

# Better Corporate Governance is the Need of the Hour

The globalisation that began in 1990s has led to the increasing convergence of originally separate initiatives in Corporate Governance. This process has speeded up following the financial turmoil in world financial markets in 2000. The globalisation of the market place within this context has ushered in an era where the traditional dimensions of Corporate Governance defined within local laws, regulations

has forced governments, regulators and boards of corporations to carefully reconsider fundamental issues of Corporate Governance as essential for public economic interest. In addition, the volatility and instability experienced in emerging markets in recent times has drawn attention to the implications of corrupt practices and mal-administration in national and international

corporations are adopting social auditing standards in dealing with such matters as the ethical sourcing of products from developing countries and the treatment of communities in which they operate.

The fact is that good Corporate Governance practices are now becoming a necessity for every country and business enterprise, and are no longer restricted to the activities of public-listed corporations in advanced industrial economies. In the midst of growing International pressure for adherence to good Corporate Governance standards, the Commonwealth is well

placed to play an influential role particularly as it comprises a unique range of nations.

## Commonwealth Perspective

As regulatory barriers between national economies are removed and global competition for capital increases, investment capital will follow the path to those countries and corporations that have adopted efficient governance standards. These standards include acceptable levels of investor protection and board practices as well as satisfactory accounting and disclosure standards. It was in this milieu that the requirement for determining a set of guidelines, or princi-

The ongoing globalisation has ushered in an era where traditional dimensions of corporate governance are being increasingly challenged by circumstances and events of global impact. Newer and newer Corporate Governance norms are being formed across the globe. The article probes this aspect, particularly in Commonwealth perspective.



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and national priorities are being increasingly challenged by circumstances and events having an international impact. Some of these are:

- Institutional investors, as they seek to deploy internationally the massive funds they represent, are insisting on high standards of Corporate Governance in companies in which they invest. In a number of cases, these institutions have set their own Corporate Governance standards as a measure for determining their investment decisions.
- Public attention through high profile corporate scandals and collapses

financial systems and on public expenditure.

- Experiences of public sector reform and privatisation in many countries have set demands on state-owned enterprises and government agencies to address standards of integrity expected of the public service.
- Other interesting developments in Corporate Governance include the rise of “ethical investors” requiring corporations to pay increasing attention to the social role of business, notably in the areas of environment, health and safety, ethnic and community relations. More and more

ples, that could appropriately represent the Commonwealth approach to Corporate Governance was identified and formulated. However, it was clearly recognised that the notion of a “one size, fits all” type of universal code was not only inappropriate but undesirable also. In any event, a number of Commonwealth member nations where the private enterprise sectors are relatively developed have individually established national codes to address their own special requirements – namely, United Kingdom (Cadbury, Greenbury and Hampel Reports), Australia (Borsch Report), South Africa (King Report), Canada (Dey Report), India and Malaysia.

Given the range of commonalities among member countries of the Commonwealth, there are reasonably consistent themes throughout the named national codes referred to above, deriving both from the origin of their commercial, legal and regulatory systems and from the continuing process of consultation on global policy issues through the various Commonwealth ministerial and private sector meetings. The Commonwealth already provides a well-established and influential framework for policy review, and in this respect the particular advantages, which the Commonwealth has to offer – both as a club of nations and as an organisation – are that member countries have:

- a similar structure and system of government, public administration and law;
- a similar structure and system of commerce – law, institutions, accounting, management and business practices;
- a common working language; and

- an organisational structure, which enables governments and professional associations to regularly meet, debate and develop common policies and ideas to promote a positive policy environment.

This unique characteristic of “Commonwealthness” greatly facilitates communication and understanding amongst a diversity of nations across the globe. If this diversity in the Commonwealth can be harnessed to achieve a degree of consensus in the development of Corporate Governance guidelines, it will surely demonstrate the possibility for all countries reaching consensus. The role of the Commonwealth, within this context, is especially significant in the current process of globalisation. It is in this area that the Commonwealth has a special role to play, and the Commonwealth Association for Corporate Governance (CACG) assisted by the Commonwealth Secretariat and the Commonwealth Fund for Technical Co-operation in affiliation with the Commonwealth Business Council have undertaken this role in the field of Corporate Governance.

