Importance of Corporate Governance in a Recessed Economy

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May 2017

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The importance of corporate governance in a recession is a key topic for Boards, CEOs and senior management who have a role to create shareholder value irrespective of the economic conditions

- Managing companies and corporations for shareholder value remain a key responsibility for the custodians of the corporation
- This fiduciary responsibility may become more challenging to fulfil during recessions
- In this opening remarks prior to the roundtable discussions, I would attempt to provide some context on:

❑ the linkages between corporate governance and economic recessions

❑ why some of our popular texts and regulations on corporate governance have been developed in a recession

❑ the dynamics between the board of directors and management during different phases of a business cycle

Before we explore the link between corporate governance and the recession, we need to answer the question: 'What is corporate governance?'

"Corporate governance is concerned with holding 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."

Sir Adrian Cadbury

Corporate Governance Overview, 1999

World Bank Report

Corporate governance refers to the structures and processes for the direction and control of companies. Good corporate governance contributes to sustainable economic development by enhancing the performance of companies and increasing their access to outside sources of capital…

Corporate Governance Unit, IFC

Corporate governance provides the structure through which the objectives of companies are set, and the means of attaining those objectives and monitoring performance are determined

Risk Management Group

of the Basel Committee on Banking Supervision

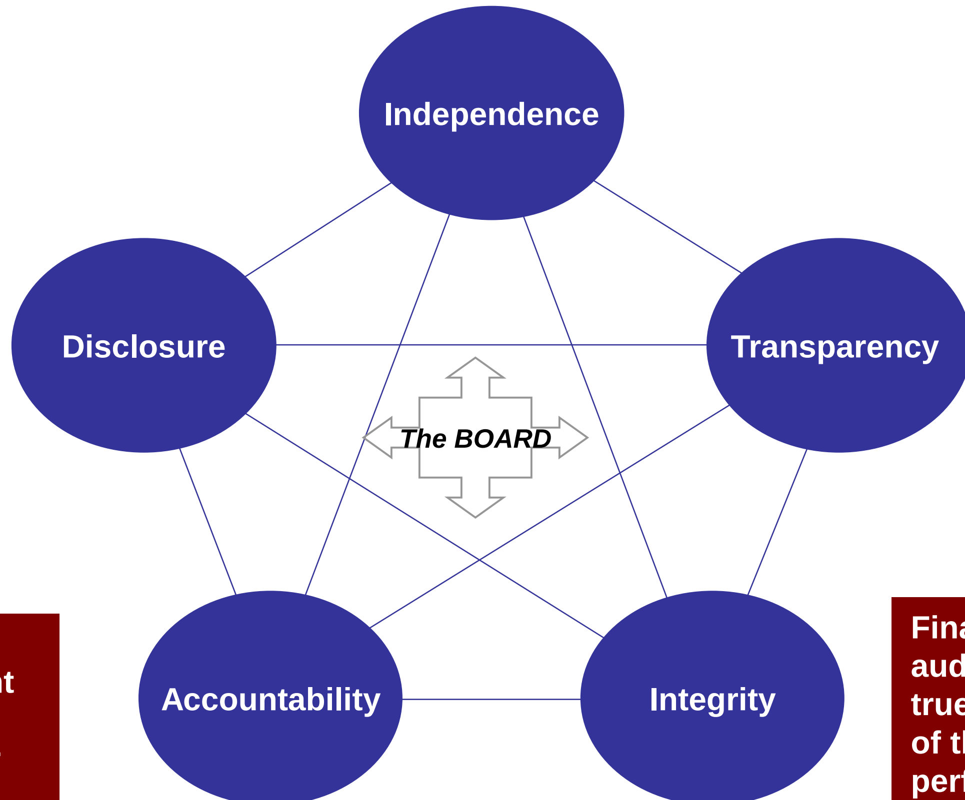
Good corporate governance focuses on protecting the interests of the owners of the company, improving the company’s control environment as well as improving financial and non-financial transparency and disclosure

What Corporate Governance is	What Corporate Governance is not
It is about oversight	***It is not about operations***
• It is focused on shaping strategy for the organisation	• It is not about day to day operations of the organisation
• It focuses on how the outcomes of operational efficiency affects the organisation’s positioning	• It is not about the implementation of structures aimed at achieving operational efficiency in the organisation
• It seeks to improve transparency and the organisation’s reputation via checks, balances and controls	
It is about effective control of power within an organisation	***It is not just about delegation of responsibilities in the organisation***
• It is aimed at shaping the relationship between the owners and the managers of the business to ensure superior and sustainable shareholder value creation	• It looks beyond the objective of revenue generation for the organisation
• It is focused on oversight of the operations of the senior management in the organisation	• It is less focused on the operational activities in the organisation

In a recession, the performance aspects of corporate governance may be subject to more scrutiny:

Clear separation of the management and oversight of the organisation

Appropriate disclosure of director and other insider-related interests



Transparency in operations and relationships with investors, regulators and other stakeholders

Directors effectively perform their oversight functions and take full responsibility for their roles and decisions

Financial reporting and audit function reflects a true and balanced view of the state and performance of the enterprise

Fig 1

Most boards and corporations would need to manage through the four phases of the business cycle, in addition to managing peaks, troughs and steady states

