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"Corporate Governance: The New Mantra"

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Abstract

Corporate governance has become the latest buzzword in the corporate sector in India. Kumaramanglam Birla was recently quoted as saying that the principal objective of good corporate governance is to enhance value. Stakeholder corporate governance is a system that effectively enforces accountability relationships between the executive management and the board of directors and also between the board of directors and shareholders of a company. Corporate governance assumes importance for publicity traded companies because of the separation between the management and the shareholders. This separation gives rise to the classic agency problem. Therefore, corporate governance system primarily addresses the agency problem.In the age of competitive Globalization and dynamic world, business enterprises need to focus on innovative practices which will help in maximizing stake and shareholders wealth. The fundamental concern of corporate governance is to ensure that the firm's directors and mangers act ethically in the interests of he firm and its shareholders and that the mangers are held accountable to capital providers for the use of assets. The concept of corporate governance can be taken as a parallel to the quality practices under the ISO standard. It also involves entry of non-executive directors into the board, and making the members more positive and dynamic in their activities. All business information must be made available to them, and system controls are activated to ensure authenticity, timeliness and effectiveness of information. The basic principles of corporate of corporate governance are based on ethical parameters such as complete transparency, integrity and accountability. The present paper addresses the issues of corporate performance, transparency, strategies, executive functions, compensation and accountability, auditors and several related issues.

Key Words: Maytas, governance, corporate, Transparency, accountability, Globalization

Introduction:

Corporate governance is the new buzzword or rather a concept in corporate management that is yet to catch up in India but that has the potential to significantly improve corporate performance. In the case of corporate governance shareholders is considered as God. Corporate governance has assumed significance in India because it has been given importance by institutions like World Bank, ADB, OECD etc.The focus on improving corporate governance and enhancing shareholder wealth is relatively new in India. Earlier, the managements were least concerned with how the shareholders were benefited from the company's performance. The role of company was topay dividends and hold AGM. There was minimum communication between company management and shareholders. Investors had to depend on news reports to get information about their companies. But all these have changed now.

In those days when business used to be small, the owner and the manger were one and the same. Years later when the businesses increased in size with the advent of the joint stock organization there emerged a need to have two distinct and separate entities, one for management and the other to protect and further the owner's interest, on other worlds to 'Govern the Corporation'. Thus emerged the concept of corporate governance-a system by which companies are directed and governed. In order for a corporation to perform well the manger should be both 'able' and 'accountable'.

Corporate governance is rightly understood as putting people at the forefront of business, because all business must be fundamentally a matter of people rather than machines, products or even money. Good corporate governance has been sought to be implemented by attending to long term strategic goals, employees, community and environment, customers and suppliers, and compliance with laws and regulations. When seen deeply these various elements have one common theme running through them-that of being attentive to and conscious of ethical treatment of people in their various relations with the corporation. The ideal situation would, therefore, be when all parties are given equal share of corporate decision making.

