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# CORPORATE GOVERNANCE

## INTRODUCTION:

**Corporate governance** is the mechanisms, processes and relations by which corporations are controlled and directed. 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 and includes the rules and procedures for making decisions in corporate affairs). Corporate governance includes the processes through which corporations' objectives are set and pursued in the context of the social, regulatory and market environment. Governance mechanisms include monitoring the actions, policies, practices, and decisions of corporations, their agents, and affected stakeholders. Corporate governance practices are affected by attempts to align the interests of stakeholders. The purpose of corporate governance is to facilitate effective, entrepreneurial and prudent management that can deliver the long-term success of the company. Corporate governance is the system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies.

Today, the corporate world as a whole is in the process of acquiring a moral conscience. The new and emerging concepts in management like corporate governance, business ethics and corporate sustainability are some of the expressions through which this emerging ethical instinct in the corporate world is trying to express or embody itself in the corporate life. In this study we examine the concept of ethics and its importance for the business, corporate governance and governance through inner consciousness and sustainability.

A business organization has to compete for a share in the global market on its own internal strength, in particular on the strength of its human resource, and on the goodwill of its other stakeholders. While its start of-the-art technologies and high level managerial competencies could be of help in meeting the quality, cost, volume, speed and breakeven requirements of the highly competitive global market, it is the value-based management and ethics that the organization has to use in its governance. That would enable the organization to establish productive relationship with its internal customers and lasting business relationship with its external customers.

Corporate governance is meant to run companies ethically in a manner such that all stakeholders, creditors, distributors, customers, employees, and even competitors, the society at large and governments are dealt with in a fair manner. Good corporate governance should look at all stakeholders and not just shareholders alone.

Corporate Governance has emerged as an important academic discipline in its own right, bringing together contributions from accounting, finance, law and management. Corporate governance now offers a comprehensive, interdisciplinary approach to the management and control of companies. Corporate professionals of today and tomorrow must imbibe in themselves the evolving principles of good corporate governance across the globe on a continual basis. Excellence can be bettered only through continuous study, research and academic and professional interaction of the highest quality in the theory and practice of good corporate governance. The corporate world looks upon especially Company Secretaries to provide the impetus, guidance and direction for achieving world-class corporate governance.

**Definitions of Corporate Governance:**

"Corporate Governance is concerned with the way corporate entities are governed, as distinct from the way business within those companies are managed. Corporate governance addresses the issues facing Board of Directors, such as the interaction with top management and relationships with the owners and others interested in the affairs of the company."- Robert Ian (Bob) Tricker (who introduced the words Corporate Governance for the first time in his book in 1984)

"Corporate Governance is about promoting corporate fairness, transparency and accountability"[1].

**NEED FOR CORPORATE GOVERNANCE:**

**Corporate Performance:** Improved governance structures and processes help ensure quality decision-making, encourage effective succession planning for senior management and enhance the long-term prosperity of companies, independent of the type of company and its sources of finance. This can be linked with improved corporate performance- either in terms of share price or profitability.

[1] James D. Wolfensohn

**Enhanced Investor Trust:** Investors consider corporate Governance as important as financial performance when evaluating companies for investment. Investors who are provided with high levels of disclosure & transparency are likely to invest openly in those companies. The consulting firm McKinsey surveyed and determined that global institutional investors are prepared to pay a premium of upto 40 percent for shares in companies with superior corporate governance practices.

**Better Access to Global Market:** Good corporate governance system attracts investment from global investors, which subsequently leads to greater efficiencies in the financial sector[2].

**Combating Corruption:** Companies that are transparent, and have sound system that provide full disclosure of accounting and auditing procedures, allow transparency in all business transactions, provide environment where corruption will certainly fade out. Corporate Governance enables a corporation to compete more efficiently and prevent fraud and malpractices within the organization.

**Easy Finance from Institutions:** Several structural changes like increased role of financial intermediaries and institutional investors, size of the enterprises, investment choices available to investors, increased competition, and increased risk exposure have made monitoring the use of capital more complex thereby increasing the need of Good Corporate Governance. Evidence indicates that well-governed companies receive higher market valuations. The credit worthiness of a company can be trusted on the basis of corporate governance practiced in the company.

