate scandal?

Limitations of Stewardship theory

- Model of man is over-simplified and unrealistic
- The stewardship model panders to the egos of senior executives
- Stewardship theory is form of casuistry (excuse/justification):
    - Donaldson et al argue for the exceptionality of senior executives

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- The needs model is unrealistic: executive behaviour has often proved to be opportunistic
- Human behaviours are not fixed or unchangeable from good servants to bad masters
- Lack of empirical (practical) evidence

Stakeholder theory (Is about everybody; NTUC/ union company)

- Management & sociology
- A perspective on CSR as well as a theory of CG
- Stakeholder theory: takes account of a wider group of constituents rather than focusing on shareholders
- A stakeholder in an organisation is any group or individual who can affect or is affected by the achievement of the organisation's objectives
- A firm should be accountable not only to shareholders, but also to employees, creditors, customers and suppliers
- Stakeholder-oriented board
    - Should encourage long-term employee ownership and encourage board representation by significant customers, suppliers, financial advisers, employees and community representatives

Google Stakeholder theory:

- Stakeholder theory challenges agency assumptions about the primacy (importance) of shareholder interests. Instead it argues that a company should be managed in the interests of all its stakeholders. These interests include not only those of the shareholder but also a range of other direct and indirect interests. The employee is obviously a key stakeholder and there have been long-running arguments amongst governance academics such as Margaret Blair that employees just as much as shareholders are 'residual risk-takers' in a firm. An employee's investment in firm-specific skills means that they too should have a voice in the governance of the firm. But stakeholder theory would also insist that other groups - suppliers and customers - have strong direct interests in company performance while local communities, the environment as well as society at large have legitimate indirect interests.

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Stakeholder theory and its implications for governance

- CEO and chairman to be different persons
- Outside directors advocated
- Large board size representative of stakeholders
- Important role for nomination committee

Limitations of stakeholder theory

- Hard to identify legitimate stakeholders
- Balancing stakeholder interests is an ill-defined notion
- If management is made to be accountable to multiple stakeholders, it may effectively end up accountable to no one
- Maximising shareholders' interests is the sole legal purpose of a firm

Transaction Cost Economics (applicable in all kind of companies) (not important)

- Decision making based on cost efficiency & care competencies (adding value to the product excellence)
- E.g im a supplier of this particular company that produce this part, when customer come to me, I did not have the care competencies at that particular part, I go outsourcing for other companies.
  - SIM provide education but not manufacturer thus they will outsource or paint, they advertise on the tender.
- Building on coase's boundary of the firm
- Firm as a governance structure
- Williamson TCE
- Make or buy decision- insource v outsource- Hierachy Vs Market
- Costs associated with either decision
- Core competencies retained?
- Transaction can be internal or external to an organisation
- Transactions occur whenever a good or service is transferred from a provider to a user
- Transaction costs depend on how the transaction is organized e.g governance structure
  - Within an organisation, costs include managing and monitoring personnel and procuring inputs
  - When buying from an external provider, costs can include source selection, contract management, and performance monitoring.

Lecture 8: Ownership structure

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Ownership structure: dispersed ownership system and concentrated ownership system.

Dispersed ownership system (e.g Microsoft)

- Characterized by strong securities markets, rigorous disclosure standards, and high market transparency, in which the market for corporate control constitutes the ultimate disciplinary mechanism (Bebchuk,1999)
- Public listed companies/firms, MNC, also government link companies.
- Limited liability, directors' indemnity (protection) (singtel annual report)
- A modern corporation is characterized by a dispersed ownership structure
- Large western corporations are characterized by dispersed owndership
- Has 'principal-agent' problem and 'free-rider' (a person who wants to ride for free) problem (stock spectacular). There should not be any innocent shareholder. Socially he must be held responsible for question he did not ask for the facts he does not know of.
- Enron, Minority shareholder, clients of Institution investors

Legal protection for Dispersed ownership

- **Common law** countries have better legal protection of shareholders
- Common law protect the minor shareholders
- Relies on independent judges and juries and legal principles supplemented by precedent-setting case law
- Because of Australia & US economy
- Common law more in practice because in the past US economy is the biggest, also the Australian where when they are born " multi-billionaire" rich in natural resources

