CORPORATE GOVERNANCE : ISSUES AND CHALLENGES

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ABSTRACT

In this era of globalization of Indian Businesses and open market policies Indian Corporate are realizing the need for initiation of good corporate governance practices in the organization so as to create a total enterprise value which is not possible in a short period of time. In fact in India corporate governance norms and guidelines are fairly robust and India has consistently a high ranker on the corporate governance regulation charts in Asia.

This paper deals with the exploratory concept of corporate governance at large. The paper begins with the concept of corporate governance and moves on to discuss the various issues related to corporate governance and the variation in the national corporate governance system and the degree to which the group of stake holders influences the strategic decisions that impact substantially so as to build the image of the company. It also reflects on the corporate social responsibility as a new mantra for corporate for good corporate governance system.

INTRODUCTION

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. Its political, economic and social history and its legal framework shape the governance mechanism. In the beginning most of the countries found company to be the convenient form of organizations that enabled entrepreneurs to raise money from large number of investors. Shareholders start agitating only when they perceive that the company is being highly mismanaged and the shareholder value is getting destroyed.

Corporate Governance when used in the context of business organizations is a system of making directors accountable to share holders for effective management of the companies, in the best interest of the company and shareholders along with

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concern for ethics and values. It is a management of companies by the board of directors. It hinges on complete transparency, integrity and accountability of management that includes executive and non-executive directors. Its genesis can be traced to the internal audit function and its importance was enhanced after the Stock Market Crash of 1987. With the CG reports of Adrian Cadbury in the United Kingdom, Mervyn King in South Africa and Kumarmangallam Birla in India the subject was reduced to controlling shareholder operations and ensure ethical practices in the financial sector. From thence, it has moved into other areas of the organization but unfortunately restricts itself to the management and control of funds.

Corporate governance has succeeded in attracting a good deal of public interest because if 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.

BASIC PRINCIPLES OF CORPORATE GOVERNANCE:

The Business Round table supports the following guiding principles:

1. The main duty of the board of directors of a public corporation is to select a Chief Executive Officer and to oversee the CEO and other senior management in the competent and ethical operation of the corporation on a day-to-day basis.
2. It is the responsibility of management to operate the corporation in an effective and ethical manner in order to produce value for stockholders. Senior management is expected to know how the corporation earns its income and what risks the corporation is undertaking in the course of carrying out its business. Management should never put personal interest ahead of or in conflict with the interest of corporation.
3. It is the responsibility of management under the oversight of the board and its audit committee to produce financial statements that fairly present the financial conditions and results of operations of the corporation and to make the timely disclosures investors need to permit them to assess the financial and business soundness and risks of the corporation.
4. It is the responsibility of the board and its audit committee to engage an independent accounting firm to audit the financial statements prepared by management and to issue an opinion on those statements based on Generally Accepted Accounting Principles. The board, its audit committee and management must be vigilant to ensure that the corporation or its employee that compromise the independence of the outside auditor takes no actions.
5. It is the responsibility of the independent accounting firm to ensure that it is in fact independent without conflicts of interest, employs highly competent staff and carries out its work in accordance with Generally Accepted Auditing Standards.

EXCELLENCE THROUGH CORPORATE GOVERNANCE

Adherence to good governance practices enhances the efficiency of corporate sector in the following manner.

1. Good governance provides stability and growth to the companies.

2. Good governance system, demonstrated by adoption of good corporate practices, builds confidence.
3. Effective governance reduces perceived risks, consequently reducing cost of capital.
4. In the knowledge driven economy, excellence ion skills like management will be the ultimate tool for corporate houses to leverage competitive advantage in the financial market.
5. Adoption of good corporate practices promotes stability and long-term sustenance of stakeholders' relationship.
6. A good corporate citizen becomes an icon and enjoys a position of pride.
7. Potential stakeholders aspire to enter into a relationship with enterprises whose governance credentials are exemplary.

Corporate governance is basically a system of making directors accountable to shareholders for effective management of the company along with concern for ethics and values. It is the management of companies by the board of directors. it hinges on complete transparency, integrity and accountability of management that includes executive and non-executive directors.

