ZENITH International Journal of Business Economics & Management Research_________________ **ISSN 2249- 8826**
ZIJBEMR, Vol.3 (6), June (2013)
Online available at zenithresearch.org.in

CORPORATE GOVERNANCE: THE CONCEPTUAL FRAMEWORK

MAHESH R.PRAJAPATI; T.S.SHIBIN;
YOGESH A.LAD

*ASST.PROFESSOR,
INTERNATIONAL AGRI-BUSINESS MANAGEMENT INSTITUTE,
AAU, ANAND

ABSTRACT

In this paper attempt has been made to discuss various aspects relating to corporate governance like origin of corporate governance and its objectives, need of corporate governance, main constituents of corporate governance, overview of corporate governance in India and challenges of corporate governance for business enterprise.

Corporate governance means the idea of ensuring proper management of companies through the institutions and mechanisms available to the shareholders. Corporate governance is looked upon with utmost importance by the legal systems and company regulatory regimes all around the world.Corporate governance essentially is about accountability and strategic direction. For too long corporate governance has been conceived as a one-dimensional focus upon monitoring, compliance and regulation.

KEYWORDS: Corporate governance, Globalization, Stakeholders, transparency

Introduction

The topic of corporate governancehas attracted substantial interest from scholarsin a wide array of academic fields. Attention to governance can be found in departments of accounting, finance, management, organization behavior, and strategy, as well as departments of economics, sociology, psychology, and law. Some of this interest is undoubtedly due to the widely noted corporate scandals of the past decade corporate governance as referring to the formal structures, informal structures, and processes that exist in oversight roles and responsibilities in the corporate context. Corporate governance is not just profit making but behaving responsibly by protecting environment, promoting healthy competition and preventing net worth erosion. Its main aim is to establish a balance between economic and social goals and between individual and commercial goals.

The origin of Corporate Governance:

The seeds of modern Corporate Governance were probably sown by the Watergate scandal in the United States. As a result of subsequent investigations, US regulatory and legislative bodies were able to highlight the control failures that had allowed several major corporations to make illegal political contributions and to bribe government officials. This led to the development of the Foreign and Corrupt Practices Act of 1977 in USA that contained specific provisions regarding the establishment, maintenance and review of systems of internal control.

This was followed in 1979 by the Securities and Exchange Commission of USA's proposals for mandatory reporting on internal financial controls. In 1985, following a series' of high profile business failures in the USA, the most notable one of which being the savings and loan collapse, the Treadway Commission was formed. Its primary role was to identify the main causes of mis-representation in Financial Reports and to recommend ways of reducing incidence thereof. The Treadway Report published in 1987 highlighted the need for a proper control environment, independent Audit Committees and an objective Internal Audit function. It called for published reports on the effectiveness of internal control. It also requested the sponsoring organizations to develop an integrated set of internal control criteria to enable companies to improve their controls. Accordingly Committee of Sponsoring Organizations was born. The report produced by it in 1992 stipulated a control framework, which has been endorsed and refined in the four subsequent UK reports: Cadbury, Rutteman, Hampel and Turnbull. While developments in the United States stimulated a debate in the UK, a spate of scandals and collapses in that country in the late 1980s and early 1990's led the shareholders and banks to worry about their investments. These also led the Government in UK to recognize that the existing legislation and self-regulation were not working.

The issue of corporate governance became particularly significant in the context of globalization because one special feature of the late 20th century globalization is that in addition to the traditional three elements of the economy, namely physical capital in terms of plant and machinery, technology and labour, the volatile element of financial capital invested in the emerging markets and in the third world countries is an important element of modern globalisation and has become particularly powerful. Thanks to the everywhere application of information technology, at the touch of a computer mouse, it is possible now to transfer billions of dollars across borders. The significance and the impact of the volatility of the financial capital was realized when, in June 1997 the currency of South East Asian countries started melting down in countries like Thailand, Indonesia, South Korea and Malaysia. It was realized by the World Bank and all investors that it is not enough to have good corporate management but one should have also good corporate governance because the investors want to be sure that the decisions taken are ultimately in the interest of all stakeholders. Honesty is the best policy is a fact that is now being re-discovered.