Concentrated ownership system

- Is characterized by controlling blockholders, weak securities markets, high private benefits of control, and low disclosure and market transparency standards, with only a modest role played by the market for corporate control
- SME, family owned firm, chairman & CEO 1 person, stewardship theory
- World-wide, firms generally have more concentrated ownership(block-holders) than they do dispersed ownership
- Reduced 'principal-agent' problems as chairman & CEO are the same hence no principal agent problem
- Conflict of interest between controlling shareholders and minority shareholders
- Protection of minority shareholders is required

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- Issue: A lot of block holders and minority holders, shareholders are block holders.
    - E.g rich friend invest your company but does not care how the other run the company.
- Bank do not exercise much control over family owned firms
    - Banks do not have shareholder in dispersed structure as firms borrow money from banks. However, for concentrated family business, you have rich friend or family members to invest as a result you do not need to borrow any money from bank thus bank has no share in the company.
- Greater control over the board of directors/ weak in corp governance
- High exploitation of the interest of minor shareholder/ tunneling(minor shareholders does not know where the money goes) in related party transactions
- Pyramid ownership with absolute control & little of actual patterns of cross holding of multi-level firms
- Family owned firm lacking knowledge & skills expertise
- Conflict of interest amongst family members/ min agency cost
- High protection of block shareholders interest/ focus on longevity of firm/less impact by short term.

Legal protection for concentrated ownership

- Common law countries have less legal protection and on concentrated ownership firm
- Civil law
    - Judges often arelife-long civil servants who administer legal codes which consist of specific rules
- Consumer law, international, agriculture, animal, entertainment, negligence, business, family law

Ownership and control

- Majority shareholders can "oppress" minority invetsors
    - Related party transactions (tunneling)
    - The transfer of corporate assets for the benefit of controlling shareholders
- Cash right vs control
    - Dual class shares
    - Pyramidal structures

Pyramidal structure

- Give company assets

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- As you get public funds to open & expand new company & you gain major share of the every companies thus there is a need to control the public funds.
- Public shareholders: lost & bullied by major shareholders
- Dual share: 2 kinds of share
    - A class → 1 vote is to 1 share
    - B class → 1 vote is to 10 share (concentrated)

Family owned firms

- Family firms: companies are primarily owned and managed by members of a family
- Family-owned business can encompass sole traders, partnerships, private companies and public companies
- Large family firms are commoner in Asia and continental Europe than in the US, UK and Australia
- More family owned firms → poorer governance and less shareholder protection
- A dominant form of business around the world
- Family firms: companies primarily owned and managed by members of a family. What's if it is either owned or managed?
- Family owned business can encompass sole traders, partnerships, private companies, and public companies
- Whatever size, good governance is beneficial
- Family-owned firms usually fare better during economic downturns in Western countries (their managers are less likely to overreact to short-term problems)
- Family-owned firms often fail after their founder retires
- Family-owned companies usually have poorer corporate governance (family firms were more likely to fail during the East Asian financial crisis than more widely held companies)

During crisis

- Disperse in economic = collapse e.g Enron
- Concentrated= family business want collapse, often fail after founder died

Corporate governance

- Board of director & CEO = control & operate the company for the growth and direction with the goals of profits

Governance structure in family-owned firms

- **Small family firm**

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    - The founder and other family members run the firm-there is no separation between ownership and control, there is a shortage of capital and a "take problems home" attitude to conflict resolution-family assembly/council
    - Problem solved in family dinner
- **Medium-sized family firm**
    - More capital is needed, there is more need for professional management experience and outside advice-advisory board
- **Large family firm**
    - Significant working capital, company can raise capital from the open market, its ownership is usually spread more widely, the family may pass on the control rights-board of directors

Governance structure of family owned firms

Advantages

- Minimum agency costs
- Less monitoring of management activity
- Better protection of shareholder interests (family owned)
- Less driven by the short-term demands
- More inclined to focus on the longevity of the firm (talking about generation after generation to take over the company)

Disadvantages

- Conflict of interests among family members
- Insufficient knowledge and skills of family members
- High exploitation (misuse, abuse) of the interests of minority shareholders

