PAPER ON CORPORATE GOVERNANCE

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ABSTRACT

Dynamic environment has put forth many challenges for today’s human being; even a common person wants to prove him or herself with the greatest efficiency in present era. Competition is multiplying every day and that has given birth to number of good or bad aspects. Some want to survive in Cutthroat competition by applying unethical practices, while some wants to enjoy healthy competition through ethical and transparent activities. The reaction of both the aspects are obviously, represent in their action positive for the positive action and negative for negative actions. Good governance is the expectations of every stakeholder, specially, shareholder. Governance is related with the controlling of the activity and controlling of the corporate sector can be termed as corporate governance. But the implementation of ‘Corporate Governance’ is not that much simple as its meaning. It is very wide subject and it includes lot of discussion. No doubt corporate governance is recently emerged concept and has taken the attention of each and every country, investors and corporate executives. Corporate governance is the practice, which requires transparency, accountability and good performance from the corporate executives. It has, its strong base from the internal management of company, to the shareholders’ value as well as corporate social responsibility. Reasons for selecting corporate level units which are functioning in India is to find out whether corporate governance is actually being practiced by the corporate level executives or not. India’s corporate governance frame work is sophisticated for developing country. However considerable room remains for improvement. While corporate governance may not dictate the economic prospects of developing countries. It certainly plays an integral role in shaping them. This contains a detailed analysis of the corporate governance architecture of one such developing country. This presents a series of suggestion designed to improve corporate governance in India. Most Notably,

- India must reform how its boards of directors function,
- Improve its enforcement mechanisms,
- Redefine its corporate laws,
- And embrace corporate governance as a philosophy.
Keywords: Board of Directors; Strategic Decision Making Process; Board Job Involvement; Corporate Governance.

INTRODUCTION

Corporate governance is a set of processes, customs, policies, laws and institutions affecting the way a company is directed and ministered or controlled. Corporate governance also include the relationship among the many stock holders, involved the goals for which the corporation is governed. It is a process that aims at allocated corporate resource in manners that maximize value for all stakeholders - shareholders, investors, employees, customers, suppliers, environment and community at large and holds these at the helms to account by evaluating their decisions on transparency inclusivity equity and responsibility. In contemporary business corporation the main external stakeholder groups are share holders, debt holders, trade creators, suppliers, customers and communities affected by the corporation’s activities. The World Bank defines governance as the exercise of political authority and the use of institutional recourses to manage society’s problems and affairs. There are many different models of corporate governance around the world. These differ according to the variety of capitalism in which they are imbedded. The Anglo American “model” tends to emphasize the interest of shareholders. The multi stakeholders’ model associated with central Europe and Japan also recognize the interests of works, managers, suppliers, customers and community. It is common to suggest that corporate governance lacks definition. One source defines it as “The set of conditions that shapes the expert bargaining over the quasi rents generated by the firm”. The firm itself is model as a governance structure acting through the mechanisms of contract. Here corporate governance may include its relation to corporate finance.

According to the organization for economic cooperation and development ("OECD") corporate governance deals with rights and responsibilities of a company’s management, its board, share holders and various stake holders”. Corporate governance in a developing country setting takes an additional importance. Good corporate governance is a vital because of its role in attracting foreign investment. The extent of bargain investment in turn shapes and prospects for economic growth for many developing countries.

CORPORATE GOVERNANCE MODELS AROUND THE WORLD

There are many different models of corporate governance around the world. These differ according to the variety of capitalism in which they are embedded. The Anglo American “model” tends to emphasize the interest of shareholders. The coordinated and multi stakeholders’ model associated with continental Europe and Japan also recognizes the interests of workers, managers, suppliers, customers and community. A related distinction is between market oriented and network oriented.

