KEEP YOUR EYE ON THE BALL

TREASURERS, PLEASE TAKE NOTE. THERE IS MUCH MORE TO CORPORATE GOVERNANCE THAN A YEARLY FINANCIAL REPORT TO SHAREHOLDERS, ARGUE **CHRISTINE MALLIN, LANCE MOIR** AND **CHRISTINE HELLIAR.**

Corporate governance is an area that has been growing steadily in importance in the last decade. The Cadbury Report, issued in the UK in 1992, laid the foundations of corporate governance, not just in the UK, but also in countries as diverse as Russia and India, which have incorporated its main principles into their own corporate governance codes.

Following on from the collapse of Enron in 2001, corporate governance has gained a much higher profile and is now a frequent topic in the financial press. There are many definitions of corporate governance, and some frequently cited ones are shown below:

- Sir Adrian Cadbury (1992): "The whole system of controls, both financial and otherwise, by which a company is directed and controlled."
- OECD (1999): "… a set of relationships between a company's board, its shareholders and other stakeholders. It also provides the structure through which the objectives of the company are set, and the means of attaining those objectives, and monitoring performance, are determined."

These definitions illustrate the principle of corporate governance, and demonstrate that it is concerned with both the internal aspects of the company, such as internal controls, and the external aspects, such as an organisation's relationship with its shareholders and other stakeholders.

Therefore, modern governance goes beyond the traditional financial report to the shareholders, and now starts with defining the objectives of the firm, before moving on to consider the wider implications for management.

WHY IS CORPORATE GOVERNANCE IMPORTANT? Corporate governance is important for many reasons and is fundamental to the operation of well-managed companies, operating at peak efficiency. Some of the most important features of corporate governance are that it:

- tries to ensure that an adequate and appropriate system of controls operates within a company to safeguard the assets, where no individual or group within the company has any unwarranted influence;
- is concerned with the relationships between a company's management, the board, its shareholders and other stakeholders;
- aims to ensure that a company is managed in the best interests of the shareholders and other stakeholders; and
- encourages both transparency and accountability, which are the fundamental principles to good corporate governance.

If a company is perceived to have good corporate governance, investor confidence may increase, future investment may be obtained at more favourable rates and corporate performance may be enhanced.

DRIVERS OF CORPORATE GOVERNANCE. There have been a number of drivers of corporate governance. First, there have been a number of corporate collapses of prominent businesses ranging from Polly Peck and Maxwell in the 1990s, through to Enron in the new millennium. Second, there has been a greater concentration of share ownership in the hands of institutional investors (particularly in the UK and the US) with, for example, about 80% of corporate UK now owned by institutional investors.

In addition, as institutional investors increasingly seek to diversify their portfolios and invest overseas, the internationalisation of cross-border holdings means that powerful investors are increasingly seeking to invest in companies with familiar standards of governance.

Many countries have now introduced corporate governance codes, complying with the OECD's (1999) principles, including emerging markets such as China, in 2001. The OECD's principles cover five areas and are generally viewed as encapsulating the key aspects of corporate governance, as follows:

- the rights of the shareholders;
- the equitable treatment of shareholders;
- the role of outside stakeholders in corporate governance;
- adequate disclosure and transparency; and
- the responsibilities of the board.

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There is, however, a recognition that 'one size does not fit all' and the UK/US model of shareholder governance is not the only model that can be adopted. For example, some Continental European countries have imposed explicit obligations on the Board to consult other groups, as seen by the German corporate governance structure, where every company has to appoint a supervisory board that encompasses employee representatives, although this system is changing. Alternatively, in Japan, there has traditionally been an influential interest in governance through the kereitsu system of cross-holdings, although this influence is also now declining.

However, what is becoming clear is that the inclusion – and practice – of the OECD principles are becoming enshrined in the corporate governance codes of many countries. In particular, developing countries that introduce these corporate governance codes or standards will find it easier to attract foreign direct investment (FDI) than countries that do not. Technological advances in communications and in the financial markets are also influencing the development of a common view of how corporate governance is a key aspect of any investment decision

HOW DOES IT AFFECT THE TREASURER? Governance is about how companies can meet their objectives, how performance is monitored, and how accountability is discharged. Therefore, treasurers need to understand the objectives of the organisation they work for, their role within it, and their part in the accountability process.

Another key objective of corporate governance is to reduce the financial, business and operational risk of a firm, and the treasurer has an important role to play in ensuring that these risks are minimised. The typical focus of the treasurer will be to arrange efficient funding and manage financial risk while recognising the interests of the shareholders.

To ensure corporate governance guidelines are complied with, the treasurer should follow the Association of Corporate Treasurers' ethical code and its seven fundamental principles:

- integrity;
- independence;
- courtesy and consideration;
- professional competence;
- confidentiality;
- compliance with laws and regulations; and
- compliance with laws and regulations of other professional bodies to which a member belongs.

In following these principles the treasurer should consider the employer, the public, bankers, other professional business associates, and colleagues. From the ethical guidelines there are four ways in which these corporate governance guidelines can be compromised: incompetence, excessive risk taking, greed and the activities of a rogue trader.

By maintaining professional excellence through CPD and other training and by ensuring that there is an effective control environment over treasury operations, treasurers will play their part in good corporate governance.

However, research we have undertaken recently, clearly demonstrated that many treasurers had not thought through these issues. In particular, they did not have a clear view of their accountability and often had not given a thought to whom they were accountable, or for what they were accountable. Most considered that their obligation was to the Board, and admitted that, through the board, they were accountable to the shareholders. Some treasurers recognised that they were responsible to lenders – but rarely looked any further.

Treasurers have specific governance implications in terms of ensuring that Boards have sufficient information to take clear decisions, but also that the sources of funding remain well-informed about the company and that this funding will remain in place. Therefore, by seeking the cheapest source of funding without regard to stability is not a satisfactory governance practice.

For example, in the early 1990s, the use of multiple banks without a long-term understanding of the business resulting in the demise of relationship banking, led to the potential for systemic risk. However, these risks were not considered and were also not disclosed to the shareholders.

This practice of borrowing from many banks led to the development of the 'London approach', where the Bank of England would intervene and call a meeting of the banks if the company found itself in financial difficulties.

Therefore, for treasurers, there is a need to think beyond the internal reports and the content of statutory filings and prospectuses. There is a need to consider how the wider purpose of the business can be met by the clear communication, and consideration, of risks, with all stakeholder groups, including shareholders, lenders, employees, customers and suppliers and determine what that means for internal reporting and education.

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