

# Strategies for Sustainability: corporate governance

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## *The foundation*

- A microinsurance operation starts with a go-ahead by its board of directors
- So should strategies for sustaining the operation over the long term: how to overcome the challenges of high risk, low premiums and low capacity of the customers to pay
- What the board often doesn't realize is that a key factor in the operation's success is how well the board carries out its own function: to govern
- The board may not fully understand what corporate governance is and what it involves

## *Down to the basics*

- When one thinks of corporate governance, Enron, WorldCom and Parmalat come to mind. They certainly helped raise awareness of the need to not only manage, but also govern a business well.
- A lot of attention has since been paid to what corporate governance is and how it can be enhanced. Reflection and debate have unearthed a number of fundamentals that can help businesses avert disasters.

## *Managing and governing*

- These basics, in their simplest form, would also apply to microfinance and microinsurance. But at that level, any enhancement of corporate governance begins with an understanding of an even more basic element: the difference between managing and governing.
- To **manage** is to administer, conduct affairs of, implement. To **govern** is to direct, rule, oversee
- To come to grips with this distinction is to know how the role of the board of directors differs from the role of management

## *The difference*

- A good relationship between management and the board, underpinned by a clear understanding of, and respect for, how their responsibilities differ, leads to good corporate governance
- A muddled relationship, marked by forays into each other's territory, produces conflicts undermining management as well as board
- Checks and balances vanish and, where integrity lacks, collusion follows. Result: Enron, WorldCom, Parmalat

## *The OECD definition*

- Corporate governance is 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 also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance

## *The World Bank view*

- The importance of the board-management relationship is recognized in The World Bank's definition and view of **governance**: “the mechanisms in which suppliers of capital are assured adequate return on investment.”
- If these mechanisms do not produce an adequate return on investment, more capital will not flow to the company and it will not grow to its potential

## *The main impediment*

- A strong relationship between the board and management counteracts the main impediment to the company's success in delivering an adequate return on capital: lack of agreement or misconception about the business's objectives and purpose and often about the business itself.

## *The four pillars*

- A good relationship promotes what the Asian Development Bank identifies as the four pillars of governance:
- 1. **Accountability**, or the capacity to call officials to account for their actions.
- 2. **Transparency**, entailing low-cost access to relevant and material information.

## *The four pillars*

- 3. **Predictability**, resulting primarily from laws and regulations that are clear, known in advance and uniformly and effectively enforced.
- 4. **Participation**, needed to obtain reliable information and to serve as reality check and watchdog for both government and corporate action.