Chapter 3

Corporate governance and accounting ethics
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Governance Structure of a Company

Learning Objectives

By the end of this chapter, students should be able to:

1. Understand the organizational structure that underpins corporate governance.
2. Explain the composition, roles, and responsibilities of the Board of Directors.
3. Distinguish between executive and non-executive directors.
4. Discuss the role of management in governance implementation.
5. Describe the functions of the company secretary and governance committees.
6. Analyze the interactions between the board, management, and shareholders in governance.

3.1. Introduction

Corporate governance exists in a specific organizational framework that stipulates the line of authority, responsibility in decision making and accountability. This structure will make the company operate efficiently and in tandem with the principles of the good governance, transparency, and accountability.

As Tricker[(1)] stresses, the governance of the firm determines the framework under which the objectives are established, the performance is tracked, and the compliance with the ethical norms is ensured. The governance system outlines the contact between the board of directors, management, shareholders and other stakeholders who all have a role in determining corporate output.

3.2. Concept Governance Structure

Governance structure can be defined as institutional and procedural set-up which determines the way corporate power is shared and wielded by various organizational organs. It defines:

- Decision-making (authority);
- The decision-making process (process); and
- Who is accountable (responsibility)?

Solomon[(2)] states that a proper structure of governance balances interests of the shareholders, management, employees and other stakeholders by determining distinct roles, duties and reporting relationships. While the OECD[(3)] considers the structure of the corporate governance as the basis through which the corporations are guided and managed to guarantee accountability and equity in the corporate transactions.

3.3. Elements of Governance Structure of a Company

The governance structure of a company typically has 3 levels:

1. Shareholders (Owners).
2. Board of Directors (Governors).
3. Management (Executives).

All these elements play various roles which are related to one another which maintain corporate performance and integrity.

3.3.1. Shareholders

The owners of the company are shareholders. They contribute capital and take residual risks, and in this way, they have the final say to appoint directors and make significant corporate decisions.

Key Responsibilities:

- Elect the members of the board of directors during Annual General Meetings (AGMs).
- Sanction audited transactions of finances and dividends.
- Approve mergers, acquisitions and re-structuring proposals.
- Make boards accountable to the performance of the company.

Nonetheless, practically, shareholders do not have to participate in daily decisions but entrust the board and the management with such aspects because they still possess takeover capabilities in the form of voting power and disclosure obligations.(4)

3.3.2. The Board of Directors

The highest decision-making organ in a corporation is the Board of Directors. It is the connection point between shareholders and management to have a strategic direction of the company to conform with the interests of the stakeholders.

According to the Financial Reporting Council of Nigeria (FRCN)(5), all companies are expected to enjoy proper leadership, enterprise, integrity and good judgment in the way the companies are being operated.

Functions of the Board:

1. Strategic Direction: Endorsing and managing the strategic plan of the company.
2. Control and checks: Management performance should be in line with corporate objectives.
3. Risk Management: This involves the identification as well as the mitigation of the possible risks in the organization.
4. Financial Integrity: Endorsing budgets, significant investments, and financial statements.
5. Ethical Leadership: Advancing corporate values and ethics.
6. Succession Plans: Making sure that there is continuity in leadership and development of management.
7. Compliance: Making sure that there is compliance with laws, regulations, and codes of governance.

Boards may be single tier (unitary, in Nigeria and the UK) or two-tier (supervisory board and management board, in Germany). Nigeria adheres to the unitary model which incorporates the executive and non-executive directors in a single board.

3.4. Composition of the Board

A board of directors ought to have an equal representation of skills, experience, gender and independence. FRCN Code 2018(5) suggests boards to have majority of non-executive directors, and they should have adequate number of independent directors not connected with any relationship that can affect objectivity.

Categories of Directors:

1. Executive Directors (EDs):
    - Full-time workers in day-to-day activities.
    - Add the Chief Executive Officer (CEO) or the Managing Director (MD).
    - Accountable in the implementation of the board-approved strategies.

2. Non-Executive Directors (NEDs):
    - Not participating in the day to day running but offer supervision and independent advice.
    - Make sure that the management choices are made in the best interest of the company.
3. Independent Directors:
    - No material association with the company.
    - Increase objectivity and defend minority shareholders.
    - Mandatory in the FRCN (2018) and SEC 2011(6) codes.