History of Corporate Governance

The seeds of modern Corporate Governance were probably sown by the Watergate scandal in the United States. As a result of subsequent investigations, US regulatory and legislative bodies were able to highlight the control failures that had allowed several major Corporations to make illegal political contributions and to bribe government officials. This led to the development of the Foreign and Corrupt Practices Act of 1977 in USA that contained specific provisions regarding the establishment, maintenance and review of systems of internal control. This was followed in 1979 by the Securities and Exchange Commission of USA's proposals for mandatory reporting on internal financial controls. In 1985, following series of high profile business failures in the USA.the most notable one of which being the Savings and Loan collapse, the Tread way Commission was formed. Its primary role was to identify the main causes of misrepresentation in Financial Reports and to recommend ways of reducing incidence thereof. The Tread way Report published in 1987 highlighted the need for aProper control environment, independent Audit Committees and an objective Internal Audit function. It called for published reports on the effectiveness of internal control. It also requested the sponsoring organizations to develop an integrated set of internal control criteriato enable companies to improve their controls. Accordingly COSO (Committee of SponsoringOrganizations) was born. The report produced by it in1992 stipulated a control framework, which has been endorsed and refined in the four subsequent UK reports: Cadbury, Rutteman, Hampel and Turnbull. While developments in the United States stimulated a debate in the UK , a spate of scandals and collapses in that country in the late 1980s and early 1990's led the Shareholders and Banks to worry about their investments. These also led the Government in UK to recognize that the then existing legislation and self-regulation were not working. The issue of corporate governance became particularly significant in the context of globalization because one special feature of the late 20th' century / 21 st century globalization is that in addition to the traditional three elements of the economy, namely physical capital in terms of plant and machinery, technology and labour,the volatile element of financial capital invested in the emerging markets and in the third world countries is an important element of modern globalization and has become particularly powerful. Thanks to the ubiquitous application of information technology, at the touch of a computer mouse, it is possible now to transfer billions of dollars across borders. The significance and the impact of the volatility of the financial capital was realized when in June 1997 the currency of South East Asian countriesStarted melting down in countries like Thailand, Indonesia, South Korea and Malaysia. It was realized by the World Bank and all investors that it is not enough to have good corporate management but one should have also good corporate governance because the investors want to be sure that the decisions taken are ultimately in the interest of all stake holders. Honesty is the best policy is a fact that is now being re-discovered. In practical terms, corporate governance has meant that there should be at the board level non-official directors who are professionals and who have no conflicting interests and who can particularly operate the two key committees, the Ethics Committee and the Finance Committee to see that there is greater transparency in the management of the enterprise. Corporate governance ultimately has to come to mean better transparency in the operations without sacrificing business strategy or business secrets which are necessary for success in the marketplace, and absolutely ethical behaviour where the conduct of the company will not only be legal but also ethical.

Concept of Corporate Governance

Corporate Governance is an integrated framework whereby people formally organise themselves for a defined purpose, and they apply critical processes consistently to achieve predicted performance for sustainable development. It is well accepted world over that Corporate Governance is critical for making competitive enterprises, improving industrial performance, creating jobs and sustainable development. Corporate Governance has thus become the most debated topic in last 15 years. There are different perceptions and beliefs around the world about corporate governance and in all this corporate governance have become a rhetoric only. Much debated principles of corporate governance like independent directors, audit committees, control on related party transactions and Investor protection cannot ensure corporate sustainability and hence corporate governance has remained a rhetoric only far from reality. The economic boundaries are vanishing and a Computer Mouse has become mightier than the sword and pen. The power of information is now in hands of PEOPLE. Now people can evaluate corporate PERFORMANCE on hundreds of parameters. On click of a mouse people change their investment portfolio, their jobs and buy the best product available anywhere in the world. Power of information has also increased competition, which is now not restricted to attracting customers, but it is more intense in attracting talent and financiers, without which companies can't stand at all. Therefore it is critical that companies must have well defined PROCESS to consistently achieve predicted results year after year. Corporate strategies and management practices are taken as given, and business ethics has become a competitive success factor. Good people associate with the companies which have a well defined PURPOSE in the form of vision and stakeholder policies and sincere efforts are put to fulfill those commitments in long run.

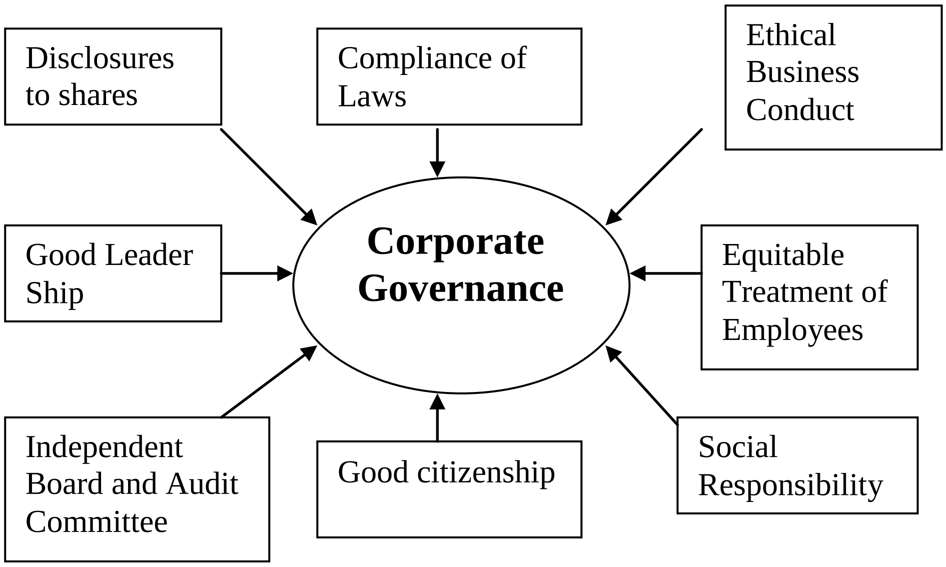
What is Corporate Governance all about?