BUSINESS GOAL & CORPORATE GOVERNANCE:

Corporate governance is also related to corporate financial goals. It is a naïve assumption that such goals are culture free. Besides making profits, the Dutch talked about assets, the German about independence from banks and the American about shareholder value. This reflects the institutional differences among the countries but also the prevailing ideologies.

Some people assume that globalization and acquisition of companies across borders will wipe out such differences and thus business leaders will become like the Americans. Others argue that these differences are rooted in national cultures that have centuries old roots, which make such convergence unlikely.

The studies here were based on a comparison of institutions across countries. Another approach is to focus on the persons of the business leaders and to compare the goals they are seen to pursue.

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.

PURPOSE OF CORPORATE GOVERNANCE:

The purpose of corporate governance includes the followings:

1. To enhance the reputation of a business/entity, which is in the public sector includes meeting expectations of model behaviors from public entities.
2. To comply with the laws and Acts.
3. To make the business entity more efficient and effective and to avoid disasters.

TRANSPERANCY ISSUE

Corporate Governance also emphasis on the transparency aspect. "Transparency is the core aspect of corporate governance" Each and every stakeholder expects transparency from the management, because stakeholders cannot get total idea inside management practices, by just referring to the Balance sheet of the firm. They must be aware about essential aspects like how much remuneration is drawn by directors, what criteria are used by company for director's appointment and reappointment.

Transparency in every single mater starting from the directors' pay scale to the number of AGM held and risk management policy followed by the company and many more. All listed companies has to follow the norm that is required by the clause 49 of listing agreement of the Company's Act and has to follow it before December 2005. If company remains transparent in disclosure creditor's trust and corporation can be improved like.

1. Investors evaluate the company as highly efficient company and market value of firm may go high.
2. Loyalty of investors toward company increases and they provide their "NOD" for every aspect.
3. It transparency is mandatory as per the corporate governance norms hence it is also advantageous for company if remain transparent.
4. If firm remains transparent it becomes efficient in overall work and it leads to increase in overall increase in firm's value.
5. Apart from increase in market value it can be imaged as ethical business and it can also attract maximum FDR and FII.
6. The picture of overall economy also changes as efficiency of economy is directly related with efficiency of corporate sector.

In today's trend it becomes essential to survive in global trends by accepting norms accepted by global corporate would, corporate governance is one of the parameters that is expectancy of every global investor.

Hence Transparency has greater significance has greater significance in corporate governance.

FINANCIAL ISSUES

Apart from the transparency Corporate Governance norms emphasis on the major aspect of the company's front and that is financial management. Finance is the major aspect for any economy and for the corporate also. Thus there are certain mandatory norms as well as certain non-mandatory norms, which are expected to be followed by the corporate people. They are supposed to disclose in front of the investors, all the data like overall capital, net worth, EPS that is Earning Per Share, Dividend pay out ratio and profitability ratio along with EVA that is Economic Value addition." If a corporation is to be viable attraction for capital, its board must ensure disclosure and transparency concerning the companies' true financial performance as well as its governance practices". Accounting games may be short-term keys but they are not long-term bases for financial creditability.

EMPHASIS ON CORPORATE VALUES

Corporate values can be defined as **share holder value, stakeholder value, customer value**, **business ethics and corporate social responsibility** put together.

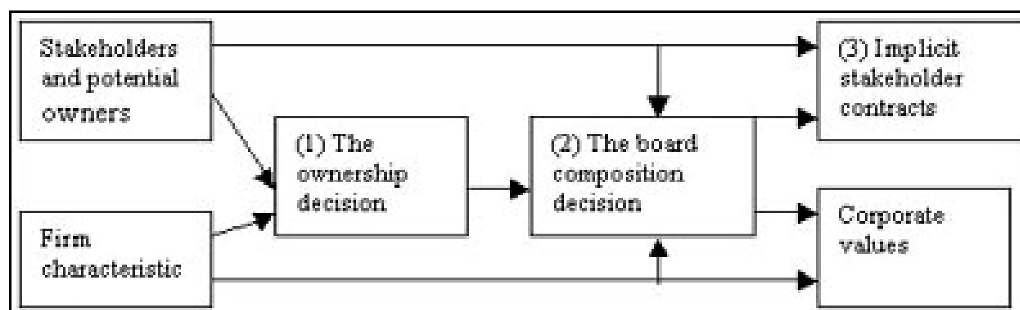
But by and large, new value systems have been marketed as general solutions applicable to all kinds of business. These values are building blocks of corporate image. Corporate values are based on high ethical standards of managers and other employees. The firm values must ultimately be derived from the preferences or values of its stakeholders. In other words, corporate values are created when companies internalize the values of salient stakeholders. Stakeholders can influence a company directly through market transactions and contracts without imposing their values on the company, but transactional costs and information

problems set a limit to use of contractual mechanisms. Internalization of stakeholder preference takes place in a hypothetical three-stage process as follows :