CORPORATE GOVERNANCE SERVICES

It includes
1. Reviewing remuneration policies and practices.
2. Improving risks and control.
3. Improving board effectiveness.
4. Remuneration committee structures and optimizing audit committee.
PARTIES INVOLVED IN CORPORATE GOVERNANCE

Key parties involved in the corporate governance include stake holders such as the Board Of Directors, management and stake holders, external stake holders such as creditors, auditors, customers, suppliers, government agencies and community at large also exert influence. The agency view of the corporation posits that the stake holders forgoes decision rights and entrusts the manager to act in stake holders best interests. Partly as a result of the separation between the two investors and managers, corporate governance mechanisms include a system of controls intended to help align managers incentives with those of stake holders agency concerns are necessarily lower for a controlling share holders.

CORPORATE GOVERNANCE INCLUDES

Suppliers, stake holders, Auditors, chief executives, Board of directors, management, creditors, customers, government agencies and community at all. All parties to corporate governance have an interest whether direct or indirect in the effective performance of the organization. Directors, workers and management receive salaries, benefits and reputation. While shareholders receive capital return, Customers receives goods and service, supplier receive compensation for their goods and services. In return these individuals provide value in the form of natural, human, social and other form of capital. A key factor is an individual’s decision to participate in an organization e. g. through providing financial capital and trust that they will receive a fair share of the organizational returns. If some parties are receiving more than their fair return then participant may choose to not continue participating leading to organizational collapse.

PRINCIPLES OF CORPORATE GOVERNANCE

The Principles of Corporate Governance includes honesty, trust and integrity, openness, performance, orientation, mutual respect, responsibility and accountability and commitment to the organization. There are very few, simple and short principles board members can easily refer to them when making decisions without losing focus. Such a process should be open and dynamic. Senior executives should conduct themselves honestly and ethically especially concerning actual or apparent conflicts of interest and disclosure in financial reports.

Five such principles of corporate governance are: -

1. **Leadership:** - An effective board should head each company. The board should steer the company to meet its business purpose in both short and long terms.

2. **Capability:** - The board should have an appropriate mix of skills, experience and independence to enable its members to discharge their duties and responsibilities effectively.

3. **Accountability:** - The board should communicate to the company’s shareholders and other stakeholders at regular intervals, a fair, balanced and understandable assessment of how the company is achieving its business purpose and meeting its other responsibilities.

4. **Sustainability:** - The board should guide the business to create value and allocate its fairly and sustainably to reinvestment and distributions to stakeholders including shareholders, directors, employees and customers.
5. **Integrity:** - The board should lead the company to conduct its business in a fair and transparent manner that can withstand scrutiny by stakeholders. They should also implement procedures to independently verify and safeguard the integrity of the company’s financial position.

### ISSUES INVOLVING CORPORATE GOVERNANCE PRINCIPLE INCLUDES

1. Dividend policy
2. Management of Risk and oversight
3. The independence of the entity’s auditors and internal control
4. Review of the arrangement of compensation for the senior executives, executives and other members which are nominated for the position on the board
5. The resources made availability to directors in carrying out their duties

Corporate Governance must go well beyond Law. The quality, quantity and frequency of financial and managerial disclosure, the degree and extent to which the board of directors exercises their trustee responsibilities and the commitment to run a transparent organization. These should be constantly evolving due to interplay of many factors and the role played by the more progressive / responsible elements within the corporate sector.

John G. Smale, a former member of the General Motors board of directors wrote “The board is responsible for the successful perpetuation of the corporation. That responsibility cannot be relegated to management.” However it should be noted that a corporation should cease to exist if that is in the best interest of its stakeholders. Perpetuation for its own sake may be counter productive.

### MECHANISM AND CONTROLS

There are both internal monitoring system and external monitoring systems. Internal monitoring can be done for example by one large shareholder in the case of privately held companies or a firm belonging to a business group. Furthermore the various board mechanism provide for internal monitoring. External monitoring of manager’s behavior occurs when an independent third party (e.g. the external auditors) attests the accuracy of information provided by management to investors. Stock analysts and debt holders may also conduct such external monitoring. An ideal monitoring and control system should regulate both motivation and ability. While providing incentive alignment toward corporate goals and objectives. Care should be taken that incentives are not so strong that some individuals are tempted to cross lines of ethical behavior e. g. by manipulating revenue and profit fixture to drive the share price of the company up.