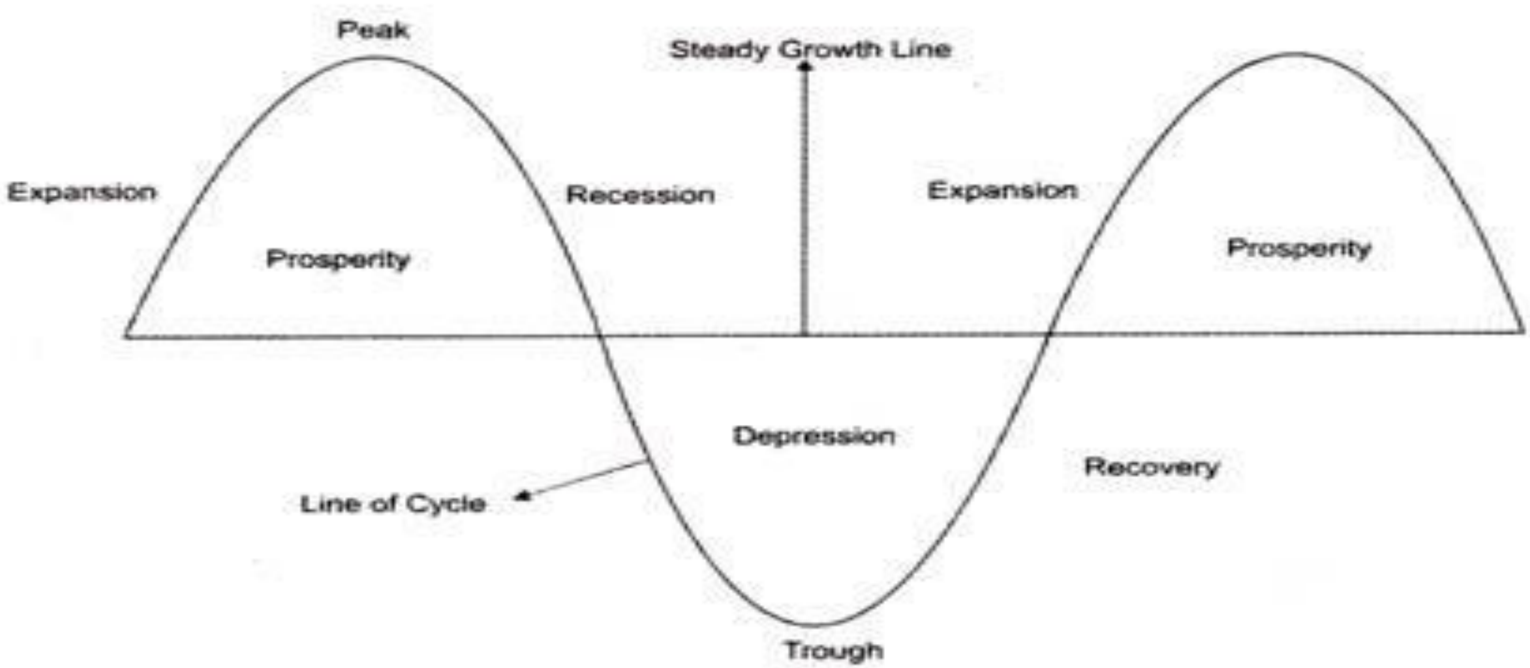


Figure-2: Representation of Phases of a Business Cycle

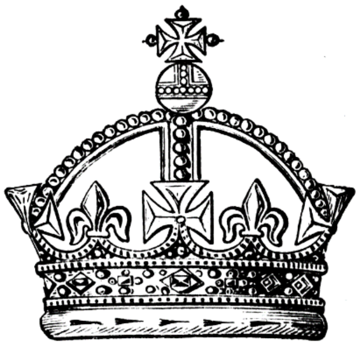
Source: http://www.economicsdiscussion.net/business-cycles/4121

The expectations from the Board and of other stakeholders are not diminished even in a recession

Board qualifications, capabilities or responsibilities	• Board members must be qualified for their roles • Board members should fully comprehend the extent of their responsibilities
Board's role regarding the organisation's strategic objectives	• The board should approve and oversee the implementation of the organisation's strategic objectives • The board should be on the watch for practices that could undermine the integrity of its oversight functions
Lines of responsibility and accountability	• The board should set and enforce clear lines of responsibility and accountability across the organisation
Ensuring efficacy of oversight by senior management	• The board should ensure that the operations and activities of the organisation's senior management is in line with the organisation's objectives, and within the framework of existing controls
Auditors and internal control functions	• The outcomes of internal and external audit reports as well as internal control reports should be properly reviewed and used to correct internal control and operational breaches as they occur
Board & key executive compensation	• The board should ensure that compensation policies are consistent with the corporate culture, long term objectives and control environment • Identify and mitigate compensation policies that encourage excessive risk taking
Transparent governance	• The board should ensure that all necessary disclosure are made to the shareholders as well as necessary regulatory bodies as they occur

Source: *Basel Committee Guidance in Corporate Governance for Banks, Eurasian Corporate Governance Roundtable Task Force on Corporate Governance of Banks in Eurasia*

How much value the Board and the CEO/ Management create during a recession is a function not only of the competitive position of that company, but also of the type of Board…..whether ceremonial or progressive

"CEREMONIAL"	***"LIBERATED"***	***"PROGRESSIVE"***
		
Ratifying chamber for the CEO initiatives Not engaged in the business	Liberated after implementation of corporate governance codes Focused on compliance and routine operational issues	Balances focus on strategic, value-added issues central to the business and compliance issues

Source: Ram Charan – Boards that Deliver

Conclusion

- Implementing the right corporate governance structures is important in every business cycle, whether during a boom or a recession
- Recessions are an acid test for the quality of corporate governance in an organisation, and an indication of the practices at the Board and management
- The role of the Board as the ultimate emblem of corporate governance is to be prepared to act, to win, and to create shareholder value irrespective of the stage of the economic cycle

Open Forum