KASNEB

CS PART III SECTION 5

GOVERNANCE AND ETHICS

THURSDAY: 26 November 2015. **Time Allowed: 3 hours.**

Answer ALL questions. Marks allocated to each question are shown at the end of the question.

QUESTION ONE

MAGARI INTERNATIONAL LTD. (MIL)

In 2007, two business associates came together and bought a controlling interest in a listed company. The company, then known as Magari International Ltd. (MIL) was one of the leading companies in its area of operations. Indeed, there were products in the market which the company distributed on behalf of the manufacturer that reflected its identity in the market.

The two business associates formed two private companies through which they acquired controlling interest in MIL. Between these two companies, their other individual nominees and themselves, they controlled over 85% of the issued and paid up capital of MIL.

At the time of acquisition by the two business associates, MIL assets base was extremely healthy. The assets included commercial property from which MIL was earning rental income.

The two business associates soon began to differ on business decisions taken by the board of directors which they had appointed comprising of seven members. None of the two sat on the board, but their appointed nominees formed the board membership. Indeed, in the first five years, three Chief Executive Officers (CEOs) had left the company. The board itself did not appear to have the final authority and powers over the business of the company.

Being a listed company, the regulator questioned the board on more than one occasion, why there was such a large turnover of senior management, including the CEOs.

In 2012, their differences reached a breaking point and they sought the court's intervention. While they were busy fighting in court corridors, the board operations in terms of major business decisions stalled, because the nominee board members could not agree on a common direction. They took sides with the individuals who put them on the board. Management was unable to operate effectively, business suffered with key staff opting to seek employment elsewhere. Suppliers were not paid on time, and most of them opted to take legal action to recover their money. The organisation engaged a number of lawyers to deal with the legal cases.

The court after considering all the grievances and the concerns of all the parties, and the effect of any decision on other shareholders and stakeholders, decided not to award a winding up order, but instead directed them to seek the help of a consultant in corporate governance in an effort to salvage MIL.

In 2013, they engaged the services of a corporate governance consultant who advised them on the need for good corporate governance, objectives of corporate governance, how the composition and the structure of the board should be and ways of eliminating the barriers to visionary board leadership so that MIL could be able to achieve its vision. They were also informed on the various roles that their nominee directors should perform in order to promote good governance in MIL.

The parties considered the views, advice and the recommendations of the consultant and unanimously agreed to implement them. This marked the beginning of MIL turnaround. The board started operating effectively, staff morale and revenue increased culminating in improved shareholders and stakeholders confidence.

Required:

(a) Identify five governance issues that require to be addressed by management in order to help Magari International Ltd. (MIL) to operate as a viable business. (10 marks)

(b) Discuss five barriers to visionary leadership, that the board of MIL could eliminate in an effort to achieving its goals. (10 marks)

(c) Analyse five roles that the nominee directors of MIL were expected to perform in promoting good governance. (10 marks)

(d) Citing five reasons, justify the need for good corporate governance to the management and board members of MIL. (10 marks)

(Total: 40 marks)

QUESTION TWO

(a) Propose five reasons why companies get involved in corporate social responsibility (CSR) activities. (10 marks)

(b) Discuss the assertion that divulging confidential information is not necessarily harmful. (5 marks)

(Total: 15 marks)

QUESTION THREE

(a) Explain the following theories of good governance:

(i) Stewardship theory. (3 marks)

(ii) Agency theory. (3 marks)

(iii) Stakeholder theory. (3 marks)

(b) Examine six benefits of separation of the roles of the chairman of the board and the Chief Executive Officer (CEO) in a company. (6 marks)

(Total: 15 marks)

QUESTION FOUR

(a) Suggest five model questions that could be used during performance evaluation of the board of directors. (5 marks)

(b) (i) Explain the term "reputation risk" as used in enterprise risk management. (2 marks)

(ii) It is believed that the saying "image is everything" is true, with respect to managing reputational risks facing the organisation.

In relation to the above statement, analyse four threats to reputational risk that an organisation might be exposed to. (8 marks)

(Total: 15 marks)

QUESTION FIVE

(a) Summarise seven contents of a board charter. (7 marks)

(b) Citing four reasons, justify why good ethical practice is necessary for the business. (8 marks)

(Total: 15 marks)

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