1. Allocation of ownership rights.
2. Board of composition.
3. The influence of important stakeholders

There is also a logical casual connection between the stages. Ownership determines the allocation of residual control rights across potential owners. The owners appoint board members and bestow the responsibilities to them. The board determines the nature of implicit contracts with the constituencies of the firm.

Figure



FOCUS ON CORPORATE SOCIAL RESPONSIBILITY

One of the newest mantra of effective corporate governance is **corporate social responsibility, which** is becoming a buzzword in management studies parlance and is a very important aspect of corporate reality. Corporate Social Responsibility can be defined as business decision making linked to ethical values, compliance with legal requirements and respect for people, community and environment. In other words corporate social responsibility can also be defined as the public ethical face of the corporation and establishes the link between the business organization and civil society, which is mutually correlated. Thus corporate social responsibility is operating a business in a manner that meets or exceeds the ethical, legal, commercial expectation that society has of the business.

The ever increasing pressure from the institutions of civil society and market forces for responsibility, accountability and transparency demands a governance model where a representative, responsive and responsible board should be reconstituted with corporate social responsibility orientation and stakeholders linked incentive system in place of shareholders linked incentive system should be adhered to. The external voluntary efforts are very good step in this direction as they do have the potential .To become stronger they need to be incorporated into the corporate governance practices for a better stakeholders protections. In this case stakeholders refer to anyone who is influenced directly or indirectly by the actions of the firm. There can also be a reference made to stockholder's theory where the business vehicle can be utilized for coordinating stake holder's interest rather than maximizing shareholders profits.

Leaders in the company generally see corporate social responsibility as more that a mere collection of discrete practices or occasional gestures or initiatives

motivated by marketing efforts, public relations or other business benefits. Rather it is viewed as comprehensive set of policies, practices and programs that are integrated through out business operations and decision-making processes that should be supported and rewarded by top level management. Corporate social responsibility forms a part of Strategic Human resource Intervention on one hand and strategic business initiatives on the other hand.

Organizational excellence is said to be achieved by a company when the business ethics gets combined with corporate governance. But the real test for the company is when the organizational excellence is converted to business sustainability. Business sustainability can be achieved by an organization by following a fair and beneficial business practices towards labour, human resources, community and region in which the corporation conducts its business.

PLAYERS IN CORPORATE GOVERNANCE:

Corporate governance systems vary across countries and these differences directly affect both the process for developing global strategies that can be adopted. Global strategic decision poses a very tough test for the effectiveness of corporate governance system. They seek maximize profit and global competitiveness.

There are five critical stakeholder players that affect the company's decision. They are (1) Employees (2) The management teams (3) Shareholders (4) Board of directors (5) Government.

EMPLOYEES

The main variable differentiates employees as a collective group across countries. The country's labour market will influence the flexibility and mobility of employees. Country such as the U.S that have employment at will where by a contract can be terminated at any time are likely to have flexible labour market and short term labour commitment. In more rigid labour markets such as Germany and Japan companies invest a great deal in bespoke in house training that tends to result in more highly skilled labour forces and company specific skills. These in turns are less transferable from one company to another. For example in France, the union rights are extended to all employees regardless of union affiliation. Here unionization will have greater influence on corporate decision making than in U.S or U.K where only union members benefits from collective bargaining agreements. Japanese companies tend to have enterprise unionism, which leads to collective bargaining at company level, and grant a strong voice to employees. In 2004 for example employee opposition to job losses prevented the restructuring via. Merger with a foreign partner of France who is financially troubled Alstom, a major producer of ships and trains. In the same year Volkswagen despite suffering from very high labour cost had to promise its Western Germany employees job security until 2011 in exchange for a wage freeze until 2007 and more flexible working hours. The company workers wield considerable power partly through co-determination rights that require employees to be consulted on corporate decision.

