UNIVERSAL CORPORATE GOVERNANCE STANDARDS: RECOMMENDATIONS FOLLOWING THE GLOBAL FINANCIAL CRISIS

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Abstract

Corporate governance can be defined as: the set of processes, customs, policies, laws and institutions affecting the way a company is directed, administered or controlled. Suggestions were investigated that the global financial crisis revealed severe shortcomings in corporate governance.
Research was conducted to establish whether these suggestions are accurate. The study found that it appeared that corporate governance has failed and action needs to be taken. The study recommends that a world supervisory body on corporate governance be established. It also proposes that a summit be called to discuss and create such an authority. In addition, the formulation of a set of universal corporate governance standards for implementation by the members was suggested.

Keywords: Board of Directors, Corporate Governance, Corporate Governance Standards, Global Financial Crisis, Regulatory and Supervisory Activities, Shareholders, Stakeholders, Sustainability

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1. Introduction

The global financial crisis revealed severe shortcomings in corporate governance. The existing standards failed to provide the checks and balances that companies need in order to cultivate sound business practices (OECD, 2011).

In recent years, the financial markets have seen the increased regulation and supervision of especially banks. Foremost was the Basel Committee on Banking Supervision ("the Basel Committee") (BIS, 2013). The Basel Committee issued several papers. In April 2005, for instance, after lengthy discussions and much debate with banks and regulators around the world, the Basel Committee issued the final paper titled "Compliance and the compliance function in banks" (BIS, 2005). The paper provided detailed compliance principles to which banks were expected to adhere in order to enhance compliance in banks and banking groups.

The Committee's paper (BIS, 2005) stipulated specifically that the board of directors of a bank is ultimately responsible for their particular bank's compliance with all relevant acts and regulations. It further stipulated that compliance should become part of the culture of a bank (BIS, 2005) and that the bank's compliance function should be adequately resourced (BIS, 2005).

Further regulatory and supervisory initiatives followed in various countries (SARB, 2004). The South African Reserve Bank, for instance, conducted a review process to assess compliance with corporate government principles on banking institutions in South Africa (SARB, 2004). Despite all the efforts, the world economy still experienced its most dangerous crisis since the Great Depression of the 1930s in the year 2008 (Yale, 2013).

The global financial crisis caused severe damage and casualties in the United States, which included the entire investment banking industry, the US's biggest insurance company, the two enterprises chartered by the US government to facilitate mortgage lending, the US's largest mortgage lender, largest savings and loan bank, and two of the largest commercial banks. In addition, other industries such as the automotive industry were also affected.

The question everybody asked was, "What caused this crisis?" (Intosai, 2010). Everyone tried to find the culprits. Shareholders, the public and politicians pointed fingers everywhere. Directors of troubled companies found themselves directly in the line of fire. Governments and even central banks were accused as they had the responsibility of upholding financial stability through proper supervision and regulation of the financial markets and its institutions (Intosai, 2010).

While few economists and other analysts predicted the financial crisis, almost everyone offered an explanation as to why it had happened. The reasons provided ranged from too much foreign money flowing into the US to the availability of easy credit and bankers bundling up these loans and selling them to investors who could not understand the complexity and risks of these financial instruments (Intosai, 2010). Yale (2013) is however of the opinion that the root of the crisis might very well lie in one fundamental human instinct: GREED.

Numerous scholars and experts are of the opinion that the lack of proper corporate governance was to blame for the financial crisis (FDIC, 2009) where corporate governance can be defined as "*The set of processes, customs, policies, laws and institutions affecting the way a corporation is directed, administered or controlled"* (Oliver, 2012:1).

The boards of directors of companies were amongst other accused that they were too complacent in allowing their management and staff to engage in risky behaviour, adopting compensation programmes that encouraged risky behaviour, giving in to pressure from shareholders to exceed prior results, and failing to monitor the business and assess its risk profile (Lieberman, 2013). Lieberman (2013) is however of the opinion that it seems questionable whether it is appropriate to blame directors for failing to predict and prevent the crisis.

