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Creating Awareness on the Importance of Good Corporate Governance Practices

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ABSTRACT: *As the economies of the different countries are turning more and more vibrant with the process of globalization, the flow of financial capital across the borders of the nation is rising. However with rise in the quantum of finance, financial irregularities have also risen in terms of number and amount of money involved. It is making a common investor getting suspicious about corporate investment and driving him away from the market. Although the institutional investment is on the rise, investment through small investors is declining. Irregularities on the part of corporates are threatening their own existence and stability of the global economy too. Measures must be taken to curb the menace to ensure legal, social, moral and ethical conduct of the corporates. The issue of Corporate Governance has got much of the attention in this regard. There is a need to create and spread more awareness about good corporate governance practices.*

However the scope of corporate governance should not be confined to just financial information disclosure. But it should also include corporate social responsibility that there conduct should not be detrimental to the environment and natural resources.

The need is already been felt many countries which have prompted to the enactment of various stringent laws. There is also immense role of independent directors, media, institutional investors in seeing that the conduct of companies for the interests of its stakeholders. Market regulators are also cautious more than ever before keeping strict eye on the market. However none of the laws can curb the menace of unending greed. It's for the corporates to realise that it would in their long term interest to perform on ethical and legal lines.

I. INTRODUCTION

Corruption has always been a part of our pubic life. The only difference had been the extent and its form has changed from time to time. Once referred to as diabetes which can be controlled but can not be cured, corruption has really engulfed all the spheres of our lives. A country once known for its moral idols like Prabhu Ramchandra, Raja Harish Chandra and Mohandas Karamchand Gandhi, faces a sad fact that it is ranked amongst one of the most corrupt countries in the world. The business world or more popularly referred to as the corporate world has also not been untouched from this disease which has seen many financial irregularities. It is not only a developing economy like India but even the most developed economy of the world, America too found itself vulnerable to corporate debacles with the fall of major corporate giants like the Enron, Worldcom. The question now is how to protect the interest of the stakeholder who has invested his efforts and money with lot of trust. The concept of "Corporate Governance" has got much of the attention all across the world in this regard.

What's Corporate Governance?

According Sir Adrian Cadbury, Corporate Governance is "… holding the balance between economic and social goals and between individual and communal goals. The governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations and society. The incentive to corporations is to achieve their corporate aims and to attract investment. The incentive for states is to strengthen their economics and discourage fraud and mismanagement"

However according to many experts scope of Corporate Governance is confined to just financial accountability thereby disclosure financial information and bottom line accounting which is of interest only to stockholders. But others have argued for enlarging the scope as wide as encompassing other groups like customers, employees and society at large. Apart from it, Chief Executive Officer, Board of Directors, Management are called as the other parties to corporate governance along with the shareholders.

By and large, it can be defined as "the conduct of business on legal, moral and ethical grounds which will result in the increase in the wealth of its stakeholders."

Key elements of good corporate governance principles include honesty, trust and integrity, openness, performance orientation, responsibility and accountability, mutual respect and commitment to the organization.

Why Corporate Governance?