In practical terms, corporate governance has meant that there should be at the board level non-official directors who are professionals and who have no conflicting interests and who can particularly operate the two key committees, the Ethics Committee and the Finance Committee to see that there is greater transparency in the management of the enterprise. Corporate governance ultimately has to come to mean better transparency in the operations without sacrificing business strategy or business secrets which are necessary for success in the market place, and absolutely ethical behaviour where the conduct of the company will not only be legal but also ethical.

Governance and Corporate governance:

Governance is common word is used to mean the way people are governed and the way the affairs of the state are administered and regulated. This concept, drawn from the public administration, has received increasingly greater attention in business world in the sense of direction and control of companies by their top management.

Corporate governance means the idea of ensuring proper management of companies through the institutions and mechanisms available to the shareholders. The Cadbury Committee Report defines corporate governance as “Corporate governance is a system by which a corporate entity is directed and controlled in a given economic, political and social environment” It also entails the interplay between different stakeholders of a corporation, viz., board of directors, equity holders, debt holders, employees, customers and government. It deals with how a company fulfill its obligations to investors and other stakeholders. It is about creating shareholder wealth while ensuring a fair play to all other stakeholders and society at large. The aim of good corporate governance is to ensure commitment of the board in managing the company in a transparent manner for maximizing long-term value of the company for its shareholders and all other stakeholders. It integrates all the participants involved in a process, which is economic, and at the same time social.

Objectives of corporate governance

The fundamental objective of corporate governance is to enhance shareholders' value and protect the interests of other stakeholders by improving the corporate performance and accountability. Hence it harmonizes the need for a company to strike a balance at all times between the need to enhance shareholders' wealth whilst not in any way being detrimental to the interests of the other stakeholders in the company. Further, its objective is to generate an environment of trust and confidence amongst those having competing and conflicting interests. It is integral to the very existence of a company and strengthens investor's confidence by ensuring company's commitment to higher growth and profits. Broadly, it seeks to achieve the following objectives:

- A properly structured board capable of taking independent and objective decisions is in place at the helm of affairs.
- The board is balance as regards the representation of adequate number of non-executive and independent directors who will take care of their interests and well-being of all the stakeholders.
- The board adopts transparent procedures and practices and arrives at decisions on the strength of adequate information.
- The board has an effective machinery to subserve the concerns of stakeholders.
- The board keeps the shareholders informed of relevant developments impacting the company.
- The board effectively and regularly monitors the functioning of the management team.
- The board remains in effective control of the affairs of the company at all times.

Needs of corporate governance

A company is a congregation of various stakeholders, namely customers, employees, investors, vendor partners, government and society. In this changed scenario an Indian corporation, as also a corporation elsewhere, should be fair and transparent to its stakeholders in all its transactions. This has become imperative in today’s globalized business world where corporations need to access global pools of capital, need to attract and retain the best human capital from various parts of the world, need to partner with vendors on mega collaborations and need to live in harmony with the community. Unless a corporation embraces and demonstrates ethical conduct, it will not be able to succeed. Corporations need to recognize that their growth requires the cooperation of all the stakeholders; and such cooperation is enhanced by the corporations adhering to the best Corporate Governance practices. In this regard, the management needs to act as trustees of the shareholders at large and prevent asymmetry of benefits between various sections of shareholders, especially between the owner-managers and the rest of the shareholders.

