ISSN 2321 - 4171

CORPORATE GOVERNANCE AND SOCIAL RESPONSIBILITY: PROBLEMS AND ISSUES

By Anubha Dwivedi

Abstract

Corporate governance is considered as a system by which companies are directed and controlled. It is a set of standards which aims to improve the company's image, efficiency, effectiveness and social responsibility. Sustainability ensures the long-term financial and economic viability of corporate investments and of requiring compliance with minimum environment viability and social standards. In this paper, the researcher has critically analysed the concept of corporate governance and corporate social responsibility and the relationship between them. The issue of corporate social responsibility is an integral part of corporate strategy, planning and operational performance. Profitability should not be the sole criteria of vision and vital factor in judging the company's performance but corporates should also focus on their responsibility towards society at large. Corporate social responsibility is the commitment of business to contribute to sustainable economic development, working with employees, their families, the local community and society at large to improve their quality of life. It covers a variety of sensitive issues such as human rights, worker's rights, supplier's relations and involvement.

Keywords- Corporate governance, social responsibility, sensitive issues

"Ideas are nobody's property; they belong to whoever expresses them best."

Emilio Cecchi

"Corporate Governance is "the system by which companies are directed and controlled"

Cadbury Committee

Introduction:

Corporate Governance

The civilization is entering into twenty first century, marked by one of the greatest invention of mankind i.e., joint –stock company. It is this very invention which is playing a major role in eroding the geographical boundaries of nations across the globe. As the mankind is making strides with the help of this very invention, care is also being taken that these organisations fulfill their objectives in the best possible manner.[1] With the growth of corporate of corporate organisations into huge sizes, characterised by separation between ownership and control, their internal organisational problems, as also their external relation to the society, have acquired new dimensions, not envisaged in the early era of the corporations. Today's company affects the average citizen's life, directly and indirectly, in many ways- he may be its shareholder, employee, supplier, dealer, customer and even if none of these, his life may still be affected by what the company does, e. g. by the pollution that its plant may create and by the company's impact on the general economy. Thus proper governance of the modern companies is a legitimate social concern expressed these days in both the developed and the developing countries.[2]

Corporate Governance: Meaning

The concept of corporate governance is poorly defined because it potentially covers a large number of distinct economic phenomenons. As a result different people have come up with different definitions that basically reflect their special interest in the field.
According to **Sheilfer** and **Vishnv**, "Corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment"[3]

According to **OECD**, "Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through

[1] Yogesh Upadhyay, Shive Kumar Singh, "Corporate Governance: Role of Corporate Laws", Pranjana, Vol. 3,No.1&2, 2000.
[2] Mohi-ud-din Sangmi, "Corporate Governance in India A 21st Century Perspective", The Business Review, Vol.6. No. 1 & 2,p. 55.
[3]< http://e.viaminvest.com/WhatIsGorpGov.asp>,accessed 1 March 2014

which the company objectives are set and the means of attaining those objectives and monitoring performance".[4]

Theories of Corporate Governance

History has revealed that there is a never-ending evolution of theories or models of corporate governance. One of the reasons is due to the very essence of social consciences that is minimal and profit making took center stage. All over the world, companies are trying to instils the sense of governance into their corporate structure. With the surge of capitalism, corporation became stronger while governments all over the world had to succumb to its manipulations and dominance. The theories of Corporate Governance can be divided in two main theories Fundamental Corporate Governance Theories and Ethical Theories. The fundamental theories in corporate governance began with the agency theory, expanded into stewardship theory and stakeholder theory and evolved to resource dependency theory, transaction cost theory, political theory and ethics related theories such as business ethics theory, virtue ethics theory, feminists ethics theory, discourse theory and postmodernism ethics theory.[5]

Fundamental Theories of Corporate Governance

Agency Theory

Agency theory having its roots in economic theory was exposited by Alchian and Demsetz (1972) and further developed by Jensen and Meckling (1976). Agency theory is defined as "the relationship between the principals, such as shareholders and agents such as the company executives and managers". In this theory, shareholders who are the owners or principals of the company, hires the agents to perform work.[6]

