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CORPORATE GOVERNANCE IN ESSENCE. CORPORATE GOVERNANCE IN THE UNITED KINGDOM

This article is concerned with corporate governance and in particular, corporate governance in the UK. It provides the etymological origins of corporate governance, definitions of it, key concepts and principles. It also considers the current corporate governance reform in the UK.

Key words: corporate governance, best practice, directors' duties, shareholders, stakeholders, reform

Introduction

With rapid business development across the globe, sophisticated corporate transactions, challenges and opportunities resulting out of them; relationships between corporate entities and their stakeholders call for effective corporate governance. This article aims to consider corporate governance in a nutshell, providing the definition of it and its key concepts based on the example of the United Kingdom since the country is known to have a well-established system of corporate governance over the centuries. Recently proposed corporate governance reform in the UK will be discussed and conclusions will be drawn towards the end of the article.

Definitions and goals of corporate governance

Etymological origins of corporate governance derive from ancient Greek and Latin. The word «corporate» originates from Latin «corpus» and «corporare» where the former means «body» and the latter is «to form into one body».¹ As for the word «governance» it comes from the ancient Greek «kubernao» which means «to drive», «to guide».² The UK Report of the Committee on the Financial Aspects of Corporate Governance provides the following definition of the corporate governance: «Corporate governance is the system by which companies are directed and controlled».³ The OECD has expanded this definition with reference to corporate

¹ Online Latin Dictionary, available at <<https://www.online-latin-dictionary.com/latin-english-dictionary.php?parola=corpus+>> accessed 18 September 2017.

² English Words of (unexpected) Greek Origins, available at <<https://ewonago.wordpress.com/tag/etymology-of-govern/>> accessed 18 September 2017.

³ UK Report of the Committee on the Financial Aspects of Corporate Governance (December 1992) paragraph 2.5, PDF of the document can be found at <<http://www.ecgi.org/codes/documents/cadbury.pdf>> accessed 10 September 2017.

governance structures and goals in the Principles of Corporate Governance 1999.⁴ According to which, «corporate governance relate to the internal means by which corporations are operated and controlled».⁵ The Principles state that corporate governance specifies rights and duties between different constituencies in the corporation, such as the board, managers, shareholders and stakeholders. Good corporate governance ensures that not only interests of shareholders, but interests of a wider community, i.e. stakeholders are also taken into account. Running a company with this policy will maintain investors' confidence and attract more long-term capital.⁶ According to Thomas Clark, «corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals».⁷ It can be seen that corporate governance is a wide term that includes principles of running business and attaining corporate goals, distribution of rights and responsibilities between participants in a company, directors' accountability for their decisions, corporate social responsibility and many other.

Key corporate governance concepts

There are seven key concepts in corporate governance which are: fairness, independence, honesty, transparency, accountability, integrity and responsibility.⁸ We shall consider each of them in turn. *Fairness/equitable treatment of shareholders* is an essential element of running business successfully. Rights of both, minority and majority shareholders as well as foreign

shareholders must be protected and opportunity for redress given to any shareholder whose right has been violated. This concept is illustrated by the OECD in the Principles (1999), II. (A.) «All shareholders of the same class should be treated equally» and «within any class all shareholders should have the same voting rights».⁹ Furthermore, it is stated that procedures for all shareholder meetings should offer equitable treatment to all shareholders. *Independence* refers to company directors and means that each of the board members are independent and should not exercise their duties based on the will of others. Directors should be *honest* in exercising their duties and in the decision-making process. The Principles (1999) state that directors should act «in good faith, with due diligence and care, and in the best interest of the company and shareholders.»¹⁰ Good corporate governance requires high *transparency* via timely and accurate disclosure of all material matters of the company, such as company performance, ownership, voting rights, board members and their remuneration, governance policies.¹¹ As for the *accountability*, board members are elected by the shareholders to act on behalf of the shareholders in the day-to-day running of the company and therefore, they are accountable for their managerial decisions to the shareholders and to the company as a whole. Furthermore, directors should have high *integrity* in the decision-making process and daily running of the company as well as to *be responsible* for their decisions and acts. They should avoid conflicts of interest in the course of performing their

⁴ OECD Principles of Corporate Governance (1999) PDF of the document can be found at <[http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=C/MIN\(99\)6&docLanguage=En](http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=C/MIN(99)6&docLanguage=En)> accessed 10 September 2017.

