Corporate Governance - The Role Of Various Stakeholders

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INTRODUCTION

Corporate Governance is basically a system of making directors accountable to shareholders for effective management of the companies in the best interests of the company and shareholders, along with concern for ethics and values. It is management of companies - with concern for ethics and values. It hinges on complete transparency, integrity and accountability of the management which includes executive and non-executive directors.

Report of Securities and Exchange Board of India (SEBI) committee on Corporate Governance defines corporate governance as, *"The acceptance by management of the inalienable rights of shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders. It is about commitment to values, about ethical business conduct and about making a distinction between personal & corporate funds in the management of a company."* The definition is drawn from the Gandhian principle of trusteeship and the Directive Principles of the Indian Constitution. Corporate Governance is viewed as ethics and a moral duty.

LITERATURE REVIEW

Though corporate governance is in its inception stage in Indian companies, many Indian companies are adopting the code of corporate governance. The government of India has also constituted several committees to study and suggest measures to improve the transparency in corporate transactions and corporate decisions. Many research works have been conducted in the area of corporate governance, the following are some among them.

☸ **Andrew Kakabadse, Keith Ward, Nada Korac-Kakabadse, Cliff Bowman (2001)** explored the results of a study based on an extensive number of interviews and focus group discussions conducted with non-executive directors (NEDs), executive and non-executive chairmen, chief executive officers (CEOs) and other key line and functional directors within UK corporations. Four critical issues concerning NEDs' performance were identified, namely the need to be responsive to boardroom dynamics, the need to be multi-competent in response to the various challenges NEDs face, the need to have the capability to address governance issues which are increasingly identified as predominating boardroom debate and the need to be sensitive to the context within which the company finds itself. Overall, NEDs are considered to provide a valuable contribution to the progress of the enterprise. However, the question that remains unanswered is what motivates NEDs to continue to address such challenges as, in the UK context, NEDs' rewards are seen to be particularly low.

☸ **Nada Korac-Kakabadse, Andrew K. Kakabadse, Alexander Kouzmin (2001)** found that there persists the belief that a firm's only responsibility to society is to maximize profits without breaking the law, hence, the role of corporate governance is to provide appropriate corporate control. Research suggests that there is a growing perception that corporations are social entities overall, answerable to social constituencies and that the role of corporate governance is to understand and adequately address the interest of such social and political constituents. A review of research studies in the area of corporate governance's contribution to corporate performance reveals that there is no conclusive evidence of contribution. Moreover, it illuminates the need for broader criteria of performance and for the adoption of a political model of corporate governance in order to facilitate a corporation's external accountabilities.

☸ **Joshua Abor, Charles K.D. Adjasi (2007)** in their research article titled "Corporate Governance And The Small And Medium Enterprises Sector: Theory And Implications" tried to examine the corporate governance practices in small and medium enterprises. They concluded that corporate governance brings new strategic outlook through external

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independent directors and enhances firms' corporate entrepreneurship and competitiveness. Again, the problems of credit constraint and managerial incompetence in the Ghanaian SME sector could also be overcome with a good corporate governance structure in place. The corporate governance practices are required in the small and medium enterprises in the same manner of large sized companies.

☸ **Jinghui Liu, Dennis Taylor (2008)** in their research work entitled "Legitimacy And Corporate Governance Determinants Of Executives' Remuneration Disclosures", found that significant relationships existed between these determinants and the extent of disclosures of rights, options and termination benefits of executives. These results suggested that under a relatively unregulated environment, corporate management will react to community and shareholders' expectations by revealing personally sensitive information when their company is placed in a situation of higher shareholder and public scrutiny and when it is structured to meet expectations of good corporate governance.

☸ **Themistokles Lazarides, Evaggelos Drimpetas (2008)** in their paper, "The Missing Link To An Effective Corporate Governance System" proposed a new enterprise system (ES) which did not diminish the problem of Corporate Governance (CG). The design and implementation of ES, according to modern CG principles and guidelines, can help all parties make rational decisions (through the power of logic and not through the logic of power), facilitate the market for corporate control, the flow of information and hence, the efficiency of the CG system. The new framework can help information systems designers to understand and create a more holistic system. Also, it can help stakeholders understand the role that the ES can play in the corporate governance system and exert influence on managers to adopt an information system that covers their needs as well.

☸ **Suzanne Young, Vijaya Thyil (2008)** in their research work titled "A Holistic Model Of Corporate Governance: A New Research Framework" proposed a new model of corporate governance that is holistic - incorporating internal and macro perspectives across legal, regulatory, sociological, ethical, human resource management, behavioral and corporate strategic frameworks. Researchers have signaled the need for *"new theoretical perspectives and new models of governance"* due to a dearth of research that is context-driven, empirical, and encapsulates the full spectrum of reasons and actions contributing to corporate crises. The proposed model is a distinctive contribution to theory and practice in three ways. **First,** it integrates the firm-specific, micro factors with the country-specific, macro factors to illustrate the holistic nature of corporate governance. **Second,** shareholders and stakeholders are shown to be only one component of the model. **Third,** it veers away from singular approaches, to deal with corporate governance using a multi-disciplinary perspective. The paper argues that such a holistic and integrated view is a necessity for understanding governance systems.

CORPORATE GOVERNANCE PRINCIPLES

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.

Of importance is 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**: Organizations 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**: Organizations 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 business issues and have the ability to review and 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. Organizations should develop a code of conduct for their directors and executives that promotes ethical and responsible decision making. It is important to understand 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 Programs 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 the 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.