Three important issues in family owned firms

1. **Pyramid ownership-** little knowledge about the actual patterns of crossholding and how they enable a family to successfully acquire or maintain near absolute control of firms. (only represent the stock owner)
2. **Nominee directors**
    - Directors representing major shareholders. Heavy concentration of stock ownership in Singapore, the practice of using nominee (or representative) directors is common.
    - Conflict of interest, as directors are required by the law to represent all shareholders
    - Nominee directors can potentially obscure the decision-making process in the boardroom because of their own agendas
3. Nominee accountants= shareholders representing other shareholders

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    - Ownership structure in Singapore and many countries difficult to capture accurately due to nominee accounts.
    - Companies for example in Singapore are not required to disclose the identity of their major shareholders, that is, direct ownership information is not reported.

Privatisation

- Most communist countries (China, Russia, Eastern Europe) had outlawed private ownership-hence they had neither public nor family firms.
- Privatisation generally occurs either by granting/selling shares to the public (IPO), to employees or to foreign firms
- The state often retains significant blocks
- Many privatized (or partially privatized) firms in formerly Marxist countries have performed poorly since privatisation

Lecture 9: Boards of directors & remuneration (roles of the board)

Roles of boards (provide entrepreneurial leadership)

- The board is responsible for determining the company's aims and the strategies, plans and policies to achieve those aims, monitoring progress in the achievement of those aims, and appointing appropriate CEO
- Combined code (2006): the board's role is to provide entrepreneurial leadership of the company within a framework of prudent and effective controls which enables risk to be assessed and managed. Directors should make decisions in an objective way and in the company's best interests

Duties of boards

To achieve these objectives, a board and its members should have:

- **Regular meeting (4-10 per year)**
    - Come together to exercise best practice
    - 4 times for quarterly reports, for 10 times, it meet monthly business, match the actual & forecast of monthly profits, they review their strategy just to ignore better

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- **Appropriate reporting procedures**
    - We advocate the important information we need, for the company to disclose to the authority
- **Separated roles of CEO & chairman (agency theory)**
- **A balance between inside and outside directors**
    - Inside: people who work inside
    - Outside: people who is outside of the company
- **Access to reliable and timely information**
- **Administrative and financial support**
- **Appropriate training (e.g SID courses)**

Board structure

2 types:

Unitary/ one-tier board

- Typically MNC& listed company
- US, UK, AUS, Singapore

Dual/ two-tier board

- Developing countries, union countries
- Germany, the Netherlands, Denmark, Taiwan, Indonesia and china

Unitary board

- Composed of both executive(inside) and non-executive(outside) directors
- Main responsibilities of directors are selection of a CEO and the overseeing of that CEO and other senior managers of the corporation on a day-to-day basis
- Corporate governance codes usually require a strong presence of independent (outside) directors on a unitary board

Dual board

- A day-to-day operation management board composed entirely of executives
- A monitoring supervisory board composed mainly of non-executive board members

Advantages

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- The complete separation of the managing role and monitoring role; more clearly defined directors' responsibilities in each board; faster decision-making; separated roles of CEO and chairman

Disadvantages

- The upper-tier directors may lose touch with the company, while the lower-tier directors become distanced from outsiders; power imbalance between two boards

Similarities between one and two-tier board structures

1. Both boards will usually appoint the top managers of the company
2. Regardless of one-tier or two-tier, all board directors usually have responsibility for ensuring that financial reporting and control systems are functioning properly and for ensuring that the corporation complies with the law
3. Both unitary board and supervisory board are usually elected by shareholders (typical normal behaviour)

~Board composition and independence components of directors s12-27

Role, duties and responsibilities of board of directors

- **Agency theory**
  - The key function of the board of directors is to serve as a monitoring mechanism, to keep self-serving managers in check and result in increased value for shareholders
- **Stewardship theory**
  - Managers will not engage in self-serving behaviour, but will rather act in the best interests of their shareholders. Directors' role is to empower the managers
- **Stakeholder theory**
  - Mangers should make decisions that take account of the interests of all stakeholders in a firm, because a firm's long-term value maximization can only be realized if stakeholders 'interests are met. Directors' role is to ensure that besides shareholders, other stakeholders' interests are taken into consideration for any decision making (to empower the manager)

CEO/chairman role duality

- Role duality refers to those CEOs who also act concurrently as the chairman of the board of directors for that company.