Board Size:

Although this is not a strict limit, efficient boards tend to have 7 to 15 members that make them diverse without making their decision-making processes inefficient.

3.5. Chairperson and Chief Executive Officer (CEO)

The board is headed by the Chairperson and the management by the CEO. The separation of such positions is the requirement of good governance to avoid the concentration of power and possible conflict of interests.

Key Distinctions:

- The Chairperson manages the board meetings and makes sure that directors make their contributions effectively.
- CEO: the CEO deals with the day-to-day running and executing board policies.
- The SEC Code (2011) and CBN Code (2014) specify that one person cannot be a Chairman and CEO at the same time.

3.6. Management and Executive Leadership

The functioning arm of corporate governance is the management. They implement the plans, which are accepted by the board, and are responsible to the performance of the corporation.

Key Functions:

1. Put in strategic plans and budgets.
2. Manage human, financial and technological resources.
3. Maintain internal controls and make sure that policies are adhered to.
4. Report to the board on a regular basis on operational performance.

The FRCN (2018) highlights that the management should maintain ethical standards and corporate culture within the company values.

3.7. The Company Secretary

The Company Secretary is very important in maintaining board efficiency and regulatory compliance. Under the Companies and Allied Matters Act (CAMA)(7), a company in Nigeria has to employ a qualified company secretary.

Key Duties:

1. Give corporate governance and legal advice.
2. Notices and minutes of the board meetings should be prepared and circulated.
3. Have board induction and training.
4. Statutory record keeping and filing with Corporate Affairs Commission (CAC).
5. Facilitate information sharing between shareholders, the management and the

board.

The company secretary serves as the governance conscious of the company.[8]

3.8. Board Committees

In order to increase efficiency, boards assign certain tasks to committees consisting primarily of non-executive directors.

Common committees include:

1. Audit Committee: Manages financial reporting, internal controls and external audit.
2. Risk Management Committee: Recognizes risks and tracks enterprise risks.
3. Nomination and Governance Committee: takes care of the appointment of directors and governance review.
4. Remuneration Committee: Establishes executive compensation and incentive systems.
5. Sustainability or CSR Committee: Manages social responsibility and sustainability reporting.

FRCN Code [5] and OECD[3] promote the independence of the committees and reporting to the board.

3.9. Interrelationships between Board, Management and Shareholders

A good system of governance ensures cooperation and responsibility of the three levels of corporate leadership.

- Board and Management: this is where the strategic direction is determined by the board and executed by the management. Accountability is maintained through constant reporting and performance review.
- Board and Shareholders: the shareholders demand accountability of the board by way of general meetings and disclosures.
- Communication: the management has a role to play in communicating with the shareholders via, reports, press releases, and annual meetings.

Fama et al., assert that agency problem arises because of the separation between ownership (shareholders) and control (management), and thus, corporate governance mechanisms are meant to reduce the occurrence of agency problem.

3.10. Typical example of a Corporate Governance Structure (Nigeria)

A good example is the Nigerian Breweries Plc.

The company has a unitary board of directors that consists of 12 members (a combination of executive and non-executive directors).

1. Board Chair is not affiliated to the management.
2. It has Audit, Risk Management, and Remuneration Committees.
3. The Company Secretary will make sure that the FRCN Code (2018) and CAMA (2020) are adhered to.

This structure is an indication of compliance to both the Nigerian and international best practices of governance.

3.11. The Problems of Corporate Governance Structure in Nigeria

Irrespective of the progress, the challenges facing Nigerian companies are:

- Board control by large shareholders.
- Laxity in applying codes of governance.

- Poor independence of directors.
- Limited gender diversity.
- Weak culture of disclosure and reporting.

Increased enforcement systems and culture of ethical boards is paramount to strengthening.[9,10]

The effective governance is the skeleton of corporate governance structure. It establishes chain of command, encourages responsibility and promotes ethical business practice. In Nigeria, the roles are clear because of the compliance with the FRCN Code (2018) and CAMA (2020) and help to improve transparency.

A perfect structure will not only ensure adherence but also ethical leadership, sustainability and trust that will be the key to the success of the business in the long run.

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