CORPORATE GOVERNANCE

* GENERAL MEANING OF CORPORATE GOVERNANCE

- Governance of Corporates
  ie Controled & operated by whom
- Corporate Governance is a
  - more responsive & Good system
  - to govern a organisation
  - system by which corporates are controlled and operated with the Interest of stakeholders
    [stakeholders : Investors, employees, customers etc]

* NEED / IMPORTANCE OF CORPORATE GOVERNANCE

- Good Governance is the heart of any successfull business
- It is essential for the Company to maintain legal & ethical compliances
- to eliminate risk of conflicts between the stakeholders.
- Good Corporate Governance framework help firm & Countries to Improve accountability, more efficiently use of capital and attract Quality & long term Investors at lower costs.
  Provide Benefits towards stakeholders & country development.
- It deals with laws, Rules, procedures, practices etc.

⇒ SOME IMPORTANT DEFINATIONS

- Corporate Governance is the system by which companies are Directed and controlled.

  [Kumar Mangalam Birla committee]

- Corporate Governance is about promoting corporate

  F - FAIRNESS

  A - ACCOUNTABILITY

  T - TRANSPARENCY

  FAT

- Corporate Governance is concerned with structures and process for

  A - Accountability

  B - Behaviour

  C - Control

  D - Decision making

  ABCD

  at the top level of management

- Corporate Governance is the process of supervision and Control Intended to ensures that the company's management acts in accordance with the Interest of Stakeholders.

OBJECTIVES / CHARACTERISTICS

FTP - SPACE

F - Fairness - True, fair behaviour
T - Transparency - No secrecy maintained
P - Participation - Decision making by management
S - Satisfaction - Stakeholder satisfaction
P - Predictibility - expectation of Company known in advance
A - Accountability - Accountable
C - Compliance with law - legally requirements fulfilled
E - Efficiency & effectiveness - honest towards stakeholders.

⇒ CORPORATE GOVERNANCE IN INDIA

→ Historical Perspective [1996 - 2009]

Reform of India's Corporate Governance

FIRST PHASE [1996 - 2008]

SECON PHASE [2009]

FIRST PHASE

CII CODE (1996-1998)

- In 1996, Reform efforts initiated by Corporate Industry Groups ie "Confedeation of Indian Industry" CII and prepare drafting of corporate Governance guidelines.
  - aiming towards making board and audit committees more Independent, powerful and focused monitors of managements channeled through number of different paths with both SEBI and MCA.
  - Main object is to develop and promote a Code for Companies whether in private sector, public sector, Banks, financial Institutions and all other Corporate entities for the transparency to Stakeholders.
  - applicable to all Companies and members.
- In April 1998, Final draft came out.

KUMAR MANGLAM BIRLA COMMITTEE REPORT [1999 - 2000]

- In 1999, SEBI Constituted a Committee on Corporate Governance under chairmanship of "Mr. Kumar Manglam Birla" on the lines of Cadbury Committee, UK. to give comprehensive views of issues related to Insider trading to protect the rights of stakeholders.
- Birla Committee submitted his reports and recomendation on corporate Governance to SEBI in 1999.
- SEBI Implemented Birla Committee proposal in less than 5 months and gives direction about such recomendation to stock exchange.
- In Feb 2000, Stock exchange accordingly Inserted clause 49 in their listing agreement which contains the Recommendation on corporate Governance.

TASK FORCE on CORPORATE EXCELLENCE Report [Nov 2000]

- Department of Company affairs (Now MCA), prepared a report on achieving corporate excellence through Governance. Depending upon the size & capabilities of the companies as well as requirements of market place.