### THREE TYPES OF CORPORATE GOVERNANCE MECHANISM AND CONTROL

1. **Internal Corporate Governance Control:** - The foremost sets of controls for a corporation come from its internal mechanism. These controls monitor the progress and activity of the organization and take corrective action when the business goes off track. Maintaining the corporation’s larger internal control fabric, They serve the internal objective of the corporation and its internal stakeholders including employees, managers and owners. These objectives include smooth operations, clearly defined reporting lines and performance measurement systems. Internal mechanism includes
   - Oversight of management
   - Independent Internal Audits
   - Structure of the board of directors into levels of responsibility
Segregation of control and policy development

2. External Mechanism: - External control mechanisms are controlled by those outside an organization and serve the objective of the entities such as regulators, governments, trade unions and financial institutions. The objectives include adequate debt management and legal compliance. External mechanisms are often imposed on organizations by external stakeholders in the form of union contracts or regulatory guidelines. External organizations, such as industry associations, may suggest guidelines for best practices, and businesses can choose to follow these guidelines or ignore them. Typically, companies report the status and compliance of external corporate governance mechanisms to external stakeholders.

3. Independent Audit: - An independent external audit of a corporation’s financial statements is part of the overall corporate governance structure. An audit of the company’s financial statements serves internal and external stakeholders at the same time. An audited financial statement and the accompanying auditor’s report helps investors, employees, shareholders and regulators determine the financial performance of the corporation. This exercise gives a broad, but limited, view of the organization’s internal working mechanisms and future outlook.

SYSTEMIC PROBLEM OF CORPORATE GOVERNANCE

- Demand for information: In order to influence the directors, the shareholders must combine with others to form a voting group which can pose a real threat of carrying resolutions or appointing directors at a general meeting.
- Monitoring costs: A barrier to shareholders using good information is the cost of processing it, especially to a small shareholder. The traditional answer to this problem is the efficient market hypothesis (in finance, the efficient market hypothesis (EMH) asserts that financial markets are efficient), which suggests that the small shareholder will free ride on the judgments of larger professional investors.
- Supply of accounting information: Financial accounts form a crucial link in enabling providers of finance to monitor directors. Imperfections in the financial reporting process will cause imperfections in the effectiveness of corporate governance. This should, ideally, be corrected by the working of the external auditing process.

WHY CORPORATE GOVERNANCE

In the recent years, there has been a considerable concern in India and other countries about the standards of corporate governance. According to Company Law, directors are obliged to act in the best interests of shareholders, but there have been many instances where we find contradiction to such obligation. There have been many cases of excessive debt financing laced with fraud, disproportionate rise in payments for executives, which have been less than transparent. The latest imbroglio involving one of India’s largest IT companies, Satyam Computer Services has virtually discredited the concept of corporate governance. Satyam sought to invest into another company i.e Maytas, involving a conflict of interest for its promoters. This in turn involved a change in the fundamental character of the company and utilization of virtually its entire cash balance. Satyam was also being accused by the World Bank for bribing its employees to get certain contracts awarded in the company’s favor. While these are allegations at this point in time, it may be noted, that the company had earlier approached suitable independent professionals to get the necessary clearances under the law of the land as well as appoint independent professionals.
directors. Ostensibly, the idea is to ‘comply’ with the code of corporate governance on paper. Ironically, this same company won the prestigious Golden Peacock Global Award for excellence in Corporate Governance as well as World Council for Corporate Governance. The ‘Satyam fraud’ is symptomatic of the Economy of shock and surprise that we live in. Satyam gives India an opportunity to lead the world by better enforcement of Clause 49 through proper selection, training, evaluation and monitoring of directors. Good Corporate Governance ensures that the business environment is fair and transparent and that companies can be held accountable for their actions. Conversely, weak Corporate Governance leads to waste, mismanagement, and corruption. It is also important to remember that although Corporate Governance has emerged as a way to manage modern joint stock corporations it is equally significant in state-owned enterprises, cooperatives, and family businesses. Regardless of the type of venture, only Good Governance can deliver sustainable.