Bird (2008) mentions that people have different opinions whether corporate governance can and should be blamed. Bird (2008) says that some people believe that corporate governance failed in significant respects in preventing the latest financial crisis whilst other people believe that corporate governance mechanisms perform their intended functions in important respects and that there is not a significant need for reforming corporate governance.

It is however important to bear in mind that in recent decades, a large part of the emphasis in corporate governance has been designed to align the interests of the board and executives with those of the equity owners (Lieberman, 2013). Executives often fell pressured to produce short-term profitability, which could have resulted in a liquidity crisis that could jeopardise the entire long-term ownership interests of the shareholders. Enron, the FINOVA Group, Inc., and Lehman Brothers are perfect examples of this (Lashinsky, 2001).

Ferguson (2012:1) offers another possible reason for the global financial crisis when he argues,

> *"Those who believe this crisis was caused by deregulation have misunderstood the problem in more than one way. Not only was misconceived regulation a large part of the cause. There was also the feeling of impunity that came not from deregulation but from non-punishment."*

It is however significant to note that numerous scholars and experts are calling for improvements in corporate governance (World Bank, 2013). Chambers (2009) is another example of these scholars calling for drastic reforms in corporate governance.

Nisa (2009) mentions that corporate governance standards differ from company to company and this is even worse from country to country. The governance standards in companies and countries are compiled based on the companies' own objectives and the political, economic, legal and social history of a country. In view of this, the question arises as to whether it is possible to have a set of universally acceptable corporate governance standards.

As a result of the statements made by Lieberman (2013), Chambers (2009) and Nisa (2009), a study was conducted amongst high-profile financial executives from around the world with the objective to ascertain whether corporate governance was to blame for this failure in corporate governance and why it might be indeed necessary to reform global corporate governance standards.

The second objective of the study was to use, amongst other, the results of the study to propose an initiative that could be used specifically to enhance corporate governance in the world.

2. Research Methodology

The research was firstly aimed at obtaining information about whether it is indeed necessary to reform global corporate governance standards. Secondly, the purpose was to obtain possible solutions. The target population included selected experts in the financial field from around the globe. The experts interviewed included bankers, central bankers, accounting experts, board members and senior management from different institutions.

The research focused firstly on a review of current corporate governance frameworks used in the different countries around the world. The purpose of this was to ascertain the extent of current frameworks.

Secondly, the selected experts were interviewed to obtain specific information regarding corporate governance. To achieve this goal, a questionnaire and semi-structured interviews were used. The interviews conducted were strictly confidential and, at their explicit request, none of the experts interviewed were named.

The following questions were used in the questionnaire:

1. Do you think corporate governance was to blame for the global financial crisis?
2. Do you think that the supervisory coverage with regard to corporate governance is sufficient?
3. Does your supervisory team have enough knowledge about corporate governance?
4. Does your institution report to multiple supervisors?
5. Do these supervisors apply the same rules?
6. Are there too many rules?
7. Does your supervisor practice risk-based supervision?
8. Is there a need for a new global supervisory architecture?

9. What solutions can you offer?

3. International Perspective

An international perspective on the current corporate governance frameworks was researched with the purpose of identifying these frameworks and ascertaining their contents and also possible use in a new future dispensation. According to the European Corporate Governance Institute (ECGI) (2013), there are 106 individual countries in the world that have some type of corporate governance framework.

An analysis of these codes yielded the following results:

- 106 countries out of a possible 193 (World Atlas, 2013) have some type of corporate governance framework;
- the countries with frameworks are spread around the globe, with the majority in Europe;
- the earliest codes/frameworks were published in 1995;
- the latest codes were published in 2013;
- the content and reach of these codes differ vastly, mainly in the areas of applicability and local legislation;
- the codes are mainly applicable to institutions within the borders of a particular country with little cross-border reach; and
- enforcement of these codes also differs between countries, from “comply or else” to “comply or explain” to “apply or explain”.

On a regional basis, the European Union (EU) has instituted a Corporate Governance Framework but the IFC (2008) states,

The European Union (EU) has achieved a great deal in terms of addressing disclosure, shareholder protection, and board structures and responsibilities since the adoption of its Action Plan for Modernizing European Company Law and Enhancing Corporate Governance in the EU. Yet, candidate and potential candidate countries are not always conversant with EU corporate governance requirements and recommendations.

