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Corporate Governance

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Abstract: **Corporate Governance (CG) is the key to well-managed system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies the shareholder's role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place. It is the relationship between the shareholders, director and management of a company as defined by corporate policies and rule law. The Corporate governance system was designed to help oversee the decisions and best interest of the shareholder. Corporate governance focus is with promoting enterprise to improve efficiency and to address disputes of interest which can be force upon burden on the business. This helps company business to improve its enterprise standard and public governance. Thus, responsible corporate governance is both from CSR (Corporate Social Responsibility) and good governance perspective.**

Keywords: **Governance, CG, CSR, Strategic decision, Public interest, financial performance, Stakeholders, Democracy, Board composition.**

1. INTRODUCTION

Good corporate governance has become an increasingly prominent issue for company, corporate Board of Director (BOD) are becoming more involved in assessing and shaping companies policies and practices on a wide range of social and environmental area. Governance implies a degree of control t be exercised by key stakeholders representatives for the furtherance of corporate growth and protection of stakeholders interests. Being guided by the principle of shareholders' democracy companies will have to make clear their policies in running the business. In the area of financial decision making, it is obvious on the part of shareholders and other stakeholders to judge whether the company's management has the ability to undertake various projects with high growth potentials. In this context, the Board of Directors is to determine corporate purpose and set broad directions for their achievement by the executive directors. Corporate Governance ensures how effectively the BOD and management are discharging their functions in building and satisfying stakeholders' confidence.

CG means that company manages its business in a manner that is accountable and responsible to the shareholders. In a wider interpretation, CG includes company's accountability to shareholders and other stakeholders such as employees, suppliers, customers and local community.

CG refers to the accountability of the Board of Directors of a corporation towards its stakeholders. In order to protect and promote the interests of all stakeholders, corporate governance should encompass well defined set of systems and processes. Systems include structural and organizational aspects like constitution of board of directors, their optimum size, composition and qualification, role and competencies, frequency of change of board members and nominal directors. The organization of different committees by board members such as management committee, share transfer committee, executive compensation committee, investment committee, audit committee, etc. forms an integral part of the system for sound corporate governance. While the main board of the company would deal with major policy decisions and strategic directions that the company should take, the constitution of these committees make focused attention on various aspects of company's working.

The board along with different committees and chief executive officer (CEO) should devise right kind of mechanism for organizational effectiveness. These may include performance management systems, periodic business reviews,

environmental audit, and energy audit, secretarial and legal audit, benchmarking customer satisfaction, bench-marking employees' satisfaction, and so on.

2. ROLE OF CORPORATE GOVERNANCE

Several changes have taken place in the corporate environment, corporate structure, stakeholders' expectations and various laws and government policies relating to corporation since the initiation of economic reforms in India. Various factors which have promoted a re-thinking about corporate governance and accountability over the year are as follows:

- **Unreal shareholders' democracy:** the basic idea of the effectiveness of company's accountability to its shareholders has come in doubt. Today company has a large number of shareholders spread all over the worlds that are generally indifferent towards the management of the company. Thus, the idea of shareholders' democracy remains confined only to the statute and to the Article of Association of the company which provide them voting rights.

- **Violation of rights:** Government department concerned with corporate affairs have often submitted critical reports about violations of the rights of shareholders. Need for extending corporate accountability to its employees, creditors, consumers and even to the society at the large has been emphasized by not only academicians but also by several committees and commissions in many countries.

- **Risk of pooled resources:** institutional investors such as banks and mutual fund are as subscribers of both ownership as well as capital have affected the structure of corporate governance.

- **Community expectation:** Society's expectations from corporations have changed. It expects corporate management to be more responsible to the needs and expectations of the society. For instance, pollution of environment is no longer tolerated.

- **Loss of job security:** As a result of intense competition all over the world, corporate giants known for providing well-praying jobs are going for corporate restructuring, down-sizing and also broad-room shake-ups. Corporations have become vastly risky places to work with no job security at any level.

- **Management complacency:** hostile take-overs have been witnessed in several countries. Many people attributed such happening to the complacency on the parts of the managements of taken-over companies. This also raises the question of the effectiveness of corporate governance.