⁵ Ibid., p. 5.

⁶ Ibid., p. 5.

⁷ Thomas Clarke, *International Corporate Governance* (first published by Routledge in 2007) 518, 2.

⁸ Chartered education, available at <<http://www.charterededucation.com/general/7-key-corporate-governance-concepts-for-acca-p1/>> accessed 10 September 2017.

⁹ Op. cit., OECD Principles of Corporate Governance (1999), p. 17.

¹⁰ Ibid., V. (A.), p. 20.

¹¹ Ibid., IV. (A.) p. 19.

director's duties. For instance, a director of one company cannot sell a company's asset to another company where he/she holds a senior position or if that position is held by the director's relative.

Corporate governance in the UK

There is a comprehensive framework of legislation and voluntary practices on corporate governance in the UK. The UK Corporate Governance Code¹² (the Code) is a part of UK company law and is a voluntary code. The code sets standards and principles of good corporate governance in relation to public listed companies. The first version of the Code — the Code of Best Practice was offered in 1992 by the Cadbury Committee and was as a response to the lack of legal framework in corporate system at that time.¹³ The Code of Best Practice established a definition of the corporate governance, its purpose and set the recommendations for companies and these recommendations became a backbone of corporate governance in the UK today, such as separation the role of the CEO and the Chairman, establishment of the minimum of three non-executive directors on the board and audit committees. This Code has also given more power to the institutional investors in promotion of best practice in corporate governance.¹⁴ As a result of the Code of Best Practice the board oversight was enhanced and corporate governance in the UK was set on the path of the significant reform.

Speaking of the current Code, it was established by the Financial Reporting Council and is considered one of the most influential codes in the world. It offers flexibility via «comply or explain» principle which means that the Code is not binding on companies but yet it requires the company to comply with it.¹⁵ If the company has chosen not to comply with the Principles and provisions of the Code then it must provide the reason for not doing so. This approach recognises that «one size doesn't fit all» and that companies are free to choose the alternative to ensure that they have good governance. «Comply or explain» principle has gained popularity across European Union and the EU Statutory Audit Directive 2006¹⁶ has required all EU member states to adopt the same principle in their corporate governance. The Code establishes four main Principles: Leadership, Effectiveness, Accountability, Remuneration, Relations with shareholders. Under the **Principle of «Leadership»** it is stated that every company should have an effective board which is responsible for the long-term success of the company. There is a unitary type of board where non-executive directors are a part of it. Their role is to «challenge and help develop proposals on strategy».¹⁷ The Code stipulates the clear division of responsibilities amongst directors and clarifies the role of the chairman, stating that the chairman is «responsible for leadership of the board

¹² FRC, The UK Corporate Governance Code (April 2016), available at <<https://www.frc.org.uk/getattachment/ca7e94c4-b9a9-49e2-a824-ad76a322873c/UK-Corporate-Governance-Code-April-2016.pdf>> accessed 10 September 2017.

¹³ 'Cadbury Committee Recommendations In A Nutshell', Business Standard (January 26, 2013) available at <http://www.business-standard.com/article/specials/cadbury-committee-recommendations-in-a-nutshell-196091801008_1.html> accessed 12 September 2017.

¹⁴ Elisabeth Dedman, 'The Cadbury Committee recommendations on corporate governance – a review of compliance and performance impacts', International Journal of Management Reviews (December 2002), available at <<http://onlinelibrary.wiley.com/doi/10.1111/1468-2370.00091/abstract>> accessed 15 September 2017.

¹⁵ Ft.com/lexicon available at <<http://lexicon.ft.com/Term?term=comply-or-explain>> accessed 16 September 2017.

¹⁶ Directive 2006/43/EC.