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- Advantages
    - CEO/Chairman is able to operate free from delay or restraint
- Disadvantages
    - The separation of the decision-management and decision-control roles disappears
    - CEO is more powerful and the firm likely to have more serious agency problem
    - Chairman's mentoring and consulting roles are surrendered
- A separation between the CEO and chairman has been widely recommended (e.g compare with judges and lawyer)
- The role of chair of the board is different from that of chief executive officer and it follows that one person cannot fulfil both roles without conflict. Therefore, the CEO runs the company with the chair ensuring that the board effectively judges management's performance

Types of directors

Executive directors

- Works in company and get salary
- Whatever decision makes benefit the company
- A director who is a full-time employee of the listed company
- Roles and duties of Executive director:
    - involve in the day-to-day operation and decision-making process
    - evaluate the performance of the firm's management team and the CEO
- strength and weakness
    - strong industry and business knowledge and participation in the decision-making process
    - Lack of independence

Non-executive directors

- Do not get salary and do not work in company
- A director who is not a full-time employee of the company, but who maintains some form of personal or professional relationship with the firm (former executive, creditor, family connection
- Strength and weakness of non-executive
    - Control or counterweight to executive directors
    - Contribute to the overall leadership and development of the company
    - Not truly independent

Independent non-executive directors

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- Independent and no relationship with the company
- They are auditor's lawyers (legal expertise), multi-media or HR from a specific expertise that is relevant to company
- Independence: There are no relationships or circumstances which could affect the director's judgment.
- Independent director: Plays the most important role in a board, aims to provide a means to monitor management activities, to reduce managers' opportunistic behaviour and result in a better firm financial performance
    - Independent directors (ID) will promotre IT (independent & transparency information) of the company
- But lack in-depth knowledge of company operations; may be busy with multiple directorships; may not be truly independent

Board sub-committees

- Manage & control through meeting from 4 to 10 times
    - How it can be done
    - Is it effective
    - Therefore it is done through the 4 committees

Audit committee (agency theory)

- The most important sub-committee
- A separate audit committee enables a board to delegate to a sub-committee a thorough and detailed review of audit matters, it enables the non-executive directors to contribute an independent judgment and play a positive role in an area for which they are particularly fitted, and it offers the auditors a direct link with the non-executive directors'
- Roles of auditors committee: oversight, assessment and review
- Independence is recommended
- Risk is also sometimes recommended as a particular responsibility of the audit committee

Remuneration committee (agency theory)

- The remuneration committee is to determine the remuneration of the company's executives including the CEO
- To provide performance-related incentive schemes etc
- To revise the remuneration package of each individual director in accordance with his/her performance
- Independence is recommended

Nomination committee (stakeholder theory)

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- The nomination committee needs to nominate and select the right candidate to fill board vacancies, as well as to evaluate an individual director's performance, to review the overall board structure and to make recommendations
- Ensure the balance of skills, knowledge, and experience on the board
    - Develop list of nominees for consideration of shareholders
- Independence is recommended

Corporate governance committee

- Less common but gaining more importance
- In some companies, the governance committee is responsible for strategy: corporate vision, mission, values and relationship with stakeholders
- In others the committee is more focused on legal compliance

Remuneration

Remuneration	Advantage`	Disadvantage
Base salary A guaranteed cash, fixed cash amount paid to an executive The amount will be set with due regard to the size of the company, the industry sector, the experience of the individual director, and the level of base salary in similar companies	Guaranteed sum of money	Is not related either to the performance of the company nor to the performance of the individual director
Bonuses Money or an equivalent given in addition to an executive's usual salary The criteria for earning bonus generally include achieving the corporate performance and goals: -profits and earning per share Revenue growth -ROA,ROE,ROI -strategic measures such as market share	Often related to one's performance	one's performance very often is uncontrollable, short-term orientation, take unnecessary risks because they receive quarterly bonus, they work hard for that short period, in order to get quarterly year bonus.
Stock Option Grants an executive the	A simple means of linking remuneration to	**Limitations:** Performance-based