## ELEMENTS OF GOOD CORPORATE GOVERNANCE:

Some of the important elements of good corporate governance are discussed as under:

### 1. Role and powers of Board:

Good governance is decisively the manifestation of personal beliefs and values which configure the organizational values, beliefs and actions of its Board. The Board as a main functionary is primary responsible to ensure value creation for its stakeholders. The absence of clearly designated role and powers of Board weakens accountability mechanism and threatens the achievement of organizational goals. Therefore, the foremost requirement of

[2] Economic development

good governance is the clear identification of powers, roles, responsibilities and accountability of the Board, CEO, and the Chairman of the Board. The role of the Board should be clearly documented in a Board Charter.

2. **Legislation:**

   Clear and unambiguous legislation and regulations are fundamental to effective corporate governance. Legislation that requires continuing legal interpretation or is difficult to interpret on a day-to-day basis can be subject to deliberate manipulation or inadvertent misinterpretation.

3. **Management environment:**

   Management environment includes setting-up of clear objectives and appropriate ethical framework, establishing due processes, providing for transparency and clear enunciation of responsibility and accountability, implementing sound business planning, encouraging business risk assessment, having right people and right skill for the jobs, establishing clear boundaries for acceptable behaviour, establishing performance evaluation measures and evaluating performance and sufficiently recognizing individual and group contribution.

4. **Board skills:**

   To be able to undertake its functions efficiently and effectively, the Board must possess the necessary blend of qualities, skills, knowledge and experience. Each of the directors should make quality contribution. [3]A Board should have a mix of the following skills, knowledge and experience:

   → Operational or technical expertise, commitment to establish leadership;

   → Financial skills;

   → Legal skills; and

   → Knowledge of Government and regulatory requirement.

5. **Sustainability:**

   Sustainability is based on a simple principle: Everything that we need for our survival and well-being depends, either directly or indirectly, on our natural environment. Sustainability creates and maintains the conditions under which humans and nature can exist in productive harmony, that permit fulfilling the social, economic and other requirements of present and future generations. Sustainability is important to making sure that we have and will continue to have, the water, materials, and resources to protect

[3] The economic structure of corporate law

human health and our environment. Sustainability has been comprehensively defined in "Sustainability is an economic state where the demand placed upon the environment by people and commerce can be met without reducing the capacity of the environment to provide for future generations. It can also be expressed in the simple terms of an economic golden rule for the restorative economy; leave the world better than you found it, take no more than you need, try not to harm life of environment, make amends if you do[4]."

Sustainable development is a broad, concept that balances the need for economic growth with environmental protection and social equity. It is a process of change in which the exploitation of resources, the direction of investments, the orientation of technological development, and institutional change are all in harmony and enhance both current and future potential to meet human needs and aspirations. Sustainable development is a broad concept and it combines economics, social justice, environmental science and management, business management, politics and law.

**WHAT IS CORPORATE SUSTAINABILITY?**

Corporate sustainability indicates new philosophy as an alternative to the traditional growth and profit maximization model under which sustainable development comprising environmental protection, social justice and equity, and economic development are given more significant focus while recognizing simultaneous corporate growth and profitability. It is a business approach that creates long-term shareholder value by embracing opportunities and managing risks deriving from economic, environmental and social developments. Corporate sustainability describes business practices built around social and environmental considerations. Corporate sustainability encompasses strategies and practices that aim to meet the needs of the stakeholders today while seeking to protect, support and enhance the human and natural resources that will be needed in the future. Corporate sustainability leaders achieve long-term shareholder value by gearing their strategies and management to harness the market's potential for sustainability products and services while at the same time successfully reducing and avoiding sustainability costs and risks. Thomas Dyllick and Kai Hockerts in 'Beyond the Business Case for Corporate Sustainability' define Corporate Sustainability[5]as, "meeting the needs of a firm's direct and indirect stakeholders (such as

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[4]Paul Hawkin's book – The Ecology of Commerce

[5]. Thomas Dyllick and Kai Hockerts

shareholders, employees, clients, pressure groups, communities, etc.) without compromising its ability to meet the needs of future stakeholders as well." The Australian government defines Corporate Sustainability as "encompassing strategies and practices that aim to meet the needs of the stakeholders today, while seeking to protect, support, and enhance the human and natural resources that will be needed in the future."

