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(General article)

Corporate Governance and Business Ethics: Essential for Socio–Economic Growth of the Country!

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Abstract

Corporate Governance and Business Ethics are the set of processes, customs, policies, laws and institutions affecting the way of corporation is directed, administrated and controlled. It also includes relationship among many stakeholders such as shareholders, management, Board of Director etc. other that these it includes labour, customer, creditors, suppliers, regulators and the country at large. Effective corporate governance is an important element for functioning of socio-economic growth of the country. Post Liberalization and globalization economic reforms have made a drastic change in Indian corporate world. Key elements of good corporate governance principles include honesty, trust, integrity, openness, performance orientation, responsibility, accountability, mutual respect and commitment to the organisation. Matter of fact is that how directors and management develop a model of governance that aligns the values of the corporate participants and then evaluate this model periodically for its effectiveness. Investors primarily consider two variables before making investment decisions--the rate of return on invested capital and the risk associated with the investment. In recent years, the "attractiveness of developing nations" as a destination for foreign capital has increased, partly because of the high likelihood of obtaining robust returns and partly because of the decreasing "attractiveness of developed nations." Good corporate-governance practices reduce this risk by ensuring transparency, accountability, and enforceability in the marketplace. While strong corporate-governance systems help to ensure a country's long-term success, weak systems often lead to serious problems. For example, weak institutions caused, at least in part, the debilitating 1997 East Asian economic crisis. The crisis was characterized by plummeting stock and real-estate prices, as well as a severe erosion of investor confidence. The total indebtedness of the countries affected by the crisis exceeded one-hundred billion dollars. While the presence of a good corporate-governance framework ensures neither stability nor success, it is widely believed that corporate governance can "raise efficiency and growth," especially for countries that rely heavily on stock markets to raise capital. In fact, some contend that the "Asian financial crisis gave developing countries ... a lesson on the importance of a sound corporate governance system." While corporate governance may not dictate the economic prospects of developing countries, it certainly plays an integral role in shaping them. This paper has a brief overview of various steps taken by the regulatory authority i.e. Security and Exchange Board of India (SEBI) to protect the investor's interest in securities and promotion & development of security market. Most notably, India must reform how its boards of directors function, improve its enforcement mechanisms, redefine its corporate laws, and embrace corporate governance as a philosophy.

Introduction

Corporate Governance and Business Ethics are the set of processes, customs, policies, laws and institutions affecting the way of corporation is directed, administrated and controlled. It also includes relationship among many stakeholders such as shareholders, management, Board of Director etc. other that these it includes labour, customer, creditors, suppliers, regulators and the country at large. Effective corporate governance is an important element for functioning of socio-economic growth of the country. Post Liberalization and globalization economic reforms have made a drastic change in Indian corporate world. Key elements of good corporate governance principles include honesty, trust, integrity, openness, performance orientation, responsibility, accountability, mutual respect and commitment to the organisation. Matter of fact is that how directors and management develop a model of governance that aligns the values of the corporate participants and then evaluate this model periodically for its effectiveness. Investors primarily consider two variables before making investment decisions--the rate of return on invested capital and the risk associated with the investment. In recent years, the "attractiveness of developing nations" as a destination for foreign capital has increased, partly because of the high likelihood of obtaining robust returns and partly because of the decreasing "attractiveness of developed nations." Good

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Legal Framework of Corporate Governance

Legal framework of corporate governance in India is based on both the company law, which defines the contractual relationship between management and providers of capital, SEBI (Security and Exchange Board of India) that is directed towards more widely held publically traded companies to ensure adequate disclosure and transparency necessary for efficient market operations.

Principles of Good Corporate Governance

Key elements of good corporate governance principles include honesty, trust and integrity, openness, performance orientation, responsibility and accountability, mutual respect and commitment to the organization.

Matter of fact is that how directors and management develop a model of governance that aligns the values of the corporate participants and then evaluate this model periodically for its effectiveness. In particular, senior executives should conduct themselves honestly and ethically, especially concerning actual or apparent conflicts of interest and disclosure in financial reports.
Commonly accepted principles of corporate governance include:

Rights and equitable treatment of shareholders:

•Organisations should respect the rights of shareholders and help shareholders to exercise those rights. They can help shareholders exercise their rights by effectively communicating information that is understandable and accessible and encouraging shareholders to participate in general meetings.

•Interests of other stakeholders : Organisations should recognize that they have legal and other obligations to all legitimate stakeholders.

•Role and responsibilities of the board : The board needs a range of skills and understanding to be able to deal with various challenge management performance. It needs to be of sufficient size and have an appropriate level of commitment to fulfill its responsibilities and duties. There are issues about the appropriate mix of executive and non-executive directors.

•Integrity and ethical behavior: Ethical and responsible decision making is not only important for public relations, but it is also a necessary element in risk management and avoiding lawsuits. Organisations should develop a code of conduct for their directors and executives that promotes ethical and responsible decision making. It is important to understand, though that reliance by a company on the integrity and ethics of individuals is bound to eventual failure. Because of this, many organizations establish compliance and ethics program to minimize the risk that the firm steps outside of ethical and legal boundaries.

•Disclosure and transparency : Organizations should clarify and make publicly known the roles and responsibilities of board and management to provide shareholders with a level of accountability. They should also implement procedures to independently verify and safeguard the integrity of the company’s financial reporting. Disclosure of material matters concerning the organization should be timely and balanced to ensure that all investors have access to clear, factual information.