Extensive work has already been undertaken by the OECD (Organisation for Economic Co-Operation and Development), of which a number of Commonwealth countries are also members. In preparing the CACG Guidelines, reference was made to the subsequent OECD Principles of Corporate Governance issued in June 1999 – endorsed by the G7 countries as an acceptable level of Corporate Governance standards with universal application and which has formed the basis of the joint World Bank/

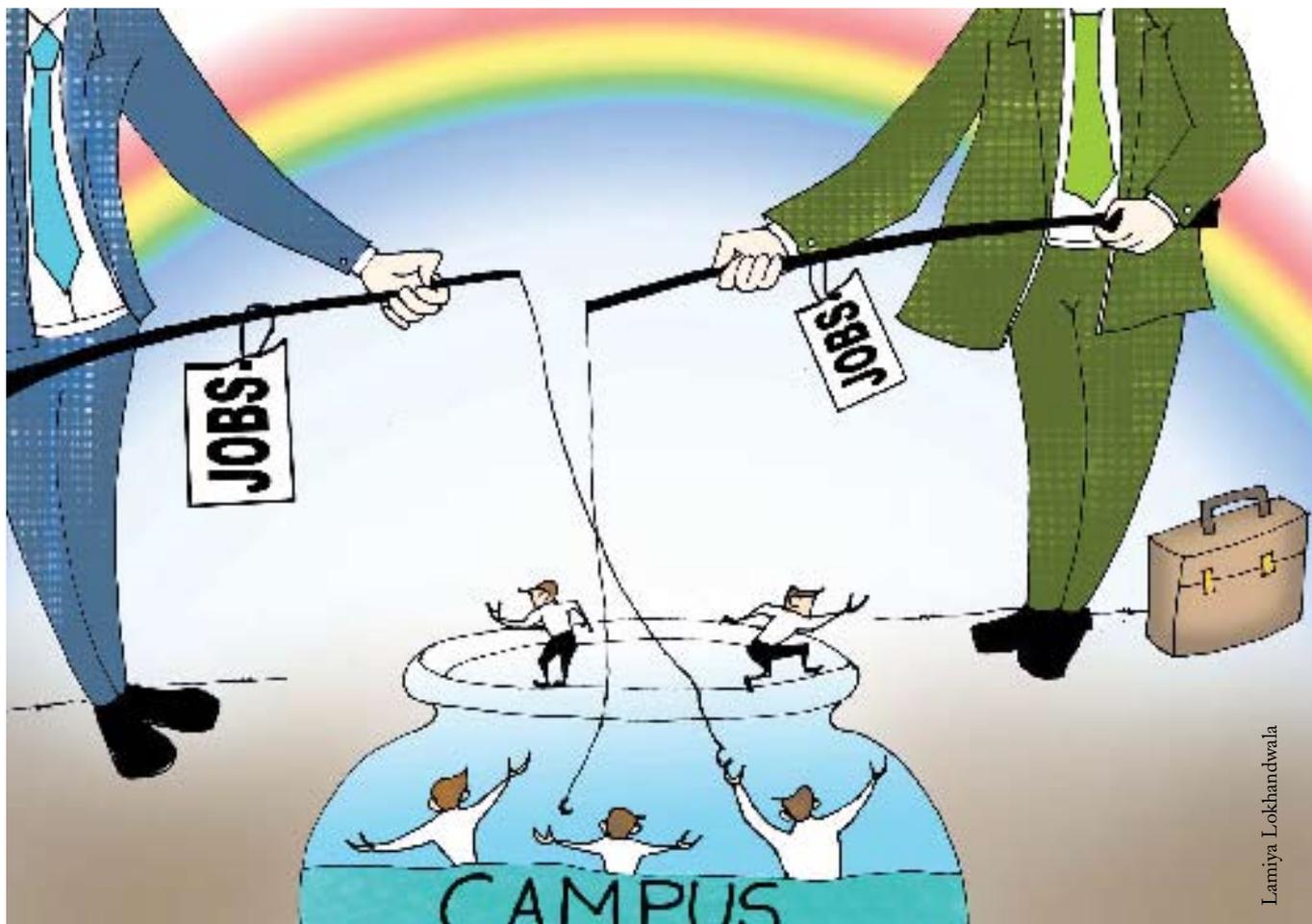
OECD initiative to form the Global Corporate Governance Forum. The Commonwealth is a participant in this initiative. In addition, considerable reference has been made to the national codes in place in Commonwealth countries in formulating the CACG Guidelines.