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right to purchase a specificd number of shares of the firm's stock at a stipulated price for the term of the option Boards often confer stock options as a lump-sum, front-end grant when a key person is hired or promoted	performance	exercising, stipulated holding period, and the fluctuation of the stock price. Management work towards their own benefit
Restricted share plans (stock grants) Shares are awarded with limits on their transferability for a set time	Stock grants require no payments to the company. Broader criteria used rather than share price No cash bleeding from the company, does not encourage speculation	Shares are taxable as income at the time of vesting
Pension Commonly known as retirement funds: use as long-term incentive for executives and directors	Encourages long term employment within company	Important to suit one's needs
Other benefits Other fringe benefits: executives and directors may receive other benefits such as paid school fees, company cars, health plans, insurance, accommodation etc. (profit sharing) Stock ownership: retirement-savings contributions can be used as a long-term incentive for executives and directors Superannuation: retirement-savings contributions can be		

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used as a long-term incentive for executives and directors		

Performance

Performance criteria:

- Market-based measures
- Accounting-based measures (financial)
- Individual measures

Problems associated with current executive remuneration

- Tendency to focus on performance only over short periods of time (window dressing)
- Remuneration often does not correlate to actual firm performance
- Financial metrics are sometimes manipulated by executives
  - The inflate sales of the month and they could end up in bad situation

Remuneration considerations

- The value of the CEO to the company
- The firm's capacity to compensate the CEO (its size and profitability)
  - When they are profitable then they can compensate (capacity)
- Firm financial performance over some time period
- Relative performance of the company compared to the industry
- Achievement of non-financial goals, especially strategic ones
- External parity with other comparable companies' CEO remuneration package
- Internal parity with the rest of the management team

Lecture 10: Institutional Investors & codes of governance

Role of Institutional Investors in corporate governance

- Institutional investors are organizations which pool large sums of money and invest those sums in securities, real property and other **investment** assets.

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- Institutional investors are generally the large investors. They comprise mainly pension funds, insurance companies, bank/unit trusts, foundations, overseas (like sovereign wealth fund) and others (like hedge funds, private equity)
    - Pension funds the largest collection of investment capital in the world (Singapore: CPF,teachers's fund. Private equity)
    - Insurance companies: have business relationship with the companies in which they invest (great eastern life)
    - Bank/ unit trusts: as trustees for everyone from pension plans to private estates (lehman brothers-related unit trusts) (the public trust the funds)
    - Universities and foundations: they are funded through endowments (NUS endowment fund

Institutional investors

Advantages

- Well resource (huge & big)
- Access to industry experts
- Good proxies for the public interest

Disadvantages

- Free-rider problem? Others depend on institutional investors and vice versa
- Are the trustees genuinely accountable? (are they doing their job? Are they selling because it is good or because of commission) The legal responsibility of trustees is to maximize returns for shareholders, not to pursue other agendas (like maximizing one's commission and pay)

Institutional ownership

- Exit and voice framework
- To use their influence as owners to ensure that the companies in which they have invested comply with the codes
- Should use their power and influence to ensure the implementation of best practice as set out in the code
- A discussion of the role of shareholders in corporate governance will mainly concern the institutions
    - Emphasize corporate governance
- Companies should seek an honest, open and ongoing dialogue with shareholders
    - Advocate independent and transparency

Engagement & activism tools of corporate governance

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Institutional engagement

- Solutions to free rider & blockholding
- Therefore the importance of these 3 roles
- More to U.S countries

Combines codes:

Dialogue with companies (wants to have a voice):

- Institutional shareholders should enter into a dialogue with companies based on the mutual understanding of objectives

Shareholder voting (to be fair in their voting system):

- Institutional shareholders have a responsibility to make considered use of their votes

Evaluation of governance disclosure (evaluate corporate governance):

- When evaluating companies' governance arrangements, particularly those relating to board structure and composition, institutional investors should give due weight to all relevant factors drawn to their attention.

