* CORPORATE GOVERNANCE *

Prince Gupta

Assistant Professor

Commerce Department

MRK College, Saharanwas, Rewari, Haryana, India.

CORPORATE GOVERNANCE

Corporate governance is the collection of mechanisms, processes and relations by which corporations are controlled and operated. Governance structures and principles identify the distribution of rights and responsibilities among different participants in the corporation (such as the board of directors, managers, shareholders, creditors, auditors, regulators, and other stakeholders) and include the rules and procedures for making decisions in corporate affairs. Corporate governance is necessary because of the possibility of conflicts of interests between stakeholders, primarily between shareholders and upper management or among shareholders.

Corporate governance includes the processes through which corporations' objectives are set and pursued in the context of the social, regulatory and market environment. These include monitoring the actions, policies, practices, and decisions of corporations, their agents, and affected stakeholders. Corporate governance practices can be seen as attempts to align the interests of stakeholders.

Interest in the corporate governance practices of modern corporations, particularly in relation to accountability, increased following the high-profile collapses of a number of large corporations in 2001–2002, many of which involved accounting fraud; and then again after the recent financial crisis in 2008.

Corporate scandals of various forms have maintained public and political interest in the regulation of corporate governance. In the U.S., these include scandals surrounding Enron and MCI Inc. (formerly WorldCom). Their demise led to the enactment of the Sarbanes–Oxley Act in 2002, a U.S. federal law intended to improve corporate governance in the United States. Comparable failures in Australia (HIH, One.Tel) are associated with the eventual passage of the CLERP 9 reforms there, that similarly aimed to improve corporate governance. Similar corporate failures in other countries stimulated increased regulatory interest (e.g., Parmalat in Italy).

MODELS OF CORPORATE GOVERNANCE

Different models of corporate governance differ according to the variety of capitalism in which they are embedded. The Anglo-American "model" tends to emphasize the interests of shareholders. The coordinated or multistakeholder model associated with Continental Europe and Japan also recognizes the interests of workers, managers, suppliers, customers, and the community. A related distinction is between market-oriented and network-oriented models of corporate governance.

Continental Europe (Two-tier board system)

Some continental European countries, including Germany, Austria, and the Netherlands, require a two-tiered board of directors as a means of improving corporate governance. In the two-tiered board, the executive board, made up of company executives, generally runs day-to-day operations while the supervisory board, made up entirely of non-executive directors who represent shareholders and employees, hires and fires the members of the executive board, determines their compensation, and reviews major business decisions.

Germany, in particular, is known for its practice of co-determination, founded on the German Codetermination Act of 1976, in which workers are granted seats on the board as stakeholders, separate from the seats accruing to shareholder equity.

United States, United Kingdom

The so-called "Anglo-American model" of corporate governance emphasizes the interests of shareholders. It relies on a single-tiered board of directors that is normally dominated by non-executive directors elected by shareholders. Because of this, it is also known as "the unitary system". Within this system, many boards include some executives from the company (who are *ex officio* members of the board). Non-executive directors are expected to outnumber executive directors and hold key posts, including audit and compensation committees. In the United Kingdom, the CEO generally does not also serve as Chairman of the Board, whereas in the US having the dual role has been the norm, despite major misgivings regarding the effect on corporate governance. The number of US firms combining both roles is declining, however.

In the United States, corporations are directly governed by state laws, while the exchange (offering and trading) of securities in corporations (including shares) is governed by federal legislation. Many US states have adopted the Model Business Corporation Act, but the dominant state law for publicly traded corporations is Delaware General Corporation Law, which continues to be the place of incorporation for the majority of publicly traded corporations. Individual rules for corporations are based upon the corporate charter and, less authoritatively, the corporate bylaws. Shareholders cannot initiate changes in the corporate charter although they can initiate changes to the corporate bylaws.

It is sometimes colloquially stated that in the US and the UK "the shareholders own the company". This is, however, a misconception as argued by Eccles & Youmans (2015) and Kay (2015).

