CORPORATE GOVERNANCE A GLOBAL PERSPECTIVE

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ABSTRACT

Corporate Governance codes have proliferated in the last 13 years since the Cadbury Code of Best Practice [1] came into effect in the United Kingdom. In the past 3 years alone, new codes have emerged in every G-7 country [2] as well as in places as diverse as Brazil, The Netherlands, India, Malta, Russia, Belgium, Sweden, and Turkey. Today, more than 50 countries have their own.

Governance codes emanate from securities commissions, stock exchanges, investors and investor associations, and supranational organizations. The Cadbury Code, for instance, made 19 recommendations addressing the structure, independence, and responsibilities of boards, effective internal financial controls, and the remuneration of directors and executives. Since companies are not required by law to comply with codes of practice, there is clearly a risk they wouldn't work. The evidence, however, suggests that they do. Even in countries where progress has been slower, the codes' existence has at the very least put corporate governance into the public domain and made managers and directors more aware of what is expected of them.

Why a code?

The Pioneering Cadbury Code was a response to a series of scandals and corporate failures among UK listed companies in the early 1990s. It aimed to help prevent similar scandals and to rebuild the trust of the public and investors by prodding companies to improve their governance practices. The codes that have followed in its wake around the world embodied similar goals. In emerging markets, which typically provide for much less transparency about what companies do, the stakes are even higher: policy makers there fear that scandals might trigger the indiscriminate selling of stocks and a systematic crisis.

We will notice that governance codes vary in scope and detail. However, almost all of these codes tackle four fundamental issues: *fairness* to all shareholders, whose rights must be upheld; clear *accountability* by the board and management; *transparency*, or accurate and timely financial and non-financial reporting; and *responsibility* for the interests of minority shareholders and other stakeholders and for abiding by the letter and spirit of the law. Policy makers around the world increasingly agree that codes embodying these principles not only protect investors against fraud and poor stewardship but also may help reduce the corporate sector's cost of capital.

Our analysis considered five different variables: independent directors, separation of duties between CEO and chair of the board, audit committees and the attestation to financial information (Exhibit I)

[1] See www.ecgi.org/Country-documents/UK/Cadbury.pdf for the Cadbury Committee's full report.
[2] Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States.

Codes of Governance: A Comparison Analysis

Audit Committees

Country	Are majority of Boards independent directors?	Separation of duties between Chair of the Board and the CEO	Composition: Majority are independent directors	Number of Members	Does the Board have a compensation/ remuneration committee?	Attestation to the accuracy of financial reporting
Australia	Yes	Yes	Yes	At least 3 members	Yes	Yes (CEO/CFO)
Belgium	Not required	Yes	Yes	No requirements	Yes	Not required
Brazil	Yes	Yes	Yes	No requirements	Yes	Not required
China	Not required	Yes	Yes	No requirements	Yes	Not required
France	At least one half of the board	Not required	Yes	At least 3 members	Yes	Not required
*Germany	Not required	Yes	Not required	No requirements	Yes	Not required
India	Not required	Not required	Yes	At least 3 members	Yes	Not required
Italy	Not required	Not required	Yes	At least 3 members	Yes	Not required
Japan	Not required	Not required	Yes	At least 3 members	Yes	Not required
Malta	Not required	Not required	Not required	No requirement	Yes	Not required
The Netherlands	Yes	Yes	Yes	No requirement	Yes	Not required
Russia	Not required	Yes	Yes	At least 3 members	Yes	Yes (CEO/CFO)
Sweden	Yes	Yes	Yes	At least 3 members	Part of the nomination committee	All the board
Turkey	Not required	Yes	Not required	No requirement	No requirement	Yes (CEO/CFO)
United Kingdom	Yes	Yes	Yes	No requirement	Yes	Not required
U.S.A.	Yes	Not required	Yes	At least 3 members	Yes	Yes (CEO/CFO)

Exhibit I

*The Supervisory Board

Codes and Laws

The attraction of a code (as opposed to a law) is in its flexibility. Legislating every aspect of corporate behavior would clearly be impossible, and statutory prescriptions would be inappropriate for many governance issues such as the number of board members in the Audit Committee. And, crucially, codes can be amended to reflect changing needs and circumstances much more quickly than legislation can.

Ultimately, corporate governance codes and laws must support each other. Legislation and government regulations should provide the minimum standards for issues such as financial reporting, auditing requirements, and the frequency and content of shareholders meetings. Corporate–governance codes, by contrast, can encourage best practices in these and other areas, including shareholders' relations and executive compensation.

Comply or Explain

Codes are most effective when combined with a mandatory disclosure, a practice known as "comply or explain." In adapting the Cadbury Code, for instance, the London Stock Exchange demanded that listed companies reveal in their annual reports whether they were complying or not with it – and if not, why. The comply or explain approach has since spread to dozens of countries, including Australia, Canada, Mexico, the Netherlands, and Singapore. Even in the United States, where legislation (most recently exemplified by the Sarbanes – Oxley Act) is preferred, the comply or explain approach has crept in. The U.S. Securities and Exchange Commission (SEC) for example, now requires companies to disclose whether they have financial experts on their audit committees and if not explain why.

The boundary between laws and codes will shift over time and vary by country. A run of financial scandals might call for the strengthening of regulations dealing with the responsibilities of audit committees. Conversely, legislators in some countries have relaxed their capital requirements because laws against fraudulent conveyance have been strengthened and innovative financial contracts make it easier for a creditor to protect itself. By contrast, in some emerging markets, where corporate-governance awareness is low and public scrutiny weak, legislation might be favored over voluntary codes.

Threats!

Despite the codes' enormous success in promoting change, three developments could jeopardize this use. Paradoxically, it is their very success that has given rise to these threats.

The three issues are:

- ♦ Regulation Creep
- ♦ Overemphasis on complying rather than explaining
- ♦ The progressive convergence of codes around the world