The EU has ordered a review of the Corporate Governance Framework, but on closer inspection of the Green Paper, it appears that important corporate governance issues such as decision-making by boards, directors’ responsibility, directors’ independence, conflicts of interest or stakeholders’ involvement have been left out of the Green Paper (Eur-lex, 2013).

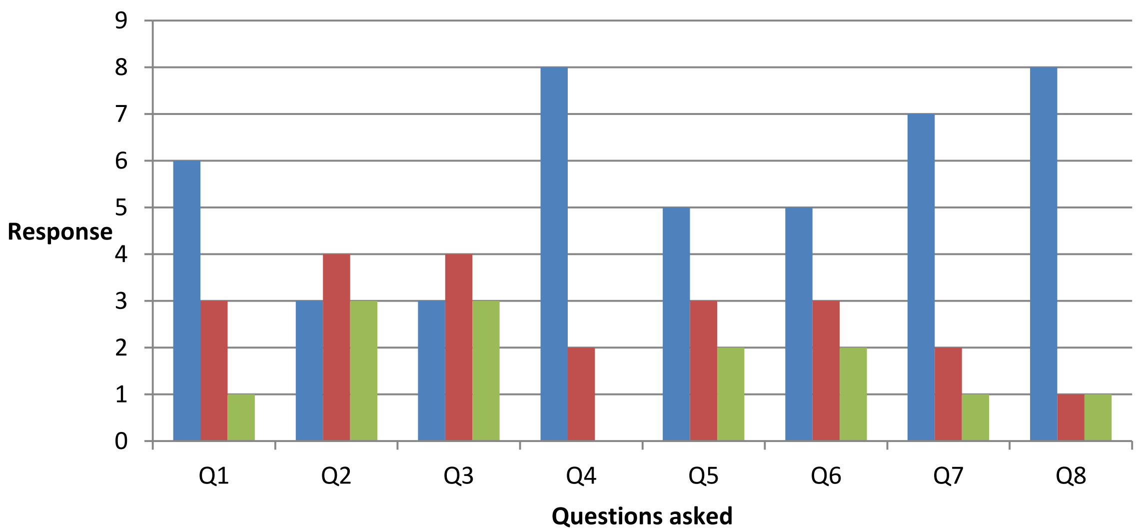
It can be concluded that just more than half the countries in the world have recognised corporate governance as important and they have some sort of framework in place. In some cases, these frameworks are fairly old and very little similarity was found amongst the different codes leading to the application of different standards throughout the world.

4. Research Findings

As mentioned in the research methodology above, the focus was firstly on a review of current corporate governance frameworks used in the different countries around the world. The purpose was to ascertain the extent of current frameworks. Secondly, the selected experts were interviewed to obtain specific information regarding corporate governance.

Figure 1 below details in graphical format the research findings. On the x-axis, Figure 1 shows the participants’ answers to the different questions as a percentage. The blue bar indicates a “yes” answer, the burgundy bar a “no” answer and the green an “uncertain” answer. The questions asked are shown on the y-axis marked as Q1 to Q8.

Figure 1. Research findings



Do you think corporate governance was to blame for the global financial crisis? (Q1)

It appeared that there was still no consensus on the issue of whether a lack of corporate governance was to blame for the global financial crisis. The majority of the respondents (60%) were however of the opinion that inadequate corporate governance was to blame.

Do you think that the supervisory coverage with regard to corporate governance is sufficient? (Q2)

The respondents were divided on whether they experienced adequate supervision by their supervisory authority. It is interesting to note that the majority of the respondents replied "no" and that there were an equal number of "yes" and "uncertain" responses. This could be an indication that the respondents were not satisfied with the supervision conducted by their supervisor as far as corporate governance was concerned.

Does your supervisory team have enough knowledge about corporate governance? (Q3)

The respondents were divided on whether their supervisory team had adequate knowledge. It is interesting to note that the majority of respondents replied "no" and that there were an equal number of "yes" and "uncertain" responses. This could be an indication that the respondents were not sure about the experience of their supervisory team as far as corporate governance was concerned.