HISTORY OF CORPORATE GOVERNANCE

The modern practice of corporate governance has its roots in the 17th-century Dutch Republic. The first recorded corporate governance dispute in history took place in 1609 between the shareholders/investors (most notably Isaac Le Maire) and directors of the Dutch East India Company (VOC), the world's first formally listed public company.

CORPORATE GOVERNANCE IN INDIA

The Securities and Exchange Board of India Committee on Corporate Governance defines corporate governance as the "acceptance by management of the inalienable rights of shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders. It is about commitment to values, about ethical business conduct and about making a distinction between personal & corporate funds in the management of a company." India is a growing economy and it is quite important to safeguard the interests of investors and also ensure that the responsibility of management is fixed. The Satyam scandal, also known as India's Enron, wiped off billions of shareholders' wealth and threatened foreign investment in India. This is the reason that corporate governance in India has taken the centre stage.

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 it is compulsory for listed companies to 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 exchange of experiences and ideas amongst corporate leaders, policy makers, regulators, law enforcing agencies and non- government organizations.

Regulation

The Companies Act, 2013 got assent of the President of India on 29th August, 2013 and it was enacted on 12th September, 2013 repealing the old Companies Act, 1956. The Companies Act, 2013 provides a formal structure for corporate governance by enhancing disclosures, reporting and transparency through enhanced as well as new compliance norms. Apart from this, the Monopolies and Restrictive Trade Practices Act, 1969 (which is replaced by the Competition Act 2002), the Foreign Exchange Regulation Act,1973 (which has now been replaced by Foreign Exchange Management Act,1999), the Industries (Development and Regulation) Act, 1951 and other legislations also have a bearing on the corporate governance principles. In addition to various acts and guidelines by various regulators, non-regulatory bodies have also published codes and guidelines on Corporate Governance from time to time. For example, Desirable Corporate Governance Code by the Confederation of Indian Industries (CII) in 2009. 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 in the to suggest 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 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. Many of these recommendations were then incorporated in the Revised Clause 49 that is seen as an important statutory requirement. Further, after enactment of the Companies Act, 2013, SEBI has amended Clause 49 in 2013 to bring it in line with the new Act.

Board of Directors

The Desirable Corporate Governance Code by CII (1998) for the first time introduced the concept of independent directors for listed companies and compensation paid to them. The Kumar Mangalam Birla Committee (2000) then suggested that for a company with an executive Chairman, at least half of the board should be independent directors, else at least one-third. The updated Clause 49 based on the report by the Narayana Murthy Committee further elaborates the definition of Independent Directors; and also requires listed companies to have an optimum combination of executive and non-executive directors, with non-executive directors comprising of at least 50% of the Board. The 2013 Act introduces the requirement of appointing a resident director and a woman director. The term 'Key Managerial Personnel' has been defined in the 2013 Act, comprising of Chief Executive Officer, Managing director, Manager, Company Secretary, Whole-time director, Chief Financial Officer; and any such other officer as may be prescribed. The 2013 Act has also introduced new concepts such as performance evaluation of the board, committee and individual directors. The revised Clause 49 (in 2013) now also states that all compensation paid to non –executive directors, including independent directors shall be fixed by the Board and shall require prior approval of shareholders in the General meeting and that limit shall be placed on stock options granted to non executive directors. Such remuneration and stock option is required to be disclosed in the annual report of the company. The independent directors are also required to adhere to a 'Code of Conduct' and affirm compliance to the same annually.

Audit Committee

The audit committee's role flows directly from the board's oversight function and delegation to various committees. It acts as an oversight body for transparent, effective anti-fraud and risk management mechanisms, and efficient Internal Audit and External Audit functions financial reporting. As per section 177 of the Companies Act, 2013 read with Rule 6 of Companies (Meetings of Board and its powers) Rules, 2014, every listed company and all other public companies with paid up capital of Rs. 10 crore or more; or having turnover of 100 crore or more; or having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding Rs.50 Crores or more, to have an Audit Committee which shall consist of not less than three directors and such number of other directors as the Board may determine of which two thirds of the total number of members shall be directors, other than managing or whole-time directors.

