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Área: Finanzas

THE STATUTE OF GOVERNANCE. A PIVOTAL LINKAGE BETWEEN PRINCIPLES OF GOVERNANCE AND CORPORATE PRACTICES

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THE STATUTE OF GOVERNANCE
A pivotal linkage between principles of governance and corporate practices

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ABSTRACT

This paper puts forward an innovative construct called the Statute of Governance, by which a company can foster and enhance its corporate governance. The paper argues that it is not enough to list some principles of governance and a set of related good practices, as the Australian Stock Exchange has done, albeit it comprises the best available guidelines for the time being. We contend, however, that a step further should be taken, consisting of a Statute of Governance designed and passed by the Board, voted through by stockholders, and enacted by the management. Such statute is a pivotal linkage between principles and good practices, because it becomes enforceable from within the company itself, as the basic by-law concerning corporate governance.

JEL codes: G34, G32

Key words: statute of governance, principles of governance, good practices, Australian Stock Exchange, corporate governance.

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INTRODUCTION

Corporate Governance does matter and if we neglected it, as empirical evidence of corporate fraud and misconduct have been unmasking in the last decades, companies would impair their growth in value as well as in reputation; still worse, they risk failure and survival. It is not surprising, hence, that there has been a wave of compelling apprehension from the side of regulators and private players in the field of business who realized, at last, the need of raising standards of corporate behavior by sticking to more reliable practices\textsuperscript{1}.

The process of improving standards and practices has come about either from a compulsory viewpoint, just as Sarbanes-Oxley ultimately did in the aftermath of Enron’ demise, or from a purposeful but softer frame of mind which takes advantage of available benchmarks produced by commerce chambers, world-wide institutions\textsuperscript{2}, central banks, or securities exchanges, like the one issued in 2007 by the Australian Stock Exchange, perhaps the best in the world so far.

However, valuable as those tools turn out to be, they mostly apply to listed companies only. But it is for the sheer life of real markets to provide the observer with another picture, by which thousands of companies are not listed. In point of fact, many countries do not enjoy a thriving capital market for public placements and they remain under dissimilar governance styles, on which private placements favored by banks and institutional investors are the rule by and large\textsuperscript{3}.

\textsuperscript{1} A comprehensive analysis of good practices around the world can be found in the book edited by professor Lopez Iturriaga (2009).

\textsuperscript{2} Mainly through the OECD, Bank for International Settlements (the Basel Bank), the World Bank, the United Nations and the International Monetary Fund, which have been very active in the field of governance.

\textsuperscript{3} On this consequential topic, the reader is referred to Carey et al. (1993) and Easterbrook and Fischel (1996) for good introductions.
This paper sets forth an alternative proposal to improve the corporate governance in thousands of not-listed companies that have almost remained on the sidelines of the conventional debate about governance. For instance, family owned companies doing business in countries where public offers are scarce, and for which transparency and accountability are culturally mistrusted by owners and managers\(^4\). This line of research draws on an earlier contribution from the author that focused on the foundational charter of any organization (Apreda, 2007c). We point out that our proposal it also holds and comes in handy for all those countries where public offers and sound capital markets are deeply ingrained into the paradigm of Anglo-Saxon Corporate Governance.

In section 1 we deal with a functional definition of Corporate Governance broad enough to encompass most organizations all over the world. Next, in sections 2 and 3, we give heed to principles of governance and good practices, respectively. It is for section 4 to delve into the Australian Stock Exchange proposal of principles and practices for listed companies. Section 5 will introduce the main contribution of this paper, the Statute of Governance. Afterwards, a contrast will be made between the Australian proposal and the Statute of Governance. Finally, a pragmatic viewpoint on the Statute of Governance will follow.

### 1. CORPORATE GOVERNANCE

Our starting point will be the notion of Corporate Governance\(^5\).

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\(^4\) For a comparative analysis of styles of governance fostered by different legal traditions the book by Mark Roe (2003) is a provocative essay worthy of being read.

