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Corporate Governance: Why Bother?

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A CEO of a major listed company once said to me: "You know, corporate governance is for the other guy."

That statement, although made half in jest, underlines two axioms I have come to appreciate about the importance and difficulties of governance.

IMPORTANCE

The first axiom is that it is generally clear to most people, even if implicitly so, that corporate governance is crucial to making the world as we know it work. Our political and corporate structures are based on a closed loop system of governance.

In the basic democratic model, political leaders are elected to set policies while civil servants are appointed to implement them. Every few years, the report cards of political leaders are examined by the electorate and, if they are found wanting, new officials are elected.

Similarly, in a corporate setting, shareholders elect the board of directors who, in turn, appoint management to run the company in the interests of the shareholders. At the annual general meeting, the board must answer to the shareholders who may elect new directors.

You could say this system of governance – which distributes the rights and responsibilities among different participants – has generally worked well.

Since the end of the Cold War in 1991 and the adoption of capitalism and democratic reforms in China, the former Soviet Union and other countries, the world economy and global wealth have grown rapidly.

When practised, good corporate governance enhances the performance of not just individual companies, but also the performance of the entire economic system.

DIFFICULTIES

Yet on several occasions the system of governance has clearly broken down. When these failures in governance are scrutinised, the causes can often be traced to the people in power acting primarily out of their own narrow self-interests instead of the greater interests of the constituents, whom they should be serving.

Therein lies the second axiom, and the core difficulty of governance: power does tend to corrupt. It is not easy, and some would even say unnatural, for those in power to serve and to always act in

the interests of, as well as be fully accountable to, the citizens or shareholders.

Harking back to the words of the CEO I noted earlier, he was essentially communicating the point that many leaders, enlightened as they may be, will say: "I agree with having controls, accountability and reporting, but I would rather not be subject to them myself."

When these leaders go too far off-course, their companies, and sometimes part of the economic system, can crash. In turn, corporate failures lead to hindsight analysis that often recommends increasing the number of rules and regulations to ensure that corporate boards and management behave in the future.

The 2001 collapse of Enron in the US resulted in the Sarbanes-Oxley Act and the drastic tightening of rules for company financial reporting. The 2008 global financial crisis resulted in US regulatory proposals to address consumer protection, executive pay and weaknesses in the banking system. At the same time, European regulators introduced Basel III regulations for banks with tighter capital, liquidity and risk-taking requirements.

In Singapore, the Pan-El debacle of 1985 led to amendments to the Companies Act alongside more statutory controls for audit committees of listed companies. After the 1997 Asian Financial Crisis and the reviews that followed, Singapore introduced a Code of Corporate Governance in 2001, which became operational in 2003. The Code has since been updated twice – in 2005 and 2012 – while the Singapore Companies Act is set to have the largest number of amendments made to it since its enactment.

CONFORMANCE OR PERFORMANCE

One setback of these “safeguards” is that new rules are often just layered upon existing ones. The process of compliance thus becomes an increasingly complex and costly one for companies.

Unfortunately, the increasing number of rules also creates the erroneous impression that corporate governance is just about ensuring compliance with the maze of rules. Instead, what boards and companies should really be doing is to focus on performance rather than on conformance.

After all, companies exist primarily to create value. The role of boards must, therefore, be to ensure that the companies they govern can, and do, create value, albeit within the context of the regulatory environment in which they operate.

At the same time, it is not commonly agreed as to what kind of value companies should be creating. Traditional capitalists would argue that it is exclusively about shareholder value. An emerging view is that it should be tempered by the broader notion of stakeholder values that include the needs of employees, the community and the environment.

Corporate governance – the mainstay of the board of directors – is therefore a crucial but not straightforward matter. In future articles in this series, my SID colleagues and I will explore these various facets of boardroom matters. ■