Does your institution report to multiple supervisors? (Q4)

The majority of the respondents (80%) indicated that they reported to multiple supervisors mainly as a result of their activities and interactions in the financial markets. Only 20% of the respondents reported to one supervisor only.

Do these supervisors apply the same rules? (Q5)

Respondents were quite vocal about this question. Half of the respondents indicated that their supervisors did not apply the same rules. The result was that financial institutions had to comply with different sets of rules that increased the cost of compliance. Respondents furthermore indicated that there were also different reporting requirements which also placed an additional burden in the financial institutions' information technology infrastructure and cost.

Are there too many rules? (Q6)

Respondents were again vocal about this question. Half of the respondents indicated that there were too many rules and regulations even within one single supervisory body. Respondents requested fewer rules to comply with and that these rules should not be overly complicated. Some respondents expressed the view that these rules should not impede on their ability to do business.

Does your supervisor practice risk-based supervision? (Q7)

The majority of the respondents (70%) were supervised according to a risk-based approach instead a rules-based approach. The respondents were of the opinion that the risk-based approach was more efficient.

Is there a need for a new global supervisory architecture? (Q8)

By way of the questionnaires, the respondents called for a new global supervisory architecture as far as corporate governance is concerned. There was no consensus about the exact structure of a new global supervisory architecture.

What solutions can you offer? (Q9)

During the interviews, the respondents offered the following possible solutions to make corporate governance more efficient in the world economic system:

- Reduce the number of international and national organisations setting and applying rules – for the sake of the consistency and efficiency of the regulated sector, the fewer the number of bodies setting and/or enforcing fewer rules, the better.
- The formulation of a set of universal rules and regulations – all institutions that perform the same economic function within a marketplace, irrespective of charter choice or name, should be regulated in an equivalent manner.
- Supervision must be risk-based – ensure that rules and supervisory techniques are indeed efficacious and risk-based.
- Improve quality of implementation by the regulatory bodies – supervisors should be well prepared for their job.
- Implement corporate governance risk management as part of the organisation's risk management regime – ensure that corporate governance risk is identified, monitored, reported on and corrective action taken.

The respondents all agreed on the above-mentioned possible solutions but could not agree which will be the best under the current circumstances. However, all agreed that something drastically had to be done.

5. Recommendations

In view of the above, this paper makes the following recommendations with regard to corporate governance:

Current there are several supervisory bodies that "govern" specific regulatory aspects in the world financial markets, such bodies as the Bank for International Settlements (BIS) and the Financial Action Task Force (FATF).

The BIS was established in 1930 and is the oldest international financial organisation in the world (BIS, 2013). The mission of the BIS is to foster international monetary and financial cooperation, and serves as a bank for central banks. Sixty central banks and monetary authorities are currently members of the BIS.

The BIS pursues its mission by (BIS, 2013):

- promoting discussion and facilitating collaboration among central banks;
- supporting dialogue with other authorities that are responsible for promoting financial stability;
- conducting research on policy issues confronting central banks and financial supervisory authorities;
- acting as a prime counterparty for central banks in their financial transactions; and
- serving as agent or trustee in connection with international financial operations.

In addition, the BIS hosts several secretariats such as the Secretariat of the Basel Committee on Banking Supervision, the Committee on the Global Financial System, the Committee on Payment and Settlement Systems, the Markets Committee, the Central Bank Governance Group, and the Irving Fisher Committee on Central Bank Statistics (BIS, 2013).

The FATF (FATF, 2013) is an inter-governmental body established in 1989 by the ministers of its member jurisdictions. FATF set standards and promote effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system.

The FATF is therefore a "policy-making body" which works to generate the necessary political will to bring about national legislative and regulatory reforms in these areas. The FATF developed a series of recommendations that are recognised as the international standard for combating money laundering and the financing of terrorism.

Other important tasks of the FATF include monitoring the progress of its members in implementing the FATF measures, reviewing money laundering and terrorist financing techniques and counter-measures, and promoting the adoption and implementation of appropriate measures globally (FATF, 2013).

In view of the aforementioned, this article proposes:

- the formulation of a world supervisory body focusing on corporate governance in organisations; and
- the formulation of a set of recommendations that can be used by the aforementioned supervisory body to compile a world-wide set of corporate governance standards.