Tools of corporate governance

One-to one meetings (one party to one party not meetings	• Meetings between institutional investors and companies • Companies sometimes arrange such meetings with large investors (e.g institutional investors) • In one-to-one meetings, frequently discussed issues are firm strategy, performance, operational plans etc • Purpose of the meetings: institutional investors fully understand the firm's business and strategy, so that the value of the business is fully recognized • Institutional investors may in turn use such meetings to investigate company governance practices (evaluate CG)
Voting	• Voting: the right to vote (attached to voting shares) (rightful & justified) • Make positive use of their voting rights and disclose their policies on voting • Voting is the fundamental element of control by shareholders • Methods to vote: in person, by post or through a proxy • On the other hand, voice limited if you are a minority shareholder • Voting tends to be blunt. One can only vote on the resolutions in the agenda • Barriers in voting: communication problems (language)(a Chinese investing in an Indian company), overseas

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	voting(form, arrangement of proxies, timing problems and language difficulties), institutional reticence, box-ticking mentality • Should voting be voluntary or mandatory (compulsory)? It should be mandatory because shareholder should have voting right if do not have and is not mandatory what is the point of being shareholder.
Shareholder proposals (options)/resolutions (changes)	• Generally on social, environmental, ethical and executive remuneration issues • Voice in changing the company • May not have necessary support from management/other shareholders. E.g in UK, any resolution request (usually at shareholders' expense) needs. ○ Members having at least 5% of voting power or ○ 100 or more shareholders with paid-up capital (investment) averaging at least 100 pounds each
Focus list (critical & serious) When the company is not doing well	• Institutional investors select a group of underperforming companies and include them on a list of companies • Criteria to be used: o Firms' financial performance o Responses to institutional investors' enquires o Incorporation of institutional investors' suggestions • Consequences: companies may receive unwanted attention, possible changes to be occurred
Corporate governance rating systems	• A powerful indicator that shows a company or a country's current corporate governance standards (e.g transparency international) • Two professional rating systems: Deminor (Belgium) and standard and poor's (S&P) • Useful to governments and firms management in understanding their corporate governance level compared to other countries or companies • Good corporate governance is generally perceived as more attractive than without

Corporate governance codes (code for the board)

The growth in corporate governance codes

- Rapid development of corporate governance codes over the last 15 years
- Establish a more transparent and accountable system, enhance investors confidence
- Corporate governance codes: voluntary disclosure basis vs comply or explain basis

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- Codes are not laws/regulations

Characteristics of CG codes

- Generally similar across countries/regions
- Emphasis on two areas: independence and transparency (IT)

More on independence

- Structural characteristic: e.g independent of management or independent of major shareholders
- But the psychological characteristic is more important, e.g board must be willing to question the decisions of managers

More on transparency

- Level of disclosure in financial results and info released by companies. Comprises content, usefulness, timeliness and means of dissemination(distribution) of information.
- Transparency tends to be subjective at times
- There is a cost for transparency- the need to compile, the setting up of investor relations department (solution)
    - Shareholders have no say except voting say.

COMPLY OR EXPLAIN

• Either you comply that CEO and chairman to be 2 different people OR Explain that why you did not agree and wants steward ship theory whereby both CEO & Chairman is 1 person

• In Business world there is no rules, regulations or law you either COMPLY your board of directors if not explain your stand.

• If they do not buy your explanation they sell the shares of company

BLACK LETTER LAW

• Letter written in black colour ink

• Similar to common law whereby it is out of precedence or success of past

• Patent, Trademark (Company financial act)

Why institutional investors are important in CG?

An institutional investor can have some influence in the management of corporations because it will be entitled to exercise the voting rights in a company. Thus, it can actively engage in corporate governance. Furthermore, because institutional investors have the freedom to buy

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and sell shares, they can play a large part in which companies stay solvent, and which go under. Influencing the conduct of listed companies, and providing them with capital are all part of the job of investment management.

Why corporate governance is important?

- framework to achieve organization goals
- system for rules, practice and process
- so that company has the direction and is in control
- balanced and protects interests of shareholders
- Protect financial position
- Delegating who is responsible for what

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