Stewardship Theory

Stewardship theory has its roots from psychology and sociology and is defined by Davis, Schoorman & Donaldson (1997) as "a steward protects and maximises shareholders wealth through firm performance, because by so doing, the steward's utility functions are maximised". In this perspective, stewards are company executives and managers working for

---

[4] ibid

[5] Haslinda Abdullah and Bendict Valentine, "Fundamental and Ethics Theories of Corporate Governance", Middle Eastern Finance and Economics <http://www.eurojournals.com/mefe_4_07.pdf > accessed 3 March 2014

[6] ibid

the shareholders, protects and make profits for the shareholders. Unlike agency theory, stewardship theory stresses not on the perspective of individualism but rather on the role of top management being as stewards, integrating their goals as part of the organization. The stewardship perspective suggests that stewards are satisfied and motivated when organizational success is attained.[7]

Stake Holder Theory

Stakeholder theory was embedded in the management discipline in 1970 and gradually developed by Freeman (1984) incorporating corporate accountability to a broad range of stakeholders. Wheeler et al, (2002) argued that stakeholder theory derived from a combination of the sociological and organizational disciplines. Indeed, stakeholder theory is less of a formal unified theory and more of a broad research tradition, incorporating philosophy, ethics, political theory, economics, law and organizational science. Stakeholder theory can be defined as “any group or individual who can affect or is affected by the achievement of the organization’s objectives”. Unlike agency theory in which the managers are working and serving for the stakeholders, stakeholder theorists suggest that managers in organizations have a network of relationships to serve – this include the suppliers, employees and business partners. And it was argued that this group of network is important other than owner manager-employee relationship as in agency theory.[8]

Resource Dependency Theory

Whilst, the stakeholder theory focuses on relationships with many groups for individual benefits, resource dependency theory concentrates on the role of board directors in providing access to resources needed by the firm. Hillman, Canella and Paetzold (2000) contend that resource dependency theory focuses on the role that directors play in providing or securing essential resources to an organization through their linkages to the external environment. Indeed, Johnson et al, (1996) concurs that resource dependency theorists provide focus on the appointment of representatives of independent organizations as a means for gaining access in resources critical to firm success. For example, outside directors who are partners to a law

---

[7] ibid
[8] ibid

firm provide legal advice, either in board meetings or in private communication with the firm executives that may otherwise be more costly for the firm to secure.[9]

Need for Corporate Governance

Although instituting corporate governance is clearly beneficial for firms and countries, the rapid pace of globalization has made the need urgent. Doing so requires that firms and national governments make some fundamental changes. Companies must change the way they operate, while national governments must establish and maintain the appropriate institutional framework. Without rules and structures of a binding nature, anarchy results. Under such conditions business becomes nothing but “casino capitalism” where investments are simply bets: bets that people will keep their word, bets that the firms are telling the truth, bets that employees will be paid, and bets that debts will be honoured. What corporate governance is all about in larger terms is how a structure can be set up that allows for a considerable amount of freedom within the rule of law.[10]

Public attention through high profile corporate scandals and collapses has forced governments, regulators and boards of corporations to carefully reconsider fundamental issues of corporate governance as essential for public economic interest. In addition, the volatility and instability experienced in emerging markets in recent times has drawn attention to the implications of corrupt practices and maladministration in national and international financial systems and on public expenditure. Good corporate governance practices are now becoming a necessity for every country and business enterprise, and are no longer restricted to the activities of public-listed corporations in advanced industrial economies.[11]

Ground Reality

The ground reality is that as years pass by, entrepreneurs shall have to face ever more challenges in the face of optimal opportunity. Corporate management shall have to address them to measuring their strength and weakness, opportunities and threats, cost-benefit-weightage and such like issues. In doing so, companies shall have to respond to challenges and seize opportunities. They should, therefore, be prepared to pay, in cash or kind, penalties for neglect. Ultimately, it stands to reason that corporate bodies shall have to add value to their organization. If not, they should be prepared to live to regret for their own doings.