World supervisory body on corporate governance

This article proposes that a world supervisory body on corporate governance be established and be called the Corporate Governance Supervisory Authority (CGSA). The formulation of a body such as the CGSA could have, amongst other, the following advantages:

- establishing a more transparent and stable financial system;
- providing countries' financial institutions with guidance on establishing an efficient corporate governance regime;
- mitigating corporate governance risk on a global scale;
- limiting the potential for bad behaviour by instituting rules to reduce potential fraud and conflict of interest; and
- providing guidelines to stay compliant with rules, regulations and laws.

The following should be salient features of the CGSA:

Establishment

The CGSA should be a supervisory body established by its members. Members could be any country that has already contributed or that wants to contribute to ensuring international financial stability. It is suggested that the establishment of the CGSA be facilitated by one of the current international supervisors or bodies such as the World Bank, BIS or FATF.

Structure and legal standing

The CGSA should be an international non-profit organisation established by its members. The recommendations should be applied to its members by the CGSA on an "adapt-or-explain" basis.

Mission

The CGSA's mission should be to establish sound corporate governance principles to maintain financial stability in world markets.

Objectives

The following should be the specific objectives of the CGSA:

- to contribute to financial stability by setting and maintaining international corporate governance standards in the form of recommendations;
- to promote the implementation of these international corporate governance standards; and
- to collaborate with other similar supervisory bodies in promoting world-wide financial stability.

Tasks

The following would be the initial tasks of the CGSA:

- setting and maintaining international corporate governance standards;
- assessing and monitoring members' adherence to the set international standards;
- identifying and engaging with non-member countries with the objective to implement the CGSA standards in those countries;
- responding to significant new threats, developments or needs;
- engaging with individual financial institutions on corporate governance;
- providing training on corporate governance to its members; and
- constantly researching new initiatives to improve corporate governance.

As the CGSA settles into its role, new tasks of refinement to current tasks could emerge.

Membership

CGSA members should be the countries to agree to work together to form the CGSA. Members should commit to:

- continuous support of the CGSA;
- work together with other members to meet the objectives of CGSA;
- implement and actively promote the corporate governance standards in their own countries;
- participate actively in the assessment of other members;
- participate actively in continuous research into corporate governance matters; and
- continuous funding of the CGSA based on a pre-determined formula.

Corporate governance recommendations

The very first task after the establishment of the CGSA is the formulation of a set of universal corporate governance standards (recommendations) for implementation by members. These universal standards would be the benchmark against which members could measure themselves and also other members. It is further proposed that these recommendations be included in the criteria when a country rating is performed.

There are numerous topics upon which the final corporate governance standards (recommendations) could be based but the following, in no particular order, are proposed as possible topics to be included in the initial debate:

Ethical behaviour

In the business world, ethical behaviour is the cornerstone of a business and means applying principles of honesty and fairness to relationships with other staff and customers (Hill, 2013). Ethical businessmen make an effort to treat everyone with whom they come into contact as they want to be treated themselves.

Ethical behaviour forms one of the cornerstones of good corporate governance as ethical procedures and principles of conduct can be regarded as a form of self-regulation, placing the responsibility to act professionally and ethically with the organisation.

Composition of the board

The boards of companies are the main management structures in such companies. Boards consist of groups of individuals who have been elected as representatives of the stockholders to establish corporate management-related policies and to make decisions on major company issues.

The boards of companies are often described as private clubs and not representative democracies (Gross, 2010). Increasing levels of boardroom regulation and risk have also placed greater demands on non-executive directors of companies meaning that selecting candidates with the right knowledge, experience and skills is of the utmost importance.

There is no consistency and agreement between companies world-wide on how the selection of non-executive directors should be conducted. In addition, in their annual reports, these international companies were silent on the selection criteria of non-executive directors. Selecting board members with the right knowledge, experience and skills is of the utmost importance.

Role and activities of the board

The board is ultimately accountable and responsible for the affairs and performance of the company. It should act fairly and independently to ensure that all relevant information is available to stakeholders as and when needed. Therefore the board should retain full and effective control over the organisation and be involved in all decisions which materially affect the financial, social, legal and environmental standing of the company.