Role of Institutional Investors

Many years ago, worldwide, buyers and sellers of corporation stocks were individual investors, such as wealthy businessmen or families, who often had a vested, personal and emotional interest in the corporations whose shares they owned. Over time, markets have become largely institutionalized : buyers and sellers and largely institutions (e.g. pension funds, mutual funds, hedge funds, other investor groups; insurance companies, banks, brokers and other financial institutions).

The rise of the institutional investor has brought with it some increase of professional diligence which has tended to improve regulation of the stock market (but not necessarily in the interest of the small investor or even of the naïve institutions, of which there are many). Note that this process occurred simultaneously with the direct growth of individuals investing indirectly in the market (for example individuals have twice as much money in mutual funds as they do in bank accounts). However this growth occurred primarily by way of individuals turning over their funds to professional’s to manage, such as in mutual funds. In this way, the majority of investment now is described as “institutional investment” even though the vast majority of the funds are for the benefit of individual investors.

Unfortunately, there has been a concurrent lapse in the oversight of large corporations, which are now almost all owned by large institutions. The Board of directors of large corporations used to be chosen by the principal shareholders, who usually had an emotional as well as monetary investment in the company and the Board diligently kept an eye on the company and its principal executives.

Nowadays, if the owning institutions don't like what the President / CEO is doing and they feel that firing them will likely be costly and time consuming, they will simply sell out their interest. The Board in now mostly chosen by the President / CEO, and may be made up primarily of their friends and associates, such as officers of the corporation or business colleagues. Since the (institutional) shareholders rarely object, the President/CEO generally takes the Chair of the Board position for his/herself (which makes it much more difficult for the institutional owners to "fire" him/her). Occasionally, but rarely, institutional investors support shareholders resolutions on such matters as executive pay and anti-takeover, aka, "poison pill" measures.

Finally, the largest pools of invested money are designed simply to invest in a very large number of different companies with sufficient liquidity based on the idea that this strategy will largely eliminate individual company financial or other risk and, therefore, these investors have even less interest in a particular company's governance.

Since the marked rise in the use of internet transactions from the 1990s, both individual and professional stock investors around the world have emerged as a potential new kind of major (short term) force in the direct or indirect ownership of corporations and in the markets; the casual participant. Even as the purchase of individual shares in any one corporation by individual investors diminishes, the sale of derivatives has soared. So, the interests of most investors are now increasingly rarely tied to the fortunes of individual corporations.

Trends in Corporate Governance

Corporate India is a model for fast growing economy. From last two decades, high level of economic development have been achieved after liberalization and globalization of economy. But at the same time FII (Foreign Institutional Investors), FDI's and financial institutions encouraged opportunistic behavior by both investors and corporate managers. It cause for better governance of the Indian capital market. Till now Indian equity market was regarded as one of the relegated markets of the world, because of the following shortcomings as :

•Lack of Transparency in operations
•Foreign Investors had limited exposure to Stock Exchanges
•Financial Statement of Companies was not sufficient to predict future.
•Lack of confidence in the system of Board Accountability.

To remove these shortcomings in April, 2001 another drastic change took place. From April 2001, SEBI enforced a regulation which made it mandatory the disclosure of information.

This led to change in Corporate Governance mechanisms of listed companies. The change was effected on the basis of a report submitted by high powered committee, formed under the chairmanship of Kumar Manglam Birla in 2000. The salient features of the committee's report were:

•Board Composition with an optional mix of executive, non-executive and independent directors.
•Board operation through committees viz. the Audit committee, the remuneration committee and the shareholders/Investors grievance committee.
•Mandatory provisions regarding powers and rights of committees.
•Mandatory provisions regarding matters which the management is required to place before the Board.
•Greater transparency through mandatory quarterly disclosures to shareholders.

Adoption of these recommendations altogether changed the market outlook and increased the confidence of investors not only in India but also abroad.

Quarterly results, quarterly shareholding pattern, segment-wise reporting, management discussion and analysis in annual report are all function of corporate governance and disclosure.

Impacts of all these measures are as follows:
•India's corporate governance has now at par with international norms.
•Increase in faith of FII's and FDI's in Indian securities.
•Reduction in BETA factor (a measure of performance of a particular share in relation to general market).
•Increase in earning and market capitalization of corporations.
•Increase in efficiency of companies.
•Above all increased faith in Indian economy.

Post – Satyam regulator calls for better corporate governance.

But despite of all these achievements the 'Satyam Scandle' has shaken the trust of investors in the robust system of corporate governance. Satyam belonging to IT sector violated the basis norms of corporate governance. But this incident is an eye-opener. Investors in the country have become mature enough to punish companies that do not follow best practices.Corporate India had to be more transparent with shareholders and ensure Corporate Governance in the post Satyam Scenario.Two actions which are being regarded by SEBI are"To require all listed companies to obtain peer audit done and in case of pledging of promoter shareholding to make this price sensitive information available to all other shareholders" said SEBI chairman C.B. Bhave in a conference on Corporate Governance organization set by Confederation of Indian Industry (CII). We have to recognize that the issue of corporate governance is a journey, which has to be constantly examined and continuous efforts are necessary to make it fruitful.SEBI is actively considering introducing rules to ensure more rigorous audit and disclosures, such as having external agencies to conduct internet audit and rotational auditors.

A 'Whistleblower Policy' is under consideration. In which employees of a company can report any wrong doing to the firms Whistleblower Committee without informing their supervisor or revealing their identities.

In any corporate malfunction, the regulatory authority should response immediately and to analyse the causes and the measures needed to correct it.

Satyam issue is a "Wake-Up-Call", the entire field of Corporate Governance needed to be addressed in greater depth. In essence, effective Corporate Governance is an essential element for safe and sound functioning of the socio-economic growth of the country.

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