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ARTICLE ON CORPORATE GOVERNANCE

Edited By:

1) **Saumya Tripathi**
   (Editor)
   Saumya.judicateme@gmail.com
   +91 9044382618
2) **Ujjawal Vaibhav Agrahari**
   (Student Editor)
   Ujjwal.judicateme@gmail.com

Publisher Details:

1) Saumya Tripathi
   +91 9044382618
   Address: Vikas Nagar, Lucknow
   Email Address: Saumya.judicateme@gmail.com

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By Cheryl Mary Verghese

Meaning of Corporate Governance

Corporate governance is the broad term that describes the processes, customs, policies, laws, and institutions that direct organizations and corporations in the way they act, administer, and control their operations.|t works to achieve the goal of the organization and manages the relationship among the stakeholders including the board of directors and the shareholders. It also deals with the accountability of the individuals through a mechanism that reduces the principal-agent problem in the organization. Fine corporate governance is an essential standard for establishing the striking investment environment which is needed by competitive companies to gain a strong position inefficient financial market. Good corporate governance is fundamental to the economies with an extensive business backgrounds and also facilitates the success of entrepreneurship. Good corporate governance can occur in the organization by putting the balance between

the ownership and control and also among the interests of stakeholders of the firm. This approach might help develop a positive attitude among the manager and shareholders and reduces agency problems in the firms.

This observation is based on the studies on corporate governance practices across several countries by the Asian Development Bank (2000), International Monetary Fund (1999), Organisation for Economic Cooperation and Development (OECD) (1999), and the World Bank (1999).

"The concept of corporate governance primarily hinges on complete transparency, integrity, and accountability of the management. There is also an increasingly greater focus on investor protection and public interest." The report of the first All Task Force on Corporate Governance under the Chairmanship of Rahul Bajaj (1998) has pointed out that there is a diversity of opinion regarding beneficiaries of corporate governance. The Anglo-American system tends to focus on shareholders and various classes of creditors. Continental Europe, Japan, and South Korea believe that companies should also discharge their obligations towards employees, local communities, suppliers, ancillary units, and so on.

According to the OECD Principles of Corporate Governance, corporate governance involves a set of relationships between a company's management, its

board, its shareholders, and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.

The three-tier governance structure ensures that:

(i) Strategic supervision (on behalf of the shareholders), being free from involvement in the task of strategic management of the company, can be conducted by the Board with objectivity, thereby sharpening accountability of management,

(ii) Strategic management of the company, uncluttered by the day-to-day tasks of executive management, remains focused and energized, and

(iii) Executive management of a Division or SBU, free from collective strategic responsibilities for ITC as a whole, focuses on enhancing the quality, efficiency, and effectiveness of the business. The core roles of the key entities flow from this structure. The core roles, in turn, determine the core responsibilities of each entity. To discharge such responsibilities, each entity is empowered formally with requisite powers. The structure, processes, and practices of governance are designed to support effective management of multiple businesses while retaining focus on each one of them. The Governance Document that sets out the structure, policies, and practices of governance within the organization is available on the company's corporate website

History and evolution of corporate governance

In 1997, the East Asian financial crisis saw the economies of Thailand, Indonesia, South Korea, Malaysia, and the Philippines crumble. It was then that the debate on the quality of governance again surfaced. The crisis led to foreign capital flight after property assets collapsed. The lack of corporate governance mechanisms in these countries highlighted the weaknesses of the institutions in their economies. There have been further such dialogues in the corporate governance practices of modern corporations since 2001, particularly due to the high-profile collapses of several large US firms such as Enron Corporation and WorldCom. In 2002, the US federal government passed the Sarbanes-Oxley Act (SOA), intending to restore public confidence in corporate governance.

Corporate Governance in India

The organizational framework for corporate governance initiatives in India consists of the Ministry of Corporate Affairs (MCA) and the Securities and Exchange Board of India (SEBI). SEBI monitors and regulates corporate governance of listed companies in India through Clause 49. This clause is incorporated in the listing agreement of stock exchanges with companies and listed companies must comply with its provisions. MCA through its various appointed committees and forums such as National Foundation for Corporate Governance (NFCG), a not-for-profit trust, facilitates the exchange of experiences and ideas amongst corporate leaders, policymakers, regulators, law enforcing agencies, and non-government organizations. The issue of corporate governance for listed companies came into prominence with the report of the Kumar Mangalam Birla Committee (2000) set up by SEBI the to

suggest the inclusion of a new clause, Clause 49 in the Listing Agreement to promote good corporate governance. On 21 August 2002, the Ministry of Finance appointed the Naresh Chandra Committee to examine various corporate governance issues primarily around auditor — company relationship, rotation of auditors, and defining Independent directors. This was followed by the constitution of the Narayana Murthy Committee (2003) by SEBI, which provided recommendations on issues such as audit committee's responsibilities, audit reports, independent directors, related parties, risk management, independent directors, director compensation, codes of conduct, and financial disclosures.