- **Unreasonable compensation:** While the employment in corporation is declining, due to automation a huge increase in developed as well as developing countries. This is particularly objected to in companies suffering from losses.

Now-a-days, all companies are required to include a brief summary regarding corporate governance in their annual reports

3. PRINCIPLE OF CORPORATE GOVERNANCE

All corporate governance follows four fundamental issues and principal:

1. Fairness to all shareholders.

2. Clear accountability by board.

3. Transparency and timely reporting.

4. Protecting minority shareholders.

Corporate governance codes are there in at least 50 countries and the earliest examples of it was the Cadbury Code of best practice in U.K. While in most countries these codes is still not mandatory, in some these have been included in the main legislative framework and those who don't comply are told to explain for their non-compliance.

4. IMPORTANCE OF CORPORATE GOVERNANCE

Corporate governance is important for the following reasons:

1. It shapes the growth and future of capital markets of an economy.

2. It helps firms in raising adequate finance from capital markets.

3. It links company's management system with its financial reporting system

4. It enables management to take innovative decisions for effective functioning of an enterprise within legal framework of accountability.

5. It provides support to investors by making corporate accountability practices transparent to them. Corporate enterprises have to resort to disclosure of financial reporting structures.

6. It provides for adequate and timely disclosure reporting requirement, code of conduct etc. Companies present material price sensitive information is made public; insiders abstain from dealing in corporate securities. It, thus, avoids insider-trading.

7. It improves the efficiency and effectiveness of an enterprise's functioning and adds to material wealth of the economy.

8. It adds to international image of the corporate sector and enables home company to raise global capital.

5. NEED OF CORPORATE GOVERNANCE

Corporate governance is needed for the following reasons:

1. Separation of ownership from management: The business of a company is run by its managers. To ensure that these managers work in the best interests of corporate owners (shareholders), corporate governance does the needful.

2. Global capital: In the globalized world of today, global capital flows in markets which are well-regulated and have high standards of efficiency and transparency. Good corporate governance is must to gain credibility and trust of global market players.

3. Investors' protection: Investors of the modern age are educated and enlightened of their rights. They want their rights to be protected by companies in which they have invested money. Corporate governance is an important tool for protecting investors" interest by improving overall effectiveness of corporate enterprise.

4. Foreign investment: significant foreign institutional investment is taking place in India. These investors expect companies to adopt globally acceptable practices of corporate governance and well-developed capital markets. Demanding international standards of corporate governance and greater professionalism in management of India corporates substantiates the need for good corporate governance.

5. Financial reporting and accountability: sound, transparent and credible financial reporting and accountability to investors and lenders so that enough capital can be raised from capital markets, can be ensured through good corporate governance.

6. Banks and financial institution: banks and financial institutions provide financial assistance to companies. They are interested in financial soundness of companies financed by them. This can be done through good corporate governance.

7. Globalization of economy: the economy today is globalized. Integration of India with the world economy demands that Indian industries should industries should conform to the standards of international rules. Corporate governance helps in doing this.

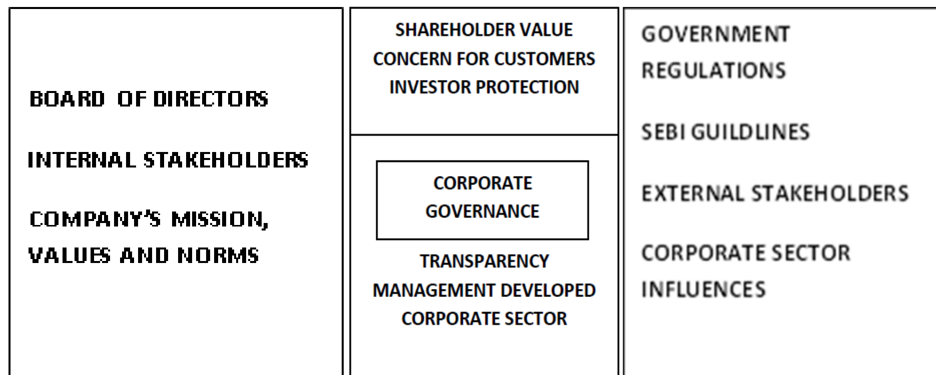
6. CORPORATE GOVERNANCE ENVIRONMENT

Good corporate governance can be achieved if the government regulations, SEBI guidelines, external stakeholders and other corporate governance affect the functioning of an enterprise positively. This is the external corporate governance environment. Actions taken by parties external to the corporate enterprise are known as regulatory actions. These actions focus on fairness (protecting shareholders" rights), transparency (disclosure of adequate information on corporate financial performance), accountability (roles and responsibility of managers) and responsibility (corporate's compliance with laws and regulations to protect the interests of the society in which corporates operate).