---

[9] supra
[10] <http://www.cipe.org/programs/corp_gov/pdf/CGHANDBOOK.pdf> accessed 3March 2014
[11] <http://www.nfcgindia.org/pdf/cacg_guidlines.pdf> accessed 5 March 2014

Intense competitive climate at international level has indeed improved conditions for investors and has helped push national stock markets to emerge amongst the best in eastern continent. Despite stringent legislative measures, waves after waves of corporate scandals involving several multinational corporations, financial institutions and investment banks are rampant. There is the story of 'terrible ten 'companies in United States known to have surreptitiously adopted dubious practices of bribing chief executive officers and have indulged in nefarious practices involving billions of dollars of scams at the cost of public money. At the national level, the media delights in splashing daily news of bungling of one kind or another. The core factor to be seriously and expeditiously addressed is to improve corporate conscience and behaviour. The transparency should be such as would mirror clearly the performance of a company as would be open to public gaze and scrutiny, and capable of being investigated, whereupon the culprits ought to be brought to books.

Over the past two decades, the government has taken bold and pragmatic steps to upgrade the Indian investment environment to global standards. National Stock Exchange has emerged as one of the world-class bureau introducing electronic trading, making price rigging impossible via voice mail. Era of forgery was ended as paper scripts were dematerialized into electronic security documents, making it facile to deliver scripts within in a couple of days of purchase.

Corporate Governance and Corporate Social Responsibility

Corporate social responsibility and corporate governance are inextricably intertwined. There is today a growing perception among enterprise that sustainable business success and shareholder value control cannot be achieved solely through maximizing short-term profits, but instead through market oriented yet responsible behavior. Companies are aware that they can contribute to sustainable development by managing their operations in such a way as to enhance economic growth and increase competitiveness whilst ensuring environmental protection and promoting social responsibility.

Business governance or corporate governance is a phenomenal set of systems and processes to ensure that a company is managed to safeguard the interest of all the stakeholders. Corporate governance and Corporate Social Responsibility are both extremely important to a company.

We cannot see a good CSR practices without a good corporate governance practices. Corporate governance depends on managerial performance as well as a consideration of social responsibility, the socio- cultural-environmental dimension of business procedure, legal and ethical practices with a focus on customers and other stakeholders of an organization. Therefore we can say the corporate governance and corporate social responsibility are interrelated.

Whistle Blowing

Any discussion on corporate governance is not complete without addressing the issue of whistle blowing. Corporate governance is the acceptance of the inalienable rights of shareholders as the true owners of the corporation and of the role of the management is perceived as that of trustees on behalf of the shareholders. It encompasses commitment to values, ethical business conduct and strikes a fine distinction between personal and corporate funds in the management of a company.[12] The aftermath of the unexpected Satyam scam awakened India to new set of norms and policies. The Ministry of Corporate affairs realised this and began to undertake measures to patch up the loopholes to prevent future corporate frauds.[13]

Whistle blowing is an act by which an employee in an organization makes public announcements of incidents of mal-practice within the organization or otherwise perpetrated by the organization. Usually, this happens when the person blowing the whistle does not get response from within the organization to check or stop the practices in question. The whistle blower is at great personal risk of losing his/ her job or being punished otherwise by the affected persons in authority. In the context of a corporation, whistle blowers are those who expose malpractices, unethical and corrupt practices of their co-workers and seniors, for the benefit of the company, stakeholders and the society at large. There is rampant personal use of company funds, misappropriation and recurrent frauds at different levels. This is clearly reflected by the satyam scams and the stamp paper scams in the past. In India , whistle blower policy is restricted to the public servants or in works connected with the central government[14] and there exists no provision for the corporate whistle blowers, except a non mandatory requirement under clause 49 of the Listing Agreement.

---

[12] Preamble, Narayana Murthy Report of the SEBI Committee on Corporate Governance.

[13] Govt re-introduces Companies Bill, SEBI & Corporate Laws, The Corporate Laws Weekly, Vol. 94, Part 1,

[14] The Central Vigilance Commission Act, 2003; Section 8.

Some Recent Corporate Scams

Harshad Mehta Scam

Harshad Mehta known to be"Big Bull of the trading floor" was an Indian stockbroker and is alleged to have engineered the rise in the BSE stock exchange in the year 1992. He and his associates draw off funds from interbank transactions and brought shares heavily at a premium across many segments, triggering the rise in the sensex. When the scheme was exposed, the banks started demanding the money back, causing the collapse. The amount that was involved in this scam was approx to Rs 4000crs.