Corporate Sustainability includes an attempt to assimilate the environmental and social dimensions into business operations: processes, products and procedures. In practical terms, the Corporate Sustainability approach leads to a very concrete and pragmatic problem; how to measure performance based on the three dimensions outlined and how natural and social values can be incorporated into corporate accounting.

**<u>Government's Role in improving Sustainability:</u>**

Reporting Governments are interceding with unprecedented levels of new regulation like SEBI mandated Business Responsibility Reporting in India for top listed companies besides the voluntary reporting for others, Integrated Reporting in South Africa and many other jurisdictions are placing similar requirement on companies to report about the sustainability aspects in addition to financial information. In 2011, Ministry of Corporate Affairs (MCA), Govt. of India issued the first voluntary reporting framework for reporting on Business Responsibility in the form of 'National Voluntary Guidelines (NVG) on Social, Environmental and Economic Responsibilities of Business'. SEBI considering the framework given under the NVG guidelines, inserted clause 55 to the listing agreement to give mandate to top 100 listed companies to adopt the Business Responsibility Framework. The other listed companies are encouraged to adopt the Business Responsibility Reporting voluntarily. The similar regulators initiatives are required in other jurisdiction also to encourage the companies to adopt the Reporting on Sustainability aspects. Over the past 10 years, environmental issues have steadily encroached on businesses' capacity to create value for customers.

**<u>Why is Sustainability an Imperative?</u>**

Sustainability is an emerging megatrend and is a measure of good corporate governance. Over the years, environmental issues have steadily encroached on businesses' capacity to create value for customers, shareholders, and other stakeholders. Globalized workforces and supply chains have created environmental pressures and attendant business liabilities. The rise of new world powers has intensified competition for natural resources (especially oil) and added a geopolitical dimension to sustainability. "Externalities[6]" such as carbon dioxide emissions and water use are fast becoming material—meaning that investors consider them central to a firm's performance and stakeholders expect companies to share information about them. These forces are magnified by escalating public and governmental concern about climate change, industrial pollution, food safety, and natural resource depletion, among other issues. Consumers in many countries are seeking out sustainable products and services or leaning on companies to improve the sustainability of traditional ones. Further fuelling this megatrend, thousands of companies are placing strategic bets on innovation in energy efficiency, renewable power, resource productivity, and pollution control. In the end, it can be concluded that the top management of an organisation can no longer afford to ignore sustainability as a central factor in their companies' long-term competitiveness.

## Role of Business in Sustainable Development:

Trade and Industry being an integral part human society has a pivotal role to play. In this direction, United Nations has already initiated UN Global Compact, a strategic policy initiative for businesses that are committed to aligning their operations and strategies with ten universally accepted principles in the areas of human rights, labour, environment and anti-corruption. Through the process a business can ensure that markets, commerce, technology and finance advance in ways that benefit economies and societies everywhere. This is the first initiative under which business world is being aligned to common goals, such as building markets, combating corruption, safeguarding the environment and ensuring social inclusion, and it has resulted in unprecedented partnerships and openness among business, government, civil society, labour and the United Nations. Over 4700 corporate from over 130 countries are participants of Global compact. The Global Compact is a policy framework for the development, implementation, and disclosure of sustainability principles and practices designed to establish sustainable business models and markets building inclusive global economy.