\(^5\) The framework of this definition has been drawn on Apreda (2006a), *The Semantics of Governance*. 
Definition 1  Corporate Governance

Corporate Governance consists in a manifold and intertwined set of variables of analysis, comprising decision-making processes, organizational structures and long-term goals, namely:

- the ownership structure of the organization as well as owners’ rights;
- the board of directors goals, as well as the fulfillment of their fiduciary duties and the scope of their control rights;
- the senior management tasks, as well as the fulfillment of their fiduciary duties and the scope of their decision rights;
- the relationship with creditors and the design of covenants on behalf of them;
- the fostering of both accountability and transparency;
- how to cope with conflicts of interests, their avoidance or resolution;
- incentives and rewards towards senior management and directors;
- looking after compliance risks;
- relationships with stakeholders comprising their rights and duties.

The preceding definition signals the denotative dimension of corporate governance, by focusing on those variables of analysis that provide not only with a blueprint of the organization, but also stands for the complex web of relationships arising between stakeholders and the organization itself. Now we must take a step forward to inquire about the connotative dimension of corporate governance.

Stakeholders of an organization are all those agents that lay claims, persistently along time, to things that they regard as legal rights entitled to them, or contractual duties the organization has committed itself to bring forward on behalf of the claimers. For this reason, they stake their claims, which are often competing and contestable, giving rise to conflicts of interests often so entangled that resolution is
far from being easily attained. And this is the point where accountability and transparency come in to enhance the company’s relationships with stakeholders.

Needless to say, some stakeholders become more prominent than others: for certain, shareholders, directors and managers are big players in the game of staking claims. In this particular case, the design of a governance structure must care for procedures and standards that help lessening conflicts among those big players.

2. REGULATORY AND DISCRETIONAL GOVERNANCE

For those of us committed not only to academic research on the subject, but also to private consultancy, it could not come as a surprise the pervading reluctance of managers and owners alike to realize that corporate governance is worthy of being included in their agendas.

For all intents and purposes, corporate governance has a dual nature. On the one hand, it is what regulators request as a matter of fact; on the other hand, owners, directors and managers enjoy the advantage of improving the governance of their organizations beyond and besides regulators. Let us look at this matter a little closer.

Whenever an organization is brought into existence, it will face a complex body of regulation to comply with, regarding the peculiar type of activity and scope that each company intends to carry out. For instance, a public company must be incorporated, which gives it a law-abiding corporate personality that entails both rights and liabilities. Moreover, a well-defined kind of information has to be released in a compulsory way, either at incorporation date or, from that moment on, under the guise of periodic disclosures established by accountancy and fiscal
duties, as well as claims from stock exchanges or ultimate lenders in the banking system.

Broadly speaking, regulatory governance adds up to decision-making constraints. In the incorporation procedure, and for the sake of illustration, the company makes known its ownership structure, the board of directors constitution, how often they will meet, the rights of block-holders and minorities, the way directors and managers discharge their fiduciary duties, the variegated assortment of commitments and responsibilities falling upon directors and managers, and so on.

If the organization does not fit the corporation model\(^6\), being a cooperative for example, the regulator will tell the founders how to design such particular architecture, what sort of internal supervisory agency will be required, how wide-ranging will be the scope of managerial functions, how to handle the conflicting roles of owners or beneficiaries in their usually strained relationships with the senior management.

Come as it may, there is no way out. A starting stage for any organizations prompts a ready-made design of governance that comes as a given fact of life on the grounds of regulation. We cannot contest such setting; on the contrary, we must follow what has been enacted so far.

But regulatory governance only amounts to schematic viewpoints about a variegated collection of organizations, leaving to the discretion of owners, directors, and managers the fine-tuning of corporate governance. Such degree of freedom must be welcomed since it will allow any organization to make a difference with its competitors, establishing profitable ties with stakeholders, fostering transparency and accountability, and nurturing a culture in the workplace that would increase the value and reliability of the going concern. While regulatory governance is

\(^6\) Hansman (2000) seems a worthy reference about the nature of a wide sort of organizations.
compulsory, discretional governance springs up as a strategic craft, a pointer to
growth and innovation in the foreseeable future.