M.S. Shoes (Insider Trading) Scam

Pawan Sachdeva, the promoter of M.S.Shoes, allegedly used company funds to buy shares of his own company and rig prices, prior to a public issue. The dominant shareholder of the firm, Pawan Sachdeva, took large leveraged positions through brokers at both the Delhi and Bombay Stock Exchanges to manipulate share prices prior to a rights issue. He is alleged to have colluded with officials in the Securities Exchange Board of India and SBI Caps, which lead-managed the issue, to dupe the public into investing in his Rs 699-crore public-cum-rights issue. When the share prices crashed, the broker defaulted and BSE shut down for 3, days as consequence.[15]

Satyam Fraud

Chairman B. Ramalinga Raju's admission that Satyam Computer Services Ltd's Balance Sheet was completely fabricated got the stock crashing down by 66.5 per cent to Rs 60 from Wednesday's high of Rs 188.70. The share hit a low of Rs 58, as details of the extent of fraud perpetrated by the promoters shook the stock market and cast a grim cloud over the corporate practices of companies. The BSE Sensex crashed 470.23 points or 4.55 per cent to9,865.70, after rising to a high of 10,469.72 earlier Wednesday. Investors aggressively cut their positions. The BSE IT Index plunged 7.70 per cent and BSE Realty tumbled 11.20 per cent. IT and other sectoral stocks were beaten down badly as the Satyam fraud raised question over corporate governance of other companies also, especially IT.

Raju's letter to the company board revealed a fraud of unprecedented proportions. He states that Satyam's balance sheet as on Sep 30, 2008, carries an inflated (non-existent) cash and

[15]< http://archives.digitaltoday.in/businesstoday/20020120/stockmarkets4.html> accessed 5 March 2014

bank balances of Rs 5,040 crore as against Rs 5,361 reflected in the books. Further, it carries an accrued interest of Rs 376 crore which is non-existent. The books carry an understated liability of Rs 1,230 crore on account of funds arranged by Raju, and an over stated debtor's position of Rs 490 crore as against Rs 2,651 crore in the books. This has resulted in artificial cash and bank balances going up by Rs 588 crore in the second quarter alone.[16]

Corporate Governance and Securities Laws

"Global market forces will sort out those companies that do not have sound corporate governance." - Mervyn King S.C. (Chairman: King's Report)

An effective regulatory and legal framework is indispensable for the proper and sustained growth of the company. In rapidly changing national and global business environment, it has become necessary that regulation of corporate entities is in tune with the emerging economic trends, encourage good corporate governance and enable protection of the interests of the investors and other stakeholders.

Further, due to continuous increase in the complexities of business operation, the forms of corporate organizations are constantly changing. As a result, there is a need for the law to take into account the requirements of different kinds of companies that may exist and seek to provide common principles to which all kinds of companies may refer while devising their corporate governance structure.

Companies in India raise capital for meeting their long term requirements of funds by way of issue of shares or through borrowing by issuing debentures. Capital can be raised though public issues or private placement. Until the advent of Securities and Exchange Board of India in 1992, the consent of Controller of Capital Issues was required for making such issues. The Controller was functionary under the Ministry of Finance, Department of Economic Affairs. The actual issue of the securities was being governed by the provisions of Companies Act, 1956. Improved corporate governance is the key objective of the regulatory framework in the securities market. Accordingly, Securities and Exchange Board of India has enacted lot of regulations and rules for regulating the dealing the stock in stock market. It has also made several efforts with a view to evaluate the adequacy of existing corporate

---

[16] <http://economictimes.indiatimes.com/Satyam_fraud_clouds_corporate_governance_of_India_Inc/articleshow/3946405.cms > accessed 6 March 2014

governance practices in the country and further improve these practices. An important focus of securities laws is the protection of investors. An investor is protected when the companies will be property governed.