The preparation of these guidelines revealed that there was a preponderance of state-owned enterprises comprising a substantive component in a large number of economies in the Commonwealth. This characteristic is predominant in emerging and transition economies, where the thrust is for privatisation and/or economic structural adjustment.

#### Corporate Governance for Development

Over the past decade or so, the pre-occupation in many of those economies has been on fiscal and monetary stabilisation. There is now a need to shift attention and the focus of policy makers to cope with policies and structures occurring on implementation of those structural adjustment and privatisation programmes. Accordingly, in the Commonwealth, there is a need for micro-economic policy instruments, which will support the macro-economic policies arising from this transition. Corporate Governance can be considered a powerful micro-policy instrument and an effective lever for change at the business enterprise and sectoral level. This can constitute an essential ingredient to the post-privatisation environment. Hence, the emphasis throughout the CACG Guidelines is on both private sector and state-owned enterprises. This should not mean that these guidelines should not apply equally, as applicable, to

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other forms of enterprise such as non-governmental organisations and agencies.

Corporate Governance in the Commonwealth is important and is concerned mainly with:

- The profitability and efficiency of Commonwealth business enterprises and their capacity to create wealth and employment.
- The long-term competitiveness of Commonwealth countries in the global market.
- The stability and credibility of the Commonwealth financial sectors.
- The relationships between business enterprises within an economy and their sustained ability to participate in global economy; and
- The relationship between such business enterprises

and their various stakeholders comprising shareholders, managers, employees, customers, suppliers, labour unions, communities, providers of finance, etc.

Corporate Governance is essentially about leadership—for efficiency, leadership for probity, leadership with responsibility and leadership that is transparent and accountable.

Business Efficiency is necessary to compete in the global economy and thereby to create jobs. Without efficient business leadership, there will be no efficient companies and without efficient companies there will be no employment.

Business Probity is necessary because investors require confidence and assurance that the management of a corpora-

tion will behave honestly and with integrity in regard to their owners (shareholders). No person or institution will trust a corporation if its managers are known, or suspected of misusing funds for improper purposes and corrupting the economic system. In a broader sense, international investors require confidence that a country's financial system and structures are secure and have credibility.

Business Responsibility is increasingly considered not to include profitability alone but to incorporate issues compatible with societal objectives and legitimate social concerns.

Transparency and Accountability are essential characteristics of good leadership because without these, leaders cannot and will not be trusted to the ultimate disadvantage and demise of a country's economy.

## Inclusive Approach

Within the Commonwealth, therefore, the primary issue surrounds the role of the director – whether of a private sector or state-owned enterprise. Nonetheless, given the particular circumstances and requirements of the many economies comprising the Commonwealth, equally germane are the issues surrounding the responsibility of such business enterprises and their directors towards the broader constituency of stakeholders – namely, employees, health and safety, securities exchange and financial market regulators, and others. The CACG advocates an inclusive approach to Corporate Governance.

The basis of the CACG's approach should, however, be clarified. It does not detract from the fundamental tenet that directors and boards owe their duty to the company and thereby are accountable to shareholders, as owners of the corporation's capital. To advocate that a board is accountable to all stakeholders, would render the board accountable to no one! This, on the other hand, does not diminish the importance of stakeholders in achieving corporate objectives or to treat stakeholders responsibly as more fully explained throughout the CACG Guidelines. The modern approach is for a board to identify the corporation's stakeholders and to agree a policy as to how the relationship with those stakeholders should be advanced and managed in the interest of the corporation. A wealth of evidence has established that this inclusive approach is the way to create sustained business success and steady growth in shareholder value.