3. PRINCIPLES OF GOVERNANCE

If we looked back to Definition 1, we would ask ourselves whether a procedure
could be devised to put into practice sound corporate governance structures. It is
the main assertion of this paper that such procedure consists in laying the
groundwork for a Statute of Governance out of principles of governance and good
practices. Let us expand on the former, leaving for next section distinctive issues
that underlie the latter.

**Definition 2 Principles of Governance**

*By principles of governance we mean precepts, that is to say, mandatory
statements, stemming from the variables of governance to which each organization
will commit itself to follow and hold true.*

The reader is referred to Exhibit 1 that lists on the right column the set of principles
put forth in this paper. It will become apparent how the chosen principles directly
stem from the variables of governance involved in Definition 1.

4. CODES OF GOOD PRACTICES

Precepts are a necessary step just to build up well-founded corporate
governances, but they are not sufficient. By essence, they are commandments to
do some things regarded as basic, almost to be accepted without opposition on
behalf of the company’s interests.
On the other hand, principles lack of functionality. They tell us “what we must do”. But they remain silent about how they should come down to earth. It will be for the so-called “good practices” to cope with this problem, installing any governance structure into the realm of practice.

**Definition 3  Codes of good practices**

*By a code of good practices it is meant a list of rules of behavior that meet the following requirements:*

*each of them derive from a specific principle of governance;*

*they abide by the law and the regulatory setting within which the organization runs its daily businesses;*

*they are operational*, that is to say, *they are reliable, observable, contestable, and upgradeable.*

It is to be noticed that codes of good practices are not compulsory. Broadly speaking, they are not regulated and this still holds for any country in the world. Instead, what we find everywhere is that chambers of commerce, securities exchanges commissions, or groups of interest provide companies with benchmarks, ready-made formats, mainly focusing on listed companies.

As time passes by, nevertheless, an increasing number of regulatory bodies and private gatekeepers are getting used to adopting a precept denoted as “comply or explain” in some quarters, and “if-not, why-not” in others. What these expressions stand for can be briefly stated in the following way:

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7 All over this paper, a construct becomes operational when, for its components and inner structure, there are procedures that bring them into practice.

8 The Australian Stock Exchange chose the latter expression.
If certain company does not want to build a code of good practices, it has for certain the right of not having one, but in such case it must explain why it would have none.

5. THE SYDNEY STOCK EXCHANGE PROPOSAL

In was in March 2003 that the Australian Securities Exchange through its “ASX Corporate Governance Council”, issued the first edition of a document entitled Corporate Governance Principles and Recommendations. Profiting from later advice and feedback\(^9\), the Council brought forward the second edition of the document in August 2007, which took effect as from January 1, 2008. In connection with the expression “recommendations”, it could be read like “recommendation to enact good practices”.

Perhaps the most worthy feature of the Australian document consists in the fruitful choice of a few principles and recommendations, as well as in the unambiguous semantics used to frame each principle, eight on the whole, that are listed in the left column of Exhibit 1, section 6.1. In addition, and after each principle, a short list of recommendations or good practices follow, adding up to twenty seven practices in all. Lastly, once principles and recommendations have been itemized, the document delves into the logic behind of each principle and each recommendation.

By all means, the ASX comes out as a remarkable proposal and, in my opinion, it seems the best available all over the world. We are going to highlight the main features of this document, stressing its ups and downs, because we intend to introduce a more comprehensive proposal, the Statute of Governance, which we need to contrast with the former as starkly as possible.