¹⁷ The UK Corporate Governance Code (April 2016) FRC, A. 4, p. 9.

and ensuring its effectiveness on all aspects of its role».¹⁸ **The Principle of Effectiveness** requires the board and its committees to possess necessary skills, experience, independence and knowledge of the company. Having all those will allow directors to perform their duties effectively.¹⁹ Under this Principle the Code provides recommendations in relation to appointments of the board; board's commitment to their duties; development of the directors' knowledge and capabilities; information and support of the board; annual evaluation of the board, its committees and individual directors; and re-election of the board members. **The Principle of Accountability** corresponds with the core concept of corporate governance of the accountability and requires the board to «present a fair, balanced and understandable assessment of the company's position and prospects.»²⁰ This Principle includes financial and business reporting; risk management and internal control; and audit committee and auditors. **The Principle of Remuneration** states that «executive directors' remuneration should be designed to promote the long-term success of the company. Performance-related elements should be transparent, stretching and rigorously applied.»²¹ Remuneration committee should act very carefully designing the schemes of executive remuneration and avoid the risk of overpaying. The Principle covers the procedure for developing policy on executive remuneration and for individual directors. The Principle states that none of the directors are allowed to take part in determining the

remuneration for themselves. In addition, the Principle guides with regard to remuneration for non-executive directors. **The Principle of Relations with shareholders** states that it is the board's responsibility to ensure that there is an effective dialogue between the board of directors and the shareholders of the company.²² The Principle requires directors to be aware of the major shareholders' issues and concerns, and via the general meetings to communicate with investors and promote their active participation. It can be seen that the Code provides companies with useful guidance with regard to running business and perhaps, can be said that it serves as a supplementary tool which assists directors in performing their duties effectively. Speaking of the directors' duties in the UK, they are stipulated in the Companies Act 2006 (Chapter 10 Part 2)²³ which is the cornerstone in the UK company law and corporate governance of the country. Sections 171–177 of the Companies Act state the following duties of the directors: (171) duty to act within powers; (172) duty to promote the success of the company; (173) duty to exercise independent judgement; (174) duty to exercise reasonable care, skill and diligence; (175) duty to avoid conflicts of interest (176) duty not to accept benefits from third parties; (177) duty to declare interest in proposed transaction or arrangement.²⁴ From this it can be seen how directors' duties, key concepts of corporate governance and its main principles correspond with each other. Compliance with the principles results in good corporate governance in the

¹⁸ Ibid., A. 3, p. 8.

¹⁹ Ibid., p. 10.

²⁰ Ibid., C. 1, p. 16.

²¹ Ibid., D. 1, p. 20.

²² Ibid., E. 1 p. 22.

²³ The Companies Act 2006, available at <<http://www.legislation.gov.uk/ukpga/2006/46/contents>> accessed 16 September 2017.

²⁴ Ibid.

country and therefore, builds an attractive platform for investment and economic growth.

2016—2018 Corporate Governance Reform in the UK

To strengthen corporate governance practices in the UK last year the Department for Business, Energy and Industrial Strategy published the Green Paper on corporate governance reform.²⁵ The reform covers executive remuneration; employee, supplier and wider stakeholder's voice representation; and corporate governance in large privately-owned businesses. Executive remuneration has been a subject of growing public concern over a number of years. According to the Green Paper, total remuneration of the CEOs of FTSE 100 companies has dramatically increased over the period of 18 years and this exceeded growth in average pay of full-time employees in the UK.²⁶ This matter raised significant concerns from shareholders and wider stakeholders whether increase in CEO's remuneration was justified by improvement in the long-term value in the companies they run.²⁷ In this regard, the Green Paper proposed changes to the executive remuneration for listed companies in the following areas:

- Increasing shareholder voting rights (e.g. making an executive remuneration package subject to a binding vote);
- Further involving shareholders in executive remuneration arrangements (e.g. establishing a senior «shareholder» committee);
- Placing further requirements on remuneration committee (e.g. requiring

the remuneration committee to consult shareholders prior preparing its remuneration policy);

- Further disclosing of executive remuneration (e.g. reporting on the ratio of CEO pay to an average UK employee pay);

- Providing explanations regarding use of long-term incentive plans as a part of the executive remuneration policy.²⁸

In addition to scrutinising the executive pay, the Government seeks improvement in employees and wider stakeholders interest's representation at the board level. As an option it has been offered to appoint a company's employee to represent employees' interests in the boardroom, however this attracted some experts' criticism for the fact that a worker does not possess necessary qualifications, nor experience in this. Instead, it would be more efficient to assign this role to an already existing non-executive director of the company.²⁹ The other options in this regard include: establishing stakeholder advisory panels, members of which could be engaged in the board meetings and consulted on matters related to executive remuneration and additional reporting based on section 172 the Companies Act 2006.³⁰ In respect of proposed change to corporate governance in large privately-owned businesses, it is suggested to extend the coverage of the UK Corporate Governance Code to large privately-owned limited liability companies or develop a new corporate governance code which would be designed specifically to this type of business. Call for the change has been caused by the fact that there are many various groups of stakeholders apart from the owners and

²⁵ Department for Business, Energy and Industrial Strategy published the Green Paper on corporate governance reform, available at <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/584013/corporate-governance-reform-green-paper.pdf> accessed 12 September 2017.

