The new role of corporate governance

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Principles versus rules

The basic reason for failure of corporate governance regulation is that this was based on a box ticking approach of compliance. This encourages companies using their ingenuity in HNTGC – How Not To Get Caught. Human ingenuity is so powerful that we always find excuses to beat the system. In fact our manhood depends on our ability to defy rules. You become a master only by transcending rules which most read as transgressing rules. The basis reason is that rules are devised to meet a certain situation and not supposed to be permanent. Hence the tendency to interpret them to suit your own convenience. Principles on the other hand are North Star fixed for all times with no scope for ambivalence. A strategy for sustainability requires we apply a principle=based approach to corporate governance.

The basic purpose of corporate governance is to hold those in power to account. So accountability is the key to corporate governance. There are 6 principles that have to be satisfied to ensure accountability. These are 6 Ds – Diversity in composition of the board and differentiating the gene pool and gender; encouragement of Dialogue as opposed to monologue; valuing Dissent, Dispersion of authority (separation of chairman and CEO is one example), disruption of status quo (critical to counter cosiness) and fostering a culture of full disclosure to build trust.

Corporate Governance-compliance Issues

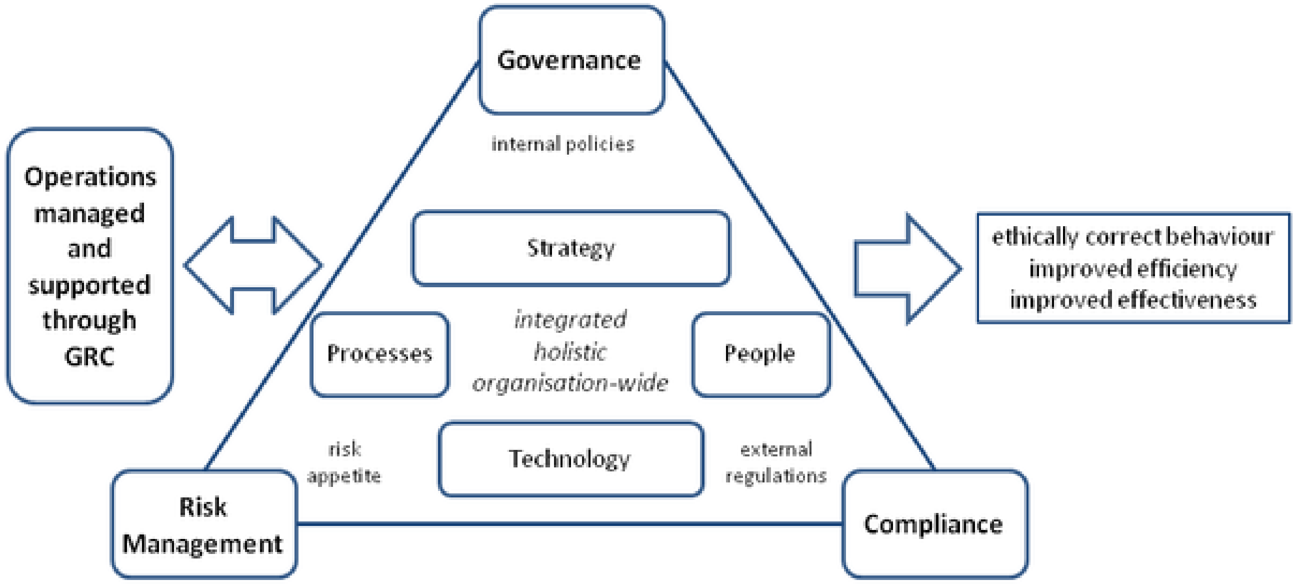
Governance, Risk Management, and Compliance or **GRC** is the umbrella term covering an organization's approach across these three areas. Being closely related concerns, governance, risk and compliance activities are increasingly being integrated and aligned to some extent in order to avoid conflicts, wasteful overlaps and gaps. While interpreted differently in various organizations, GRC typically encompasses activities such as corporate governance, enterprise risk management (ERM) and corporate compliance with applicable laws and regulations.