\(^9\) A code of good practices is not a single once-made-always-kept construct, and this is also true for principles of governance. Over time, they must be changed, updated, or amended,
The Australian Corporate Governance Council starts by defining Corporate Governance in a way that it suits not only its objectives but also the Anglo-Saxon tradition. Accordingly, the Council says that

*Corporate Governance is the framework of rules, relationships, systems and processes within and by which authority is exercised and controlled in corporations.*

It is our contention that such approach to governance issues seems consistent but too narrow whenever we establish similarities and differences with other available definitions. For instance, let us notice the following perspectives:

- Monks and Minow (1997) have stated that Corporate Governance deals with “the relationship among various participants in determining the direction and performance of corporations”;
- the OECD Principles of Corporate Governance (2004) laid the foundations for an influential notion of corporate governance\(^\text{10}\);
- Professor Alma Whiteley (2007) chose an approach dealing with trust and the employee perspective: “Corporate Governance is concerned with ensuring that managers run firms honestly and effectively so as to provide a fair and acceptable return to those who invest resources in them. […] Trust refers to a person’s belief that others make sincere efforts to uphold

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\(^{10}\) In the OECD web page we found this definition (at the Glossary section): *Corporate governance deals with the rights and responsibilities of a company’s management, its board, shareholders and various stakeholders. How well companies are run affects market confidence as well as company performance. Good corporate governance is therefore essential for companies that want access to capital and for countries that want to stimulate private sector investment. If companies are well run, they will prosper. This in turn will enable them to attract investors whose support can help to finance faster growth. Poor corporate governance on the other hand weakens a company’s potential and at worst can pave the way for financial difficulties and even fraud.*
commitments and do not take advantage of that person given the opportunity’’;

• lastly, our own definition in section 1. The extent to which the definitions from the ASX Council and this paper differ will have a direct bearing on our line of argument.

6. THE STATUTE OF GOVERNANCE

Whereas codes of good practices are well spread around the world they refer almost exclusively to listed companies, either financial or non-financial, which trade in stocks or over-the-counter exchanges. Therefore, the codes are naturally constricted to a slim set of companies, most of them doing businesses in countries displaying the Anglo-Saxon style of governance\(^\text{11}\).

It is our viewpoint that we ought to give heed to any sort of companies, in any country. Overwhelmingly, most of those organizations do not issue securities to be placed through public offers, and their ownership structure hinges upon the so-called “closed and family-owned companies”\(^\text{12}\). Furthermore, it does not seem sensible to limit the universe of organizations to profit-seekers only, in the quest of better practices. Hence, we must allow for mutuals, cooperatives, venture capital companies, state-owned firms, and foundations\(^\text{13}\).

Following our line of research, we advocate that a statute of governance is to be designed. Such statute will be contingent upon the agreement of the board of

\(^{11}\) On this account, see Lopez Iturriaga (2009) for an updated reference to codes around the world either for listed or non-listed companies.

\(^{12}\) On private placements and closed companies the contributions by Carey et al (1993) and Easterbrook-Fischel (1996) are conspicuous.

\(^{13}\) Hansmann expands on this matter, and even assimilates a corporation to a cooperative.
directors\textsuperscript{14} and should be passed as a by-law through an ordinary meeting of the relevant owners.

\textbf{Definition 4 \quad The Statute of Governance}

\textit{By the Statute of Governance we mean a construct consisting of two related components:}

- the principles chosen by the organization as the foundation of its governance;

- the practices that stem from each principle by which the organization commits itself to make the latter fully operational.

\textit{Besides, this construct must be set out by the board of directors, passed through an ordinary meeting of shareholders, enacted as a by-law of the organization and enforced by the board of directors and the senior management afterwards.}

We have to highlight some features actually embodied in the definition above.

a) the Statute of Governance cannot be regarded only as a list of principles and good practices that stand apart from each other, but there is a focal correspondence between them, in the sense that for each principle the organization commits itself to formally adopt some practices linked with such principle;

b) it is for the board of directors to draw up the Statute, being helped on this account by the senior management;

\textsuperscript{14} If not a corporation, we mean the supervisory body that fits best to the organization under analysis.
c) it is for the board of directors to convene a formal ordinary meeting of shareholders in order the Statute be assented, passed and lastly enacted as a by-law of the organization;

d) it is for the board of directors and the senior management to make the Statute not only binding but performing, as a matter of course.