Managing stakeholders

Financial institutions should respect the rights of stakeholders and enable stakeholders to exercise their rights by effectively communicating information what is relevant, timely, understandable and easily accessible. Stakeholder relationships that are mismanaged have fewer favourable consequences for companies.

Stakeholder management is a difficult process for organisations as it requires investment and commitment. It is important to note that satisfied stakeholders get what they need and identify the company as an overall positive experience.

Committee structures for each and every risk identified

The board has to establish a number of committees to assist it in discharging its responsibilities. The type of committees established should be in line with risks faced by the particular company. Typical committees could include an audit committee, a risk committee, a governance committee and a compliance committee.

These committees should be chaired by independent non-executive directors, supported by the company secretary or his or her delegate, and free to take independent professional advice as and when necessary.

Management structure

Companies should create a management structure which is directed towards the achievement of organisational goals. The structure of an organisation can help or hamper its progress toward accomplishing these goals. This structure should support activities such as task allocation, coordination and supervision.

Specific management structures cannot be promoted but should be constructed according to a company's specific needs. The structure should however ensure efficient corporate governance and streamline operations, and it should be able to incorporate multiple jurisdictions, improve performance and focus on sustainability.

Risk and compliance management

Companies should introduce effective risk and compliance management structures and activities. Hobbs (2012) is of the opinion that this should be affected by an organisation's board of directors, management and other personnel. It should be applied in a strategy setting across the organisation. It should be designed to identify potential events that may affect the entity and manage risk to be within its risk appetite and provide reasonable assurance regarding the achievement of entity objectives.

External and internal audit

Corporate governance depends to a large extent on the efficiency of external and internal audit activities (Mitra, 2012). The auditor, external or internal, does not have direct corporate governance responsibility but rather provides assurance on the information aspects of the governance system.

Ojo (2009) is of the opinion that the external auditor's primary role is to verify whether the financial information given to investors is reliable and accurate. The external auditor expresses an expert opinion on the fairness of the financial statements in all material respects, a company's financial position, results of operations, and cash flows.

Advtech (2013) mentions that the internal auditor examines and evaluates the company's procedures and systems, including internal controls, disclosure procedures and information systems, ensuring these are functioning effectively. As an independent assurance function, the auditor also provides assurance with regard to the effectiveness of risk management, compliance and governance activities.

Liaison with supervisors and regulators

The mission of supervisors and regulators is to safeguard the integrity and soundness of the markets. In order to achieve this, supervisors and regulators follow specific programmes to supervise the companies under their jurisdiction.

The role of regulation in influencing the development of corporate governance principles has become an important policy issue and should receive attention. The regulator and the supervisor should therefore play a more active role in establishing standards and rules to make corporate management practices in organisations more accountable and efficient.

Sustainability

It is accepted world-wide that sound corporate governance practices enhance shareholder value and by conducting the company's affairs with integrity it will ensure the long-term sustainability of the business (Seardel, 2013). An effective corporate governance system employed in a company can assist in creating the confidence and trust necessary for the company's existence in the market economy. Corporate governance and the complexity of sustainability call for global cooperation, based mainly on the coordination of strategies and adopting of the best decisions.

What should happen next?

This article proposes that a summit be called to discuss and create the CGSA. The author is of the opinion that the World Bank or a similar world body should take the lead in this. At this summit, all the issues on the formulation, membership and funding of the CGSA should be discussed.

Conclusion

Suggestions that the global financial crisis revealed severe shortcomings in corporate governance were investigated. Research in this study has found that boards of directors were amongst other accused that they were too complacent in allowing their management and staff to engage in risky behaviour, adopting compensation programmes that encouraged risky behaviour, giving in to pressure from shareholders to exceed prior results, and failing to monitor the business and assess its risk profile.

In order to enhance corporate governance in companies around the world the formulation of a world supervisory body on corporate governance should be established and be called the Corporate Governance Supervisory Authority. It was also proposed that a summit be called to discuss and to create the CGSA. In addition, the formulation of a set of universal corporate governance standards (recommendations) for implementation by the members was suggested.

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