At the same time, in the course of the preparation of the CACG Guidelines, it was recognised that emerging

economies are substantially driven by entrepreneurs who take business risks and initiatives. While conformance must obviously underpin any approach to Corporate Governance, it is equally imperative that the corporation is measured by its business performance as well. The CACG, accordingly, advocates that Corporate Governance standards and practices should not stifle, or for that matter be at the expense of, enterprise and profitability. Corporate Governance must be seen to facilitate, and engender, economic growth and prosperity but not at the expense of integrity. It is on this basis that the emerging economies of the Commonwealth should develop sufficiently to participate meaningfully in the global economy. This must remain the pre-eminent objective of Commonwealth countries.

## Purpose of CACG Guidelines

The CACG Guidelines are intended to facilitate best business practice and behaviour, whether of a private sector or state-owned enterprise. These guidelines are neither mandatory nor prescriptive and have been designed as 'evolutionary' in concept. In other words, the CACG Guidelines are seen as a "continuum", remaining flexible and responsive to further developments in Corporate Governance in the global economy. The CACG Guidelines have been structured on a basis complementary to the OECD Principles of Corporate Governance, with particular focus on the emerging and transition economies in the global market, which comprise a substantial number of Commonwealth countries.

- The challenge is now to move away from the philosophical debates on

Corporate Governance to dealing with the "hard" issues of practical implementation and the application of good Corporate Governance practices throughout the world. Naturally, each country must define for itself what its special circumstances and priorities are within this context. In the wake of a range of CACG initiatives, several countries have set up Task Forces to draft national codes of Corporate Governance and to define strategies for implementation. At the same time, this has led to dormant professional bodies being resuscitated and pursuing a professional approach to Corporate Governance.

The next phase of the CACG's activities will include establishment of "Centres of Excellence" in collaboration with the World Bank to provide training at regional and country level in the various elements constituting a suitable Corporate Governance framework.

Issues of Corporate Governance are, by their very nature, complex. It will, therefore, be necessary to analyse the particular circumstances of each country, their legal and regulatory systems, structures of business enterprise, inherent cultural characteristics and heritage, before defining any specific approaches to addressing issues of Corporate Governance.

While the CACG Guidelines have placed particular emphasis on boards of directors of all business enterprises – whether private, public, family owned or state-owned – other important aspects should also be considered within this framework. For this reason, other issues of Corporate Governance have

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to be highlighted – namely, Corporate Governance and state enterprises in the Commonwealth, business ethics and corruption, the role of professions in the Commonwealth as well as a plethora of other evolving issues. These issues are all critical to improving Corporate Governance in the Commonwealth, whatever standards of economic development currently prevail, and require equal consideration.

In identifying that good Corporate Governance hinges upon the competence and integrity of directors and the board, it should be observed that standards of probity and fiduciary responsibility in the wider business environment are as critical. In other words, an effective legal and regulatory regime, efficiency and probity in the state sector, rea-

sonably competitive markets, active and responsible capital providers, an informed and critical media, and appropriate considerations towards a broad range of stakeholder interests all should play a role to ensure good Corporate Governance.

The CACG looks forward to co-operating not only with Commonwealth countries but also with international organisations and agencies such as the World Bank, OECD, International Monetary Fund, regional organisations, private sector bodies and other such institutions in seeking to harmonise and consolidate a practical and pragmatic approach to Corporate Governance universally. To this end, the CACG is engaged with the World Bank, through the Global Corporate Governance Forum, in coordinating

a multi-faceted approach to the process of economic reform and implementation of good Corporate Governance standards.

The CACG Guidelines brings to conclusion the research and development of a set of principles that form the foundation for the next phase of its work in Commonwealth countries. It should be reiterated that these guidelines are directed particularly at emerging and transition economies and will constitute a “living document” that will be updated from time to time in accordance with international developments in Corporate Governance.

#### Corporate Governance in International Business: A Commonwealth Prospective

It is the responsibility of the board of directors to ensure good Corporate Governance. This involves a set of relationships between the management of a corporation, its board, its shareholders and other relevant stakeholders. Accordingly, the board must agree on the corporation’s purpose (what it is for), its values (what it stands for), and the strategy to achieve its purpose. It must account to shareholders and be responsible for relations with its stakeholders.