**Concluding remark**

Although having a code of good practices is good for any organization, this is not the final step to take. They must be rooted in principles, being this feature a major accomplishment in the ASX proposal. However, merely having a list of principles with attachable corporate practices does not lead to better governance, unless we build up the statute of governance that becomes a by-law for the organization. Commitment and enforcement is what brings the whole matter into completion.

### 6.1 MAKING A CONTRAST WITH THE AUSTRALIAN PROPOSAL

At this juncture a sharp distinction seems due and necessary between the proposal conveyed in this paper (SGP)\(^{15}\) and the Australian proposal (AP). Needless to say, the contrast will resort to the most outstanding characteristics, without pretending to be exhaustive in any way. For the sake of the argument, Exhibit 1 will show the principles recommended by the Australian Stock Exchange on the left column, and the list of counterpart principles in the Statute of Governance in the right column. Let us move on the contrast.

- *On the underlying definition of governance*

The SGP profits from a wide-ranging framework of governance that makes it suitable for any kind of organization around the world, whereas the AP focuses on

\(^{15}\) Statute of Governance Proposal.
listed companies in the Australian Stock Exchange loyal to an Anglo-Saxon style of governance. Furthermore, the SGP consists of a list of principles of governance rooted in the variables of analysis embraced in Definition 1.

- **On a methodological distinction**

The AP neglects the imperative “must” that provides backing to any principle, and takes up the more lenient “should” instead. This is a debatable usage that might prevent principles from being seriously enacted in many countries where politicians unremittingly impair the institutional quality, and law enforcement seems open to doubt, to say the least. I feel that “should” comes in handy only when dealing with practices, which must be flexible of necessity.

- **On the separateness of board and management**

Whereas in the AP first principle the role of the board and the role of management are overlapping, the SGP sets up three principles: the first one is concerned with owners rights (which I feel must be the starting principle in any conceivable list), next we have a principle devoted exclusively to the board of directors, and lastly, another one to stress the role of the senior management.

In doing so, compliance of the big players with their fiduciary duties becomes a noticeable matter of accountability. Therefore, we highlight and link ownership rights, control rights for the board and decision rights for the management.

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16 Basically, we mean the duties of diligence, loyalty and good faith. For further comments on this topic, see Flannigan (2004).

<table>
<thead>
<tr>
<th><strong>Principles recommended by the Australian Stock Exchange</strong></th>
<th><strong>Principles recommended for The Statute of Governance</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>P1 Companies should establish and disclose the respective roles and responsibilities of Board and those delegated to senior executive and disclose those functions.</td>
<td>P1. The company must safeguard owners’ rights and endorse their bid for value.</td>
</tr>
<tr>
<td>P2 Companies should have a Board of an effective composition, size and commitment to adequately discharge its responsibilities and duties.</td>
<td>P2. The board of directors must perform a fiduciary role toward the owners in the quest for the organization’s value; control rights must be clearly stated.</td>
</tr>
<tr>
<td>P3 Companies should actively promote ethical and responsible decision-making.</td>
<td>P3. The senior management must perform a fiduciary role toward the board of directors; decision rights must be clearly defined.</td>
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<tr>
<td>P4 Companies should have a structure to independently verify and safeguard the integrity of their financial reporting.</td>
<td>P4. The organization must be accountable.</td>
</tr>
<tr>
<td>P5 Companies should promote timely and balanced disclosure of all material matters concerning the company.</td>
<td>P5. The organization must be transparent.</td>
</tr>
<tr>
<td>P6 Companies should respect the rights of shareholders and facilitate the effective exercise of those rights.</td>
<td>P6. The organization must preserve creditors’ ownership rights.</td>
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<tr>
<td>P7 Companies should establish a sound system of risk oversight and management and internal control.</td>
<td>P7. The organization must cope with, prevent and carefully treat conflicts of interests arising from its relationships with internal or external stakeholders.</td>
</tr>
<tr>
<td>P8 Companies should ensure that the level and composition of remuneration is sufficient and reasonable and that its relationship to performance is clear.</td>
<td>P8. Suitable incentives and remunerations programs must be designed to reward performance and loyalty, but all of them must be contingent upon creation of value for the company.</td>
</tr>
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<td></td>
<td>P9. There must be a mindful following up and resolution of compliance risks.</td>
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<tr>
<td></td>
<td>P10. The organization must care for and be accountable to internal and external stakeholders as well.</td>
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</tbody>
</table>
Another point of contention arises when we spotlight P4 in the AP, which consists in a principle that builds up the audit committee to grant independence in board decision-making. We reason that such a principle should not be designed as a standalone one; instead, such committee ought to be included as a good practice in the principle that deals with the board of directors.

