Unit–5

Corporate Governance

Introduction

- Corporate governance refers to the set of processes, customs, policies, laws and institutions, influencing the administration of a corporation.
- Corporate governance includes the relationships among the many players and the goals of the corporation.
- Accountability of individuals and economic efficiency of the corporation are the important aspects of corporate governance. Corporate governance is a multi-faceted subject.

Definitions and Important Features

"Corporate governance is concerned with ways of bringing the interest of investors and managers into line and ensuring that firms are run from the benefit of investors."

Important features of corporate governance

1. It promotes an adequate and appropriate system of controls operative within a company and, thereby, assets can be safeguarded.
2. It prevents any single individual becoming too powerful.
3. It is concerned with the relationship between a company's management, board of directors and all the stakeholders including shareholders.
4. The company is managed in the best interests of all.
5. It promotes transparency and accountability.
6. It aims at promoting the best corporate performance through the best corporate management practices.

Principles of Corporate Governance

1. Rights of shareholders
2. Equal treatment for shareholders
3. Protection of the interests of stakeholders
4. Role of Board of Directors
5. Ethical behaviour
6. Disclosure and transparency

Issues Involved in Corporate Governance

- Internal control
- Correct preparation of financial statements
- Compensation of CEO and other directors
- Nomination of members of the Board of Directors
- Disclosure norms
- Rights of corporation

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Need for Corporate Governance

1. It reduces the risk of the investor because of its professional management coupled with values.
2. It increases the mobilisation of capital because of the confidence of the investors.
3. It enhances the value and good image of the companies. In modern days, importance is given to the reputational capital.

Theories of Corporate Governance

The development of corporate governance is a global event and as such, it is a complex area because of diversities in legal, cultural and other differences. The following are the important theories of corporate governance.

- Agency Theory
- Transaction Cost Economics
- Stakeholder Theory
- Stewardship Theory

Board Structure

Role, Duties and Powers of Independent Directors

There is an urgent need to minimise corporate frauds and scans, Audit committees should play an important role through the guidance of independent directors.

The independent directors should be independent in their thinking, approach and actions. They have to play an important advisory role. An independent director is required because of independent judgment, technical expertise and to build investor confidence.

- **Duties of Independent Director**
- **Powers of Independent Directors**

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Role, Duties and Responsibilities of the Board of Directors

- Chief Executive officer
- Chairman
- Senior Independent Director
- Company Secretary
- Audit Committee
- Remuneration Committee
- Nomination Committee
- Risk Committee
- Non-executive Directors
- Director’s Remuneration
- Performance Measures

Training and Development of Directors

- There is a need for the development of some good training for the directors.
- The directors who are elevated from managerial roles find it difficult to understand their new roles. It is more than a change of responsibility.

Accounting Standards

- Accounting standards regulate accounting policy so as to use the suitable accounting principles and methods.
- Accounting standards also ensure adequate disclosures in financial statements.
- The use of uniform accounting policy improves comparability and uniformity.

Rights Of Employees as Stakeholders of the firm

Employee rights	Issues involved
Right to freedom from discrimination	Equal opportunities, Affirmative action, Reverse discrimination, Sexual and racial harassment
Right to privacy	Health and drug testing, Work-life balance, Presenteeism, Electronic privacy and data protection
Right to due process	Promotion, Firing, Disciplinary proceedings
Right to participation and association	Organization of workers in works councils and trade unions, Participation in the company's decisions
Right to healthy and safe working conditions	Working conditions, Occupational health and safety
Right to fair wages	Pay, Industrial action, New forms of work
Right to freedom of conscience and speech	Whistleblowing
Right to work	Fair treatment in the interview, Non-discriminatory rules for recruitment

Three Different models of Corporate Governance in India

India has so far three models of corporate governance.

- **The Managing Agency Model (1850-1956)**
- **The Business House Model (1956-1991)**
- **The Anglo-American Model of Governance (1991-till date)**

Recommendations of Confederation of Indian Industry (CII) on Corporate Governance

1. The full board should meet at least six times a year at an interval of two months. Each meeting should have an agenda of time which requires at least half a day's discussion.
2. No single person should be a director in more than ten companies.
3. The non-executive directors should play an important role in corporate decision-making and maximizing long-term shareholder view.
4. The non-executive directors should be given sitting fees and stock options.
5. The reappointment of directors should be based on the attendance and performance of the directors.

Recommendations of Kumar Mangalam Birla Committee on Corporate Governance

1. The board should have an optimum combination of executive and non-executive directors. At least 50 percent of the board should be of non-executive directors.
2. A qualified and independent “Audit committee” should be set up by the board of the company.
3. The board should set up a “remuneration committee” to determine the specific remuneration packages for executive directors.
4. A committee should be set up to look into shareholder issues and redress of complaints.
5. All payments made to directors should be disclosed in the corporate governance section of the annual report.

RECENT CORPORATE SCAMS IN INDIA

Corporate frauds have emerged as the biggest risks which companies are exposed to, and are increasingly becoming a big threat. Incidents of frauds are increasingly at an alarming rate and in the process:

- Destroy the confidence of investors in stock markets
- Results in enormous destruction in wealth of investors
- Damage the reputation of the affected company, its management and board of directors
- Erode ability of affected company to borrow and thus creating financial stress.

Many small businesses in India have been hit hard by the global pandemic. MSMEs are unsure if they can survive the multiple crises that keep on coming. COVID-19 has brought with it an increased risk of corruption not only in the public health sector but also in the private sector. Corporate governance failures have resulted in flashy business tycoons Vijay Mallya and Lalit Modi absconding from India and the arrest of corporate heavyweights like Rana Kapoor, Chanda Kochhar and the Singh brothers.Recovering to a business environment of fairness and integrity won't be possible without standing #unitedagainstcorruption. The holy grail of corporate governance is not infallible. Investors have found this out the hard way when massive corporations like Jet Airways, DHFL, YES Bank, IL&FS, Kingfisher Airlines collapsed. GST and the insolvency law have been blamed, yet failure to comply with corporate governance rules and not sticking to legislation cannot be ruled out as the reasons.

MAJOR CORPORATE FRAUDS IN INDIA

1. Satyam computer (Satyam)
2. Kingfisher Airlines (KLA)
3. Jet Airways
4. Bhushan Steel
5. PNB
6. ILFS
7. DHFL
8. PMC Bank
9. Yes Bank

Some Common Threads in these frauds:

- Poor corporate governance practices
- Board of directors consisting of unquestioning or silent yes man directors
- Centralisation of decision-making powers in hands of promoters or a few top management officials
- Lack of effective internal controls and systems, Including IT control and internal audit system
- Lack of effective oversight and monitoring mechanism
- Absence or lack of MIS systems
- Non- adherence to systems and controls
- Ambitious expansion in non- core area funded through overleveraging of Balance Sheet
- Imprudent bank /NBFC lending practices
- Absence of effective whistle blower mechanism
- Disgruntled and poorly paid employees, who are tempted to commit frauds
- Complex corporate structures with multiple subsidiaries, which make it easy to commit frauds through complex web of transactions
- Absence of system requiring confirmations for bank balance, key debtors, advance, suppliers etc. (root cause Satyam fraud)