Good Corporate Governance requires that the board must govern the corporation with integrity and enterprise in a manner, which entrenches and enhances the licence it has to operate. This licence is not only regulatory but embraces the corporation’s interaction with its shareholders and other stakeholder such as the communities in which it operates, bankers and other suppliers of finance and credit, customers, the media and public opinion makers and pressure groups.

While the board is accountable to the owners of the corporation (shareholders) for achieving the corporate objective, its conduct in regard to factors such as business ethics and the environment for example may have an impact on legitimate societal interests (stakeholders) and thereby influence the reputation and long-term interests of the business enterprise.

The guidelines which follow set out 15 Principles of Corporate Governance aimed primarily at boards of directors of corporations with a unitary board structure, as will most often be found in the Commonwealth. The Principles apply equally to boards of directors of all business enterprises – public, private, family owned or state-owned. The Principles are applicable to both executive and non-executive directors. The term “director” should be taken as being synonymous with any person responsible for the direction of a business enterprise. Similarly, the principles can be usefully applied to other forms

of enterprise such as non-governmental organisations and agencies.

These Principles are not to be regarded as legal statutes and thus need not be followed in letter and rather be followed only in spirit. They indicate the standards of the duties of care and diligence, which should be observed by directors. The Principles are designed to assist directors of all forms of business enterprises to make judgments on whether general or particular conduct conforms or conflicts with the guidelines set out. Clearly, some of these Principles may not yet be capable of implementation in a number of Commonwealth countries but represent an objective to which all business enterprises in the Commonwealth should aspire in the fullness of time.

The Commonwealth is participating in the Global Corporate Governance Forum in order to co-ordinate efforts globally in the multi-faceted process of reform that may be needed in some countries

while putting more emphasis on the board of directors as a critical area for improvement.