The Kumar Mangalam Birla Committee, Naresh Chandra Committee and the Narayana Murthy Committee recommended constitution, composition for audit committee to include independent directors and also formulated the responsibilities, powers and functions of the Audit Committee. The Audit Committee and its Chairman are also entrusted with the ethics and compliance mechanisms of an organization, including review of functioning of the whistleblower mechanism. The revised Clause 49 expands the role of the Audit Committee with enhancing its responsibilities in providing transparency and accuracy of financial reporting and disclosures, robustness of the systems of internal audit and internal controls, oversight of the company's risk management policies and programs, effectiveness of anti-fraud and vigil mechanisms and review and administration of related party transactions of the organization.

Subsidiary Companies

The rationale behind having separate provisions with respect to subsidiary companies in the Revised Clause 49 was the need for the board of the holding company to have some independent link with the board of the subsidiary and provide necessary oversight. Hence, the recommendation of Narayana Murthy Committee to make provisions relating to the composition of the Board of Directors of the holding company to be made applicable to the composition of the Board of Directors of subsidiary companies and to have at least one independent director on the Board of Directors of the holding company on the Board of Directors of the subsidiary company, were incorporated in the Revised Clause 49 of the Listing Agreement. Besides the Audit Committee of the holding Company is to review the financial statements, in particular investments made by the subsidiary and disclosures about materially significant transactions ensures that potential conflicts of interests with those of the company may be taken care of. The definition of 'subsidiary' is also widened by the Companies Act, 2013 to include joint venture companies and associate companies.

Role of Institutional Investors

Fast growing countries like India have attracted large shareholding by international investors and large Indian financial institutions with global ambitions. This has resulted in a significant progress in the standards of corporate governance in the investee companies. Many research reports published in recent years show that companies with good governance system have generated high risk-adjusted returns for their shareholders. So, if a company wants institutional investor participation, it will have to convincingly raise the quality of corporate governance practices. Indian companies thus need to adopt the best practices such as the OECD Corporate Governance Principles (revised in 2004) that serve as a global benchmark. In countries like India where corporate ownership still continues to be highly concentrated, it is important that all shareholders including domestic and foreign institutional investors are treated equitably.

Institutional investors are expected to actively participate in the AGM voting on the shares held by them in their portfolio companies along with public disclosure of their voting records and reasons for non-disclosures. Their reason for assenting or dissenting to any Board Resolution of their portfolio companies shall be disclosed on their website.

Stakeholders Relationship Committee

As one of its mandatory recommendations, the Kumar Mangalam Birla Committee propounded the need to form a board committee under the chairmanship of a non-executive director to specifically look into the redressing of shareholder complaints like transfer of shares, non-receipt of balance sheet, non-receipt of declared dividends etc. The Committee believed that the formation of shareholders' grievance committee would help focus the attention of the company on shareholders' grievances and sensitise the management to redress their grievances. The 2013 Act as well as the revised Clause 49 now mandate the formation of such a committee with broader remit to cover issues and concerns of all stakeholders and not just shareholders.

The 2013 Act now mandates companies with more than one thousand shareholders, debenture-holders, deposit-holders and any other security holders at any time during a financial year are required to constitute a Stakeholders Relationship Committee consisting of a chairperson who shall be a non-executive director and such other members as may be decided by the Board to resolve the grievances of security holders of the company.

Risk Management

The Kumar Mangalam Birla Committee report included mandatory Management Discussion & Analysis segment of annual report that includes discussion of industry structure and development, opportunities, threats, outlook, risks etc. as well as financial and operational performance and managerial developments in Human Resource /Industrial Relations front. Clause 49 included this recommendation as a part of management disclosures. Risk Management was however propounded for the first time by the Narayana Murthy Committee (2003) in its report by which it required that the company shall lay down procedures to inform Board members about the risk assessment and minimization procedures. These procedures shall be periodically reviewed to ensure that executive management controls risk through means of a properly defined framework and overlooked by a Risk Management Committee. This is incorporated in Clause 49 as a part of internal disclosures to the Board.

