Study on the uk corporate governance code finance essay

Stakeholders are any entity (person, group or possibly non-human entity) that can affect or can be affected by the actions or policies of an organization. It is a bi-directional relationship. Each stakeholder group has different expectations about what it wants and different claims upon the organization. If we took governance only into account it means it is the process of decision-making and the process by which decisions are implemented. And corporate governance is a set of associations between a company's directors, its shareholders and other stakeholders. And it also provides structure through which the objectives of the company are set, and the means of obtaining these objectives and monitoring performance are determined.

In other words, Directors and manager need to be aware of the interests of stakeholders in governance, however their responsibility towards them is judged.

All in short, corporate governance is a structure by which an organization is controlled.

UK CORPORATE GOVERNANCE CODE 2010

The new Code applies to accounting periods beginning on or after 29 June 2010 and, as a result of the new Listing Regime introduced in April 2010, applies to all companies with a Premium Listing of equity shares regardless of whether they are incorporated in the UK or elsewhere.

The financial crisis which came to a head in 2008-09 triggered widespread reappraisal, locally and internationally, of the governance systems which might have alleviated it. In the UK, Sir David Walker was asked to review the

governance of banks and other financial institutions, and the FRC decided to bring forward the Code review scheduled for 2010 so that corporate governance in other listed companies could be assessed at the same time.

The " comply or explain" approach is the trademark of corporate governance in the UK. It has been in operation since the Code's beginnings and is the foundation of the Code's flexibility. It is strongly supported by both companies and shareholders and has been widely admired and imitated internationally.

Levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the company successfully, but a company should avoid paying more than is necessary for this purpose. A significant proportion of executive directors' remuneration should be structured so as to link rewards to corporate and individual performance.

Relations with shareholders:

There should be a dialogue with shareholders based on the mutual understanding of objectives. The board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place.

This is just a brief summary of the principles, The comprehensive detail on above codes could be found on http://www. ecgi. org/codes/documents/uk_cgc_june_2010_en. pdf

SYSTEM OF CORPORATE GOVERNANCE

Below figure distinguishes between underlying governance arrangements along three interrelated aspects: shareholder vs. stakeholder orientation,

arm's length as opposed to relational contracting, and the separation vs. the coupling of ownership and control.

Source: Michael Carney & Eric Gedajlovic, " Corporate Governance and Firm Capabilities: A Comparison of Managerial, Alliance & Personal Capitalism," Asia Pacific Journal of Management, Vol. 18, 2001, p. 338.

Banks are of unique nature and are key players in an economy since they have great influence on macro-economic and monetary policies. However, banks face various risks ranging from business, finance, operation and event so inappropriate handling of theses risks may impact negatively to the economy. As a matter of fact, sound corporate governance constructs a disciplined environment whereunder banks set their objectives and the means of attaining them, as well as monitoring the performance of those objectives (Greuning and Brajovic-Bratanovic, 2003). They recommend a " partnership" among key players to strengthen corporate governance in banking sector within the context of financial risk management and market-based approach. Eight key players are identified for this purpose: regulators authorities; supervisory authorities; shareholders; board of directors; management, audit committee and internal auditors; external auditors; the general public. Their key responsibilities and functions are illustrated in below diagram

BACKGROUND OF CORPORATE GOVERNANCE:

Corporate governance is most often viewed as both the structure and the relationships which determine corporate direction and performance. The board of directors is typically central to corporate governance. Its

relationship to the other primary participants, typically shareholders and management, is critical. Additional participants include employees, customers, suppliers, and creditors. The corporate governance framework also depends on the legal, regulatory, institutional and ethical environment of the community. Whereas the 20th century might be viewed as the age of management, the early 21st century is predicted to be more focused on governance. Both terms address control of corporations but governance has always required an examination of underlying purpose and legitimacy. – – James McRitchie, 8/1999 http://corpgov. net/library/definitions. html

Globalization has not only significantly increasing and intensifying business risks, but also it has compelled Indian companies to adopt international norms of transparency and good governance.

Since the late 1970’s, corporate governance has been the subject of significant debate in the U. S. and around the globe. Bold, broad efforts to reform corporate governance have been driven, in part, by the needs and desires of shareowners to exercise their rights of corporate ownership and to increase the value of their shares and, therefore, wealth. Over the past three decades, corporate directors’ duties have expanded greatly beyond their traditional legal responsibility of duty of loyalty to the corporation and its shareowners.

In the first half of the 1990s, the issue of corporate governance in the U. S. received considerable press attention due to the wave of CEO dismissals (e. g.: IBM, Kodak, Honeywell) by their boards. And in 1997, the East Asian Financial Crisis saw the economies of Thailand, Indonesia, South Korea,

Malaysia and The Philippines severely affected by the exit of foreign capital after property assets collapsed. The lack of corporate governance mechanisms in these countries highlighted the weaknesses of the institutions in their economies.

The world has recently faced a one of the largest financial crises of the history in mid 2008. After the recession many organization disappeared from the world's economy, in which one of the biggest name was Lehman Brothers. Who was previously acted as a giant player of US market.

