CORPORATE GOVERNANCE: THE CONCEPT

Corporate governance basically refers to a set of systems and subsystems by which a company is controlled and directed.

HALLMARKS OF GOOD CORPORATE GOVERNANCE

- ❖ It seeks to maximise the long run corporate value, the interest of various stakeholders and particularly the stockholders who are residual claimants.
- ❖ It is transparent and effective.
- ❖ It is able to prevent corporate crimes.
- ❖ It promotes competitiveness and overall growth of the organisation. It is fully accountable to the various stakeholders of the company.
- ❖ It maintains a healthy corporate culture that meshes well into the socio-economic and cultural profile of the society.
- ❖ It is able to resolve successfully the conflicts between the various categories of stakeholders within and outside the company, particularly between the owners and the managers of the company.
- ❖ It is ethical and socially responsible.
- ❖ It is flexible and dynamic, capable of adjusting to the changing context and times.
- ❖ It provides adequate avenues to shareholders for effective contribution to the governance of the company without getting involved in the day-to-day functioning of the economy.

- ❖ **LEADING INDICATORS OF CORPORATE GOVERNANCE**

- ❖ ***Existence of Good Governance Code***
- ❖ ***The Role, Responsibility and Competence of the Board***
- ❖ ***Involvement of Non-Executive or Independent Directors***
- ❖ ***Dissemination of Material Information***
- ❖ ***Distinction Between the Role and Responsibilities of the Board and the Management***
- ❖ ***Specialised Board Committees***
- ❖ ***Disclosure of Remuneration Package***
- ❖ ***Accounting Standards and Financial Reporting***

- ❖ **CORPORATE GOVERNANCE NORMS IN INDIA**

- ❖ Development of the governance codes in other countries have mounted pressure in the
- ❖ country for the development of a governance code. three codes have been recently
- ❖ evolved.
- ❖ Desirable Corporate Government in India-A code, by Confederation of Indian Industry (CII), 1997.
- ❖ Kumar Mangalam Committee Report on Corporate Government (appointed by SEBI under the Chairmanship of Kumar Mangalam Birla, 1999).
- ❖ Naresh Chander Committee on Corporate Governance.

Some Weakness of the Companies Act

- ❖ No formal role is assigned to the non-executive directors though they can play an important role in providing independent and objective opinion in discussions on many strategic areas.

- In most cases, non–executive directors have only ornamental value and lack a sense of commitment.
- Under the existing provisions, the approach to financial reporting is highly rule– based and ritualistic and lacks transparency.
- There are no formal qualifications prescribed for a director in the Act.
- The Act formally provides for the appointment of auditors by the shareholders but practically auditors work more closely with the company management.
- A large number of companies hardly provide any service to investors, particularly with regard to redressal of grievances.

The CII code

- The main recommendations of the code are as follows:
- A single well performing board is desirable.
- A listed company with annual turnover of Rs. 100 crore and above should have professionally competent and acclaimed non-executive directors.
- No single person should hold directorship in more than 10 companies.
- In order to get better inputs from non-executive directors they should be paid a commission over and above sitting fees for their professional services.
- While reappointing members of a board, companies should furnish attendance record of directors.
- Listed companies should set up Audit Committees within 2 years. The committee should assist the board in fulfilling its functions relating to corporate accounting, reporting practices, financial and accounting controls and financial statements and proposals.
- A listed public company provides additional information to its shareholders. On high and low monthly averages of share price in all the stock exchanges where the company is listed.

- **Kumar Mangalam Birla Report**
- The major recommendations of the committee are as follows.
- **Board of Directors**
- The board of a company should have an optimum combination of executive and non-executive directors with 50 per cent of the board consisting of non-executive directors.
- Financial institutions should have no direct role in managing the company and should normally not have nominees on the board merely by virtue of their financial exposure in the company.
- Chairman's role should be different from that of the chief executive.
- A director should not be a member in more than ten committees or act an chairman of more than five committees across all companies in which he is a director.
- **Audit Committee**
- Standards of government applicable to the full board should be applicable to the audit committee as well.

- The composition of the Audit Committee should be as follows:
- At least three non-executive directors as members.
- One of the independent directors as Chairman.
- The finance director, head of the internal audit and a representative of external auditor as invitees at the meetings of the audit committee.
- The company secretary as the secretary of the committee.
- The committee should meet at least thrice in a year.
- The Committee must have the power to seek information from any employee, obtain outside legal or other professional advice and secure attendance of outsiders with relevant expertise, if necessary.
- **Director's Remuneration**
- The remuneration of the non-executive directors should be decided by the entire board.
- Shareholders should be fully informed about the remuneration of directors. The following disclosures must be made in the section on corporate governance of the annual report of the company.
- All the elements of remuneration package (like salary, benefits, bonus, stock option, pension etc.)
- Details of fixed component of remuneration and performance linked incentives (including performance criteria).
- Service contract details.
- Stock option details, if any.
- **Accounting Standards and Financial Reporting**
- The companies should be required to give consolidated accounts in respect of all of its subsidiaries in which they hold 51 per cent or more share capital.
- **Company Management**
- The board must clearly define the role of the management.
- The management must disclose to the board all material financial and commercial transactions.
- As a part of management disclosure **Management Discussion and Analysis Report (MDAR)** should form a part of the annual report to the shareholders.
- **Shareholders**
- In case of appointment or re-appointment of a director, shareholders must be provided with a brief resume of the person concerned, his expertise in specific functional areas, names of the companies in which he holds the directorship and the names of the board committees of which he is a member.
- Shareholders should have right to participate in and have sufficient information on :
- a) Decisions concerning basic corporate changes;
- b) Takeovers, sale of assets or division of the company.
- c) Changes in capital structure which has the potential to bring about a change in control of the company.
- Half-yearly declaration of financial performance and summary of significant developments in the company over the last six month period should be sent to each shareholder.