In Academics, corporate governance refers to an economic, legal and institutional environment that allows companies to diversify, grow, restructure and exist, and do everything necessary to maximize long term shareholders value.

Adrian Cadbury defines "Corporate governance is the system by which companies are directed and controlled"

The Institute of Directors (UK) "Effective corporate governance ensures that long term strategic objectives and plans are established, and that the proper management and management structure are in place to achieve these objectives, while at the same time making sure that the structure functions to maintain the corporate integrity, reputation, and accountability to its relevant constituencies.

In Short, corporate governance should be recognized as a set of standards which aims to improve the company's image, efficiency, effectiveness and social responsibility. It is simply no longer enough to comply with legal requirements. In one line, the relationship between the owners and mangers in directing and controlling companies as separate legal entities. Corporate governance at the highest level is about the Board of Directors.



Corporate Governance: The New Mantra

The age old Ricardian Theory of Competitive Advantage has been replaced by very many theories on competition and co-existence among the competitors leading to a new coinage, 'co-appetition' by Ray Noorda of Novell Software in 1993. The phrase corporate governance is of recent vintage. According to Bob Tricker there term come to the fore in early 1980s in the United States during the heydays of the corporate takeovers.

The major driving forces behind the changes were the collapse of anti-capitalist political ideologies, technology and its impact substantially contributed for the change in investor attitude and the investors were convinced that only good governance leads to good performance and the corporates have a responsibility towards the society as good "corporate Citizens" in this context it is worth mentioning that for the first time in India the "Corporate Citizen Award for school Relevance" was conferred on the Infosys Foundation. Corporate governance also aims at enhancing the value for both the shareholders and the stakeholders and also ensures the proper growth of the capital market in an economy.

Studies by some of the leading management consultancies attributed the reasons for corporate failures to three main factors viz. manipulation of financial statements, misuse of expense accounts and corruption at various levels. The best in few days back is **B. Ramalinga Raju, Chairman; Satyam** Computer Services has finally painted himself into a corner. Business today takes look at how the promoters of Satyam undid 21 years of endeavour in less than a fortnight. The six Satyam's deadly sins are as follows:

1. **Proposing a selfish, high-risk acquisition:** Mr. Raju announced to acquire two families owned businesses i.e. 100% share holding in Maytas properties and 51% in Maytas infrastructure.
2. **Overvaluing the proposed acquisition:** Analyst consider dishonest is the price the cash-rich Satyam was willing to pay for the two Maytas firms. Raju was willing to pay 6500crore but net worth of the Maytas firms was 1125crore.
3. **Promoters pledging their entire holdings:** The promoters informed Satyam that all their shares in the company were pledged with institutional lenders, and that some lenders may exercise or may have exercised their option to liquidate shares at their discretion to cover margin calls.
4. **Refusing to resign:** Nine days after Satyam announced its aborted acquisition bid, five Directors quit the Satyam. The big question, however, is should the management itself have resigned, given the huge breach of corporate governance at the company.
5. **Not being able to utilize cash effectively:** Satyam had cash of Rs5300crore on its balance sheet, which it did not seem to be

utilizing as effectively as some of its competitors were doing.

6. **Messing up a sound company:** It has some 690 clients and 28 development centers around the world, that's nothings to be sneezed at, it's a pity somebody did.

Corporate Governance: Worldwide

Corporate governance guidelines and best practices have evolved over a period of time. The Cadbury report, on financial aspects of corporate governance published in UK during 1992 was the starting point. Though the issues of corporate governance differ in each country depending on corporate traditions, tax laws and regulations, two broad types can be identified. The first is the case of US and Britain and the second type is found in Japan and Europe, notably in Germany. The two models reflect the different ownership patterns of companies.