CLAUSE 49 [2000-2003, 2004]

↓ Implemented in 2006

- In feb 2000, stock exchange accordingly inserted clause 49 in their listing agreement which contains the recommendations on corporate Covenance.
- clause 49 contains the provisions of corporate governance based on Narayan Murthy committee Report.
- further amended in 2004 in response to murthy committee reccomendations, Implemented in 2006.
- clause 49, currently Includes the following Key Requirements - Listed Companies

① Composition of Board :

Chairman

- **Executive**
  - at least $\frac{1}{2}$ of Board should be Independent directors.
- **Non-executive**
  - at least $\frac{1}{3}$ of Board should be Independent directors
- **Promoter or related to promoter or senior official**
  - at least $\frac{1}{2}$ of Board should be Independent directors.

② Audit Committee

- listed Companies must have ~~audit~~ audit Committee
- Minimum 3 directors required to constitute Committee
- $\frac{2}{3}$ of members must be Independent directors
- all other roles & responsibilities of audit Committee.

③ Disclosure Requirement

- Listed co. will provide complete disclosure in annual reports
- Details of - Related Party transaction
  - Remuneration to directors
  - KMP
  - Large shareholders
- Disclosure of Accounting treatment

④ CEO/CFO certification

They must certify the following in written:

- financial statements are fair
- accept responsibility for Internal control.

⑤ Annual Report

Listed Co. must carry status reports about compliance with Corporate Governance norms.

RBI - REPORT

① In March 2001, Report on adoption of International Standards to develop Corporate Governance ie OECD principles

② In April 2001, Report of Consultative Group

RBI established Consultative Group of directors of Banks and Financial Institutions

- to review the supervisory role of boards of banks & financial institution
- to obtain Feedback on the functioning of boards compliances, transparency, disclosures, audit Committee etc.

• Make recommendations for making role of directors more effective.

NARESH CHANDRA COMMITTEE REPORT [Dec 2002]

- Ministry of finance and Company affairs ~~established~~ a Constitutes a committee under chairmanship of Mr. Naresh chandra to examine various corporate governance issues
- Recomend changes in area like [Corporate Audit]
  - Statutory auditor
  - Company relationship
  - appointment of auditors.
  - determination of audit fees
- It also reflected on other measures such as Certification of accounts & financial statements by the management and directors.

N.R NARAYAN MURTHY COMMITTEE [Feb 2003]

- SEBI Constituted a committee to study the role of Independent directors, related party, risk mgmt, directorship and director compensation, codes of conduct and financial disclosure.

Gives Recomendations on following parameters:
- Fairness
- accountability
- transparency
- ease of implementation
- verifiability and enforceability.

Naresh chandra Committee Part-II [July 2003]

- Government Constituted a committee in Jan 2003 to ensure Scientific & regulatory environment.
- The main focus of this Report are →
  - The companies Act, 1956
  - The Indian Partnership Act 1932

Private co. and Partnerships.

- Final Report submitted in July 23, 2003

SECOND PHASE

- Reform due to "Satyam Scandal"
- In Jan 2009, India's corporate community experienced a shock with damaging revelations about board failure and fraud in the financials of "SATYAM" known as Satyam scandal.
- Now Indian Government is to rethink about the corporate Governance, disclosures, accountability etc.
- Again CII began examining the corporate governance issues arising out of satyam scandal.

SEBI actions after "Satyam Scandal"

- In sep 2009, the SEBI committee on disclosure & accounting standards issued a discussion paper that considered proposal for

1. Appointment of CFO by the audit committee after assessing the qualification, experience & background
2. voluntary adoption of IFRS
3. Interim disclosure of balance sheets (audited) on half yearly basis.
4. streamlining of timelines for submission of various financial statements by listed entities as required under listing agreement.
5. Rotation of audit partners every 5 years

- In 2010, SEBI amended the listing agreement to add provision related to above mentioned points ① to ④ only.

MCA Actions after "Satyam Scandal"

- In late 2009, MCA released a set of voluntary Guidelines for corporate Governance.