The 2013 Act and Revised Clause 49 specify requirements related to risk management. Audit Committee and the independent directors of the company are entrusted with the responsibility of evaluating the robustness of the risk management systems and policy laid down by the Board.

Ethics

A code of conduct creates a set of rules that become a standard for all those who participate in the group and exists for the express purpose of demonstrating professional behaviour by the members of the organization.The Naresh Chandra Committee for the first time recommended that companies should have an internal code of conduct. The Report by Narayana Murthy Committee further recommended that a company should have a mechanism (whistle blower) to report on any unethical or improper practice or violation of code of conduct observed and that Audit Committee would be entrusted with the role of reviewing functioning of the mechanism.

Clause 49 incorporated these recommendations further mandating directors of every listed company to lay down a Code of Conduct and post the code on their company's website. The Board members and all senior management personnel are required to affirm compliance with the code annually and include a declaration to this effect by the CEO in the Annual Report. The recommendation of Narayana Murthy Committee to make Audit Committee responsible for reviewing the functioning of the whistle blower mechanism, where it exists, is incorporated in the Clause 49. The 2013 Act and revised Clause 49 mandate establishing Whistleblower mechanism to let employees and directors blow whistles on financial and non-financial wrong doings and also that such mechanism should provide protection to the whistle blower from victimization and provide direct access to the Chairman of the Audit Committee in exceptional cases.

Executive Remuneration

The overriding principle in respect of directors' remuneration is that of openness and shareholders are entitled to a full and clear statement of benefits available to the directors. The 2013 Act and Revised Clause 49 mandate the formation of a Nomination & Remuneration Committee comprising of at least three directors, all of whom shall be non-executive directors and at least half shall be independent. The Nomination and Remuneration Committee is to ensure that the level and composition of remuneration is reasonable and sufficient; the relationship of remuneration to performance is clear and meets appropriate performance benchmarks; and the remuneration to directors, key managerial personnel and senior management involves a balance between fixed and incentive pay reflecting short and long-term performance objectives appropriate to the working of the company and its goals. There are also compulsory disclosures to be made in the section on corporate governance of the annual report - All elements of remuneration package of all the directors i.e. salary, benefits, bonuses, stock options, pension etc.; Details of fixed component and performance linked incentives, along with the performance criteria; Service contracts, notice period, severance fees; Stock option details, if any – and whether issued at a discount as well as the period over which accrued and over which exercisable.

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 so as 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 in accordance with 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.

The Naresh Chandra Committee for the first time required the signing officers, to declare that they are responsible for establishing and maintaining internal controls which have been designed to ensure that all material information is periodically made known to them; and have evaluated the effectiveness of internal control systems of the company. Also, that they have disclosed to the auditors as well as the Audit Committee deficiencies in the design or operation of internal controls, if any, and what they have done or propose to do to rectify these deficiencies. Clause 49 requires the CEO and CFO to certify to the board the annual financial statements in the prescribed format and establishing internal control systems and processes in the company. CEOs and CFOs are, thus, accountable for putting in place robust risk management and internal control systems for their organization's business processes. The 2013 Act and revised Clause 49 have also brought much rigour into internal controls certification by making it as one of the parts of Directors' Responsibility Statement.

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 on the basis of 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. 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 relation between corporate governance and market value of a company, it does enhance shareholder satisfaction. Corporate Governance in India plays a key role in protecting valuations of a company because the ultimate goal of good governance is to maximise 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 is 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 organisation can ensure people about their inherent governance practises that people will believe them. Trustworthiness that has been established over ages plays a strong role in upholding the company's image even during tough situations.

