Corporate Governance
Sub-categories: Principles and issues in corporate governance (including governance role of the company secretary)

Question

A UK listed company has a reputation for confrontation with its employees and frequent industrial action. The board of directors has justified its aggressive attitude to employees by arguing for the need to improve operational efficiency and cut labour costs in order to maintain profitability. The frequent industrial action causes great inconvenience to the general public.

Conscious of the company’s poor reputation, the board of directors set up a working party to consider ways of improving relationships between the board and the company’s shareholders, employees, customers and the public in general.

A suggestion made by the working party to the board in a report to the board was that the board should develop and issue a code of corporate ethics. The working party has also suggested that financial reports and other statements published by the company should be improved, and need to be more ‘transparent’. Finally, the working party suggested that to promote and establish a code of ethics, the company secretary should be required to act as the ‘conscience of the company’, and should report regularly to the board on ethical issues, as a matter of good governance practice.

Required:

(a) Explain the meaning of transparency in reporting and suggest how the application of this principle may contribute to better corporate governance. (5 marks)

(b) Suggest how a code of ethics might help to improve the governance and financial performance of the company. (8 marks)
(c) Explain how the company secretary contributes to better practice in corporate governance, including the company secretary’s role as conscience of the company.

(12 marks)

(Total marks 25)
Answer

A feature of this question is that each part of the question asks for a number of ‘facts’: about transparency, a code of ethics and the role of the company secretary, but also asks for an explanation of how each of these contributes to good corporate governance.

Part (b) goes a bit further, and also asks how (if at all) a code of ethics may affect financial performance.

The best-prepared students for the corporate governance exam are those who have thought about the relevance of each ‘topic’ in the syllabus to good corporate governance, and what difference they could make to company performance.

Part (a)

To get a reasonable mark for this question, it is necessary to define transparency reasonably well. Do not confuse transparency with 'understandability' (being easy to understand). They are not the same thing.

Try to make a sufficient number of points in your answer – enough to justify 5 marks.

The answer may cover the following points.

(1) Transparency is a core principle of good corporate governance.

(2) Transparency means openness (and honesty in communication). In the context of corporate governance transparency exists when the company is clear and open about what it is trying to achieve, and what it has done (successfully or otherwise).

(3) Transparency should apply to communications with all stakeholders, not just shareholders.

(4) Transparency should create trust in the company by stakeholders. Good relations should be encouraged when stakeholders believe what they are told by the company, and can understand what the company is trying to achieve.

(5) Transparency should therefore improve the accountability of the board of directors to the shareholders, which should be a key requirement of good corporate governance.

Other points of a similar nature would also be acceptable.

Text reference for Part (a): Chapter 1 paragraph 6.
**Part (b)**

A brief explanation of the possible content of code of corporate ethics would be a useful start to the answer, but this explanation should be fairly brief. It sets the answer into context, but explaining what a code of ethics is does not provide a direct answer to the question in part b.

1. A corporate code of ethics is a formal document, published by the board of directors, setting out the standards of ethical behaviour that the company expects its employees to comply with (including the directors themselves). The code may be disclosed to other stakeholders, and action should be taken against employees who breach requirements of the code.

2. It has been suggested that there are three reasons why a company may introduce a code of ethics, and that these may be progressive, with companies moving from one reason for having a code, to the next and finally to the third.

3. The initial reason for having a code of ethics may be to establish clear standards of behaviour for employees to follow, and to maintain or improve standards of customer service. Compliance with certain ethical standards is necessary for legal and commercial reasons (Ethical standards of customer service will also help the company to avoid a poor reputation amongst customers.)

4. The second reason is that a code of ethics, if applied, can help a company to improve its relations with stakeholders. For example, ethical dealing with employees and their representatives may help to improve the quality of industrial relations within the company. Ethical behaviour may also improve relations with shareholders and other investors, who have their own policies of socially responsible investment (SRI).

5. The third reason is that a code of ethics can help a company to establish a value-based organisation, in which its leaders and employees seek to create value for all stakeholders – customers, shareholders, employees and so on. It might be expected that when a company’s employees seek to add value, the company will eventually benefit commercially.

6. However, a connection between ethical behaviour (and a code of ethics) and commercial and financial success has not been established. Ethical behaviour may possibly contribute to commercial success, but this has yet to be proved.

7. It could be argued that if employees are motivated to act ethically, they are less likely to commit fraud and more likely to ‘blow the whistle’ on unethical or improper behaviour by others in the organisation. This argument is also difficult to prove.

**Text reference for Part (b):** Chapter 1 paragraph 8.
Part (c)

This part of the answer should be fairly straightforward, but a reasonably clear explanation of 'conscience of the company' is required.

In addition, the question asks about the role of the company secretary in all aspects of corporate governance, not just compliance.

Because the question is quite straightforward, answers should prove a large number of points to earn a good mark. However, each point should be sufficiently complete. Answers that present very brief bullet point-style answers will not get a good mark.

Points that could be made in an answer are as follows. These are listed briefly.

1. Help the chairman to prepare and maintain a list of matters reserved for decision-making by the board. When the list is established, the company secretary acts as a monitor to check that the board does exercise its decision-making powers over these matters and does not delegate any of them.

2. Help the chairman to ensure that the board committees are properly constituted and are given clear terms of reference.

3. Help the chairman to set the agenda for board meetings, and should ensure that relevant information is sent out to all directors before meetings, giving the directors sufficient time to read and study it before the meeting is held.

4. Help the chairman by providing advice and assistance on matters relating to succession planning for the board.

5. The company secretary will usually be responsible for arranging directors’ and officers’ liability insurance.

6. Contribute to the flow of information between the board and its committees, for example by circulating minutes of committee meetings to other board members.

7. Act as a source of information and advice for all directors on corporate governance matters.

8. Arrange for directors to obtain independent professional advice at the company’s expense, where this is requested and appropriate.


10. Assist the chairman by helping to provide continuing professional development opportunities for individual directors, as appropriate.
(11) Provide advice and assistance for the chairman for the annual performance review of the board and its directors.

(12) Ensure that the remuneration committee is fully aware of the provisions in the UK Corporate Governance Code about directors’ and senior executives’ remuneration.

(13) Ensure that the audit committee is fully aware of the provisions in the UK Corporate Governance Code about its responsibilities.

(14) The company secretary may act as secretary to all the main board committees.

(15) Assist the chairman of the board and committee chairmen to prepare their annual statements on governance issues for the annual report and accounts.

(16) The company secretary should have responsibility for ensuring that the company complies with the requirements of the UK Corporate Governance Code, or that the board is aware of non-compliance.

(17) Ensure compliance with all other regulatory requirements relating to governance issues, and report any non-compliance to the board.

(18) Keep all developments in regulations and codes under review, and inform the board when these occur.

(19) May be the person to whom whistleblowers should go in the first instance, when they have a matter to report in confidence.

(20) The role of the company secretary as ‘conscience of the company’ refers to the responsibility of the company secretary to remind directors and others of the need to comply with best practice in corporate governance, and to speak to them when they fail to do so. The company secretary should speak out clearly against bad governance practice and unethical practice in the company.

(21) In doing this the company secretary acts as a conscience for others, reminding them about how they should act and behave. This calls for an independent character.

Text reference for Part (c): Chapter 3 paragraph 6.