Professor Arturo Bris – describe that For Lehman, it has been assumed the Lehman collapse in September 2008 was the outcome of greed, multipart derivatives and extreme leverage and complacency of rating agencies. The evaluation of the whole report shows instead of incredible similarities b/w the collapses of Enron in 2001 and Lehman in 2008. In 2001, Enron Collapsed due to misconduct of executives which would possible because of the inaction of both the board and the auditing firm. The Enron executives transform increase in the leverage into positive cash flows, without any impact on the balance sheet. The examiner from court showed that effect, in the absence of prepay transaction, it's debt to asset ratio would be 45% instead of 38% reported in 1999.

Lehman Brothers basically used repos reportedly for financing reasons, but accounted for them as asset disposals. As per report, these repo proceeds amounted to about $50 billion by September 2008. Problem is it failed to disclose this. And because of the legal constraints in the US on the treatment of repo transactions as asset disposals, Lehman Brothers engineered them

through its UK subsidiary. They were clearly used as leverage-reducing transactions because otherwise Lehman could have secured short-term financing at much lower rates – a Repo 105 (5 is " haircut") implies a cost of financing of five percent, plus interest! Enron also used pre-pays to hide leverage.

Finally, there is controversy on the role of Ernst & Young and its knowledge of the Repo 105 program. The lead partner in the auditing firm states that " Ernst & Young did not approve the Accounting Policy", it rather " became comfortable with the Policy for purposes of auditing financial statements".

The examiner's conclusion is devastating: " There is sufficient evidence to support a finding that claims of breach of fiduciary duty exist against Fuld, O'Meara, Callan and Lowitt and colorable claim of professional malpractice exists against Ernst &Young". He also adds some evidence of questionable practices by JP Morgan with respect to its requests for collateral.

This case teaches us many lessons like how much corporate governance plays a role in a corporate or more broadly said in an economy. And second lesson is we don't learn from past as the basic structure of collapse of Lehman bros. resembles to some cases from the past like Enron, Parmalat and Worldcom. We should consider and actively adopt the corporate governance to avoid such circumstances in future.

http://www. imd. ch

http://www. imd. org/research/challenges/TC039-10. cfm

Sainsbury's Corporate Governance:

The Company applies the main principles of Section 1 of the UK Combined Code on Corporate Governance June 2008 (the " Code"). The Board is committed to strong governance practices and, during the year, the Company has complied with all the provisions of the Code.

Here below are examples of some practices which are adopted by Sainsbury's.

Division of responsibilities

There is a clear division of responsibilities between the Chairman and the Chief Executive which is set out in writing and has been approved by the Board.

Independence/Non-Executive Directors

The Chairman satisfied the independence criteria of the Code on his appointment and all the Non-Executive Directors are considered to be independent according to the provisions of the Code.

The Board's role

The Board has a number of key responsibilities and formally reserved powers.

The Board delegates certain responsibilities to its principal committees. The Audit Committee ensures the integrity of financial information, the effectiveness of the financial controls and the internal control and risk management systems. The Remuneration Committee sets the remuneration policy for Executive Directors and determines their individual remuneration

arrangements. The Nomination Committee recommends the appointment of Directors and has responsibility for evaluating the balance of the Board and for succession planning at Board level. The Corporate Responsibility (“ CR”) Committee reviews key CR policies, taking into account the Company’s CR objectives and the overall strategic plan

Case Study:

The Drivers:

In the 1990s there was growing pressure, particularly from the investors, for companies to demonstrate their commitments to stakeholders. It was this pressure, together with an increasing demand from all stakeholders for more information as CSR concerns became prevalent, that made Sainsbury’s realize it needed to take affirmative action.

An additional driver has been the leadership of past and present CEOs. The current CEO Justin King is personally committed to CSR.

Taking Action

In the year 2000, the board agreed to develop a CSR section on the Sainsbury’s website where all stakeholders could obtain relevant information. The CEO was the overall champion of the project and a number of the company directors each took responsibility for overseeing a stakeholder group.

A CSR unit was set up to implement the project with the aim of launching the website in 2001. To assist the unit a CSR steering group comprising senior managers across the business was established under the Chairmanship of a

Board Director to advise and ensure the range and depth of Sainsbury's work in CSR was accurately captured.

The business benefits

Sainsbury's is now widely recognized as one of the best in its sector in CSR: demonstrated by the company's consistently high rating on the Dow Jones Sustainability Indices and awards from Business in the Community and Business in the Environment.

Another benefit derived from this approach to CSR has been the development of new " networks". This has included working with other businesses, including competitors, and the NGO community on various initiatives. These include the " The London Benchmarking Group" that consists of leading international corporations who have come together to manage, measure and report their involvement in the community.. Another benefit has been an improvement in the company's dialogue with certain stakeholders. Previously, if an NGO had an issue with the company, the first the business would know about it would be through the media – a headline story. But, now if there is a problem, Sainsbury's will talk directly with the group to discuss and explain the issues and perspectives.