Financial aspects of corporate governance

Business, Corporate Governance

European corporate law has enjoyed a renaissance in the past decade. Fifteen years ago, this would have seemed most implausible. In the mid-1990s, the early integration strategy of seeking to harmonies substantive company law seemed to have been stalled by the need to reconcile fundamental differences in approaches to corporate governance. Little was happening, and the grand vision of the early pioneers appeared more dream than ambition.

Yet since then, a combination of adventurous decisions by the Court of Justice, innovative approaches to legislation by the Commission, and disastrous crises in capital markets has produced a headlong rush of reform activity. The volume and pace of change has been such that few have had time to digest it: not least policymakers, with the consequence that the developments have not always been well coordinated. The recent 2007/08 financial crises have yet again thrown many - quite fundamental - issues into question.

In this article, we offer overview of Key concepts of Corporate Governance in European countries based on EU law. Corporate governance is traditionally defined as the system by which companies are directed and controlled 1 and as a set of relationships between a company's management, its board, its shareholders and its other stakeholders 2 . The corporate governance framework for listed companies in the European Union is a combination of legislation and ' soft law', including recommendations 3 and corporate governance codes.

While corporate governance codes are adopted at national level, Directive 2006/46/EC promotes their application by requiring that listed companies

refer in their corporate governance statement to a code and that they report on their application of that code on a ‘ comply or explain’4 basis. Supervisory Function: A supervisory board or supervisory committee, often called board of directors, is a group of individuals chosen by the stockholders of a company to promote their interests through the governance of the company and to hire and supervise the executive directors and CEO.

Corporate governance varies between countries, especially regarding the board system. There are countries that have a one-tier board system (like the U. K.) and there are others that have a twotier board system like Germany. Boards of directors have a vital part to play in the development of responsible companies. And in many respects, the role played by the chairperson seems to have a considerable impact on the board’s functioning and success. Read about Corporate Governance at Wipro

Roles for NEDs: In 2007, the European Commission published a report on Member State implementation of Recommendation 2005/162/EC (the “ Recommendation”). This Recommendation addresses the role of non-executive or supervisory directors of listed companies and that of the (supervisory) board’s committees. It was adopted to promote standards ensuring that the boards of listed companies offer sufficient guarantees of independence. In doing so, it promotes the convergence 1 2 3 4

Report of the Committee on the Financial Aspects of Corporate Governance (The Cadbury Report), 1992, p. 15, accessible at http://www. ecgi. org/codes/documents/cadbury. pdf. OECD Principles of Corporate Governance, 2004, p. 11, accessible at http://www. oecd. org/dataoecd/32/18/31557724. pdf. For a list of EU measures in the field of

corporate governance, see Annexes. This approach means that a company choosing to depart from a corporate governance code has to explain which parts of the corporate governance code it has departed from and the reasons for doing so.

of the national corporate governance codes enacted in the Member States, so that investors may benefit from an equivalent level of protection and transparency within the European Community. In addition to contributing to the business efficiency in the internal market, the Recommendation is also a response to recent corporate fraud scandals. As the Member States were invited to implement the Recommendation by June 30, 2006, the purpose of the Report was to evaluate whether Member States have developed the necessary legal framework to give effect to the Commission's key proposals.

In Recommendation 2005/162/EC on the role of non-executive or supervisory directors " in order to ensure that the management function will be submitted to an effective and sufficiently independent supervisory function, the supervisory board should comprise a sufficient number of committed non-executive or supervisory directors, who play no role in the management of the company or its group and who are independent in that they are free of any material conflict of interest.

In view of the different legal systems existing in Member States, the proportion of supervisory board members to be made up of independent directors should not be defined precisely at Community level" 5 The Idea of Disclosure: Transparency is letting the truth be available for others. Today the new concept of transparency includes action or motion, putting new responsibilities on the company. New concept of transparency requires not

only letting the truth be available but imposes to disclose it to every stakeholder.