Governance describes the overall management approach through which senior executives direct and control the entire organization, using a combination of management information and hierarchical management control structures. Governance activities ensure that critical management information reaching the executive team is sufficiently complete, accurate and timely to enable appropriate management decision making, and provide the control mechanisms to ensure that strategies, directions and instructions from management are carried out systematically and effectively.

Risk management is the set of processes through which management identifies, analyses, and where necessary responds appropriately to risks that might adversely affect realization of the organization's business objectives. The response to risks typically depends on their perceived gravity, and involves

GRC Research

A publication review carried out in 2009 found that there is hardly any scientific research on GRC as of today. The authors went on to derive the first scientifically grounded GRC short-definition from an extensive literature review. Subsequently the definition was validated in a survey among GRC professionals. "GRC is an integrated, holistic approach to organisation-wide governance, risk and compliance ensuring that an organisation acts ethically correct and in accordance with its risk appetite, internal policies and external regulations through the alignment of strategy, processes, technology and people, thereby improving efficiency and effectiveness." The authors then translated the definition into a frame of reference for GRC research.



Frame of reference for research of integrated GRC

Governance, Risk Management and Compliance are the core *disciplines* of GRC. Each of the disciplines consists of the four basic *components* of GRC: strategy, processes, technology and people. The organization's risk appetite, its internal policies and external regulations constitute the *rules* of GRC. The disciplines, their components and rules are now to be merged in an integrated, holistic and organization-wide (the three main *characteristics* of GRC) manner – aligned with the (business) operations that are managed and supported through GRC. In applying this approach, organizations long to achieve the *objectives* of GRC: ethically correct behaviour, and improved efficiency and effectiveness of any of the elements involved.

Internal corporate governance controls

Internal corporate governance controls monitor activities and then take corrective action to accomplish organizational goals. Examples include:

Monitoring by the board of directors: The board of directors, with its legal authority to hire, fire and compensate top management, safeguards invested capital. Regular board meetings allow potential problems to be identified, discussed and avoided. Whilst non-executive directors are thought to be more independent, they may not always result in more effective corporate governance and may not increase performance. Different board structures are optimal for different firms. Moreover, the ability of the board to monitor the firm's executives is a function of its access to information. Executive directors possess superior knowledge of the decision-making process and therefore evaluate top management on the basis of the quality of its decisions that lead to financial performance outcomes, *ex ante*. It could be argued, therefore, that executive directors look beyond the financial criteria.

Internal control procedures and internal auditors: Internal control procedures are policies implemented by an entity's board of directors, audit committee, management, and other personnel to provide reasonable assurance of the entity achieving its objectives related to reliable financial reporting, operating efficiency, and compliance with laws and regulations. Internal auditors are personnel within an organization who test the design and implementation of the entity's internal control procedures and the reliability of its financial reporting.

Balance of power: The simplest balance of power is very common; require that the President be a different person from the Treasurer. This application of separation of power is further developed in companies where separate divisions check and balance each other's actions. One group may propose company-wide administrative changes, another group review and can veto the changes, and a third group check that the interests of people (customers, shareholders, employees) outside the three groups are being met.

Remuneration: Performance-based remuneration is designed to relate some proportion of salary to individual performance. It may be in the form of cash or non-cash payments such as shares and share options, superannuation or other benefits. Such incentive schemes, however, are reactive in the sense that they provide no mechanism for preventing mistakes or opportunistic behavior, and can elicit myopic behavior.

In publicly-traded U.S. corporations, boards of directors are largely *chosen* by the President/CEO and the President/CEO often takes the Chair of the Board position for his/herself (which makes it much more difficult for the institutional owners to "fire" him/her). The practice of the CEO also being the Chair of the Board is known as "duality". While this practice is common in the U.S., it is relatively rare elsewhere. It is illegal in the U.K.

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