- A separate board committee should be set up under the chairmanship of a non-executive director to take care of the shareholders complaints relating to transfer of shares, non-receipt of balance-sheet, declared dividend etc.
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- **Naresh Chandra Committee Report, 2002**
- The major highlights and recommendations of the committee report are as follows.
- It makes no distraction between a board with an executive Chairman and a non-executive chairman.
- It is sufficient to have compulsory rotation of audit partners in every five years.
- Independent directors should play a larger role to ensure that corporate governance practices are improved and that the interests of stakeholders other than promoters are protected.
- There should be increased level of disclosure by a company and its auditors.
- At least 50 per cent of the directors on the board of any listed company and unlisted public limited company with paid-up share capital and free reserves of Rs. 10 crore or more or turnover of Rs 50 crore or more should be independent.

CORPORATE GOVERNESS

Introduction

- ❖ A corporation or company is an enterprise authorised by law to conduct business.
- ❖ Governance implies a degree of control to be exercised by key stakeholders' representatives for the furtherance of corporate growth and protection of stakeholders' interests.
- ❖ Corporate governance is a system by which companies are directed and controlled based on code for good corporate practices.

Definition of Corporate Governance

- ❖ Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals.
- ❖ Corporate governance is concerned with the efficiency use of resources, value addition and wealth creation within the broad parameters of corporate philosophy established by corporate governance
- ❖ **Nature of Corporate Governance**
- ❖ Corporate governance is the overall control of activities in a corporation
- ❖ It is concerned with the formulation of long-term objectives and plans
- ❖ It entails that the structure, functions of the organization is such that its integrity and responsibility to its various stake holders

Need of Corporate Governance

- ❖ The basic idea of the effectiveness of company accountability to its shareholders has come in doubt.
- ❖ There is a need for extending corporate accountability to employees, creditors, consumers and society at large.
- ❖ Society's expectations from corporations have increased

Benefits of Good Corporate Governance

1. Good governance provides stability and growth of the company
2. Good governance builds confidence among the investors and reduces the cost of capital to a considerable extent.

3. Adaptation of good corporate practices promotes stability and long term sustenance of stakeholders' relationship.

4. A good corporate citizen becomes an ethical icon and enjoys a position of pride in corporate culture.

5. A well governed company enthuse employees to acquire and develop company specific skills.

Arguments against business performing social responsibility activities

i. Organisations cannot act effectively as moral agents for all company shareholders.
ii. time money and attention diverted to social causes undermine market efficiency.

Factors influencing Corporate Governance

i. Ownership structure
ii. The Structure of Company Boards
iii. The Financial Structure
iv. Institutional Environment

Contents of Corporate Governance Code

a) Constitution of Board of Directors
b) Disclosure of Information
c) Management Practices

Principles of Corporate Governance

a) Transparency
b) Accountability
c) Independence
d) Reporting
e) **The Davis Model of Corporate Social Responsibility**
f) **Proposition 1:** Social responsibility arises for social power
g) **Proposition 2:** Business shall operate with open receipt of inputs from society and open disclosure of its operations
h) **Proposition 3:** The social costs and benefits of an activity shall be thoroughly calculated
i) **Proposition 4:** The social costs related to each activity shall be passed on to the consumer
j) **Proposition 5:** Business institutions have the responsibility to become involved in certain social problems that are outside their normal areas of Operation

Corporate Governance in India

- Corporate governance is concerned with the system of law, regulation, and practice which will promote enterprise and ensure accountability.
- Various reports on corporate governance were given by a number of committees set up to review and suggest ways and means to make CG more effective.
- Names committees are presented below
- Report of the Kumar Manglam Birla committee on Corporate Governance (SEBI, May 7th, 1999
- Report of the Task Force on Corporate Excellence through Governance (Department of Company Affairs, November 20th, 2000)
- Report of the Advisory Group on Corporate Governance: Standing Committee on International Finance Standards and Codes (RBI, March 24, 2001)
- Report on the Consultative Group of Directors of Banks/ Financial Institutions (RBI, April,2002)
- Report of the Naresh Chandra Committee on Corporate Audit and Governance Committee (Report 1) (SEBI, December 23 rd 2002)
- Recommendations of the Naresh Chandra Committee
- Disclosure of Contingent Liabilities (Section 2.5 of Naresh Chandra Committee Report)
- CEO / CFO Certification (Section 2.10 of Naresh Chandra Committee Report
- Report of the committee on Regulation of Private Companies and Partnership (Naresh Chandra Committee – II, July 2003

- **Conclusion**
- Progressive firms in India have made an attempt to put systems of good corporate governance in place.
- Good governance is expected when different interests are accommodated in a socially acceptable balance.
- Hence the concept of corporate governance hinges on total transparency, integrity and accountability of the management.
- **Summary**
- Corporate governance is a newly introduced system for managing a company in the best interest of all its stakeholders
- Corporate governance is the overall control of activities in a corporation.
- The best-known arguments against performing social responsibility activities have been advanced by Milton Friedman a distinguished economist.

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- Good governance is expected when different interests are accommodated in a socially acceptable balance.