"If a country does not have a reputation for strong corporate governance practices, capital will flow elsewhere. If investors are not confident with the level of disclosure, capital will flow elsewhere. If a country opts for lax accounting and reporting standards, capital will flow elsewhere." - Arthur Levitt (Former Chairperson: US Securities Exchange Commission)

In India, the concept of corporate governance is no longer a fashion statement. It has been embedded in the statutes namely Companies Act, 1956 and Clause 49 of the listing agreement. The corporate failures and the rising dissatisfaction with the functioning of the corporations gave rise to the need of reassuring the stakeholders; as a result the emphasis was laid on improving the corporate governance practices. Corporate Governance practices were desirable from all quarter's i.e. alert shareholders, cautious customers, dedicated employees, conversant business associates, regulatory bodies, Government and to a certain extent by the companies themselves to improve their image in the eyes of the public.

Good corporate governance in a corporate set up leads to maximize the value of the shareholders legally, ethically and on a sustainable basis, while ensuring equity and transparency to every stakeholder – the company's customers, employees, investors, vendor-partners, the government of the land and the community . It is a must for ensuring the required values to different stakeholder groups. It enhances the performance of corporations, by creating an environment that motivates managers to maximize returns on investment, enhance operational efficiency and ensure long–term productivity growth. Consequently, such corporations attract the best talent on a global basis. It also ensures the conformance of corporations with the interests of investors and society, by creating fairness, transparency and accountability in business activities among employees, management and the board

Accounting is a process of compiling information for reporting the internal affairs of any entity to different stakeholders at the end of a certain interval. It is defined as the language of business and can play a vital role for ensuring and continuing with Good corporate governance. It can be used as a tool for ensuring good governance within a corporate setup. Auditors are playing a important role in ensuring good corporate governance. Good corporate governance increases public confidence in a corporation, and lowers the cost of capital for investment. Today, good corporate governance becomes slogan sand a pride.

Corporate Social Responsibility

Corporate Social Responsibility is the voluntary role and contribution on the part of the business community towards a better social and environmental development, which is beyond their investment to organizational development. The business organisations can be lead by large multinationals and for small, locally based businesses. While, the actions on the part of business organisations here to be ethically bound to its stakeholders, who include customers, owners/investors, government, suppliers and competitors. Corporate Social Responsibility consists of a wide-range activities and programs that involve businesses looking at how to improve their social, environmental and local economic impact, their influence on society, social cohesion and human rights, and fair trade. Key areas of concern are environmental protection and the well being of employees, the community and civil society in general, both in present and in future.

It refers to the comprehensive approach that a corporation takes to meet or exceed stakeholder expectations beyond measures of revenue, profit and legal obligation. The industrial expansion is a threat to the people living nearby and it invites protest from many like consumer, investors, activist groups, government regulators and other stakeholders. To develop a better rapport with the community in the implementation of the developmental activities the Non Governmental organisations can play better role with the industry and community. They can help the industrial management in convincing the expansion program to the community and there by develop a proactive and social environmental and industrial development policy. Lower operating costs, Enhanced brand image and reputation, reduced regulatory oversight, Product safety and decreased liability, improved financial performance etc are the benefit to the organisation. The benefit of Corporate Social Responsibility not only for the community and organisation but also for the employees.[17]

Business dies when society condemns and rejects it. No business can survive without societal approval and sanction. The inter-dependant nature of relationship between the business and the society is best illustrated by the management guru Peter Drucker (1954) by the example of a ship and sea. He states that the relationship between business and society is "like the

[17] http://www.indianmba.com/Faculty_Column/FC292/fc292.html ,

relationship between a ship and the sea which engirds it and carries it, which threatens it with storm and shipwreck, which has to be crossed but which is yet alien and distant.

Profit is oxygen to business. No business can survive without profit. Hence, business must earn profit but with social concern. Business operations need to benefit business and society on a symbiosis basis. Alternative business practices of blending concern for profit with human concerns ensuring stay and survival of business abound in corporate history. Corporate social responsibility does not impinge upon business profitability; rather it helps increase the profitability in long run, if not in short-run.