Good Business Performance. A company that is well-governed is one that is accountable and transparent to its shareholders and other stakeholders. Conversely, weak corporate governance leads to waste, mismanagement, and corruption. It is also important to remember that although corporate governance has emerged as a way to manage modern joint stock corporations it is equally significant in state-owned enterprises, cooperatives, and family businesses. Regardless of the type of venture, only good governance can deliver sustainable good business performance.

THE BENEFITS OF CORPORATE GOVERNANCE

A - The Benefits to Companies

Compliance with the CG principles can benefit the owners and managers of companies and increase transparency and disclosure by:

- Improving access to capital and financial markets
- Help to survive in an increasingly competitive environment through mergers, acquisitions, partnerships, and risk reduction through asset diversification
- Provide an exit policy and ensure a smooth inter-generational transfer of wealth and divestment of family assets, as well as reducing the chance for conflicts of interest to arise (very important for the investors).
- Also, adopting good CG practices leads to a better system of internal control, thus leading to greater accountability and better profit margins.
- Good CG practices can pave the way for possible future growth, diversification, or a sale, including the ability to attract equity investors – nationally and from abroad – as well as reduce the cost of loans/credit for corporations.
- Many businesses seeking new funds often find themselves obliged to undertake serious corporate governance reforms at a high cost and upon the demand of outsiders, often in a time of crisis. When the foundations are already in place investors and potential partners will have more confidence in investing in or expanding the company’s operations.

B - The Benefits to Shareholders

- Good CG can provide the proper incentives for the board and management to pursue objectives that are in the interest of the company and shareholders, as well as facilitate effective monitoring.
- Better Corporate Governance can also provide Shareholders with greater security on their investment.
Better Corporate Governance also ensures that shareholders are sufficiently informed on decisions concerning fundamental issues like amendments of statutes or articles of incorporation, sale of assets, etc.

C - The Benefits to the National Economy

- Empirical evidence and research conducted in recent year’s supports the proposition that it pays to have good Corporate Governance. It was found out that more than 84% of the global institutional investors are willing to pay a premium for the shares of a well-governed company over one considered poorly governed but with a comparable financial record.
- The adoption of Corporate Governance principles - As good Corporate Governance practice has already shown in other markets - can also play a role in increasing the corporate value of companies. “If a country does not have a reputation for strong corporate governance practices, capital will flow elsewhere. If investors are not confident with the level of disclosure, capital will flow elsewhere. If a country opts for lax accounting and reporting standards, capital will flow elsewhere. All enterprises in that country suffer the consequences.” (Arthur Levitt, former chairman of the US Securities & Exchange Commission)

Objectives of Corporate Governance

Good governance is integral to the very existence of a company. It inspires and strengthens investor’s confidence by ensuring company’s commitment to higher growth and profits. It seeks to achieve following objectives:

- That a properly structured Board capable of taking independent and objective decisions is in place at the helm of affairs;
- That the Board is balanced as regards the representation of adequate number of non-executive who will take care of the interests and well-being of the independent directors and all the stakeholders;
- That the Board adopts transparent procedures and practices and arrives at decisions on the strength of adequate information;
- That the Board has an effective machinery to sub serve the concerns of stakeholders;
- That the Board keeps the shareholders informed of relevant developments impacting the company;
- That the Board effectively and regularly monitors the functioning of the management team
- That the Board remains in effective control of the affairs of the company at all times, the overall endeavour of the Board should be to take the organization forward to maximize long-term value and shareholders’ wealth.

Factors Influencing Quality of Corporate Governance

Quality of governance primarily depends on following factors:

- Integrity of the management
- Ability of the board
- Adequacy of the process
- Commitment level of individual board members
- Quality of corporate reporting
• Participation of stakeholders in the management.

