Unit 3 & Chapter 14

Investments, Stockholders Rights,Corporate Governance and the Role of Government in Corporate Governance

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Stockholders

Stockholders (or shareholders, as they also are called) are the legal owners of business corporations.

Individual stockholders are people who directly own shares of stock issued by companies.

Institutions such as pensions, mutual funds, insurance companies, and university endowments, also own stock.

(Figure 14.3)

Types of Investments

Ownership Investment

Stocks
Businesses
Real Estate
Precious Objects & Collectibles

Lending Investments

Personal Savings Account
Bonds

Types of Investments

Cash Equivalent

Money Market Funds

Socially Responsible Investments /
Sustainable Investing

Environment, Social & Governance
Green Finance
Impact Investments
Principles of Responsible Investment
Integrated Reporting

Corporate Governance

Refers to the process by which a company is controlled, or governed.

The board of directors is an elected group of individuals who have a legal duty to establish corporate objectives, develop broad policies, and select top-level personnel to carry out these objectives and policies.

Principles of Good Governance

- Select outside directors to fill most positions.
- Hold open elections for members of the board.
- Appoint an independent lead director (also called a non-executive chairman of the board).
- Align director compensation with corporate performance.
- Evaluate the board's own performance on a regular basis.

Executive Compensation

Can be excessive.

Under U.S. government rules, companies must clearly disclose what their five top executives are paid, and lay out a rationale for their compensation.

Companies must also report the value of various perks, from the personal use of corporate aircraft to free tickets to sporting events.

Socially Responsible Investing

Growth in Socially Responsible Investing has been driven, in part, <u>by government rules requiring pension funds</u> to disclose the extent to which they use social, environmental, or ethical criteria in selecting investments.

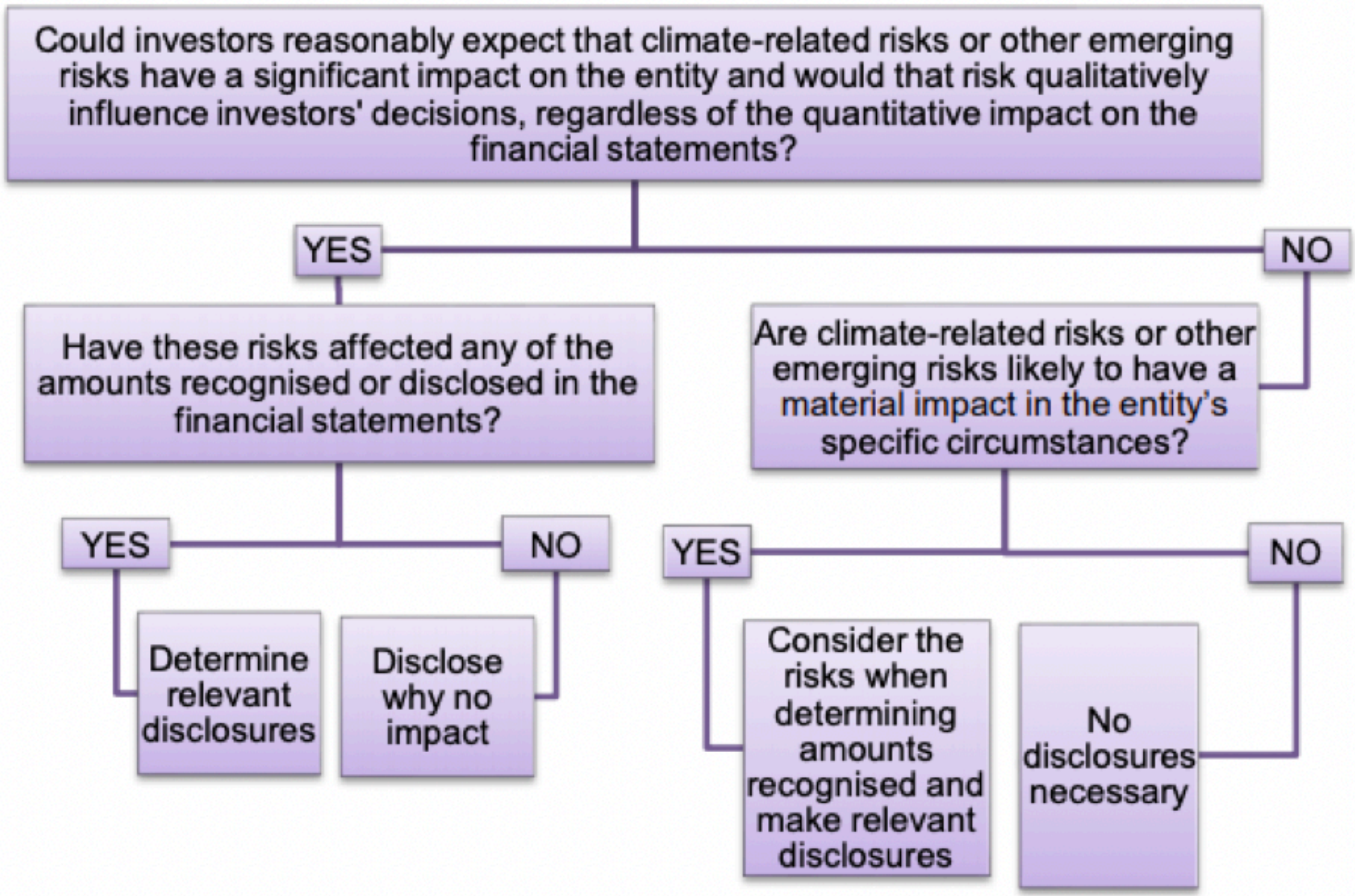
Most evidence shows that socially screened portfolios provide returns that are competitive with the broad market.