Conclusion

"You must be the change you wish to see in the world . . ." - Mahatma Gandhi

Modern business world demands quality, ethics and excellence, properly injected into the organisation at the level of person, process and product. To cope with this change, core competency is indentified and leveraged for success and all this is made possible through corporate governance. Corporate governance is the modern expression for an old issue called accountability. It has been assuming greater significance in recent years, following major business failures world across. Basically, corporate governance is about how those assigned with the tasks of day to day management are held accountable to the shareholders and other providers of funds. Corporate governance becomes strong when the corporate entities are directed and controlled; covering the entire gamut of activities involved in the functioning of the company, placing the board of directors in the centre of the system. The concept of corporate governance is closely related to ISO standards guaranteeing quality practices. This would also include defining the powers of directors, particularly the non executive making available information on the company's current state of affairs to all the directors and system control to ensure the authenticity, timeliness and effectiveness of information.

Corporate governance is not just corporate management. It is something much broader to include a fair, efficient and transparent administration to meet certain well defined objectives with a system by which the operations are well streamlined. The system facilitates a set of incentives, safeguards and dispute resolution mechanisms so as to co-ordinate and control the activities by the Board of Directors. Hence, corporate governance relates to a code of conduct that the management of the company observes while exercising its powers.

The governance framework is there to encourage the efficient use of resources and equality to require accountability for the stewardship of human resources. This aim is to align as nearly as possible the individuals, corporation and society.This aim is to align as nearly as possible the individuals, corporation and society. The incentive for states is to strengthen their economies and discourage fraud and mismanagement. The basic objective of corporate governance is to maximize long-term shareholder value.

When an investor invests money in a corporation, he expects the board and the management to act as trustees and ensure the safety of the capital and also earn a rate of return that is higher than the cost of capital. In this regard, investors expect management to act in their best interests at all times and adopt good corporate governance practices.

The underlying principles of corporate governance are the values, ethics and commitment to follow best business practices. Thus, it rests upon the foundations of transparency, disclosures and fairness in dealing with its stakeholders. The business strategy and plans should be consistent with the welfare of all stakeholders and should be in line with the economic policies adopted by the nation. Therefore, the Corporates should continuously endeavour to take forward the best practices to enhance stakeholder's value.

This can be evidenced from the view that good governance is primarily about good values, it is important to state them and live with them. CSR can be called an external expression of those values. Corporate governance is generally going beyond the traditional core governance function to incorporate the value dimension.

Corporate responsibility is quite dynamic these days. It is coming up to be understood as the space where business accountability boundaries can be negotiated. Most of the companies shared responsibility about social issues in supply chain or human rights, labour etc. Growing impetus on CSR drives a changing basis of accountability within a business which gives impetus on the basis of which corporate governance is framed and implemented.

It is high time for Indian Companies to look at corporate governance system and make an honest appraisal of the confidence they command with investors either foreign or Indian, technology suppliers, alliance partners and funding institutions. There are a number of companies like Infosys, Reliance, ICICI, HDFC etc. which are following the current corporate governance compliance. In other words, corporate governance is a pre- requisite to globalisation and success.

Suggestions

Success of corporate governance is based on complete transparency and "arms length" relationship between owners and managers. Historically, there have always been reasons, excuses and incentives to encourage, "beating the system" and unhealthy corporate practices like tax evasion, as an attempt to create a level playing field in an unfriendly business and regulatory environment. Therefore, the need for a regulatory mechanism which will ensure effective monitoring for good corporate governance is now realized.

1. Clause 49 needs to be suitably amended by specifying positive attributes for independent directors such as integrity, experience and expertise, foresight, managerial qualities and ability to read and understand financial statements etc.
2. The Roles of Chairman and CEO should be separated to promote balance of power. A "comply or explain" approach should be adopted.
3. The constitution of remuneration committee should be made mandatory.
4. Adoption of Whistle Blower Policy should be made mandatory, to begin with, for listed companies. A model policy in this regard may be specified covering important clauses that protect the Whistle Blowers also.
5. Public and Investor Relations Cell should be established by all Companies.
6. Audit committee should also have legal expert. Legal Experts are helpful in highlighting legal issues.

Corporate Governance framework is there to encourage efficient use of resources and require accountability for the stewardship of those resources. The aim is to align the interest of the individuals, corporations and society." Finally, it may be concluded that
Corporate Governance and Corporate Social Responsibility are the two parts of the same coin. Both of the concepts are correlated with each other. Therefore, we cannot expect a company socially responsible without following good governance practices.