1. Independence of Board of Directors
2. Responsibilities of the board, audit Committee, auditors, secretarial audits
3. Mechanisms to encourage and protect whistle blowing.
4. Provisions for Issuance of a formal appointment letter to directors.
5. Separation of office of chairman & CEO
6. Institution of a Nomination Committee for selection of directors.
7. limiting the No. of companies in which an Individual Can become a director
8. Tenure & remuneration of directors
9. Training of directors
10. Performance evaluation of directors
11. Additional provisions for Statutory Auditors.

SUMMARY - Historical perspective - CG in India.

First Phase
[1996 - 2008]

- CII Code (1996 - 1998)
- Kumar Manglam Committee Report (1999-2000)
- Task force on corporate excellence Report (Nov 2000)
- Clause 49 (2000 - 2003)
  Amended clause 49 2006
- RBI - Report
  March 2001 : OECD
  April 2001 : consultancy group
- Naresh chandra committee Report (Dec 2002)
  Part 2 (July 2003)
- N.R Narayan Murthy committee (Feb 2003)

Second Phase
[2009]

- Jan 2009 Satyam case
- CII began examination
- SEBI Actions
- MCA Actions.

→ Stakeholders

Key stakeholders are:

- Creditors
- Directors
- Employees
- Government & its agencies
- Shareholders
- Suppliers
- Unions
- Community from which the business draws its resources.

→ Role of stakeholders in Corporate Governance.

- Stakeholder can affect or be affected by the organisations actions, objectives & policies.
- Rights of stakeholders, Investors & all other stakeholders are established by law are to be respected.
- performance of employees participation shall be permitted to develop.
- where stakeholder participates in Corpore Governance process the company shall ensure them access to relevant, sufficient & reliable Information on timely basis.
- all stakeholders shall be able to freely communicate their Concern about illegal or unethical ~~practis~~ practices to the board & their rights shall ~~not~~ Not be compromised by doing this.

CORPORATE GOVERNANCE IN FAMILY BUSINESS

- Under Family business majority of stake is held by the person who has established or acquired the Company and at least 1 Representative of Family Involved in the management of the business.
  - form of small business ~~can be large~~
  - Family Controlled businesses included all enterprises that are owned, controlled or influenced by a specific family and having dominant position in firm's equity.
  - Good Governance will tend to have more focused view of business and benefit from the view of outsiders.

- The governance of a family firm is in many ways more harsh & complex as compare to non family firm because family relationship have to be managed in addition to business.

also There is risk of unreliable degree of expropriation related party transactions etc.

- Good governance strengthens the activities of the family controlled firm ~~which~~ while Improving its competitiveness.

- Plan stable ownership
- ensure inclusive & action oriented decision making
- Manage the roles of family members in the business.
- Requires striking a balance between management & shareholding roles.

GOVERNANCE ISSUES in family business

① Role of BOD
Family directors who are also managers in the business would naturally encourage reinvesting profit in the company. On the contrary family directors who do not work make the decision of distributing the profits as dividend to family shareholders ~~between~~, These views may create conflicts and negative impact on functioning.

② Role of CEO
In family business CEO is a family member, this become Quite difficult & awkward which can create further unsuitable problems for management & as a whole business.

③ Succession Plan
On family business there is a saying "the first generation creates, the second Inherits & third destroys" Succession Planning seem so simple & easy to follow & yet it so difficult ~~too~~ because it means coming to terms with the fact that you are not indispensable.

④ Internal Control Formation
Many family businesses controlled & managed by the founders or their childrens this is ~~problems~~ major concern for external investors for their decision making & long term survival as superior control in the hands of Family members.

⑤ Retaining talent
Family businesses believe that attracting the right talent & then retaing it is a challenge.

⑥ Need for New technology.
Lack of resources and time to do R&D hence fails to adapt latest technology. they think that their older business model become obsolute.

⑦ challenges with Internationalisation
Major operations are :
- exchange rate fluctuations
- Competition
- economic situations in other markets
- Understanding or complying with local regulations.