CODES AND GUIDELINES

Corporate governance principles and codes have been developed in different countries and issued from stock exchanges, corporations, institutional investors, or associations (institutes) of directors and managers with the support of governments and international organizations. As a rule, compliance with these governance recommendations is not mandated by law, although the codes linked to stock exchange listing requirements may have a coercive effect. One of the most influential guidelines has been the OECD Principles of Corporate Governance—published in 1999 and revised in 2004. The OECD guidelines are often referenced by countries developing local codes or guidelines. Building on the work of the OECD, other international organizations, private sector associations and more than 20 national corporate governance codes formed the United Nations Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) to produce their Guidance on Good Practices in Corporate Governance Disclosure. This internationally agreed benchmark consists of more than fifty distinct disclosure items across five broad categories:

- Auditing
- Board and management structure and process
- Corporate responsibility and compliance in organization
- Financial transparency and information disclosure
- Ownership structure and exercise of control rights

Companies listed on the New York Stock Exchange (NYSE) and other stock exchanges are required to meet certain governance standards. For example, the NYSE Listed Company Manual requires, among many other elements:

- Independent directors: "Listed companies must have a majority of independent directors...Effective boards of directors exercise independent judgment in carrying out their responsibilities. Requiring a majority of independent directors will increase the quality of board oversight and lessen the possibility of damaging conflicts of interest." (Section 303A.01) An independent director is not part of management and has no "material financial relationship" with the company.
- Board meetings that exclude management: "To empower non-management directors to serve as a more effective check on management, the non-management directors of each listed company must meet at regularly scheduled executive sessions without management."
- Boards organize their members into committees with specific responsibilities per defined charters. "Listed companies must have a nominating corporate governance committee composed entirely of independent directors." This committee is responsible for nominating new members for the board of directors. Compensation and Audit Committees are also specified, with the latter subject to a variety of listing standards as well as outside regulations.

The investor-led organisation International Corporate Governance Network (ICGN) was set up by individuals centered around the ten largest pension funds in the world 1995. The aim is to promote global corporate governance standards. The network is led by investors that manage 18 trillion dollars and members are located in fifty different countries. ICGN has developed a suite of global guidelines ranging from shareholder rights to business ethics.
The World Business Council for Sustainable Development (WBCSD) has done work on corporate governance, particularly on accountability and reporting, and in 2004 released Issue Management Tool: Strategic challenges for business in the use of corporate responsibility codes, standards, and frameworks. This document offers general information and a perspective from a business association think-tank on a few key codes, standards and frameworks relevant to the sustainability agenda. In 2009, the International Finance Corporation and the UN Global Compact released a report, Corporate Governance - the Foundation for Corporate Citizenship and Sustainable Business, linking the environmental, social and governance responsibilities of a company to its financial performance and long-term sustainability. Most codes are largely voluntary. An issue raised in the U.S. since the 2005 Disney decision is the degree to which companies manage their governance responsibilities; in other words, do they merely try to supersede the legal threshold, or should they create governance guidelines that ascend to the level of best practice. For example, the guidelines issued by associations of directors, corporate managers and individual companies tend to be wholly voluntary but such documents may have a wider effect by prompting other companies to adopt similar practices.

HISTORY OF CORPORATE GOVERNANCE IN INDIA

A. Pre-Liberalization

When India attained independence from British rule in 1947, the country was poor, with an average per-capita annual income under thirty dollars. However, it still possessed sophisticated laws regarding "listing, trading, and settlements." It even had four fully operational stock exchanges. Subsequent laws, such as the 1956 Companies Act, further solidified the rights of investors. In the decades following India's independence from Great Britain, the country turned away from its capitalist past and embraced socialism. The 1951 Industries Act was a step in this direction, requiring "that all industrial units obtain licenses from the central government." The 1956 Industrial Policy Resolution "stipulated that the public sector would dominate the economy." To put this plan into effect, the Indian government created enormous state-owned enterprises, and India steadily moved toward a culture of "corruption, nepotism and inefficiency." As the government took over floundering private enterprises and rejuvenated them, it essentially "convert private bankruptcy to high-cost public debt." One scholar referred to India's economic history as "the institutionalization of inefficiency."