- **On the commitments with creditors**

The AP seems to sidestep the fact that external finance in any organization raises a fiduciary role toward creditors. Broadly speaking, creditors involve bondholders\(^{18}\), banks, institutional investors, preferred stockholders, suppliers, venture capital, private equity investment funds, and institutional angels.

In contrast, the SGP sets this important class of stakeholders apart and allows for the inclusion of covenants on behalf of creditors' property rights\(^{19}\).

- **On the management of conflicts of interests**

Albeit this is a topical matter, it does not seem enough, as the AP intends, to assume that governance deals with authority and control only. The wave of corporate scandals witness the failure of organizations founded only on the sole exercise of authority and control, by which opportunistic behavior like rent-seeking and soft-budget constraint\(^{20}\) are utterly fostered eventually.

Instead, corporate governance conveys a two-tiered structure. On the one hand, it provides the organization with a blueprint for its internal architecture; on the other hand, it establishes principles, practices, procedures and developments to meet goals or targets.

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\(^{18}\) Plain bonds, or convertible bonds alike.

\(^{19}\) Vehicles that foster corporate governance are enlarged upon in Apreda (2010, 2007b, 2004).

\(^{20}\) On this see Apreda (2005).
It is from the complex web of relationships between the organization and stakeholders that conflict of interests lurk and arise, placing the company’s whole performance in jeopardy\textsuperscript{21}. Coping with conflicts of interests means not only to master a clinical approach to them, but also to keep an agnostic mind\textsuperscript{22}.

- \textit{On accountability and transparency}

Accountability does not only refer to responsibilities but to commitments. It has been rewarding that in the last decade a wider notion of accountability was set in by academics and practitioners, eliciting commitments on a par with responsibilities. Therefore, it is agreed that we are being held accountable to the extent of our success or failure in fulfilling previous commitments.

As far as transparency is concerned, the Basel Committee on Banking Supervision (2010, 1998) drafted the most standard and operational:

\textit{Any kind of disclosed information will be regarded as transparent when it is comprehensive, timely, relevant, comparable, reliable, and material.}

- \textit{On the handling of risks}

First of all, in the AP all sort of risks are treated as if they were alike. By all means, in the real world both financial and economic risks put a threat on the turnover of any company and, it goes without saying, careful and diligent managers have been handling them for decades so far. The problem is still harder when the company is a financial institution. But to hinge all risks upon a single principle of governance it seems farfetched, to say the least.

\textsuperscript{21} Conflicts of interests among the primary stakeholders are developed in Apreda (2007c, 2002).

\textsuperscript{22} The clinical approach to organizations was introduced by Pranger (1965).
To deal with this issue, a more suitable proposal was the one set forth by the Basel Bank (2005) that defined “compliance risks” as those which follow when a company fails to comply with regulations and internal norms, to the extent of bringing about material consequences for the organization. Surely, risks of this kind should be treated in the realm of corporate governance by a principle like P9 in the SGP, leaving for the Management Protocol the handling of non-compliance risks.

- **On the remaining stakeholders**

Although P3 fixes up the issue of ethical and responsible decision making, it fails to reach the broader subject of the whole constituency to which the company commits to and will be held accountable for. That is to say, the AP stays focused only on three kinds of stakeholders: the board of directors, the senior management and the shareholders. In this way, creditors, employees, customers, suppliers, the government, and the parties related to environmental problems turn out to be ancillary issues even under the guise of P3.