- There has been increased recognition to the fact that a firm's corporate governance affects both its economic performance and its ability to access long – term, low cost investment capital. The only way for a corporation to exist and capitalism to survive is to be a part of the whole society. Companies have to be concerned with owners, the employees, the customers and community at large.
- Strong corporate governance culture provides strong internal control system, risk assessment and identification system. It ensures accurate, reliable and timely financial information by the company. It enlarges companies' access to various resources of capital, helps it reduce the cost of capital and generates more wealth and employment.
- With the process globalization getting more and more momentum with the use of information technology and telecommunication, the movement of four economic means physical capital, financial capital, technology and labor has become faster and easier , turning the whole world into a giant global village.
- Movement of financial capital has tremendous impact on the economy. Foreign Institutional Investors have started investing in the emerging markets. These investors want to make themselves sure that the companies in which they have invested were not only managed properly but also that the companies work under the frames of certain values which results in the optimum utilization of physical, human and financial resources. On one hand we see companies which were efficiently managed but ill- governed. On the other hand in India we see companies considered to be blue chip companies getting indulged in illegal transactions like that of Hawala. Having just effective governance is not important but it must be made sure that they have got ethical governance. Illegal and unethical practices of a company can give a severe blow to its brand image in the market In the long run it will bring down the trust of its investors.
- The organizations' spread of operations across the globe would also mean that its financial failure in one part of globe would seriously affect its operations in the other part; thereby having profound impact on global economy. Similarly organizations having bad corporate image as far as social and environmental compliance is concerned can also face stiff opposition while entering into a new country. The recent protest against multinational Posco in India should be viewed in this regard.
- One can sight the example of South East Asian economies' collapse in 1997. The reasons attributed for it were crony capitalism and a high degree of corruption. Jeremy Porrass and James Collins have made an interesting survey about the factors that were behind the success of what they call visionary companies. These are the companies which are more than 50 to 100 years old and which had survived over the years, inspite of dynamic environment surrounding them. When compared in terms of market capitalization from 1950-1990, their market capitalization was 15 times that of normal companies. In terms of longevity also they were more than 50 years old compared to the average life of 15-20 years of company. As they analyzed to causes of the success of these companies, the factors sighted were their vision and values to which they stuck through thick and thin. It is their corporate culture based upon strong values and vision which made them set and focus upon super – ordinate goal which probably in the long run helped the company to overcome the challenges which an enterprise has to constantly meet.
- It will be interesting to find a correlation between the countries that are rated high on the corruption scale and their relative levels of competitiveness. In terms if global competitiveness India is ranked 50/53 and in corruption India is 9th most corrupt country in the world. One can easily relate corruption has brought down competitiveness of the country.
- By having a short run view of meeting expectations of analysts about quarterly results, a company can go for inflated profit figures in order to soar the prices of its shares. However in the long run it may lose the most valuable thing which has got with itself i.e. its existence. One can see what happened to Enron.

II. AWARENESS ABOUT CORPORATE GOVERNANCE

Corporate governance guidelines and best practices have evolved over a period of time. With the increased awareness on the issue there have been efforts on the part of both government and private sector to address the issue. Many committees were set up to resolve a code of ethic for the corporate.

- The Cadbury Report on the financial aspects of corporate governance, published in the United Kingdom in 1992, was a landmark. It led to the publication of the Vienot Report in France in 1995. General Motors Board of Directors Guidelines in the United States and the Dey Report in Canada were very influential in the evolution of other guidelines and codes across the world. Over the past decades, various countries have issued recommendations for corporate governance. Compliance with these is generally not mandated by law, although codes that are linked to stock exchanges sometimes have a mandatory control.
- The Sarbanes-Oxley Act, which was signed by the U.S. President George W. Bush into law in July 2002, has brought about sweeping changes in financial reporting. This is perceived to be the most significant

change to federal securities law since the 1930s. Besides directors and auditors, the Act has also laid down new accountability standards for security analysts and legal counsels.

