1. Introduction

This note is designed to assist fund managers assess corporate governance risks in their portfolio companies. It is not intended to be a detailed technical guidance document.

The Organisation for Economic Co-operation and Development defines corporate governance in its 1999 Principles of Corporate Governance as the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it provides the structure through which the company objectives are set, and the means for attaining those objectives and monitoring performance.

2. Why is corporate governance important for investors?

Good corporate governance makes good business sense as a key part of the value creation process. Good corporate governance increases profitability and returns on investment, reduces investment risks and mitigates reputational risk, and thereby contributes to economic development and a sustainable investment environment. Good governance is not only associated with sound and commercially successful companies, but also with companies committed to high standards of business integrity, and environmental and social impact. In the broader context, corporate governance promotes transparency, integrity and the rule of law, thereby increasing the protection of investors' interests, which are vital to maintaining investor confidence and attracting foreign investors. Further, the UK's 2018 Corporate Governance Code emphasises the need for companies to build trust with their stakeholders and calls on them to develop a corporate culture that aligns the company purpose, business strategy, and promotes integrity and values diversity.

3. Advice for Fund Managers

Fund managers, through the influence they exert through their investments, have the possibility to detect governance risks in their portfolio companies at an early stage and take appropriate steps to strengthen their corporate governance capability. There is a multiplicity of corporate governance codes across geographies, however, the basic principles, such as a functioning board, protection of shareholder rights, the promotion of

frequent financial reporting and the role of the board in risk management remain some of the underlying practices of good corporate governance across the world.

- During due diligence fund managers should consider:
- How the company demonstrates commitment to implementing high-quality corporate governance policies and practices.
- The board's effectiveness in overseeing the strategy, management and performance of the company.
- The adequacy of the company's risk management to ensure sound stewardship of the company's assets and compliance with relevant regulations.
- Whether the company's financial disclosures are a faithful representation of its economic transactions and resources.
- How the company ensures the equitable treatment of shareholders.

4. Further resources

The DFI Corporate Governance Toolkit provides three key corporate governance tools for governance risks assessment during due diligence:

- An Instruction Sheet to introduce the concept of corporate governance, the value of corporate governance for portfolio companies and to describe each of the key areas of the DFI Corporate Governance Toolkit.
- A Corporate Governance Progression Matrix which relates five key areas of governance to four levels of achievement. The matrix highlights the importance of continued improvements in the governance practices of portfolio companies.
- A Corporate Governance Questionnaire sets out the basis for governance risk assessment during due diligence.

- Further information and guidance
  OECD Guidelines for Multinational Enterprises

In a global environment, it is important for companies to make sure they adhere to all relevant regulatory obligations. These guidelines provide a global context of a non-binding standard for responsible business practice.

Subsidiary board governance

When considering the effectiveness of board governance, it's important to remember all aspects of a company's business, which includes subsidiaries.

Institute of Directors' Corporate Governance Code

Corporate governance has many definitions. The Institute of Directors provides a factsheet that discusses the definition of corporate governance and the legal framework around the concept, outlining the main principles of the UK Corporate Governance Code.

IFC Corporate Governance Progression Matrix

IFC provides a toolkit to help assess current governance in a company.

Ethics Resource Centre

Board members have a responsibility to act with diligence, care and skill, in the best interests of a company. The Ethics Resource Centre provides organisations with a platform to engage with peers and learn new insights into ethics and compliance.

Institute for Global Ethics

Directors have a fiduciary responsibility to act with a duty of care. The Institute for Global Ethics provides members with tools, frameworks and processes to help analyse ethical decision making and act accordingly.

UK CCAB's guidelines

An organisation's code of ethical conduct is a critical tool in managing BI risks. The Consultative Committee of Accountancy Bodies provides a guide for businesses on developing and implementing a code of ethical conduct.

IFAC's guide Defining and Developing an Effective Code of Conduct

A company’s ethical code of conduct must be effective and implemented with the support of the board. The International Federation of Accountants provides guidance on developing and implementing a code of conduct in a value-based culture.

EY’s Global Code of Conduct

A code of conduct must reflect a company’s operating environment. The EY Global Code of Conduct provides an example of a company’s ethical framework forming the basis of its business decisions in its operating context.

Unilever Committee TORs

A company that has sub-committees must clearly state its terms of reference (TORs), which should include the scope of its E&S and BI responsibility. An example of clearly outlined TORs can be seen in Unilever sub-committees.