On the side of the SGP, the remaining stakeholders are wholly included. Owing to their importance, relationships with creditors will deserve a distinctive principle, P6, whereas relationships with other stakeholders are specifically handled by P10.

- **On the incentives and remunerations to senior management and the board**

Corporate scandals, epitomized by Enron’s demise and the credit crunch in 2008-2009 convey a lesson that must be learnt once and for all when devising both the governance structure and the Statute of Governance. The AP seems to neglect

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23 By material consequences, in this paper, we follow the Basilea’s definition (1998): information must be regarded as material “if its omission or misstatement could change or influence the assessment or decision of a user relying on that information.”

24 Apreda (2007 and 2006b) handles the issue of compliance risk in non-financial institutions.
such lesson and falls short of an innovative principle, by constraining P8 only to the engineering of an incentives and remuneration package.

In point of fact, the SGP takes a step further and requests that incentives and remunerations be conditional upon whether they create or destroy economic value for the company. In doing so, short-termism, rent-seeking, and soft-budget constraints, become contemptible patterns of behavior grounded on the infringement of the fiduciary duties.

7. A PRAGMATIC VIEWPOINT

To assess the nature, scope and functionality of the Statute of Governance we are going to provide the reader with a complete sample of the construct. To keep our line of reasoning within a precise context, let us imagine that we have to produce such statute for a closed, family-owned company.

• Principle 1

_The company must safeguard the owners’ rights and endorse their bid for value._

_Practice 1_ A Stockholders Agreement will lead their relationships. For instance, the succession of the founding fathers or senior stockholders, the entrance of a new family member to the company, future reorganization processes, the role of minority stockholders, the board composition and control rights, mechanisms for the exit of stockholders and the shaping of differential voting rights.

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25 For further background, see Apreda (2008, 2005, 2002).
• Principle 2

The board of directors must perform a fiduciary role towards the owners in their quest for the organization’s value; control rights must be clearly stated.

Practice 1  A Board Protocol is to be approved by stockholders, comprising the nature of control rights to be delegated, the board's composition, activities and frequency of its meetings, agenda setting, and delegated decision rights to the senior management.

Practice 2  The board will have two independent directors at least; the CEO can be appointed executive director but not chair of the board.

Practice 3  There will be an Auditing Committee, ruled by a particular Protocol, which states the committee’s functions, goals, and authority. There will have majority of independent directors, and one of them will sit as chair of such Committee.

Practice 4  Directors are to be replaced by means of a staggering process. Training and qualifications of directors will be depicted in the Board Protocol.

• Principle 3

The senior management must perform a fiduciary role toward the board of directors; decision rights must be clearly defined.

Practice 1  A Senior Management Protocol is to be approved by the board, comprising the management structure, activities, tasks schedule, agenda setting, delegated decision rights, as well as the relationship with the board of directors.
Practice 2 There will be an Executive Council, led by the CEO, to follow up the daily operations of the going concern as well as the bringing into practice of strategic decision making, as requested by the board of directors.

Practice 3 Commitments and responsibilities expected from all members in the Executive Council will be included in the Management Protocol, as well as procedures to measure the performance and compliance of managers in their jobs.

- Principle 4

The organization must be accountable.

Practice 1 The senior management will design an Accountability System within and without the company, clearly defining commitments and responsibilities. It is the task of the Executive Council to follow up and redress the wrongs that could arise in such system of accountability.

Practice 2 It is for the board to authorize the design of the Accountability System of accountability, to control at least once a year the compliance of the senior management with the system, and to request the updating or changes in such system.

- Principle 5

The organization must be transparent.

Practice 1 The senior management must design a Protocol of Transparency pointing to transparency priorities in the company. The protocol must be flexible, to allow for upgrades or changes when requested by the board of directors.