Family business challenges

① Managing the diverse opinions of family members in the business, solving internal issues & disputes etc
② Creating clear succession plans between siblings or cousins
③ Difficulties the younger generation may face in proving themselve to former generation.
④ Conflicts between the view of former & younger generation
⑤ Regular & streamlined access to capital to help grow & develop the business.

→ **Advantages** of family businesses over Non-Family business

① Commitment, passion & dedication
- take better care of their businesses as they have personal stakes involved.

② Decision making abilities
- they don't have responsibilities toward any shareholders ~~which~~ ~~issu~~ so they ~~can~~ take decision faster.

③ Deep Industry Insight
- they typically work in one Industry for longer duration, this gives them ~~adder~~ advantage of understanding & appreciating faced in better way

④ Mutual trust
- Family businesses runs on mutual trust & believe in maintaining long term relationships.

→ **Disadvantages** of family businesses over Non Family business.

① Staff Recruitment
- external talent can ~~bee~~ resist to join the family businesses as they would not enjoy the same the same freedom that the other businesses offer.

② Raising funds for growth
- It is difficult to raise the required funds

③ family conflicts
- conflicts between members major drawback.

④ ownership vs management
- by same person major problem for the business

⇒ Corporate Governance in State owned business (SOEs) – THE MOU SYSTEM

In Global Context | In India context

→ In the global Context

- Good governance of SOEs is essential for efficient & open markets at both the domestic & International level.
- In many countries SOEs are the main providers of Key Public services including public utilities.
  This means that their operations have an impact on citizen's everyday life and on competitiveness of the rest of the economy.

OECD GUIDELINESS

- OECD guidelines on corporate governance of SOEs are recomendations to government on how to ensure that SOE's operate efficiently, transparently and in an accountable manner.
- They are the Internationally agreed Standard for how governments should exercise state ~~prove~~ ownership function & to avoid the pitfalls of both passive ownership & exercise state Intervention.
- first developed in 2005 and further updated in 2015.
- aim towards
  - professionalise the state as an owner
  - make SOEs operate with similar efficiency, transparency and accountability as good practice private enterprises.
  - ensures that ~~Co~~ competition between SOEs and private enterprises, where such occurs, is conducted on a level playing field.

OECD PRINCIPLES / GUIDELINES are as follows:

① State acting as an owner

- the state should act an Informed & active owner
- ensuring that the governance of SOEs is carried out in transparent & accountable manner, with a high degree of professionalism and effectiveness.

② Equitable treatment of Shareholders and other investors

- where SOEs are listed or unlisted, includes non state investors among their owners, the state and enterprises should recognise the rights of all shareholders and ensures shareholders equitable treatment and equal access to corporate Information.

③ Disclosure and transparency

- state owned enterprises should observe high standards of transparency and be subject to the same high quality accounting, disclosure, compliance and audited standard as listed companies.

④ Responsibilities of Boards of SOEs

The boards of SOEs should have the necessary authority, Competencies and objectivity to carry out their functions of strategic guidance and monitoring of management. They should act with integrity & be held accountable for their actions.

⑤ Rationale for state ownership

The state exercises the ownership of SOEs in the Interest of general public. It should carefully evaluate & disclose the ~~subjectivity~~ objectives that justify state ownership & subject these to a recurrent review.

6. SOEs in the marketplace

the legal & regulatory framework for SOEs should ensure a level playing field and fair competition in the marketplace when SOEs undertake economic activities.

7. Stakeholder relations & Responsible business

the state ownership policy should fully recognise SOEs responsibilities towards stakeholders and request that SOEs report on their relations with stakeholders.
It should make clear any expectations ~~that~~ the ~~state~~ state has in respect of responsible business conduct by SOEs.

→ In the Indian Context

- In India MOU is a negotiated document between the Government and specific Public sector enterprise.
- It should contain the Intentions, obligations and mutual responsibilities of Government and the PSE.