Directors' Responsibility Statement

To promote better disclosures and transparency, the 2013 Act, requires the company's Annual Report to include a Director's Responsibility Statement stating the following:

(a) Applicable accounting standards had been followed in the preparation of the Annual accounts

(b) The directors have selected such accounting policies and applied them consistently and made judgments and estimates that are reasonable and prudent to give a true and fair view of the state of affairs of the company.

(c) Proper and sufficient care for the maintenance of adequate accounting records following the provisions of this Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities

(d) The annual accounts of the company are prepared on a going concern basis

(e) The directors have laid down internal financial controls to be followed by the company and that such internal financial controls are adequate and were operating effectively

(f) The directors had devised proper systems to ensure compliance with the provisions of all applicable laws and that such systems were adequate and operating effectively.

CEO/CFO Certification

Internal control is a process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Why is Corporate Governance so important?

- **Risk Mitigation and compliance** There is a direct relationship between governance, risk mitigation, and compliance. If a company is governed based on sound principles, it will naturally work efficiently and ensure compliance with every statutory law and guideline. Being on track with the policies and law ensures that the company is braced well for any uncertainty and thus has risk

mitigation mechanisms in place. The more disciplined a company is in its operations, the better it is placed to face any risk or disruption arising out of political, technological, and economic events.

- **Enhances shareholder value**
  While there is no established relationship between corporate governance and the market value of a company, it does enhance shareholder satisfaction. Corporate Governance in India plays a key role in protecting the valuations of a company because the ultimate goal of good governance is to maximize the interest of all stakeholders. The value accumulated by the company over the years can be wiped away by a single unlawful incident, thus internal controls at the right place are mandatory.
- **Better image during economic downturns**
  During the last few months, we have heard many stories of banking frauds and financial malpractices. It is but natural for people to believe that all banks and financial institutions are involved in all these, which is not true. It is only when an organization can ensure people about their inherent governance practices that people will believe them. Trustworthiness that has been established over the ages plays a strong role in upholding the company's image even during tough situations.
- **Improved organizational efficiency**
  Corporate Governance is an important determinant of industrial competitiveness. Nowadays there are many questions raised on the way a company is governed. Better governance ensures enhanced corporate performance and better economic results. Corporate Governance lays the foundation for the behaviour of the company, the utilization of resources, product/service innovation, and overall corporate strategies.
- **Crucial during mergers & acquisitions**
  Corporate Governance in India plays a critical role during restructuring events such as mergers and acquisitions. Not only does the corporate governance of a company helps to differentiate between good deals from bad ones, but M&A activity by a company with good corporate governance is better received by stakeholders in the market. Another aspect to be mentioned is that mergers and acquisitions also have the power to improve the quality of corporate governance of the organization.

Corporate Governance in India: The unseen force behind an

Organization A company is not all about just profits, market valuations, P/E multiples, and turnovers, there is a lot that goes into building its position and image. Corporate Governance is one such hidden force. After numerous scandals, maligned reputations, and economic downturns, companies are now realizing that few concrete steps towards better governance could have saved years of their labor. Most companies chase only monetary gains and take corporate governance for granted. Due to lack of trust in governance, investor

sentiments go awry resulting in a mass outflow of FII funds, sale by majority shareholders, reduced market value, and so on. Designing the framework of corporate governance in India is no mean task in itself. The requirement and fundamentals vary across sectors, industries as well as nationalities. Profound corporate governance is a must for banks and healthcare in particular. Other sectors, such as FMGG, IT, and Retail need to prioritize good governance, but this may not help them in enhancing their market value. The influence of governance on value also varies. It gains more important during tough times rather than smooth sailing periods. Nevertheless, corporate governance in India will continue to be crucial no matter what. The approach must be a perfect balance between excessive stringency and too much flexibility. Only the framework must be holistic and take the interests of all the stakeholders into account. The need for Corporate Governance in India In the last decade, corporate fraud and governance failure is occurring frequently which is why we require good corporate governance in the country. India provides proper norms and laws aligned with international requirements to govern a corporation. Some of the important reasons are discussed below which raised the need for corporate governance in India.

1. A corporate has a lot of shareholders with different attitudes towards corporate affairs, corporate governance protects the shareholder democracy by implementing it through its code of conduct.

2. Large corporate investors are becoming a challenge to the management of the company because they are influencing the decision of the company. Corporate governance sets the code to deal with such situations.

3. Corporate governance is necessary to build public confidence in the corporation which was shaken due to numerous corporate fraud in recent years. It is important for reviving the confidence of investors.

4. Society having greater expectations from corporate, they expect that corporates take care of the environment, pollution, quality of goods and services, sustainable development, etc. code to conduct corporate is important to fulfill all these expectations. Takeovers of the corporate entity created lots of problems in the past. It affects the right of various stakeholders in the company. This factor also pushes the need for corporate governance in the country.

5. Globalization made the communication and transport between countries easy and frequent, so many Indian companies are listed with international stock exchange which also triggers the need for corporate governance in India.

6. The huge flow of international capital in Indian companies is also affecting the management of Indian Corporates which require a code of corporate conduct.