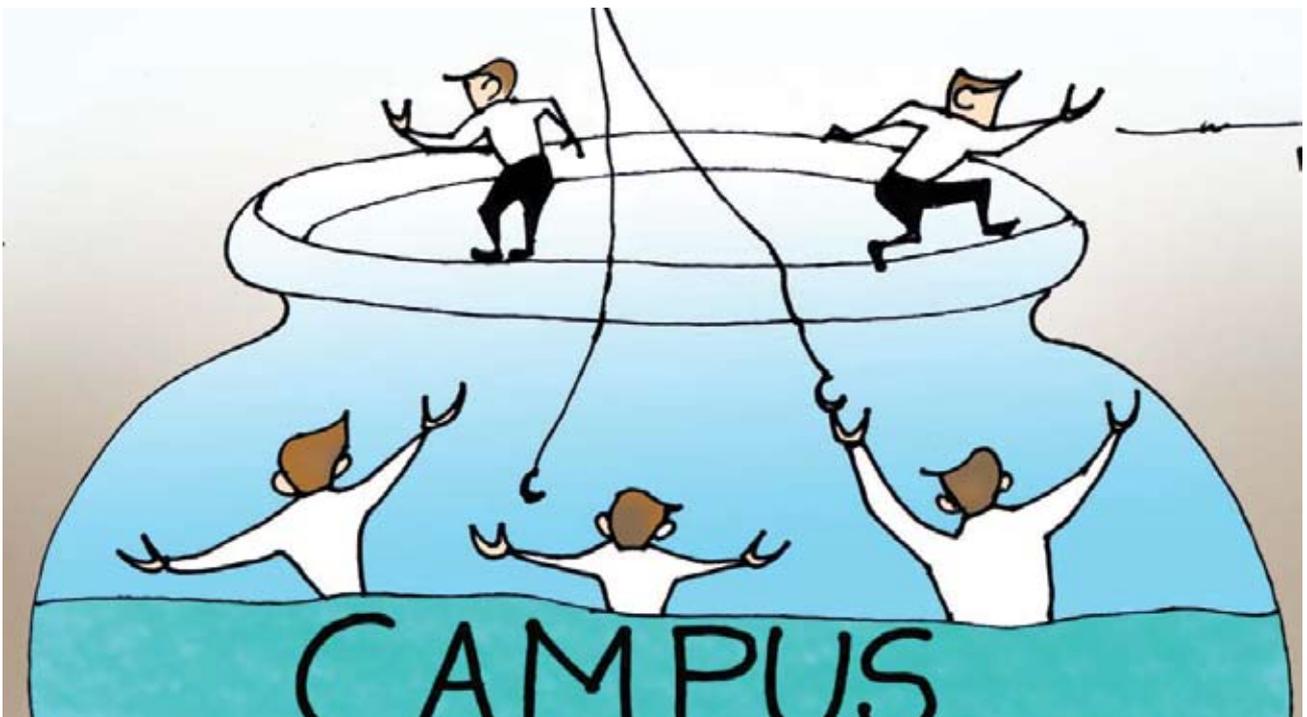
### Executive Summary of Guidelines

#### *The board should:*

Principle 1 – Exercise leadership, enterprise, integrity and judgment in directing the corporation so as to achieve continuing prosperity for the corporation and to act in the best interest of business enterprise in a manner based on transparency, accountability and responsibility.

Principle 2 – Ensure that through a managed and effective process board appointments are made that provide a mix of proficient directors, each of whom is able to add value and to bring independent judgment to bear on the decision-making process.

Principle 3 – Determine the corporation’s purpose and values, determine the strategy to achieve its purpose and to implement its values in order to ensure that it survives and thrives, and ensure that procedures and practices are in place



that protect the corporation's assets and reputation.

Principle 4 – Monitor and evaluate the implementation of strategies, policies, management performance criteria and business plans.

Principle 5 – Ensure that the corporation complies with all relevant laws, regulations and codes of best business practice.

Principle 6 – Ensure that the corporation communicates with shareholders and other stakeholders effectively.

Principle 7 – Serve the legitimate interests of the shareholders of the corporation and account to them fully.

Principle 8 – Identify the corporation's internal and external stakeholders and agree a policy, or policies, determining how the corporation should relate to them.

Principle 9 – Ensure that no one person or a block of persons has unfettered power and that there is an appropriate balance of power and authority on the board which is, *inter alia*, usually reflected by separating the roles of the chief executive officer and Chairman, and by having a balance between executive and non-executive directors;

Principle 10 – Regularly review processes and procedures to ensure the effectiveness of its internal systems of control, so that its decision-making capability and the accuracy of its reporting and financial results are maintained at a high level at all times;

Principle 11 – Regularly assess its performance and effectiveness as a whole, and that of the individual directors, including the chief executive officer.

Principle 12 – Appoint the chief executive officer and at least participate in the appointment of senior management, ensure the motivation

and protection of intellectual capital intrinsic to the corporation, ensure that there is adequate training in the corporation for management and employees, and a succession plan for senior management.

Principle 13 – Ensure that all technology and systems used in the corporation are adequate to properly run the business and for it to remain a meaningful competitor;

Principle 14 – Identify key risk areas and key performance indicators of the business enterprise and monitor these factors.

Principle 15 – Ensure annually that the corporation will continue as a going concern for its next fiscal year.

#### Other Corporate Governance Issues

##### *(a) Corporate Governance and State Enterprises in Commonwealth*

A predominant feature of the Commonwealth is the preponderance of state-owned enterprises or business enterprises in which the state has a significant commercial or other material interest. This is particularly relevant to those Commonwealth countries loosely categorised as emerging or transition economies.

In an era of privatisation of such enterprises, usually as part of some form of structural economic adjustment programme, the issue of Corporate Governance practices has been highlighted. Many of the inherent conflicts and problems associated with the Corporate Governance debate have been found to occur in such business enterprises – whether pre and/or post privatisation. A particular difficulty has been the apparent lack of independence of state enterprise boards, as appointments are often associated with political influences and crony-

ism. It would be pertinent to observe that this has not necessarily been the exclusive domain of state enterprises alone. Similar excesses in the private sector give rise to demands for action in the 1980s in the OECD countries and, again, in the latter part of the 1990s following the Asian crisis.