The main constituents of corporate governance

- **Role and powers of Board:** the foremost requirement of good corporate governance is the clear identification of powers, roles, responsibilities and accountability of the Board, CEO and the Chairman of the board.
- **Legislation:** a clear and unambiguous legislative and regulatory framework is fundamental to effective corporate governance.
- **Code of Conduct:** it is essential that an organization's explicitly prescribed codes of conduct are communicated to all stakeholders and are clearly understood by them. There should be some system in place to periodically measure and evaluate the adherence to such code of conduct by each member of the organization.
- **Board Independence:** an independent board is essential for sound corporate governance. It means that the board is capable of assessing the performance of managers with an objective perspective. Hence, the majority of board members should be independent of both the management team and any commercial dealings with the company. Such independence ensures the effectiveness of the board in supervising the activities of management as well as make sure that there are no actual or perceived conflicts of interests.
- **Board Skills:** in order to be able to undertake its functions effectively, the board must possess the necessary blend of qualities, skills, knowledge and experience so as to make quality contribution. It includes operational or technical expertise, financial skills, legal skills as well as knowledge of government and regulatory requirements.
- **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 jobs, establishing clear boundaries for acceptable behaviour, establishing performance evaluation measures and evaluating performance and sufficiently recognizing individual and group contribution.
- **Board Appointments:** to ensure that the most competent people are appointed in the board, the board positions must be filled through the process of extensive search. A well defined and open procedure must be in place for reappointments as well as for appointment of new directors.
- **Board Induction and Training:** is essential to ensure that directors remain abreast of all development, which are or may impact corporate governance and other related issues.
- **Board Meetings:** are the forums for board decision making. These meetings enable directors to discharge their responsibilities. The effectiveness of board meetings is dependent on carefully planned agendas and providing relevant papers and materials to directors sufficiently prior to board meetings.
- **Strategy Setting:** the objective of the company must be clearly documented in a long term corporate strategy including an annual business plan together with achievable and measurable performance targets and milestones.
- **Business and Community Obligations:** though the basic activity of a business entity is inherently commercial yet it must also take care of community's obligations. The stakeholders must be informed about the approval by the proposed and ongoing initiatives taken to meet the community obligations.

- **Financial and Operational Reporting:** the board requires comprehensive, regular, reliable, timely, correct and relevant information in a form and of a quality that is appropriate to discharge its function of monitoring corporate performance.
- **Monitoring the Board Performance:** the board must monitor and evaluate its combined performance and also that of individual directors at periodic intervals, using key performance indicators besides peer review.
- **Audit Committee:** is inter alia responsible for liaison with management, internal and statutory auditors, reviewing the adequacy of internal control and compliance with significant policies and procedures, reporting to the board on the key issues.
- **Risk Management:** risk is an important element of corporate functioning and governance. There should be a clearly established process of identifying, analysing and treating risks, which could prevent the company from effectively achieving its objectives. The board has the ultimate responsibility for identifying major risks to the organization, setting acceptable levels of risks and ensuring that senior management takes steps to detect, monitor and control these risks.

Good corporate governance recognizes the diverse interests of shareholders, lenders, employees, government, etc. The new concept of governance to bring about quality corporate governance is not only a necessity to serve the divergent corporate interests, but also is a key requirement in the best interests of the corporate themselves and the economy.

Overview of Indian corporate governance

Since its financial liberalization began in 1991, India has undergone significant corporate governance reform. By the time of Independence in 1947 India had functioning stock markets, an active manufacturing sector, a fairly developed banking sector, and comparatively well developed, British-derived corporate governance. However, from 1947 through 1991, the Indian government pursued socialist policies. The state nationalized most banks, and became the principal provider of both debt and equity capital for private firms. The government agencies who provided capital to private firms were evaluated based on the amount of capital invested rather than return on investment. Competition, especially foreign competition, was suppressed. Private providers of debt and equity capital faced serious obstacles to exercising oversight over managers due to long delays in judicial proceedings and difficulty enforcing claims in bankruptcy. Public equity offerings could be made only at government-set prices. Indian corporate governance deteriorated, and Indian firms looking for outside capital had to rely primarily on government sources (World Bank, 2005). The Indian economy performed poorly. In 1991, the Indian government faced a fiscal crisis. It responded by enacting a series of reforms including reduction in state-provided financing, bank privatization, and general economic liberalization. The Securities and Exchange Board of India (SEBI) -- India's securities market regulator – was formed in 1992. By the mid-1990s, the Indian economy was growing steadily, and Indian firms began to seek equity capital to finance expansion into the market spaces created by liberalization and the growth of outsourcing. The need for capital, amongst other things, led to corporate governance reform. The Confederation of Indian Industry (CII), an association of major Indian firms, issued a voluntary Corporate Governance Code in 1998, and then pressed the government to make the central elements of the code mandatory for public firms, which SEBI did the following year, by adopting a reform package known as Clause 49. The principal elements of Clause 49 include :

