Corporate Governance Basics

Corporate governance is the system of rules, practices and relationships by which a company is directed and controlled. It sets out who decides what, who is responsible to whom, and what information must be shared. Good governance matters for every company, from a small family business to a large listed group. The G20/OECD Principles of Corporate Governance, first issued in 1999 and updated several times since, are an international reference used by many countries. This video explains four basics: the role of the board, accountability, transparency and shareholder rights.

1. The Role of the Board

The first basic is the role of the board of directors. The board sets the strategic direction of the company, appoints and oversees senior management, and watches over risk, financial reporting and internal controls. Its members should act in the interest of the company and its shareholders, and a good board includes members who can judge independently. Directors are expected to act on a fully informed basis, in good faith and with due care. The board guides and checks, while managers run the daily business.

Example: A neighbourhood sports club has an elected committee. Applying the board's role, the committee sets the plan for a new pitch and asks the manager for a monthly progress report.

At work: Tarek joins the board of a manufacturing company. Applying the board's role, he asks how the proposed strategy deals with risk and requests a report from management, instead of running the factory himself.

2. Accountability

The second basic is accountability. Management is accountable to the board, and the board is accountable to the company and its shareholders. Without clear accountability, mistakes are hard to correct, because nobody feels responsible for them. Clear roles help, for example a chair who leads the board and a chief executive who leads the business, often held by different people. Boards also review their own performance, and shareholders can hold them to account.

Example: The club committee reports to the members at the annual meeting. Practising accountability, it explains its decisions and answers questions.

At work: Tarek's board agrees clear goals with the chief executive and reviews them every quarter. Practising accountability, the board asks for an explanation when a target is missed.

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3. Transparency

The third basic is transparency. Companies should disclose timely and accurate information about their finances, performance, ownership, governance and main risks. Independent auditors check the financial statements, so that readers can trust them. Good disclosure helps shareholders, lenders and employees make better decisions. Disclosure should be clear and not buried in long documents that few people can follow.

Example: The sports club publishes its accounts and its plans for all members. Applying transparency, members can see how the fees were spent.

At work: Tarek asks that the annual report explain the main risks clearly and that independent auditors review the accounts. Applying transparency, investors receive information they can trust.

4. Shareholder Rights

The fourth basic is shareholder rights and fair treatment. Shareholders should be able to vote on key matters, such as electing directors, and to receive information in good time. Shareholders of the same class should be treated equally, and minority shareholders need protection from abuse by controlling ones. Stakeholders such as employees and creditors also have rights that the law and the company should respect. Without these rights, investors may hesitate to provide capital, and companies find it harder to grow.

Example: In the club, every member has a vote at the annual meeting, and members with the same type of membership pay the same fee. Applying shareholder rights, a small group of members cannot change the rules without a vote.

At work: A family group holds most of the shares of Tarek's company, and a few small shareholders hold the rest. Applying shareholder rights, the board makes sure that important decisions are put to a vote and that small shareholders receive the same information.

Conclusion

In summary, corporate governance is the system by which a company is directed and controlled. The board sets the direction and oversees management, is accountable to shareholders, shares clear information and respects shareholder rights. The G20/OECD Principles offer an international reference for all four basics. Good governance builds trust, and trust helps a company to grow.

Sources

• OECD (2023). G20/OECD Principles of Corporate Governance 2023. OECD Publishing – https://www.oecd.org/en/publications/g20-oecd-principles-of-corporate-governance-2023_ed750b30-en.html

• Financial Stability Board: G20/OECD Principles of Corporate Governance (Key Standards) – https://www.fsb.org/2023/09/g20-oecd-principles-of-corporate-governance/

• European Corporate Governance Institute (ECGI), research and resources on corporate governance – https://www.ecgi.global

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