For the market, Strong transparent disclosure regime is pivotal for market based monitoring of companies and central to shareholder ability to exercise ownership rights. It can be powerful tool for influencing companies and protecting investors. It can help to attract capital and maintain confidence in the markets. And weak disclosure can contribute to unethical behaviour and loss of market integrity, costing not only company but also economy as a whole.

Insufficient or unclear information may hamper ability of markets to function, and then increase cost of capital and result in poor resource allocation The Action Plan for Disclosure: 5 Commission Recommendation of 15 February 2005 on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board (2005/162/EC) Disclosure requirements are a highly effective market-led way of rapidly achieving results. It is of highly necessity to enhance corporate governance disclosure.

Two examples taken from the Action Plan can well illustrate it: All listed companies will be required to include in their annual documents a coherent and descriptive statement covering the key elements of their corporate governance structure and practices. This should include, inter alia, the operation of the shareholder meeting and its key powers, the composition and operation of the board and its committees, and a reference to a code on corporate governance, designated for use at national level, with which the company complies or in relation to which it explains deviations.

Companies will be obliged to be more transparent in the way they operate. They will have to demonstrate that they comply with accepted standards on Corporate Governance or explain why not. Disclosure is enforced further by our proposals in the Takeover and Transparency Directives. The second example relates to institutional investors who play a key role in the governance of companies in which they invest. There is presently very little clarity or transparency in the way they operate.

We consider that they should therefore be obliged to disclose their investment policy and their policy on the exercise of their voting rights. They must disclose, and hence justify, to their beneficial holders how these rights have been used in a particular case. In 14 September 2010 actions were brought to the court in the case of Stichting Corporate Europe Observatory verses Commission (Case T-395/10) . The Applicants were Stichting Corporate Europe Observatory (Amsterdam, the Netherlands) (represented by: S. Crosby, Solicitor, and S.

Santoro, lawyer) and the defendants were European Commission. Form of order sought: - Annul the implied refusal of the applicant’s confirmatory application; - Order the Commission to pay the applicant’s costs. Pleas in law and main arguments were as such: By means of this application the applicant seeks annulment of the Commission implied decision rejecting the applicant’s request, pursuant to Regulation No 1049/2001 [1], of the access to certain documents relating to the trade negotiations between the EU and India. In support of its application the applicant puts forward three pleas in law.

First, it claims that the Commission infringed the Regulation No 1049/2001 by failing to reply to the confirmatory application within the prescribed time. Second, the applicant contends that the Commission infringed the Regulation No 1049/2001 and the Treaty by constructively rejecting a confirmatory application without giving any reasons or without giving reasons to the standards required by the Treaty and by the Court. Third, it submits that by failing to reply to the confirmatory application the Commission infringed an essential procedural requirement and/or committed an error of law.

Several power bases on the board: Corporate governance systems play a central role in economic performance because they provide mechanisms affecting the returns on suppliers' investment of externalfinanceto firms. The task of modernizing company law and enhancing the quality of corporate governance poses itself in all industrial countries. It is estimated that within the European Union, the contents of up to 80 per cent of all legislation in the field of business law is determined by the legislation in Brussels.

One of the core features of the corporate governance is investor ownership; it means that shareholders have a significant right of control over their companies. 6 The second characteristic is delegated management, which implies that shareholders generally exercise this control indirectly, by participating in the selection of directors, for example. Regarding the company forms, there is a different aspect between continental European corporate laws and UK company law. The first one generally distinguishes 'open' corporate forms with freely transferable shares, and 'closed' forms, in which transferability is restricted.

On the other hand, UK company law uses the term 'closely held' to define corporations whose shares do not trade freely, and term 'publicly held' for corporations that adopt the open corporate form. One of the most important aspects of corporate law is the shareholders' position. 7 At first sight it could be concluded that the rules in this field are based on different strategies: the appointment rights strategy, decision rights, trusteeship, incentives, constraints, and affiliation rights strategies. The appointment strategy is the dominant way of protecting the shareholders' interests.