Essence of Corporate Governance

Prachi Singh

MATS University, Raipur (C.G), India
E-mail : prachi.rajeev@gmail.com

Abstract - "Success is not the art of making mistakes when nobody is looking at, true success is the truthful expression of the performance when it is measured"." Business is going to change more and more in the next ten years than it has in the last 50 years. These changes will occur because of a disarmingly simple idea: the flow of digital information. Who does not like the progress? Progress leads to success in terms of satisfaction of desires and expectations. When any individual compares his past performance with the present and when the graph is upward then individual appreciates himself or herself. The same is in the case of corporate or country or any country’s economy, which want to be sound then they need success. But success is not simple to get. Now days there are many ways through which success can be achieved. The ways can be short cuts or may be long ways, where more sincerely and ethically one has to work. Corporate governance can be put in this 2nd category. Corporate Governance is the term given to the management practices followed by the business organization. Corporate governance is a way of life and not a set of rules. It is more of a way of life that necessitates taking interests in every business decision. It has succeeded in attracting a good deal of public interest because it’s apparent importance for the economic health of corporations and society in general. We know each corporation obtains its funds from different class of investors. When they do so, it becomes their prime responsibility to see that the funds are used in proper direction. The investors are also even needed assurance for such matter. “Corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting return on their investment.” It has emerged as one of the key elements of public policy reforms individuals. It is still in its infancy; it has been around only for the last three to four years. It is however not a foolproof concept as it relies heavily on data available from insiders. A key element of good corporate governance is transparency projects through a code of good governance which incorporates a system of checks and balances between key players board of management, auditors and shareholders. Corporate governance is defined as the system by which business entities are monitored, managed and controlled. Corporate governance practices have become an essential prerequisite for the ability to acquire and retain financial resources necessary for restructuring long term investment and sustainable growth. At one end of the spectrum the shareholders are the owners of business entity as they are risk takers. At the other end the managers or the executive director of the company who are in control of its day-to-day affairs. It is the responsibility of entire board of directors for smooth running of the company; corporate disclosure and governance requirements though relatively low in some countries, are also changing. Awareness of the developments of accounting standards, securities regulation, globalization of financial markets, world wide effect of corporate strategic alliance has led to some alternative view of governance process. A good structure of corporate governance is that encourages balanced relationship among shareholders, executive directors and the board of directors.

Keywords - Corporate Governance, Directors, Transparency, Ethical, Management.

I. INTRODUCTION

Corporate governance is a multi-faceted subject that has no precise definition - the narrow view sees “governance” as a fancy term describing the way directors and auditors handle their responsibilities towards investors and shareholders, whilst the wider view sees corporate governance as a firm’s relationship to society, often confusing corporate governance with corporate social responsibility. By and large, corporate governance refers to the system of check and balances between the board of directors, management and investors to produce an efficiently functioning organization that can produce long-term value. It describes what the board of the directors should do to learn what is really going on within the organization. The Organization for Economic Co-Operation and Development (OECD)’s definition of Corporate Governance is widely accepted: “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 which the company objectives are set, and the means of attaining those objectives and monitoring performance. Corporate governance is a critical aspect of modern businesses with their reliance on the smooth functioning of principal agent relationships. There are multiple stakeholders involved like equity holders, debt holders, customers, employees, and society. Balancing the interests of all parties is a challenging task. This is even more so in developing economies like India where markets and regulators structures are yet to mature and where business groups are prevalent. Generally, the company's philosophy on corporate governance is to attain the highest level of transparency, accountability and integrity. The true meaning of corporate governance is to satisfy the aspirations of all stakeholders, customers, suppliers, leaders, employees, the shareholders and the expectations of the society. Each company must eventually tackle corporate governance and unfortunately there is no easy way to go about this. Corporate governance is a complex and tiresome subject requiring companies to look at a wide variety of factors and regulations into account and to shape thorough and strong programs to constantly monitor and mitigate any number of possible risk factors and changing laws when handled properly. Corporate governance can be overwhelming for those companies that are growing and just beginning to realize the importance of tackling this issue which in the end becomes a full-time job. There can never be genuine CORPORATE GOVERNANCE until the Organization's custodians show willingness to be self-governed by a VALUE system at personal level. Values are not merely posters for decoration of reception area. We rather not have them on the wall and live them. The 21st century has moved from Management to Governance. Organizations not prepared to be ethical and transparent run the risk of becoming endangered species. Corporate governance is most often viewed as both the structure and the relationships which determine corporate direction and performance. The board of directors is typically central to corporate governance. Its relationship to the other primary participants, typically shareholders and management, is critical. Additional participants include employees, customers, suppliers, and creditors. The corporate governance framework also depends on the legal, regulatory, institutional and ethical environment of the community. Whereas the 20th century might be viewed as the age of management, the early 21st century is predicted to be more focused on governance. It is important that companies be able to understand the fundamentals and foundational elements of any solid corporate compliance program to begin with.