Institutional arrangement for Implementing MOU Policy

- It provides a system through which the commitments of both the parties to the MOU can be evaluated at the end of the year.
- the apex of Institutional arrangement is the HPC ie. HIGH POWER COMMITTEE
- the function of HPC are to review the draft MOUs before the final draft is signed & to make an end of the year evaluation to judge how far the commitment by both parties have been met.

→ Composition of HPC

① Cabinet secretary, chairman
② finance secreatary, member
③ expenditure secretary, member
④ Planning Commission secretary, member
⑤ Programme Implementation secretary, member
⑥ chairman (Public ~~board en~~ enterprise selection board), member
⑦ chief economic Advisor, member
⑧ secretary (Public enterprise), member secretary.

→ Power to approve final MOU

- Power has been delegated to TF/DPE

  TF - Task force

  DPE - Department of Public enterprises.

- In case TF is not able to take decision, then referred to HPC.

⇒ Task force (TF)

- objective ~~behind~~ behind creation of Task force was to provide technical expertise for MOU negotiation & evaluation.
- Main functions are as follows:

① examine the design of MOU at the beginning of the year.

② evaluate the composite score for each enterprises at the end of year.

- Composition of task force
  1. Retired civil servants
  2. executives of public sector
     - management professional
     - Independent members
     - with considerable experiences.

⇒ Department of Public enterprises (MOU Division)

- HPC and Task force are assisted by MOU division in the department of public enterprises.
- It acts as permanent secretariat to HPC and task force.

Main functions

1. provide logistical, technical & administrative support to task force.
2. act as buffer between task force members and 2 signatories to the MOU.
3. develop Information and data base on MOU signing PSEs.
4. assist the HPC
5. monitor the progress of MOU
6. advise & Consent to the MOU signatories on basis of MOU policy.
7. Coordinate research & training on various aspects of MOU policy.

WORKING OF MOU SYSTEM

- MOU division issues guidelines for drafting of MOU.
  (guidelines Indicates
  - board structure
  - aspects to be covered in draft MOU)
- draft MOU prepared by Public sector enterprises.
- submitted to Department of public enterprises after discussing in Board & with concernend ~~depart~~ administrative ministry /department in the month of December.
- Draft MOU received in DPE are examined in detail with consulting task force.

→ Final approved MOU is signed by the ~~Govt &~~ Government & PSE.

Objective of MOU system

1. Improve the performance of PSEs
2. Remove haziness in goals & objectives
3. evaluate Management performance through objective criteria.
4. provide Incentive for better future performance.

⇒ IMPACT OF clause 49 on IT Governance

- Most Indian corporates entities have witnessed a heavy penetration of IT in running of business processes. They follow ERP system to develop IT sector.
- The Impact of all developments boils down to the fact that road ~~of~~ to Corporate governance definetly lies through achieving IT Governance.
- Many of Indian corporate entities have started recognizing the Importance of having a chief Information officer working Independently and reporting directly to board of directors.
- IT Governance ensures right decision & accountability framework for encouraging desirable behaviour in the use of IT.

IT Governance should not be considered in Isolation because IT linked to other key enterprise assets ie (Human, financial, Intelletual property, physical & relationships). Thus, IT Governance might share mechanisms with other governance processes.

→ CORPORATE GOVERNANCE PRACTICES / CODE IN INDIA

Companies Act 2013 - Key Initiatives

① Corporation and society
- Corporate social responsibility
- Recognisation of Stakeholders Interests in corporate governance.

② Absentee shareholder primacy and protection
- Restraints on Interested shareholders voting Rights
- Containing other private Benefits of Control
- Containing the perils of pyramiding

③ Boards and their processes
- separation of office of chairman & CEO
- Composition of board
- Making board Independence count
- Improving Independent director effectiveness
- enhancing board Independency & objectivity

④ Disclosure & transparency in Reporting
- on financials
- on Audits & Auditors
- on prevention of oppression & mismanagement

⑤ Unlisted Companies Governance
- Indian Corporate governance Standards
- on empowering Board Independence
- on strengthening audit Independence
- on Disclosure & Reporting