The absence of a corporate-governance framework exacerbated the situation. Government accountability was minimal, and the few private companies that remained on India's business landscape enjoyed free reign with respect to most laws; the government rarely initiated punitive action, even for nonconformity with basic governance laws. Boards of directors invariably were staffed by friends or relatives of management, and abuses by dominant shareholders and management were commonplace. India's equity markets "were not liquid or sophisticated enough" to punish these abuses. Scholars believe that "takeover threats act as [a] disciplining mechanism to poorly performing companies" because as the stock price of poorly governed firms decreases (because disgruntled investors discard stock), the firms become susceptible to hostile-takeover attempts. Thus, "the fear of a takeover is supposed to keep the management honest." However, until recently, hostile takeovers were almost entirely non-existent in India, and therefore, the poorly governed Indian firms had little to worry about in terms of following
corporate laws once they had raised capital through their initial public offering. Thus, corporate governance in India was in a dismal condition by the early 1990s.

B. Post-Liberalization

In 1999, in a defining moment in India's corporate-governance history, the Indian Parliament created the Securities and Exchange Board of India ("SEBI") to "protect the interests of investors in securities and to promote the development of, and to regulate the securities market." In the years leading up to 2000, as Indian enterprises turned to the stock market for capital, it became important to ensure good corporate governance industry-wide. Additionally, a plethora of scams rocked the Indian business scene, and corporate governance emerged as a solution to the problem of unscrupulous corporate behavior. In 1998, the Confederation of Indian Industry ("CII"), "India's premier business association," unveiled India's first code of corporate governance. However, since the Code's adoption was voluntary, few firms embraced it. Soon after, SEBI appointed the Birla Committee to fashion a code of corporate governance. In 2000, SEBI accepted the recommendations of the Birla Committee and introduced Clause 49 into the Listing Agreement of Stock Exchanges. Clause 49 outlines requirements vis-à-vis corporate governance in exchange-traded companies. In 2003, SEBI instituted the Murthy Committee to scrutinize India's corporate-governance framework further and to make additional recommendations to enhance its effectiveness. SEBI has since incorporated the recommendations of the Murthy Committee, and the latest revisions to Clause 49 became law on January 1, 2006.

THE CURRENT STATE OF CORPORATE GOVERNANCE IN INDIA

Corporate governance reform in India has focused primarily on the "role and composition of the board of directors." Each of the three sets of recommendations (the CII Code recommendations from 1997, the Kumar Mangalam Birla Committee recommendations from 2000, and the Murthy Committee recommendations from 2003) has advanced a more nuanced and sophisticated understanding of corporate governance in this respect. For example, while the CII Code was silent on the financial-literacy levels expected of directors, the Murthy Committee recommended that companies train their "Board members ... in the business model of the company as well as the risk profile of the business parameters of the company." Another notable recommendation of the Murthy Committee was that the Audit Committee be comprised entirely of "financially literate non-executive members with at least one member having accounting or related financial management expertise.

CONCLUSION

In the end we can say that Corporate Governance is a multi–faced subject but important theme of corporate governance to ensure the accountability of certain individuals in an organization through mechanisms that try to reduce or eliminate the principal – agent problem. Corporate Governance has become the latest buzzword today. Almost every country has institutionalized a set of Corporate Governance codes, spelt out best practices and has sought to impose appropriate board structures. Despite the 'Corporate Governance revolution' there exists no universal benchmark for effective levels of disclosure and transparency. There are several corporate governance structures available in the developed world but there is no one structure, which can be singled out as being better than the others. There is no "one size fits all" structure for corporate governance. Corporate governance extends beyond corporate law. Its fundamental objective is not the mere fulfillment of the requirements of law but in ensuring commitment of the board in managing the company in a transparent manner for maximizing long term
shareholder value. Effectiveness of corporate governance system cannot merely be legislated by law. As competition increases, technology pronounces the death of distance and speeds up communication. The environment in which companies operate in India also changes. In this dynamic environment the systems of corporate governance also need to evolve. The recommendations made by different expert committees will go a long way in raising the standards of corporate governance in Indian companies and make them attractive destinations for local and global capital. These recommendations will also form the base for further evolution of the structure of corporate governance in consonance with the rapidly changing economic and industrial environment of the country in the new millennium.

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