TOP MANAGEMENT TEAMS

Managers in U.S and U.K tend to have professional background and strong functional background in finance or marketing. This is not the case in Germany where managers are more technical oriented. There is also variation in the international experience and background of managers. Managerial career mobility

tends to be very fluid in U.S and U.K due to open labour markets. In Japan and France managers tend to remain with a company for a long period of time. There is also wide acceptance of leaders from across boarders in the U.K.

SHAREHOLDERS

Countries vary in their mix types of shareholders. At one extreme the U.S and U.K have mostly arms length, natural shareholders who are focused on shareholder value maximization. Employee shareholders typically use their ownership to block the global relocation of jobs. This applies even in the U.S where united Airlines provide a rare example of a large public company with majority ownership (55 percent owned by an employee stock ownership plan). This employee stake and hence control have greatly constrained the ability of the Airline to relocate job overseas.

GOVERNMENT

Government intervention is usually in the form of market regulation. A representative measure for government intervention in the economy is regulation around takeovers. In countries such as France, Germany, Italy and Japan government intervention often provide strong takeover barrier such as golden shares, which bestow on the holder veto power over changes to the company's charter. The variation hindrance to hostile takeovers in many continental European countries continues to make it difficult for foreign companies to make acquisition across border in Europe. In 2001 plans for a European takeover code, which would guarantee the right of shareholder to be consulted during bids were shelved following objection from German government. The previous year Vodafane, the U.K telecom company made a successful hostile bid for Mannesmann, a German telecoms company and the German government was worried that other local companies might fall into foreign land. For example Volkswagen is protected from takeover by special law. Sweden, which fall in the continental governance model that use multiple voting rights to help and prevent its companies from becoming vulnerable to takeover. France is also particularly active in preserving national ownership of major companies. In 2004 the French government brokered the takeover of Aventis a French Germany pharmaceutical company by France's Sanofi-synth and Laboratories.

CHALLENGES FACED FOR INSTALLING A PROPER CORPORATE GOVERNANCE SYSTEM

Various problems are faced by organization so as to install a proper corporate governance system is posing as a major challenge for the organization so as to overcome these problems and be a successful organization. They are as follows —-

(a) Effectiveness of the board

The board may not in all cases may all-time be having an entity independent of management. No outsider can inquire into this from inside. Some external procedures followed as part of the rules can well be checked but that alone does not suffice the purpose to justify independent entity, Appointment of committees and sub committees may in many cases be preplanned with certain determined goals.

(b) Balanced board

Board of directors of the company may not be found appropriately balanced. Many a times it is found in many cases the board is not having an appropriate mix of business experience and functional discipline.

(c) Directors Turnover

It is well known fact that in some companies Directors turnover is not supported with strong director evaluation procedure. Director's appointed may not be having strategic planning or risk management experience. And or sometimes against expectations traditional director may tend to stick with the company by certain practices not prescribed in the norms.

(d) Cultural Behavioral Element

In any company, irrespective of size or nature of product or services, it is clearly found that ultimately it is the behavioral culture inbuilt in the members which play major role i governing the unit. This behavioral part plays more important role when CEOs in the respective companies perform better and enjoy commanding height as functionaries. Behavioral segment is important in context of conflict resolution, reengineering the growth, reinvesting the assets etc. In such case problem is to anticipate and identify behavioral norms in respect of the cultural lag that precisely exists within the board between the boards of directors.

As already discussed some of the means by which the organization can incorporate a **proper corporate governance system** can be summed up as follows –

1) Discipline in operations

Operational discipline refers to healthy manufacturing practices; Full utilization of installed capacity in accordance with financial viability and demand pressures must be practiced. Operational discipline asks for quality approval at every stage of predictor services. It refers to the effective and optimum application of the technology available at times. Integration and coordination in the entire system is but the prime requirement for the operational efficiency.