²⁶ Ibid., p. 16.

²⁷ Ibid., p. 16.

²⁸ Norton Rose Fulbright, 'Corporate governance reform – will the Green Paper make a difference?' (December 2016), available at <<http://www.nortonrosefulbright.com/knowledge/publications/144986/corporate-governance-reform-will-the-green-paper-make-a-difference>> accessed 15 September 2017.

²⁹ 'Corporate Governance reforms can be effective', Financial Times, August 29, 2017, available at <<https://www.ft.com/content/d50a6ae8-8ca7-11e7-9084-d0c17942ba93>> accessed 17 September 2017.

³⁰ Op. cit., Norton Rose Fulbright.

directors of the private company which have a strong interest in success of the company and which can be badly affected when the business fails.³¹ The Financial Reporting Council aims to consult regarding the amendments to the UK Corporate Governance Code in the autumn 2017 and publish an updated Code by the middle of 2018. This would mean that most of the companies should start complying with the Code in 2019.³²

Conclusion

Good corporate governance is important for all members of the society – from the government, to constituencies of the company, to the wider stakeholders. It helps maintain the investors' confidence and as a result, enhances company's image, its market value and builds strong economy. Good corporate governance ensures effective management of the company, effective corporate social responsibilities, it eliminates risks and enables business growth. Good corporate governance is not established in one day, it requires profound review of political, corporate and business cultural values, solid legal reforms, development its own best practices tailored to the economic and business needs of a particular country, as well as adoption best practices from around the globe. With regard to the UK corporate Governance, Business Secretary Greg Clark said: «One of Britain's biggest assets in competing in the global economy

is our deserved reputation for being a dependable and confident place in which to do business. Our legal system, our framework of company law and our standards of corporate governance have long been admired around the world. We have maintained such a reputation by keeping our corporate governance framework under review. Today's reforms will build on our strong reputation and ensure our largest companies are more transparent and accountable to their employees and shareholders.»³³ This quotation summarises well state of corporate governance in the UK and signifies the current reform. In my opinion, this reform will place corporate governance in the UK into a new more advanced platform and will further enhance transparency in the financials of the company and executive remuneration policy in particular. It will provide shareholders with more power in the company and strengthen the voice of the employee in the boardroom. This will bring a positive change into the country's corporate governance and attract more investment, both domestic and foreign. However, at the same time, placing directors remuneration under more scrutiny could, perhaps, create some unexpected affect on the end result of the long-term run of the company. Yet this could only be seen after the reform will have been successfully completed and the new policy will have been complied with.

³¹ Op. cit., Norton Rose Fulbright.

³² Department for Business, Energy & Industrial Strategy, 'World-leading package of corporate governance reforms announced to increase boardroom accountability and enhance trust in business', available at <<https://www.gov.uk/government/news/world-leading-package-of-corporate-governance-reforms-announced-to-increase-boardroom-accountability-and-enhance-trust-in-business>> accessed 10 September 2017.

³³ Ibid.

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Дана стаття стосується корпоративного регулювання та, власне, корпоративного регулювання в Об’єднаному Королівстві Великобританії. В статті розглянуті етимологічні походження поняття та його визначення, ключові концепти та принципи. Також розглянута запропонована реформа в системі корпоративного регулювання Англії.

Ключові слова: корпоративне регулювання, найкращі практики, обов’язки директорів, акціонери, зацікавлені сторони, реформа.

Журавель М. В. Корпоративное регулирование. Корпоративное регулирование в Объединённом Королевстве Великобритании.

Даная статья касается корпоративного регулирования, и в частности корпоративного регулирования в Объединённом Королевстве Великобритании. В статье рассмотрены этимологические происхождения понятия и его определения, ключевые концепты и принципы. Также рассмотрена предложенная реформа в системе корпоративного регулирования Англии.

Ключевые слова: корпоративное регулирование, наилучшие практики, обязанности директоров, акционеры, заинтересованные стороны, реформирование.