The independence of directors and boards of state enterprises, in their various forms, in many emerging and transition economies remain a challenge – not only for the directors themselves but also for those with whom such enterprises contract. A particular difficulty is the shortage of skills and lack of familiarity with board functions and fiduciary responsibilities. The lack of enforcement of existing regulatory measures, whether outdated or not, has contributed to poor Corporate Governance practices.

What have not always been readily recognised are the economic costs of inefficient management practices associated with state assets, arising from typical Corporate Governance issues of responsibility and accountability. According to World Bank estimates, losses in public enterprises through inefficient or inappropriate use of state assets in the lowest income countries are between 8 per cent and 12 per cent of GDP – often amounting to more than is spent on health and education in those countries. The inevitable restructuring associated with privatisation programmes has, in consequence, often imposed the burden of further economic and social costs that could otherwise have been avoided. Raising standards of competence and efficiency, especially in the poorest countries with scarce resources and great social need is imperative if they are to compete or even partici-

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pate in the so-called “global economy”.

The Commonwealth has recognised the importance of drawing state enterprises into the Corporate Governance fold for the following reasons:

- While the conventional fiduciary relationships between shareholder and the board (as found in the private sector) do not necessarily apply, directors of state enterprises nevertheless owe a fiduciary responsibility to account to a country’s taxpayers and the communities which such enterprises serve for the efficient utilisation of state-owned assets:
- The taxpayers, for the proper utilisation of their taxes
- The communities, for the efficient delivery of services in expectation of the payment of taxes and other fiscal charges, e.g. power, water, telecommunications, roads, etc.
- In emerging and transition economies, the main or substantive commercial activity usually rests with the state enterprises. These enterprises often constitute the primary (and sometimes only) customer or supplier on whom an emergent private sector activity may depend. With the emphasis on encouraging the development of small, micro and medium enterprises, this has significant economic consequences. The conduct and efficacy of state enterprises can, therefore, act as a “driver” of good Corporate Governance practices in ensuring that this permeates through to an emergent private sector. Given the diversity of state

enterprises by virtue of the many industries and economic activities in which they are to be found in the Commonwealth, and having regard to the particular characteristics and stages of economic development to be found in countries comprising the Commonwealth, there is obviously no single or uniform model of Corporate Governance that could or should be recommended for such enterprises. However, the CACG in conjunction with the Commonwealth Secretariat has identified the role of state enterprises in the effective application of Corporate Governance practices as a critical element and one, which requires considerable focus and attention.

#### *(b) Business Ethics and Corruption*

The CACG advocates that business enterprises should respond to a range of interests beyond their shareholders, in respect of ensuring that its activities and conduct are not detrimental to the legitimate concerns of other stakeholders with whom a corporation may have direct or indirect relationships. As previously emphasised, this does not remove the imperative that the board shall remain accountable to the owners of the capital of the corporation (shareholders).

It is acknowledged that there is an argument which suggests that corporations which are properly managed and controlled by directors with long-term vision and purpose will, in their own enlightened self interest, ensure that they take proper account of these wider objectives. Increasing importance is now rightly attached by corporations to their dependence on corporate reputation for commercial success, reiterated by increasing scrutiny from regulators, the press, pressure

groups, labour unions, employees, communities in which they operate, etc.

In this regard, most contracts concluded by corporations involve mutual rights and obligations. This involves trust and the responsibility of management to ensure that the conduct of the corporation, internally and externally, is based on enterprise and integrity. The fiduciary duties and responsibilities of directors should, at all times, remain paramount. All stakeholders with a like to the corporation should feel confident that their dealings with the corporation are undertaken with honesty, openness and fairness. It is advocated that one of the responsibilities of directors of any business enterprise – whether private, public, family owned or state-owned – should be to determine the moral and ethical climate of the business. This can take many forms, normally documented and widely disseminated in the organisation, but at the end of the day the conduct of the directors in their dealings both within the corporation and outside will set the example by which others will follow!