The US approach to corporate governance has been to minimize conflicts of interest between owners and mangers. This is attempted by giving mangers profit related incentives such as shares and stock options. Oversight by outside directors is sought to be sought to be strengthened by devices such as the audit and other committees that go into the details of the corporation's functioning.

In Germany there is statutory role the employees in the corporate governance system. The ownership of property is seen as imposing concomitant duties for its use for public weal. Unlike in USA, where banks con not trade in securities, banks in Germany not only provide long-term finance but also hold stocks of companies.

Today the corporate governance model in India is a mix of the US and Germany models. This is because of the way capital is raised here. Historically development agencies provided money for growth, however, in recent times a fairly active capital market has been doing this job. Corporate governance is regulated by SEBI enacting take over code, depository act and introducing corporate governance clause 49 as a part of listing agreement. If we consider some recent happenings for example Escort transferred 4.73 million shares held in escort tractors to at book value and not market value, this lost 55.24crore, ITC Bhadrachalam reportedly selling ITC finance and investment to ITC classic at a price of 23.8crore which was lower 14crore than its net value and Satyams' manipulation of accounts worth Rs.8000crores.

After three unsuccessful attempts made in 1993, 1997 and 2003 to revise the companies Act 1956 the present UPA government has taken a fresh initiative once again and released a concept paper on company law in 2004. An expert committee under the chairmanship of Dr. JJ Irani was constituted on December 2004 to evaluate the comments an suggestions received on concept paper and provide recommendations to the government in making a simplified modern company law. The committee submitted its report on May31, 2005. The contents of the committee report have been explained in 7 parts consisting of 13 chapters. Irani committee recommendations are relating to issues like board of directors (size, selection, age limit, tenure and remuneration etc), Relationships with stakeholders, audit and auditor, financial reporting and code of conduct.

Corporate Governance: Three Views

Corporate Governance issues are in general receiving greater attention as a result of the increasing recognition that a firm's corporate governance affects both its economic performance and its ability to access long term investment capital. We present below three different perspectives of governance.

1. **J.J Irani,** Director Tata Sons viewed that being ethical does not mean one cannot also profitable. It is most important to make profits and to generate wealth because only then can one have the resources to do good for the community. The differentiator between good and bad business practices is what happens to the wealth after it has been generated. He also viewed that we need a paradigm shift in our mindsets. Fortunately, mindsets are not permanent and these can be changed. We need to learn from our success stories rather than be bogged down by the tales of difficulty around us.
2. **Subir Raha,** Chairman and MD, ONGC New Delhi viewed that corporate social responsibility, a jargon which we keep using very often, is not really a matter of giving away some money as charity or sponsoring or supporting some cause; it is actually the way corporates interact, the way they get involved with people outside, and, in the truest sense, their stakeholder some of whom happen to be their shareholders. When professional reach the top, they have to meet a lot of expectations from all the constituencies because when they become CEOs, by definition, the responsibility stops with them. And, this is where, to my mind, lies the essence of corporate governance. It is quite possible that managers will come to a point in their career where they know that if they stand up and disagree vocally, they will miss their next promotion or even lose their jobs. That would be the moment when they test their judgment on their learning or value system in terms of corporate governance.
3. **Suresh Prabhu, MP** (LokSabha) opined that we have governments but not governance-that is the problem. And governments, by definition, do not provide governance. In the bureaucracy, governance is failing because nobody is

responsible for delivering, nobody gets punishment for not delivering and nobody has any incentive for delivering.

Essential Governance Principles

The Basel Committee has issued several papers on specific topics. These include “Frame work for internal control systems in banking organizations” (September-98) “Enhancing bank Transparency” and Principles for the management of credit risk (July-99).The following practices to avoid governance problems.

The Company should lay solid foundations for management and oversight: recognize and publish the respective roles and responsibilities of board and management.

Structure the board to add value: have a board of an effective composition, size and commitment to adequately discharge its responsibilities and duties.

Actively promote ethical and responsible decision making.

Safeguard integrity and financial reporting: have a structure to independently verify and safeguard the integrity of the company’s financial reporting.