Ethical to the Core: A code of ethics is central to any successful corporate compliance strategy in order to help outline and define a company's business practices. Beginning with a company's employees is how this definition needs to be created. Organizations are built and defined by its employees and all too often those at the top have a tendency to forget this. Hiring individuals who share that same ethical and moral code that they want to shape the company's corporate culture is essential for employers to focus on.

Aligning Company Goals with Governance Objectives: Corporate governance is a full-time job and one which can be difficult to upkeep. Planning ahead and framing the goals of the company to meet with certain goals of their governance program so that the two may work towards a mutual end is a way company's leaders can lighten this burden.

Strategy in Management: Corporate governance is all about ensuring that the interests of a company's stakeholders are defended and that these individuals are granted more say in handling of important company matters, at its roots. Companies will need to begin developing strategic plans regarding these individuals and their role in company matters in order to better guide the transition of certain powers as they become necessary in order to account for the growing control and importance being placed on shareholders.

Organization: Essential to the fluid implementation and dispersal of corporate structure and dispersal of corporate governance objectives is having a solid structure and organization within a company. Companies will need to be able to effectively monitor all of their dealings, interactions, and transactions, and this means having a rigidly structured framework through which to efficiently trace all such activity, as one of the fundamental objectives of corporate governance is for companies to develop more transparent business practices.

Reporting Systems: Fraud risk management is therefore a subject of fundamental importance to the thorough implementation of a compliance strategy as the prevention of any unlawful or illicit activity is one of the more obvious goals of corporate governance practices. Reporting systems should allow companies to successfully monitor and detect any fraudulent activity by using their employees as its eyes and ears only if it is well-designed and applied. Training employees to detect a potential trouble with such reporting systems that can include phone or email lines to contact as well as notes on pay stubs is a start to this sort of system. Be sure to
include that these employees can remain anonymous as a way to encourage such reporting.

Transparency: Transparency means accurate, adequate and timely disclosure of relevant information to the stakeholders. Without transparency, it is impossible to make any progress towards good governance. Business heads should realize that transparency also creates immense shareholder value. But, information sharing is hindered under the excuse of confidentiality. There is need to move towards international standards in terms of disclosure of information by the corporate sector and through all this to develop a high level of public confidence in business. Once a company has public shareholding it is imperative that its commitment to financial transparency must be total. The Company is a trustee of the investors' money and this responsibility in turn demands full disclosure. Corporations in India must learn to work with transparency and impeccable integrity as these are the essential ingredients to maximize their wealth and wealth of the nation. Transparency and disclosure are the pillars of corporate governance because they provide all the stakeholders with the information necessary to judge whether their interests are being taken care of.

Accountability: Corporate governance is a top down approach. Chairman, Board of directors and chief executives must fulfill their responsibilities to make corporate governance a reality in Indian Industry. In companies with good governance, accountability is not just bottom up but also follows the reverse order. A department head is responsible for every decision taken on behalf of his department.