## ETHICS:

The organization's values greatly influence the decisions that individuals make. The approach to ethical issues is not only on the basis of what the employees learned from their own

[6] The fact of existing outside the perceiving

background but also on what they learn from others in the organization and the Organization culture. Organisation culture comprises the attitudes, experiences, beliefs and values of an organization. It can be defined as the specific collection of values and norms that are shared by people and groups in an organization and that control the way they interact with each other and with stakeholders outside the organization. An important component of corporate culture is the ethical climate. The ethical climate of an organization is the shared set of understandings about what is correct behaviour and how ethical issues will be handled. This climate sets the character for decision making at all levels and in all circumstances. The ethical climate reflects whether the firm has an ethical conscience. The ethical climate is a function of many factors including corporate policies on ethics, top management's leadership on ethical issues, industry culture etc. The ethical tendency or climate of organizations is set at the top. What top managers do, and the culture they establish and reinforce, makes a huge difference in the way lower-level employees act and in the way the organization as a whole acts when ethical dilemmas are faced. When the ethical climate is not clear and positive, ethical dilemmas will often result in unethical behaviour. Organizations have ethics programme as a way of minimizing the risk of ethical misconduct or wrongdoing by employees. These programmes consist of policies, processes and education and training initiatives that explain the company's business ethics. These programmes clarify how ethics should translate into operating procedures and workplace behaviour. The focus of ethics programmes is compliance and is focused on rules and regulations.

**ETHICS PROGRAMME:**

A company must have an effective ethics program to ensure that all employees understand its values and comply with the policies and codes of conduct that create its ethical climate. Two types of control systems can be created. Both the control systems can be adopted simultaneously.

Compliance Orientation Programme: A compliance orientation creates order by requiring that employees identify with and commit to specific required conduct. It uses legal terms, statutes, and contracts that teach employees the rules and penalties for noncompliance.

Values Orientation: Values Orientation strives to develop shared values. Although penalties are attached, the focus is more on an abstract core of ideals such as respect and responsibility. Instead of relying on coercion, the company's values are seen as something to which people willingly aspire. Most companies begin the process of establishing organizational ethics programs by developing codes of conduct. Codes of conduct are formal statements that describe what an organization expects of its employees. Such statements may take three different forms a code of ethics, a code of conduct, and a statement of values. A **code of ethics** is the most comprehensive and consists of general statements, sometimes altruistic or inspirational, that serve as principles and the basis for rules of conduct. A code of ethics generally specifies methods for reporting violations, disciplinary action for violations, and a structure of due process. A **code of conduct** is a written document that may contain some inspiration statements but usually specifies acceptable or unacceptable types of behaviour. A code of conduct is more akin to a regulatory set of rules and as such, tends to elicit less debate about specific actions. One problem with codes of conduct is that they tend to be developed without broad-based participation from stakeholders. Another final type of ethical statement is a statement of values, it serves the general public and also addresses distinct groups such as stakeholders. Values statements are conceived by management and are fully developed with input from all stakeholders. A company can have a `credo' which can be used as a tool to define the ethical practices that the company pursues and the respect for stakeholders including (customers, employees, community). Credo is a Latin word which means "a set of fundamental beliefs or a guiding principle." For a company, a credo is like a mission statement.

## FEATURES OF GOOD ETHICS PROGRAMME:

The following factors indicate the success of an ethics programme:

- Leadership: that executives and supervisors care about ethics and values as much as they do about the bottom line.
- Consistency between words and actions: that top management "practises what it preaches". This is more important than formal mechanisms such as hotlines for people to report wrongdoing.
- Fairness: that it operates fairly. To most employees, the most important ethical issue is how the organization treats them and their co-workers.
- Openness: that people talk openly about ethics and values, and that ethics and values are integrated into business decision-making.

## CODE OF ETHICS:

A code of ethics should reflect top managements' desire for compliance with the values, rules, and policies that support an ethical climate. The development of a code of ethics should involve the president, board of directors, and chief executive officers who will be implementing the code. Legal staff should also be called on to ensure that the code has correctly assessed key areas of risk and that it provides buffers for potential legal problems. Corporate codes of ethics often contain about six core values or principles in addition to more detailed descriptions and examples of appropriate conduct. The six values that are desirable for codes of ethics include: (1) trustworthiness, (2) respect, (3)responsibility, (4) fairness, (5) caring, and (6) citizenship.