Ethics is an aspirational objective, and should represent the intrinsic cultural values of the society in which a corporation operates as well as the behaviour expected of the corporation in all its dealings with shareholders and other stakeholders generally. Where a corporation sees fit to codify ethical conduct, such guidelines should be succinct but sufficiently detailed to give a clear direction to the behaviour of those to whom it is directed. Ethical practices and issues are both complex and vexed. No single or universal model can be defined or prescribed other than to empha-

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size the significant importance with which this issue is viewed not only by the CACG but also international institutional investors and other significant interested parties. A typical template setting out ethical conduct issues, which was prepared as an appendice to the King Report on Corporate Governance, has been reproduced and accompanies these CACG Guidelines.

While difficult to quantify in precise economic terms, the impact of bribery and corruption on countries, communities and business enterprises has been devastating. Given the many and subtle forms that this may take, it has been estimated by the Asian Development Bank that losses due to corruption can total more than a country's foreign debt in lost revenues and additional costs for goods and services. The reciprocal approach of developed and advanced economies in discouraging and/or prohibiting corrupt practices has to play an equal part in removing this scourge in the emerging and transition economies. Any form of corruption, whether through improper paying or receiving of benefits, is not to be tolerated.

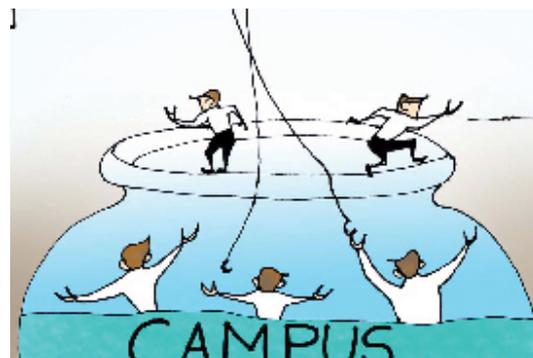
#### *(c) Role of Professions in Commonwealth*

An important aspect of Corporate Governance is, in the opinion of the CACG, the role of the professions. While bodies such as the CACG can make recommendations and participate in training programmes for directors and managers of corporations, the reinforcement of Corporate Governance practices often rests with the professions in the form of regulatory reporting and the basis of professional advice rendered to corporations.

Accordingly, the development of new capacities, in-

cluding the establishment of professional institutions where these do not presently exist or have fallen dormant, in emerging and transition economies requires some degree of focus. The conduct of professions in these economies must, by definition, determine the behaviour and conduct of business enterprises. The CACG would prevail on the professions – accountants, corporate secretaries, lawyers, directors, etc. – and particularly those with international affiliations, to contemplate the measures by which they can contribute in practical terms in good Corporate Governance practices in Commonwealth countries in which they are engaged (whether by direct representation or indirectly through professional affiliation).

Given the emphasis of the 15 Principles in the CACG Guidelines, it is now essential that directorship be regarded as a professional role for which incumbents must be trained and qualified. Some countries now insist that no person should be a member of the board of a stock exchange-listed or state-owned corporation without formal training, while some countries have instituted the status of “chartered” director gained only through a combination of formal examination and minimum experience. In the complex environment of the global economy and with the many, and varied, demands placed on boards it is no longer sufficient for directors to simply regard their position as honorific with no special duties or responsibilities. It can only be reiterated that the role of the director is an onerous task with significant responsibility and personal liability.



#### *(d) Other Issues*

There are undoubtedly numerous other issues of Corporate Governance that could be considered within the context of that already covered in this document. However, the purpose of the CACG Guidelines is to identify those areas and aspects of Corporate Governance, which currently predominate the Commonwealth, and it is not intended nor necessarily desirable to provide a detailed exposition on the many other issues that may be peculiar to any particular country or business enterprise. As mentioned in the preamble, Corporate Governance is a dynamic and evolutionary process.

In a number of countries, issues specific to the environment, health and safety, equal opportunity, worker participation on boards and associated consultative processes, have been defined by legislation or other regulation. Accordingly, the CACG does not necessarily propagate a particular position or stance on these issues but instead offers to co-ordinate or source access to such issues and/or developments through its network and affiliations in the Commonwealth and with other bodies by way of exchange of information and mutual experience. It is in this regard, that the CACG's involvement with the World Bank's Global Corporate Governance Forum should prove mutually beneficial. □

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