Merit based Management: A strong board of directors is necessary to lead and support merit based management. The board had to be an independent, strong and non-partisan body where the sole motive should be decision making through business prudence. Though corporate governance is much broader than corporate management, an efficient and effective administration of corporate sector is essential for meeting the desired objectives. Corporate governance ensures that long term strategic objectives and plans are established and that the proper management structure is in place it achieve those objectives while at the same time ensuring that the structure functions to maintain the company's integrity, reputation and responsibility to its various stakeholders. Thus, corporate governance involves the broad parameters of reporting system accountability and control.

II. FACTORS INFLUENCING CORPORATE GOVERNANCE

The Ownership structure: The structure of ownership of a company determines, to considerable extent, how a corporation is managed and controlled.

Our corporate sector is characterized by the existence of state owned, private and multinational enterprises. The shares of these enterprises (except those belonging to the public sector) are held by institutional as well as small investors. Large shareholders tend to be active in Corporate Governance either through their representatives on company boards, through their active participation in annual general body meetings. The Structure of Company Boards; Along with the structure of ownership, the structure of company boards has considerable influence on the way the companies are managed and controlled. The Board of Directors is responsible for establishing corporate objectives, developing broad policies and selecting top-level executives to carry out those objectives and policies. The board also requires management's performance to ensure that the company is run well and shareholder's interests are protected.

The Financial Structure: Along with the notion that the structure of ownership matters in Corporate Governance is the notion that the financial structure of the company i.e., proportion between debt and equity, has implications for the quality of governance. Banks can perform the important function of screening and monitoring companies as the (banks) are better informed than other investors. Further, banks can diminish short-term biases in managerial decision-making by favouring investments that would generate higher benefits in the long run. Banks play a more favourable role than other investors in reducing the costs of financial distress.

The Institutional Environment: The legal, regulatory and political environment within which a company operates determines in large measure the quality of Corporate Governance. In fact, Corporate Governance mechanisms are economic and legal institutions and often the outcome of political decisions. The extent to which shareholders can control the management depends on their voting rights as defined in Company Law and the extent to which the market for corporate control efficiency operates to discipline underperforming management will depend on take-over regulations. Why do we have bad corporate governance? We have bad governance because the conventional methods we use allow us to have bad governance. We do not have one fundamentally correct way to organize and describe our enterprises that everyone accepts and follows. Instead, we have a myriad of different methods that are used for management and a myriad of different ways any enterprise can be presented. Our conventional methods do nothing to protect the interest of investors. They don't even allow the best intentioned corporation to plan and manage the return on their own investments. Basically, our corporations are forced to either spend or
speculate with investment funds. Accounts can be defined and redefined in different ways. Rules can be bent to fully disclose distorted information. It is very difficult to understand what is presented in statutory reports beyond taking what is shown at face value. We know the book assets are not the true assets of the corporation. We spend enormous sums on the easy accounting and reporting from the point we receive money until the point we spend or invest the money. But, the important information for corporate governance must come from the dark side of accounting from the time we spend or invest money until the point we have created something of value to receive money. Internal audit, generally, has settled into a mechanical routine of seeing that certain rules are being followed, without understanding anything of deeper significance. We can tweak the methods we use all we want. All we can do is address the symptoms of problems. We can never solve the problems. What produces good corporate governance? Basically it is ensuring that the enterprise maintains a viable strategy to create substantiated future value and that the enterprise capital is developed and utilized over time to create the actual value. So, what is the problem with conventional methods? First, we have no way to understand and plan how we create strategic value. Secondly, we don't manage our capital; we don't even understand what much our capital is. So, we have no hope of developing and utilizing capital to produce value. The real problems lie in the way we structure our corporations. Conventional organization methods provide many ways to structure corporate functions and performance. If we are going to gain good corporate governance, we need to restructure our corporations in a standard way that is easy to understand. We need to set up corporations as true value-chains with ways to manage all the links in the chain to create strategic value like:

- Organize corporations based on value created across the corporation in a complete value chain - not today's contrived "value-chains" for products or sales
- Set a clear strategy for improving existing links in the chain and adding new links to create stakeholder value
- Establish management responsibility and goals for creating value
- Organize capital, including financial supply, utilized to create value into categories so that it can be managed properly
- Manage the day-to-day utilization of capital to create value
- Manage capital development to add value to the chain to provide the benefits and return

- Manage the cost of capital consumed, including executive compensation and external contracts, against the capital created in the chain
- Manage the relationships among links in the chain to reach the final values in products, services, revenues, profits, etc.
- Set up stakeholder value as a managed objective with day-to-day tracking against goals and estimates
- Evaluate progress in achieving stakeholder value and the stated strategy
- Establish the worth of the corporation as the capability to create value over future years

We can never ensure good corporate governance until we structure our corporations to be governed. We need a true strategy to create real value. We need a complete value chain across the enterprise to understand all the value we create, all the costs we incur, and the value added at each link in the chain. We can then track the progress in creating value to achieve strategic value goals and provide value over the years for all stakeholders. We can only achieve good corporate governance by establishing a new foundation that enables good governance. Corporate governance becomes important for the society as a whole. It is interesting to look at the most pronounced tendencies in corporate governance development. First, it is increasing institutional investor activism. Big asset management funds, pension funds and other institutional investors now not only passively wait for return on their invested funds, but discharge accountability, for instance, when it comes to directors' remuneration. Second, there is some evidence of harmonization in corporate governance standards. This process is led by globalization of international trade and financial activities. Third, the scope of corporate governance goals has also increase. Nowadays, managers of corporations make decisions taking into account corporate social responsibility. In other words, social and environmental issues now increasingly determine how well the company performs. To sum up, corporate governance in the 21st century is the system of checks and balances which ensures that business entities act in a socially responsible way in all their endeavours, while maximizing shareholders' value.

III. RECOMMENDATIONS

Better Defined Rules : The Chair of the Board should be an Independent Director with the roles segregated from that of the CEO

Guidelines for legal liability of Independent Directors: As long as the Independent directors show
due diligence, the law should exempt them from all types of liabilities for the actions of the board or the managing director they may not be aware of.

**Improved transparency:** Remuneration of CEOs should be decided by a regulatory body like SEBI based on size of the company or decided by institutional investors holding a significant stake in the company.

**Better effectiveness:** Medium term lock-in options (medium term stock options which are convertible only after 4-5 years or simply through contracts for the number of years of stay) for the CEO to prevent the CEO from acting in ways to gain short term gains from unethical governance.

**Training Program for new Directors:** In order to have a better clarity on the issues facing the business and the upcoming challenges in the industry, many companies could do more in terms of a formal and tailored induction program (which is a recommendation of the Narayana Murthy Report) for their new directors.

### IV. CONCLUSION

Corporate governance is now the focus area of all business entities. The relation between corporate governance and organizational performance is of fundamental importance. There are few compelling results that clearly demonstrate how corporate governance produces the outcomes desired by stockholders or more broadly stakeholders. We certainly believe that appropriate governance mechanisms are a necessary and vital part of a capitalistic economy.

However, we have considerable concern about whether any of the existing structural measures of governance rating provides a useful basis for identifying good governance. So before imposing a governance structure in a company, it must verify scientifically that the changes are likely to produce necessary outcome. To survive in the competitive world, an organization must have a value-based governance system. Thus to conclude one can say that corporate governance is not the luxuries goods that only wealthier countries can afford but if the developing countries like India take one step to move towards mandatory implementation of the Corporate governance by the corporate sectors, whether public corporate or the private, then it will lead to the excellent growth of the nation as well as the economy.

### V. REFERENCES