2) Transparency in dealings and disclosures

Transparency here means "perfection" with "holistic approach". It means that dealings with clients, customers, suppliers, distributors to whomsoever, must be fair and healthy. Legitimate grounds for differentiation should be can be maintained in consideration of the relationship. Transparency includes fairness with purchasers and sellers. Disclosure pertaining to the balance sheet must be perfect in tune with the standardized accounting practices. Besides observance of legal norms, commitment to the moral standards must be reflected in accounting procedures. "Hidden charging ", "Secrecy" which violate the fundamentals of accounting in theory and practice be not allowed. Disclosures through the balance sheet must be in tune with prevailing taxation norms.

3) Accountability to shareholders

Let the company perform in a manner through which shareholders long term economic interest may remain intact. Accountability includes taking shareholders into confidence. This is legal binding also. Let there be healthy democratic practices to be followed by the company, convening anneal general meeting, minimum time in advance notice to be saved comprising all technical adequacies, free and fair election of board of directors. Chartered Accountant, these are the prime requirements. Dividend, bonus all other legitimate interests to be performed in adequate manner. Shareholders are virtual partners; hence their trust in the company and their goodwill for the company does work as an asset. This must be considered as part of accountability.

4) Responsibility of company's action

Company's all actions must be well planned and thoughtful. Any action of haste may prove boomerang. In event of any failure or poor performance company must done to share the responsibilities. Strategic actions may some time not sound well. Human resource practices adopted may at times affect to the growth of the company. All such results must be treated positively and corrections over period of time be made without any kind of bias or prejudices. What may apparently seem too little as action or result may sometimes turn into too big impacts.

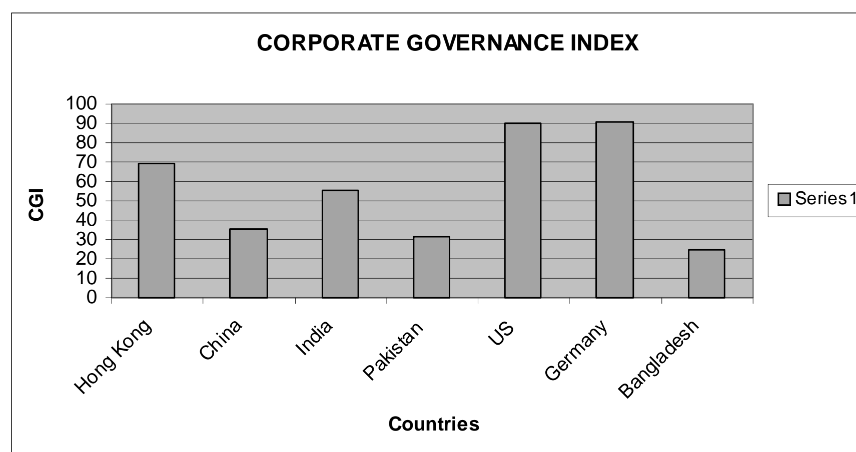
5) Social Responsibility

To think strictly in respect of shareholders' interest is considered too narrow view. There are many stakeholders beyond the shareholders. The society in general is the largest stakeholders. There fore observance of social responsibility must be reflected in Toro, prudence in environmental norms, adding to the societal value, sharing with Government or other agencies in social uplift men's tasks these are to be considered as "Investments" rather than more "cost", social health if cared for a long period may enhance "wealth" of the company over a period of time.

Parameters/Countries	**Regulation Quality**	Corruption Control	**Rule of Law**
Hong Kong	99	92.3	90.5
China	45.6	30.9	42.4
Pakistan	28.6	21.3	19.5
US	90.8	91.3	91.9
India	46.1	47.3	56.2
Germany	92.7	93.2	94.3
Bangladesh	20.9	9.7	24.8

Source –World Bank Data Best Possible Score: 100,Worst :0

VIEW ON CORPORATE GOVERNANCE INDEX



Source : World Bank Expert Daniel Kaufmann With 2004 Data Best Possible Score: 100,Worst score :0

A VIEW ON WORLD BANK RANKING OF COUNTRIES ACCORDING TO QUALITY OF GOVERNANCE IN THREE AREAS –

1) Regulation Quality
2) Corruption Control
3) Rule of Law

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. It is certainly believed 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.

With the recent debacle of Satyam Computers Services and exposure of fraud has again put the spotlight on the quality of corporate governance and regulation in India.

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.

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