Every corporate enterprise has an internal environment also that affects good corporate governance. This consists of the company's board of directors, internal stakeholders, and the company's mission, values and norms. Actions taken by parties internal to the corporate enterprise foe ensuring good corporate governance are voluntary actions. Firms must set up codes of conduct for their managers and non-managers. This is done to comply with good governance practices.

The diagrammatic representation of corporate governance is shown below:

CORPORATE GOVERNANCE ENVIORNMENT



7. SEBI CODE ON CORPORATE GOVERNANCE

SEBI had constituted a Committee on Corporate Governance under the Chairmanship of Shri Kumar Mangalam Birla, Member, SEBI Board to promote and raise the standard of Corporate Governance in respect of listed companies. The SEBI Board in its meeting held on January 25, 2000 considered that recommendation of the committee and decided to make the amendments to the listing agreement in pursuance of the decision of the Board, it is advised that a new clause, namely clause 49, be incorporated in the listing agreement as under:

Corporate Governance:

a) Board of Directors:

1) The company agrees that the board of directors of the company shall have an optimum combination of executive and non-executive directors with not less than fifty percent of the board of directors comprising of non-executive directors. The number of independent directors would depends whether the Chairman in executive or non-executive. In case of a non-executive chairman at least one-third of board should comprise of independent directors and in case of executive chairmen, at least half of board should comprise of independent directors.

For the purpose of this clause the expression 'independent directors' means directors who apart from receiving directors' remuneration, do not have any other material pecuniary relationship or transaction with the company, its promotors, its management or its subsidiaries, which in judgment of the board may affect independence of judgment of the director.

2) The company agrees that all pecuniary relationship of transactions of the non-executive directors viz-a-viz, the company should be disclosed in the Annual Report.

b) Audit Committee:

1) The company agrees that a qualified and independent audit committee shall be set up and that:

A. The audit committee shall have minimum three members, all being non-executive directors, with the majority of them being independent, and at least one director having financial and accounting knowledge.

B. The chairman of the committee shall be an independent director.

C. The chairman shall be present at Annual General Meeting to answer shareholder queries.

D. The audit committee should invite such of the executive, as it considers appropriate to be present at the meeting of the committee, but on occasion it may also meet without the presence of any executive of the company. The finance directors, head of internal audit and when required, a representative of the external auditors shall be present for the meetings of the audit committee.

E. The Company Secretary shall act as the secretary to the committee.

2) The audit committee shall meet at least thrice a year. One meeting shall be held before finalization of annual accounts and one every six months. The quorum shall be either two members or one third of the members of the audit committee, whichever is higher and minimum of two independent directors.

3) The audit committee shall have powers which should include the following:

A. To investigate any activity within its terms of reference.

B. To seek information from any employee.

C. To obtain outside legal or other professional advice.

D. To secure attendance of outsiders with relevant expertise, if it considers necessary.

4) The company agrees that the role of the audit committee shall include the following:

A. Oversight of the company's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.

B. Recommending the appointment and removal of external auditor, fixation of audit fee and lso removal for payment for any other services.

C. Reviewing with management the annual financial statement before submission to the board, focusing primarily on:

➢ Any changes in accounting policies and practices.

➢ Major accounting entries based on exercise of judgment by management.

➢ Qualifications in draft audit report.

➢ Significant adjustments arising out of audit.

➢ The going concern assumption.

➢ Compliance with accounting standards.

➢ Compliance with stock exchange and legal requirements concerning financial statements. Any related party transactions i.e. transactions of the company of material nature, with promoters or the management, their subsidiaries or relatives etc. that may have potential conflict with the interests of company at large.

A. Reviewing with the management, externa land internal auditors, the adequacy of internal control systems.

B. Reviewing the adequacy of internal audit function, including the structure of the internal audit department, staffing and seniority of the official heading the department, reporting structure, coverage and frequency of internal audit.