1. Make timely and balanced disclosure of all material matters concerning the company.
2. Respect the rights of the shareholders and facilitate the effective exercise of those rights.
3. Recognize and manage risk through system of risk oversight and management and internal control.
4. Fairly review and Encourage enhanced performance.
5. Remunerate fairly and responsibly and its relationship to corporate and individual performance is defined.
6. Recognize the legitimate interests of stakeholders.
7. Corporate governance rating be made mandatory for listed companies.
8. Ensure that the board members are well qualified and not subject to pressure.
9. Ethical Approach: A clearly ethical basis to the business.
10. Conducting corporate governance in a transparent manner.

Corporate Governance and Stakeholders interests

A corporation has many human extensions of its being–namely, shareholders/Investors, employees, Customers, Suppliers and trading partners, community and environment.

Shareholders

The institutions see themselves as investors and not as owners. Their interest is in their funds and the performance of the funds rather than the companies in which they have invested. The small shareholder can claim very little moral influence as an individual in corporate performance.

Employees

It is clearly beneficial to the company to acquire, nourish and maintain a reputation for responsibility all round, including caring for the future of the employees. Fair treatment and active involvement of the workforce results in great benefits from loyalty to efficiency.

Customers:

Frequent contact with all customers is needed to keep them from deserting, and the level of their satisfaction and happiness with the company has to be assessed periodically, and strengthened, and their perception of corporate governance must be respected.

Suppliers and Trading Partners:

The old fashioned adversarial attitude has given place to partnership relationship with suppliers and dealers. It means working together for common good and mutual benefit. No one can deny its influence on their governance. This trend of products being purchased within the network of such partnerships is growing. Close customer-supplier relationships are developed resulting in such efficient processes as JIT (Just in Time)

Community and Environment

The impact on environment is highly influential not only for the present but also for the future. The environmental issues are highly ethical because they also are compounded with the issue of human rights of the affected.

The State

The corporations must be a good citizen. If the state demands a high rate of tax, the industry will seek defensive measures much against the interest of society. A balance needs to be struck which benefits all parties.

Approach to Good Corporate Governance

The law sets minimum standards of conduct. But it does not and can not embody the whole duty of man, and mere compliance with the law does not necessarily good company. The following steps are recommendable for good governance.

1. **Independent board:** constitution of board with at least 50% independent directors.
2. **Employees’ participation**: For better governance, employees’ participation and motivation, and given higher priority.
3. **Operational performance**: on the operational side, the companies have to implement risk management system for the whole company and periodical reporting and assurance to board be made on quarterly basis.
4. **Disclosure**: no doubt financial transparency and discipline is a must, but what is required is the fairness to all, compliance to law.

Conclusion

The separation of the owner and the manger in a modern public owned company has given rise to the concept of corporate governance. Liberalization and globalization have led t greater interest in the corporate governance practices in India. Lately a number of examples of corporate miss-governance have emerged which accentuate the need for better corporate governance in this country. In short, Corporate Governance is about commitment to values and ethical business conduct. The relationship of board and management with:

1. Shareholders should be characterized by candor;
2. Employees by fairness;
3. Society by good citizenship and
4. Government by commitment to compliance.

Governance is based on organizational culture and leadership. It is a journey and not destination. A journey the route of which should be decided by the corporate. It is the journey never ending and a journey for the growth and value addition. The Corporate governance must address the issues of interplay between companies' shareholders, creditors, capital markets, financial sector institutions, and the state represented by Company Law. It is a fairly substantive and radical code. It is vital for the well-being of corporate India it is what makes a company into 'My Company'. Corporate governance abuses perpetrated by a dominant shareholder pose a difficultregulatory dilemma in that regulatory intervention would often imply a micro-management ofroutine business decisions. The regulator is forced to confine himself to broad proscriptionswhich leave little room for discretionary action. Many corporate governance problems are illsuited to this style of regulation. In short, the key to better corporate governance in India today lies in a more efficient and vibrant capital market. Over a period of time, it is possible that Indian corporate structures may approach the Anglo-American pattern of near complete separation of management and ownership. At that stage, India too would have to grapple with governance issues like empowerment of the board. Until then, these issues which dominate the Anglo-American literature on corporate governance are of peripheral relevance to India.

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