- **Improved organisational 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 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 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 has the power to improve the quality of corporate governance of the organisation.

Corporate Governance in India: The unseen force behind an organisation

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 realising that few concrete steps towards better governance could have saved years of their labour.

Most companies chase only monetary gains and take corporate governance for granted. Due to lack of trust on governance, investor sentiments go awry resulting in 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 FMCG, 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 importance 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.

CORPORATE GOVERNANCE INITIATIVES IN INDIA

Confederation of Indian Industry (CII) set up a committee to examine corporate governance issues and recommend a voluntary code of best practices and started the initiative to improve corporate governance in India. The first draft of the code was prepared by April 1997, and the final document was released in April 1998.

The document said, "The objective of good corporate governance is maximizing long-term shareholder value. Since shareholders are residual claimants, this objective follows from a premise that, in well performing capital and financial markets, whatever maximizes shareholder value must necessarily maximize corporate prosperity, and best satisfy the claims of creditors, employees, shareholders and the state.

Some of the recommendations are:

Recommendation 1 - There is no need to adopt the German system of two-tier boards to ensure desirable corporate governance. A single board, if it performs well, can maximise long term shareholder value just as well as a two- or multi-tiered board. Conversely, there is nothing to suggest that a two-tier board, per se, is the panacea to all corporate problems. However, the full board should meet a minimum of six times a year, preferably at an interval of two months, and each meeting should have agenda items that require at least half a day's discussion.

Recommendation 2 - Any listed companies with a turnover of Rs.100 crores and above should have professionally competent and acclaimed non-executive directors, who should constitute· at least 30 percent of the board if the Chairman of the company is a non-executive director, or · at least 50 percent of the board if the Chairman and Managing Director is the same person.

Recommendation 3 - No single person should hold directorships in more than 10 companies. This ceiling excludes directorships in subsidiaries (where the group has over 50% equity stake) or associate companies (where the group has over 25% but no more than 50% equity stake).

Recommendation 4 - For non-executive directors to play an important role in maximising long term shareholder value, they need to· become active participants in boards, not passive advisors; · have clearly defined responsibilities within the board; and · know how to read a balance sheet, profit and loss account, cash flow statements and financial ratios and have some knowledge of various company laws. This, of course, excludes those who are invited to join boards as experts in other fields such as science and technology.

Recommendation 5 - To secure better effort from non-executive directors, companies should: · Pay a commission over and above the sitting fees for the use of the professional inputs. The present commission of 1% of net profits (if the company has a managing director), or 3% (if there is no managing director) is sufficient. · Consider offering stock options, so as to relate rewards to performance. Commissions are rewards on current profits. Stock options are rewards contingent upon future appreciation of corporate value. An appropriate mix of the two can align a non-executive director towards keeping an eye on short term profits as well as longer term shareholder value.

Recommendation 6 - While re-appointing members of the board, companies should give the attendance record of the concerned directors. If a director has not been present (absent with or without leave) for 50 percent or more meetings, then this should be explicitly stated in the resolution that is put to vote. As a general practice, one should not re-appoint any non-executive director who has not had the time attend even one half of the meetings.

Recommendation 7 - Key information that must be reported to, and placed before, the board must contain:

* Annual operating plans and budgets, together with up-dated long term plans. · Capital budgets, manpower and overhead budgets.

* Quarterly results for the company as a whole and its operating divisions or business segments.

* Internal audit reports, including cases of theft and dishonesty of a material nature. · Show cause, demand and prosecution notices received from revenue authorities which are considered to be materially important. (Material nature is any exposure that exceeds 1 percent of the company's net worth).

CONCLUSION :- After concluding above the study we have to say that Corporate governance includes the processes through which corporations' objectives are set and pursued in the context of the social, regulatory and market environment. These include monitoring the actions, policies, practices, and decisions of corporations, their agents, and affected stakeholders. Corporate governance practices can be seen as attempts to align the interests of stakeholders. 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.

SOURCES:- Wikipedia.org

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