Practice 2 It is for the board of directors to authorize the Protocol of Transparency and control its implementation at least once a year.
To put into practice the Protocol of Transparency, the senior management will be responsible for setting up a whole Internal Control System, and the CEO will be held accountable for such system to the Auditing Committee.

- **Principle 6**

_The organization must preserve creditors’ ownership rights._

**Practice 1** For each debt contract, there will be attached a suitable set of covenants (protective safeguards).

**Practice 2** For each debt contract, it will be for the Auditing Committee to assess, reject or approve the issuance of debt that surpasses an established level. The Senior Management Protocol will state the amount of debt that would not require the approval of the Auditing Committee.

**Practice 3** When issuing convertible bonds or convertible preferred stock, it will be for the stockholders to approve not only the issuance but also the attachable covenants.

- **Principle 7**

_The organization must cope with, prevent, and carefully treat conflicts of interests arising from its relationships with internal or external stakeholders._

**Practice 1** The senior management will draft, implement, and follow up a Clinical Approach System to conflicts of interests.\(^2^6\)

**Practice 2** It is for the Auditing Committee to approve the diagnosis and treatment suggested for the senior management to cope with strategic conflicts of

\(^{26}\) See Pranger (1965).
interest, whereas the senior management will be held accountable for tactical conflicts of interest.

**Practice 3** If conflicts of interest arose from the relationship between stockholders and (or) members of the board, the final decision should lie upon a general stockholders meeting.

**Practice 4** If the conflict of interest stemmed from the Statute of Governance, or the Stockholders Agreement, they would be changed only by convening a general stockholders meeting.

- **Principle 8**

  *Suitable incentive and remuneration programs must be designed to reward performance and loyalty, but all of them must be contingent upon creation of value for the company.***

**Practice 1** The board of directors will set up a Nomination, Incentives and Remunerations Committee, comprising at least three members of the board, with majority of independent directors. Neither the CEO nor any executive director will belong to the committee.

**Practice 2** The senior management will design a system of performance measures that must be approved by the board of directors. The system must be flexible, attainable, changeable, and always contingent upon value creation\(^{27}\).

**Practice 3** Any system of incentives and remunerations that involves ordinary or preferred stock, as well as convertible bonds, should become operational only when meeting the approval of the majority of stockholders.

\(^{27}\) Overwhelming evidence out of corporate scandals show that, at the root of those shameful events, we always find a purposeful scheme to destroy value.
• Principle 9

There must be a mindful following up and resolution of compliance risks.

Practice 1 The senior management will design a managerial function called Compliance Office, which will deal with compliance risks. It is for the board of directors to approve the function, the Compliance Officer to be appointed, and the budget of the new office.

Practice 2 The Compliance Officer will behave with independence, exclusively reporting to the CEO, and will get access to any kind of information from any section that he needed to fulfill his functions. However, in extraordinary or sensitive situations, the Compliance Officer can directly take his complaints to the Auditing Committee eventually.

Practice 3 Every year, the Compliance Office will submit a Statement of Compliance to the CEO, to be assessed and finally approved by the Auditing Committee.

• Principle 10

The organization must care for and be accountable to internal and external stakeholders as well.

Practice 1 The senior management is responsible for the drafting, implementing, and following up of a Social Responsibility Statute, which must be ratified and endorsed by the board of directors.

Practice 2 The senior management is responsible for the drafting, implementation, and following up of a Code of Conduct for internal stakeholders, which must be ratified and endorsed by the board of directors.
CONCLUSIONS

Governance matters and that is why stockholders, directors, and managers must honor their pledges of commitments and responsibilities.

But accountability involves bringing to light principles that lay the foundation of corporate governance, as well as good practices to enable those principles to be put into practice.

This paper has developed and argued that a suitable construct to enhance corporate governance is the Statute of Governance, which resembles a constitutional device within the company, a by-law in point of fact, that links principles and practices by means of an enforceable vehicle to be followed by stockholders, directors and managers.

Lastly, and by way of illustration, the paper includes a material statute of governance intended for a closed, family-owned company.

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