- In November 2003, the SEC approved changes to the NYSE and NASDAQ listing requirements. The changes focused mainly on Board independence, independent committees of the Board, audit committee composition, code of business conduct and ethics and related party transactions.
- The Higgs Report on non-executive directors and the Smith Report on audit committees, both published in January 2003, form part of the systematic review of corporate governance being undertaken in the U.K. and Europe. This is in light of recent corporate failures. The recommendations of these two reports are aimed at strengthening the existing framework for corporate governance in the U.K. Enhancing the effectiveness of the non-executive directors and switching the key audit relationship from executive directors to an independent audit committee are part of this. These recommendations are intended as revisions to the Combined Code on Corporate Governance.
- In April 2004, the governments of the 30 Organization for Economic Co-operation and Development (OECD) countries approved a revised version of the OED's Principles of Corporate Governance adding new recommendations for good practice in corporate behavior with a view to rebuilding and maintaining public trust in companies and stock markets. The revised principles call on governments to ensure effective regulatory frameworks and on companies to be more accountable. The principles include increased awareness among institutional investors, enhanced role for shareholders in executive compensation, greater transparency and effective disclosures to counter conflicts of interest.
- Learning from the financial collapse of 1997, the South East Asian countries realized the importance of financial discipline. The Thailand government gave high priority to good corporate governance declaring 2002 as year of good corporate governance. Thai stock market instituted many measures like giving training to directors, disseminating information through T.V., Radio and magazines, rewarding companies with outstanding achievement in implanting corporate governance. Even in China investors are slowly discovering the importance of independent boards and auditors
- Apart from the regulatory efforts there have been voluntary efforts on the part of the companies which are setting up code of ethics and guidelines for itself. the oil major, Shell, has institutionalized stakeholder consultations as part of its corporate strategy, and its statement of business principles now includes its responsibilities towards customers and employees -- in addition to shareholders. Interestingly enough, Shell says that its responsibility to shareholders is to provide ``acceptable" returns as against maximized returns. And then again, IBM's current corporate social responsibility strategy refers to enhancing stakeholder value and to the delivery of measurable results to society at large. Similarly, Dow Chemicals includes service to stakeholders in its vision statement which says: ``To be successful, we have to provide a balance to the needs of all four of these groups (customers, employees, shareholders and society). If we maximize the return to any one or two of these stakeholder groups at the expense of the others, we won't survive very long."
- On the domestic front Indian companies like ICICI, Infosys and TATA have set up policies on corporate governance. In India, the Confederation of Indian Industry (CII) took the lead in framing a desirable code of corporate governance in April 1998. This was followed by the recommendations of the Kumar Mangalam Birla Committee on Corporate Governance. This committee was appointed by the Securities and Exchange Board of India (SEBI). The recommendations were accepted by SEBI in December 1999, and are now enshrined in Clause 49 of the Listing Agreement of every Indian stock exchange. SEBI also instituted a committee under the chairmanship of Mr. N. R. Narayana Murthy which recommended enhancements in corporate governance. SEBI has incorporated the recommendations made by the Narayana Murthy Committee on Corporate Governance in Clause 49 of the listing agreement. The revised Clause 49 has been made effective from January 1, 2006.In addition, the Department of Company Affairs, Government of India, constituted a nine-member committee under the chairmanship of Mr. Naresh Chandra, former Indian ambassador to the U.S., to examine various corporate governance issues.
- Some of the practices which Infosys has put in its Corporate Governance Report :

- ♦ Happy companies have robust growth in revenues, strong balance sheets, and healthy profits that reflect genuine business success, not phony bookkeeping.
- ♦ And they share other important traits as well.
- ♦ They abide by high ethical standards, which is a key to their solid success.
- ♦ They don't obstruct the flow of information to shareholders, but rather view the shareholder as the ultimate owner and the ultimate boss.
- ♦ They choose directors on the strength of their abilities, character, and capacity for independent judgment.
- ♦ And their internal controls work well, so that the company's executives can take immediate corrective action when something goes wrong.

III. SPREADING AWARENESS ABOUT CORPORATE GOVERNANCE

Firstly one must understand when there is overall fall in moral standards across the society itself expecting one of the entities of the society i.e. business houses should keep themselves unaffected by the happening would be a too unrealistic. What happens in the society gets reflected in its different spheres. The efforts are to be made to uplift the value system in the society. Countries like Australia have made ethics as a part of their schools' curriculum and the education system. Many B-schools too have included business ethics as a part of their course.