Pillars of Corporate Governance

- **Fairness**

Fairness touches on the points of uniform and equal treatment of all the shareholders about receiving of considerations regarding shareholdings. The fairer the company appears to stakeholders, the more likely it is that it can endure in the league.

- **Accountability**

Corporate accountability is an act of responsibility and obligation to explain the company's actions and activities. Corporate Accountability includes the followings:

  - Presentation of a balanced and simple analysis of the company's orientation and prospects.
  - Responsibility for determining the character and extent of the adopted risks by the company.
  - Maintenance of adequate risk management and internal control structure.
  - Setting up formal and unclouded arrangements for corporate reports and a suitable relationship with the company's auditor.
  - Proper communication with shareholders regarding diversification, progress, and financial reports at frequent

- **Responsibility**

The CEO and Board of Directors are accountable to the shareholders on behalf of the company regarding the execution of responsibilities. Thus, they should exercise their authority with full responsibility. The Board of Directors is responsible for conducting the management of the business, appointing the suitable CEO, overseeing the affairs of the company, and keeping an eye on the performance of the company.

- **Transparency**

Transparency means a company should reveal an informative piece of data about their activities to shareholders and other stakeholders. It also includes the open-mindedness and willingness to divulge financial figures which are genuine and correct in reality. The unveiling of reports regarding the organization's accomplishments and activities should be on time and strive for accuracy. Such steps ensure the investors' access to transparent and factual data that finely mirrors the financial, environmental, and social position of the organization.

Example of Corporate Governance

Now, after the elongated discussion and explanation, let us understand the concept with two examples!

HDFC Bank

(Industry — Private Banking and Financial Services)

HDFC Bank identifies the significance of good corporate governance, which takes care of the long-term interests of shareowners and helps to win the public trust in the Company. Therefore, the Corporate Governance scheme is introduced to proffer a course and structure for managing and regulating the bank following the principles of superlative corporate governance policies.

HDFC Bank was amongst the first four companies which earned a Corporate Governance and Value Creation (GVC) rating by The Credit Rating Information Services of India Limited (CRISIL). The bank has been successful in achieving a 'CRISIL GVC Level 1' rating for the last two consecutive years. This symbolizes that the bank has the potential to create wealth for all its stakeholders while preaching the highest degree of corporate governance practices. The Bank truly believes in transparent disclosures and the empowerment of shareholders for weaving value. The chart shows the past 17 years of

data from the year 2000. Going by the chart, HDFC bank has generated huge wealth over the years and is known for its laurel worthy Corporate Governance.

Corporate Governance Framework in India

The Indian framework on Corporate Governance has been vastly in sync with the international standards. Broadly, it can be described in the following:

1. The Companies Acts 2013 has provisions concerning Independent Directors, Board Constitution, General meetings, Board meetings, Board processes, Related Party Transactions, Audit Committees, etc.

2. SEBI (Securities and Exchange Board of India) Guidelines ensure the protection of investors and have mandated the companies to adhere to the best practices mentioned in the guidelines.

3. Accounting Standards issued by the ICAI (Institute of Chartered Accountants of India) wherein the ICAI is an autonomous body and issues accounting standards. The disclosure of financial statements is also made mandatory by the ICAI backed by the Companies Act 2013, Sec. 129.

4. Standard Listing Agreement of Stock Exchanges applies to the companies whose shares are listed on various stock exchanges.

5. Secretarial Standards Issued by the ICSI (Institute of Company Secretaries of India) issues standards on 'Meetings of the board of Directors', General Meetings', etc.. The companies Act 2013 empowers this autonomous body to provide standards which every company is required to adhere to so that they are not punished under the Companies Act itself.

Issues in Corporate Governance in India

Although there exist many issues in the field of Corporate Governance especially in India, an effort has been made to highlight only the major ones here:

- **Board performance**

The requirement of at least one woman director is necessary, and also the balance of executive and non-executive directors are not maintained. Evaluation is not performed from time to time and transparency is lost somewhere. The performance is not result-oriented. These requirements are not always met.

- **Independent Directors**

Independent directors are appointed for a reason which does not seem to be fulfilled in the current scenario. Even after SEBI guidelines being issued to the corporates, for the appointment of an audit committee or giving of a comprehensive definition of the independent directors, the actual situation appears to be worse.

- **Accountability to Stakeholders**

The accountability is not restricted to that of the shareholders or the company, it is for the society at large and also the environment. The directors are not to keep in mind their interests but also the interests of the community.

- **Risk Management**

The risk management techniques are to be mandatorily be undertaken by the directors as per the Company Laws and they have to

mention in their report to shareholders as well. This is not being done in the most sincere manners required for the job.

- **Privacy and Data Protection**

This is an important governance issue. Cybersecurity has evolved to be the most important aspect of modern governance. Good governance can only be achieved once the directors and other leaders in the company are well known about the hazards in this field.

- **Corporate Social Responsibility (CSR)**

Being among the few countries to legislate on CSR, it is mandatory for companies to invest a minimum of 2% of the profits in the last 3 years for CSR activities. Otherwise proper reasons should be mentioned in the reports in case of failure. The companies seem to be reluctant towards making such investments.