CORPORATE GOVERNANCE: AN OVERVIEW

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Corporate Governance: An overview

Introduction

With the advent globalization phenomena the demand for corporate governance by the different stakeholders has increased drastically. Globalization involves the movement of four economic parameters namely, physical capital in terms of plant and machinery, financial capital in terms of money invested in capital markets or in FDI, technology, and labour moving across national borders. The pace of movement of financial capital has become greater because of the pervasive impact of information technology and the world having become a global village.

When investments take place in emerging markets, the investors want to be sure that not only are the capital markets or enterprises with which they are investing, run competently but they also have good corporate governance. Corporate governance represents the value framework, the ethical framework and the moral framework under which business decisions are taken. In other words, when investments take place across national borders, the investors want to be sure that not only is their capital handled effectively and adds to the creation of wealth, but the business decisions are also taken in a manner which is not illegal or involving moral hazard.

Creating effective Corporate Governance is a complex matter. The issues are many and varied; the corporate scandals of the past few years have had a profound effect on the way companies do business – and on the attitudes of regulators and shareholders.

Definition

The term corporate governance has come to mean two things.

1. The processes by which companies are directed and controlled.

2. A field in economics, which studies the many issues arising from the separation of ownership and control.

Corporate governance is about promoting and encouraging corporate fairness, lucidity, transparency and accountability. Relevant rules include applicable laws of the land as well as internal rules of a corporation. Relationships include those between all related parties, the most important of which are the owners, managers, directors of the board, regulatory authorities and to a lesser extent employees and the community at large. Systems and processes deal with matters such as delegation of authority.

The corporate governance structure specifies the rules and procedures for making decisions on the corporate affairs of the company. It also provides the structure through which the company objectives are set, as well as the means of attaining and monitoring

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the performance of those objectives which the companies have to fulfill.

Corporate governance is used to monitor whether are in accordance the company has achieved whatever the company had planned and to motivate the organization to be more fully informed in order to maintain or alter organizational activity along with the goal set. Corporate governance is the mechanism by which individuals including Board of Directors, employees and other staff members are motivated to align their actual behaviors with the overall participants.

Corporate governance is therefore concerned with such issues as:

i. The effectiveness and efficiency of operations of the organizations

ii. Consistency of financial reporting

iii. Acquiescence with current laws and regulations

iv. Safeguarding of assets and the goodwill of the Company

Objective Of Corporate Governance

1. To build up an environment of trust and confidence amongst those having competing, challenging and conflicting interest

2. To enhance, improve, develop the shareholders' value and protect the interest of other stakeholders as well as investors by enhancing the corporate and commercial presentation, accuracy and accountability

Parties to corporate governance

The business of a corporation is managed under the direction of the corporation's board. The Parties involved in corporate governance include the regulatory body (e.g. the Chief Executive Officer (CEO), the board of directors, management and shareholders). Other stakeholders who participate in the day to day business of the organization include suppliers, employees, creditors, customers and the community at large.

The authority and responsibility for managing the everyday affairs of the corporation is delegated by the board to the CEO and through him or her it is delegated to other senior management of the organization. The Directors monitor the management of the organization on behalf of the corporation's stockholders.

A board of directors often plays a key role in corporate governance. It is their responsibility to sanction the organisation's strategy, develop the directional policy, appoint, supervise, administer and remunerate senior executives and to ensure accountability, responsibility and liability of the organisation to its owners and authorities.

The Company Secretary is a high ranking professional who is trained to uphold the highest standards of corporate governance, effective and

efficient operations, compliance and administration.

All parties to corporate governance have an interest, whether direct or indirect, in the effective performance of the organisation. Directors, workers and management receive salaries, benefits and reputation, while shareholders receive capital return. Customers receive goods and services; suppliers receive compensation for their goods or services. In return these individuals provide value in the form of natural, human, social and other forms of capital.

Principles to good Corporate Governance

The basic elements of good corporate governance principles include sincerity, conviction, honesty, reliability and integrity, openness, performance orientation, responsibility and accountability, mutual respect, and commitment to the organization. In particular, senior executives should conduct themselves honestly and ethically, in particular to the matters concerning conflicts of interest, and disclosure in financial reports.

Effective corporate governance requires a proactive, focused state of mind on the part of directors and senior management, who all must be committed to business success through maintenance of the highest standards of responsibility and ethics.