- The corporate frauds that are witnessing today are far greater in frequency, intensity and magnitude. Uncontrollable greed is the biggest reason behind it and can well become death knell of the capitalism. The question is how to contain this greed. Corporate governance should not become a legal formality. Business houses should bring an attitudinal change in them following law not in letters but spirit also. As Stephen Covey mentioned in his book " 7 Habits of Highly Effective People" an 'inside – out' approach is what necessary that organizations that they should change themselves first if they wish a prosperous future for them.
- Organizations too on their own are making efforts by spelling out rules for themselves. For example, the GM Board guidelines reflect the company's efforts to improve its own governance capacity. Such documents can have wider multiplying effect prompting other companies to adopt similar documents and standards of best practice.
- 'Corporate Role Models' is the need of the hour. We need corporate leaders having strong ethical values. It's the leader whose values lay a strong foundation for the creation of organizational culture. We need good corporate leaders with their excellent value commitment who can be looked upto as being the role models for others. Leaders like N. R. Narayana Murthy and his company Infosys has shown that it's possible to achieve success while keeping ethical considerations above everything.
- The role of independent directors on the board becomes very important when it comes to supervising whether the management is working with transparency or not. They are entrusted with this responsibility by the shareholders and they should maintain their independent status by asking management serious questions over its working. However one would wonder how some 5 or 6 persons keep control on the functioning, that too when they are meeting just few times in a year. In India there is general tendency among the directors who like to maintain amicable and pleasant environment of the board meeting and avoid of getting into any kind of conflicts as against the directors in the western countries. But they should prove their might with prior deep study and investigative questioning and at times taking on the rest of the members even at the cost of disturbing sooth sailing meeting, when it comes to protecting the interest of the stakeholders of whom they are the trustees.
- The ever rising remuneration of directors has also become a matter of concern especially at a time when company itself is going through bad financial times. Some have suggested it would be appropriate if they are paid for their performance in the form of the shares of the company whereby making them to make honest efforts for the progress of the company. They would ensure that at the end they are not left with shares having a penny worth price. At least this selfishness would ensure the interest of the stakeholders
- Institution investors and lenders should also deal with the companies complying corporate governance standards and also keep check on the functioning through directors appointed by them
- The employees too must be given training when it comes to adhering to ethical principles set up by the company. The CEO of the company should also act as being Chief Ethical Officer and not just being Chief Executive Officer. Being the captain of the ship he should set high standards in front of his employees when it comes to moral conduct. It would be appropriate on the part company to take strong action against the employees found to be violating code of ethics set up by the company. Employees too on the other hand can keep check on the activities of the company and top executives through "Whistle Blowing"
- The role of media as a watchdog in this regard can't be overlooked. Only one statement made on television channel "Disinvestment ministry jaye bhad main" by a senior political leader brought the BSE Sensex down by 800 points. Especially with electronic media and several of business channels running 2457 coverage, for a common investor getting corporate updates has become very easy. Financial analysis, expert advice & market updates keep on rolling on various channels. Media can play vigilant role by reporting about company affairs to common investor and thereby helping him make wise investment decisions.
- Unholy nexus of corporate and politics become more vivid when it comes political funding. Political parties need corporate houses for funding their election campaign and corporate need political connections when it comes to getting government favors. However political funding must be accounted for and should be made through only cheques. In India many corporate houses have taken efforts in this regard.
- Corporate houses must realize the fact that just complying financial norms won't be enough. They have got their commitment to the society at large. It's the society first which grants theses companies their existence and later on the shareholders. Environmental considerations should be addressed when it comes to using

natural resources. Wastage management, environmental pollution are the issues corporates must address. It should provide its customers qualitative products at economical costs, treat its employees with fairness. Some have gone has far as saying that the employees should be given representation on the Board because they are the one who have got much more stake in the company when it comes to its long term running rather than shareholders who have eye on the short term quarterly results.

- Some of the Credit Rating Agencies are rating companies on the basis of corporate governance. This involves carrying out fundamental research on the company and providing a valuation to the shares. This is not a buy/sell recommendation, but assessment of the fundamental value of the share. Issuers benefit by providing investors with an independent opinion on the value of their shares. This concept is slowly gaining ground. For example, CRISIL believes that corporate governance is a process by which corporates create value for shareholders. In line with this, they have devised a globally unique model which assesses a company's ability to create wealth for stakeholders on a sustainable basis, through good governance practices. Titled, CRISIL GVC Ratings, they assess a company on three broad parameters, strength of relationship with stakeholders, viz. corporate governance processes and management capability. This 360 degree evaluation provides good insights into companies and their ability to create wealth for stakeholders. CRISIL GVC Ratings provide an insightful opinion about a company's governance practices and its ability to sustain wealth creation for shareholders. Every company which gets itself assessed is provided a detailed report identifying areas of good practices and areas where they fall short of best practices. As managements focus on these areas and work towards improving these, the overall governance standards in the company will go up. Lastly, investors and other stakeholders are also monitoring the companies' performance motivating them to showcase the improvements they have made. As more and more companies go in for rating, the overall governance standards in India are expected to improve.

IV. CONCLUSION

Today corruption has become low risk high profit business. The Regulator of the Capital market and the 'Law of the Land' has to be stringent enough whereby increasing risk element for corruption. However one must understand no law or threat of stringent punishment can deter fraudulent executives and directors from committing illegal acts. Breakers of law have time and again proved themselves far wiser than the makers of law. Self – governance would be a more effective way of ensuring that companies adhered to best business practices rather than enforcing it through law.

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