C. Discussing with internal auditors any significant findings and follow up there on.

D. Reviewing with findings of any internal investigations by the internal auditors into matter where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the board.

E. Discussing with external ousters before the audit commences nature and scope of audit as well as have post-audit discussion to ascertain any area of concern.

F. Reviewing the company's financial and risk management policies.

G. To look into the reasons for substantial defaults in the payment to the depositors, debenture holders, shareholders and creditors.

5) If the company has set up an audit committee pursuant to provision of the Companies Act, the company agrees that the said audit committee shall have such additional functions/features as it contained in the Listing Agreement.

c) Remuneration of Directors:

1) The company agrees that the remuneration of non-executive directors shall be decided by the board of directors.

2) The company further agrees that the following disclosures on the remuneration of directors shall be made in te section on the corporate governance of the annual report.

A. All elements of remuneration package of all directors i.e. salary, benefits, bonuses, stock options, pension etc.

B. Details of fixed components and performance linked incentives, along with the performance criteria.

C. Service contracts, notice period, severances fees.

D. Stock option details, if any-and whether issued at a discount as well as the period over which accrued and over which exercisable.

d) Board Procedure :

1) The company agrees that the board meeting shall be held at least four times a year, with a maximum time gap of four months between any two meetings.

2) The company further agrees that a director shall not be a member in more than 10 committees or act as Chairman of more than five committees across all companies in which he is a director. Furthermore, it should be a mandatory annual requirement for every director to inform the company about the committee positions he occupies in other companies and notify changes as and when take place.

e) Management

1) The company agrees that as part of the directors' report or as an addition there to, a Management Discussion and Analysis report should form part of the annual report to the shareholders. This Management Discussion and Analysis should include discussion on the following matters within the limits set by the company's competitive position:

A. Industry structure and developments.

B. Opportunities and threats.

C. Segments-wise or product-wise performance.

D. Outlook

E. Risks and concerns

F. Internal control systems and their adequacy.

G. Discussion on financial performance with respect to operational performance.

H. Material developments in Human Resources/Industrial Relations front, including number of people employed.

2) Disclosures must be made by the management to the board relating to all material financial and commercial transaction, where they have personal interest that may have a potential conflict with the interest of the company at large.

f) Shareholders:

1) The company agrees that in case of the appointment of a new directors or reappointment of a director the shareholders must be provided with the following information:

A. A brief resume of the director

B. Nature of his expertise in specific functional areas

C. Names of companies in which the person also holds the directorship and the membership of committees of the board

2) The company further agrees that information like quarterly results, presentation made by companies to analysts shall be put on company's web-site, or shall be sent in such a form so as to enable the stock exchange on which the company is listed to put in on its own web-site.

3) The company further agrees that a board committee under the chairmanship of a non-executive director shall be formed to specifically look into the redressing of shareholder and investors complaints like transfer of shares, non-receipt of balance sheet, non-receipt of declared dividends, etc. this Committee shall be designated as 'Shareholders/Investors Grievance Committee'.

g) Report on Corporate Governance:

The company agrees that they shall be a separate section on corporate governance in the annual reports of company, with a detailed compliance report on corporate governance. Non-compliance of any mandatory requirement i.e. which is part of the listing agreement with reasons thereof and the extent to which the non-mandatory requirements have been adopted should be specifically highlighted.

h) Compliance:

The company agrees that it shall obtain a certificate from the auditors of the company regarding compliance of conditions of CORPORATE GOVERNANCE as stipulated in the directors' report, which is sent annually to all the shareholders of the company. The same certificate shall also be sent to the Stock Exchange along with the annual returns filed by the company.

8. CONCLUSION

Corporate governance is about what the company does and has it set the values of the companies. Good governance can have wider impacts to business sector because it is fundamentally about improving transparency and accountability within existing systems.

The purpose of corporate governance is to fascinate effective, entrepreneurial and prudent management that can deliver the long-term success of the company. It is intended to increase the accountability of company and to avoid massive disaster before they occur. With pursuing the emerging frontier of corporate governance as social responsibility is a platform for new research and new policies that, if designed effectively, may generate a more equitable global business environment.

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