- Firms should have 50% outside directors if the CEO and Chairman are the same person, and 30% outside directors if the firm has a nonexecutive chairman
- Firms should have an audit committee with at least three nonexecutive members, all with experience in financial matters
- The CEO and CFO should certify the firm's financial statements and the adequacy of its internal controls and
- Firms should provide disclosure similar to that required for firms cross-listed in Europe

Legal reform has been ongoing, with SEBI amending Clause 49, the government amending the Companies Law, and Irani Committee report recommending further changes.

Challenges of corporate governance in business enterprises

The challenges faced by corporate governance in business enterprises:

- Failure by the Board of Directors to understand the risk their firm is taking.
- Conflicts of Interest and a lack of independent Board members or senior executives.
- Boards entering into, or allowing, transactions that benefited few at expense of many.
- Weak system if internal controls or control system which appeared only on paper but implemented in practice.
- Failure of internal or external audit because of negligence or incompetence.
- Transactions and organistanal structures designed to reduce transparency and prevent regulators from getting correct picture of firm’s conditions.
- Corporate culture which fosters unethical behavior and in particular discourages difficult questions from being asked.
- A lack of commitment and leadership driving change at political, regulatory and Board and executive level.
- Conflicting objectives, commercial and non-commercial.
- Lack of independence of Boards.
- Not appointing suitably qualified or independent thinking directors with relevant business skills
- Political interference at Board level.
- Conflicting roles of government itself.
- Insufficient monitoring by shareholders.

Conclusion

Corporate governance, which refers to the structures and processes by which an organization’s assets and activities are overseen, is of profound significance in modern economies. Corporate governance has gained a lot of importance and momentum the worldover. The objective of any corporate governance system is to simultaneously improve corporate performance and accountability as a means of attracting financial and human resources on the best possible terms and of preventing corporate failure. At the end the corporate governance is maintaining and following certain hard and fast rules and that should be continue with the changing of the situation. It is the question of values and principles, and it should be follow by each and every organization so that the trust of the stakeholders will be remain maintain in the organization.

References

- Das, A. and Ghosh S. (2004) Corporate Governance in Banking System: An Empirical Investigation, Economic and Political Weekly, March 20, 2004, pp. 1263-1266.
- Hambrick, V. Werder, and Zajac (2008) New Directions in Corporate Governance Research, Organization Science,Vol. 19, No. 3, May–June 2008, pp. 381–385
- Rajendran V,(2012) Corporate Governance Practices - Emerging Trends, Asian Journal of Marketing & Management Research Vol.1 Issue 1, September 2012, ISSN,pp.29-37.
- Rangarajan C. (2000) Corporate Governance – Some issues, Indian Management, Vol. 39, No. 2, Feb. 2000, pp. 18-21.
- http://business.gov.in/corporate_governance/concept_objectivess.php access on 15/12/2013
- http://orp.aiub.edu/FileZone/OtherFiles/orpadmin-8589946470387316660/aiub-bus-econ-2008-10.pdf access on 12/12/2012
- http://www.researchgate.net/publication/45428732_The_Relation_between_Firm-Level_Corporate_Governance_and_Market_Value_a_Study_of_India access on 02/01/2013
- http://psrcentre.org/images/extraimages/312018.pdf access on 24/12/2012
- http://smallbusiness.chron.com/improve-corporate-governance-corporate-responsibility-40418.html access on 10/12/2012
- http://www.iica.in/images/Corporate_Governance.pdf access on access on 02/10/2012