Socially Responsible Accounting

International Accounting Bodies argue that climate-related risks and other emerging risks are currently discussed separately from companies' financial statements, if at all.

This must change as physical climate impacts and investor expectations make such risks 'material', therefore warranting disclosures when preparing financial statements.

Considerations in Assessing Materiality



Socially Responsible Accounting

<u>Auditors of the financial statements should consider:</u>

Climate-related risk and other emerging risks as part of their risk assessment. If there is an assessed risk of material misstatement in the financial statements, the auditor should respond appropriately to the risks of material misstatement.

Whether climate-related risk and other emerging risks are relevant for accounting estimates including assumptions used to arrive at a fair value estimate and potential impairment.

Government Protection of Stockholder Interests

The major government agency protecting stockholders’ interests is the Securities and Exchange Commission (SEC).

Giving stockholders more and better company information is one of the best ways to safeguard their interests, and this is a primary mission of the SEC.

Insider Trading

Occurs when a person gains access to confidential information about a company’s financial condition and then uses that information, before it becomes public knowledge, to buy or sell the company’s stock.

Insider trading is illegal under the Securities and Exchange Act of 1934.

Stockholders

By providing capital, monitoring corporate performance, assuring the effective operation of stock markets, and bringing new issues to the attention of management, stockholders play a very important role in <u>making the business system work</u> and in the way that corporate leaders <u>manage stockholders and other stakeholders such as employees, government and others</u>.

Self-Regulation Advantages

1. <u>Proximity</u>. Being closer to the action, self-regulators are better situated to identify potential problems more quickly.

2. <u>Flexibility</u>. Governmental regulators do not relish dealing with politically unpopular or extremely complex issues, so these issues can be delegated to self-regulatory bodies - ex. NYSE).

3. <u>Resources</u>. Self-regulatory bodies may have a better ability to secure needed resources.

Self-Regulation Disadvantages

1. Conflicts of Interests. Knowing an industry better does not mean that a self-regulator will have the proper incentives to regulate it more effectively.

2. Inadequate Sanctions. The greater flexibility afforded self-regulatory organizations also means they may have the discretion to measure out only modest sanctions against serious violators.

Self-Regulation Disadvantages

3. Under-enforcement. Self-regulators' conflicts of interest and flexibility may also make it more likely that compliance with rules will be insufficiently monitored.

The Role of Government in Corporate Governance I

The crisis of confidence in America's capital markets, sparked by the corporate scandals of the past several years, has generated widespread debate over proposals for regulatory changes.

Government regulation versus self-regulation, principles versus rules, or criminal versus civil penalties—the choices government faces are not simple or based upon 2 choices.

The Role of Government in Corporate Governance II

Government has many roles such as <u>policymaker, enforcer, and overseer</u>—in different situations, including the role of the <u>analyst</u>, seeking to identify the conditions under which to deploy different configurations of regulatory institutions, standards, and enforcement practices.

The Role of Government in Corporate Governance III

Government decision makers will need to understand thoroughly the effects that <u>different regulatory actions</u> can have in terms of a <u>range of policy criteria</u>.

Must conduct <u>careful evaluation</u> of <u>structural changes</u> in self-regulatory organizations.

The Role of Government in Corporate Governance IV

Government needs to understand better what makes <u>different degrees of specificity and generality</u> “right” for particular types of regulatory problems.

The government should also assess whether certain <u>hybrid (a mixture of 2 things)</u> systems can overcome some of the limitations of rules or principles alone.

The Role of Government in Corporate Governance V

On the issue of enforcement, state and federal officials should analyze why some individuals and organizations <u>adhere responsibly to regulatory standards</u>—and why others <u>do not</u>.

Such analysis would help enhance government's ability to pursue <u>optimal enforcement</u>, instead of under or over enforcement.