Also for effective corporate governance one requires a clear understanding of the respective roles of the board and of senior management and their relationships with others in the corporate structure. The relationships of the board and management with stockholders should be characterized by candor; their relationships with employees should be characterized by fairness; their relationships with the communities in which they operate should be characterized by good citizenship; and their relationships with government should be characterized by a commitment to compliance

Corporate governance therefore calls for three factors:

1. Transparency and lucidity in decision-making

2. Accountability, liability and responsibility which follows from transparency because responsibilities could be fixed easily for actions taken or not taken.

3. The accountability is for the safeguarding the interests of the stakeholders and the investors in the organisation.

Corporate governance depends upon two factors. The first factor is the commitment of the management for the principle of integrity and transparency in business operations. The second is the legal and the administrative framework created by the government. If public governance is weak, we cannot have good corporate governance.

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In the Indian context, the need for corporate governance has been highlighted because of the scams we have been having almost as an annual feature ever since we had liberalization from 1991. We had the Harshad Mehta Scam, Ketan Parikh Scam, UTI Scam, Vanishing Company Scam, Bhansali Scam and so on.

Key to Effective Corporate Governance

Corporate governance is the system by which companies are directed and controlled, in the interest of shareholders and other stake holders in order to enhance and sustain value.

Effective governance is, at its core, simply about doing the right things for stakeholders. It is enabled by having the right checks and verification in place within an organization. Compliance with regulations is the starting point, but excellence in corporate governance is the goal.

To achieve truly effective corporate governance, companies need to view it as a strategic challenge, which few of the companies have yet done. Rather than simply responding to the recurring imposition of new requirements and putting out the next regulatory fire, companies should clearly define what good governance means for them and what they need to do to attain that objective. Then a meaningful, cohesive, and effective governance framework can be put in place

Functions of the management committee

1. The board should meet regularly for discharging their duties effectively and efficiently. There should be a formal schedule of matters specifically reserved for its decision.

2. Directors should receive accurate, timely and clear information.

3. Management should provide such information but directors should seek clarification / amplification.
4. The chairman should ensure that the directors continually update their skills and have the knowledge and familiarity with the company that requires to fulfill their role on the board and its committees.

5. The chairman should ensure that the views of shareholders are communicated to the board as a whole.

6. The chairman should discuss governance and strategy with major shareholders.

7. The chairman should hold meetings with the non-executive directors without the executive present.
8. The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.

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9. Where directors' concerns about the running of the company or a proposed action cannot be resolved they should ensure that they are recorded in the board minutes.

Audit Committee

Every publicly owned corporation or listed companies with either a turnover of over Rs.100 crores or a paid-up capital of Rs.20 crores should set up Audit Committees within two years should have an audit committee comprised solely of independent directors. Audit committees typically consist of 3 to 5 members. The listing standards of the major securities markets require audit committees and require that an audit committee have at least 3 members and that all members of the audit committee qualify as independent under the applicable listing standards, subject to limited exceptions.

The audit committee should understand the corporation's risk profile and oversee the corporation's risk assessment and management practices.

The audit committee should review and discuss with management and the outside auditor the corporation's critical accounting policies and the quality of accounting judgments and estimates made by management.

For Audit Committees to discharge their fiduciary responsibilities with due diligence, it must be incumbent upon management to ensure that members of the committee have full access to financial data of the company, its subsidiary and associated companies, including data on contingent liabilities, debt exposure, current liabilities, loans and investments. The audit committee should review and discuss the corporation's annual financial statements with management and the outside auditor and, based on these discussions, recommend that the board approve the financial statements for publication and filing.

The audit committee should meet with the internal and outside auditors, without management present, at every meeting and communicate with them between meetings as necessary.

Corporate Governance Committee

A corporate governance committee should be comprised solely of independent directors. While the CEO typically works closely with the corporate governance committee, a committee made up exclusively of independent directors reinforces the idea that the governance processes of the corporation are under the control of the board, as representatives of the stockholders.

A corporate governance committee performs the core function of recommending nominees to the board. The committee also recommends directors for appointment to committees of the board.

A corporate governance committee should monitor and safeguard the independence of the board. A corporate governance committee should develop and recommend to the board a set of

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corporate governance principles applicable to the corporation.

Conclusion

In order to convince and restore market confidence the corporate governance ethic must be lived by companies on a daily basis. While regulators are essential for establishing principles, they play a secondary role when it comes to putting them into practice. Ultimately, it is companies' practices that determine whether corporate governance delivers benefit or not

Finally, corporate governance is the net result of the individual sense of values, the values held in society or part of a society like professional bodies or business associations and finally the system of public governance. If those who violate the norms are effectively punished then there is a fear and there will be adherence of the principles of corporate governance.

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