**In India, Clause 49 of the Listing Agreement requires that:**

(i) The Board shall lay down a code of conduct for all Board members and senior management of the company. The code of conduct shall be posted on the website of the company.

(ii) All Board members and senior management personnel shall affirm compliance with the code on an annual basis. The Annual Report of the company shall contain a declaration to this effect signed by the CEO. Explanation: For this purpose, the term "senior management" shall mean personnel of the company who are members of its core management team excluding Board of Directors. Normally, this would comprise all members of management one level below the executive directors, including all functional heads. In the United States of America, Section 406 of the Sarbanes Oxley Act, 2002 requires public companies to disclose whether they have codes of ethics and also to disclose any waivers of those codes for certain members of senior management. Section 406(a) of Regulation S-K requires companies to disclose:
- whether they have a written code of ethics that applies to their principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions;
- any waivers of the code of ethics for these individuals; and
- any changes to the code of ethics.

If companies do not have a code of ethics, they must explain why they have not adopted one. A company may file its code as an exhibit to the annual report, post the code on the company's Web site, or agree to provide a copy of the code upon request and without charge. A code of ethics outlines a set of fundamental principles. These principles can be used both as the basis for operational requirements (things one must do) and operational prohibitions (things one must not do). A code of ethics is based on a set of core principles or values and is not designed for convenience. Those subject to the code is required to understand, internalize, and apply in situations the code does not specifically address. Organizations expect that the principles, once communicated and illustrated, will apply in every case, and that failure to apply the principles can be a cause for disciplinary action.

## CODE OF CONDUCT:

Code of conduct or what is popularly known as Code of Business Conduct contains standards of business conduct that must guide actions of the Board and senior management of the Company. The Code may include the following: (a) Company Values. (b) Avoidance of conflict of interest. (c) Accurate and timely disclosure in reports and documents that the company files before Government agencies, as well as in Company’s other communications. (d) Compliance of applicable laws, rules and regulations including Insider Trading Regulations. (e) Maintaining confidentiality of Company affairs. (f) Non-competition with Company and maintaining fair dealings with the Company. (g) Standards of business conduct for Company’s customers, communities, suppliers, shareholders, competitors, employees. (h) Prohibition of Directors and senior management from taking corporate opportunities for themselves or their families. (i) Review of the adequacy of the Code annually by the Board.(j) No authority of waiver of the Code for anyone should be given. The Code of Conduct for each Company summarises its philosophy of doing business. Although the exact details of this code are a matter of discretion, the following principles have been found to occur in most of the companies:

- Use of company’s assets;
- Avoidance of actions involving conflict of interest;
- Avoidance of compromising on commercial relationship;
- Avoidance of unlawful agreements;
- Avoidance of offering or receiving monetary or other inducements;
- Maintenance of confidentiality;
- Collection of information from legitimate sources only.
- Safety at workplace
- Maintaining and Managing Records
- Free and Fair competition

- Disciplinary actions to create a code of ethics,

An organization must define its most important guiding values, formulate behavioural standards to illustrate the application of those values to the roles and responsibilities of the persons affected, review the existing procedures for guidance and direction as to how those values and standards are typically applied, and establish the systems and processes to ensure that the code is implemented and effective. Codes of ethics are not easily created from boilerplate. Ideally, the development of a code will be a process in which Boards and senior management actively debate and decide core values, roles, responsibilities, expectations, and behavioural standards.[7]

Ethics is the first line of defence against corruption, while law enforcement is remedial and reactive. Good corporate governance goes beyond rules and regulations that the Government can put in place. It is also about ethics and the values which drive companies in the conduct of their business. It is therefore all about the trust that is established over time between the companies and their different stakeholders. Good corporate governance practices cannot guarantee no corporate failures. But the absence of such governance standards will definitely lead to questionable practices and corporate failures which surface suddenly and massively.

## CONCLUSION:

This principle concerning the quality of life of all people, affirms an obligation to protect fundamental human rights and to respect the diversity of all cultures. We must attempt toensure that the products of our efforts will be used in socially responsible ways, will meet social needs and will avoid harmful effects to health and welfare of others.

[7] Foundations of corporate law