Issues involving corporate governance principles include:

☸ Internal controls and the independence of the entity's auditors;
☸ Oversight and management of risk;
☸ Oversight of the preparation of the entity's financial statements;
☸ Review of the compensation arrangements for the chief executive officer and other senior executives;
☸ The resources made available to directors in carrying out their duties ;
☸ The way in which individuals are nominated for positions on the board ;
☸ Dividend policy.

Nevertheless, *"corporate governance"* despite some feeble attempts from various quarters, remains an ambiguous and often misunderstood phrase. For quite some time, it was confined only to corporate management. That is not so. It is something much broader, for it must include a fair, efficient and transparent administration and strive to meet certain well defined, written objectives. Corporate governance must go well beyond law. The quantity, quality and frequency of financial and managerial disclosure, the degree and extent to which the Board of Directors (BOD) exercise their *trustee* responsibilities (largely an *ethical* commitment), and the commitment to run a transparent organization- these should be constantly evolving due to interplay of many factors and the roles played by the more progressive/responsible elements within the corporate sector.

In *A Board Culture of Corporate Governance,* business author Gabrielle O'Donovan defines corporate governance as, *"An internal system encompassing policies, processes and people, which serves the needs of shareholders and other stakeholders, by directing and controlling management activities with good business savvy, objectivity, accountability and integrity. Sound corporate governance is reliant on external marketplace commitment and legislation, and also on a healthy board culture which safeguards policies and processes"*.

All parties to corporate governance have an interest, whether direct or indirect, in the effective performance of the organization. Directors, workers and management receive salaries, benefits and reputation, while shareholders receive capital return. Customers receive goods and services; suppliers receive compensation for their goods or services. In return, these individuals provide value in the form of natural, human, social and other forms of capital. Corporate governance is a way of life and not a set of rules. It is a way of life that necessitates taking interests in every business decision. A key element of good corporate governance is transparency projected through a code of good governance which incorporates a system of checks and balances between key players-board of management, auditors and shareholders.

The sub prime crisis can be viewed as a failure of Corporate Governance. The Indian corporate sector's score on corporate governance is only mediocre. The parties to the corporate governance are:

(i) Shareholders **(ii)** Board of Directors **(iii)** Accountants **(iv)** Auditors and **(v)** The Government

ROLE OF SHAREHOLDERS

There are two types of shareholders, Viz., Individual shareholders and Institutional shareholders. Those shareholders who have entered the share market prior to 1990 are categorized into pre-globalization and those who entered after 1990 are termed as post-globalization shareholders. The investors of pre-globalization era were satisfied with the available dividend and performance of the company. At the most, they expected a decent return, a little bit higher than the bank return with periodical bonus shares. The shareholders play an important role. Shareholders have to keep an eye about the decisions of the company. With regular intervals, they have to examine the performance of the company.

They should feel their responsibility in participating in the Annual General Meeting (AGM) of the company. They have to raise their voice in the general meeting of the shareholders.
Institutional shareholders are a powerful group, in all the countries. In fact, the state of corporate governance is comparatively better in developed countries because of the active role played by this category of shareholders. In fact, most of the Financial Institutions (FIs) in India are the proxies of the government as they are promoted and wholly owned by the government till recently. The past contains many incidents where the commercial prudence is not considered. In the eighties, the takeover attempt of Swaraj Paul was thwarted not by any code, but by the Institutions, at the instructions of the North Block. The decisions were taken by the ministers and the bureaucrats and not by the officials of the institutions. Hence, the decisions of these organizations were taken only from the society point of view and not from the point of view of an investor. Though they have a commanding position to dictate the companies , in most of the time, it is only the companies who dictate and milk as much concessions as possible, which are highly unreasonable from the point of view of an investor. In most of the companies, institutional shareholders are holding a majority stake, even marginalizing the promoters. In spite of such controlling powers in the hands of institutional investors',it is the promoters who have a stay in the management of the company. Usually, they are given a representation in the Board i.e., nominee directors. Generally, the officials of the institutions are deputed as the nominee directors. Such posts are only ornamental. It was an accepted code that the nominee directors are supposed to be satisfied with the information provided and they should not seek clarification and block any resolution. The Financial Institutions (FIs) need not interfere in the day-to-day affairs. They could intervene in the company affairs whenever they are prejudicial to the interest of the shareholders. Even on such occasions, the nominee directors were not permitted to act in the interest of the company at large.

ROLE OF THE BOARD OF DIRECTORS

The Board Of Directors often plays a key role in corporate governance. It is their responsibility to endorse the organization's strategy, develop directional policy, appoint, supervise and remunerate senior executives and to ensure accountability of the organization to its owners and authorities. The board's primary responsibility is to steward the company to achieve its full potential. Board of Directors plays a significant role because they are strategists who formulate the strategies. The top management teams around the world face a period of unprecedented business opportunities and threats. The board composition should be adhering to the corporate governance code of conduct. It should include independent directors, executive directors. The top management must recognize, grasp and achieve five fundamental objectives to secure a firm basis for competitive success:
a. Improving the efficiency of management to compete globally.
b. Good relationships with customers.
c. Usage of latest technology to satisfy the customers' expectations.
d. The development and maintenance of pro-active and dynamic role for top management.
e. The effective use and development of human resources.
In theory, the board is elected by the shareholders, but their job goes beyond catering to only the shareholders. The board balances the needs of the shareholders, employees, customers, vendors, partners and society at large.
Multinational companies in India like Hindustan Lever, ITC, etc, have Board of directors with a very high proportion of Whole-Time Directors (WTDs). On the other hand, companies like Larsen and Toubro and TISCO have equal number of Whole Time Directors and Part Time Directors.

ROLE OF THE ACCOUNTANTS

The role of accountants is very vital in corporate governance. Financial reporting is a crucial element necessary for the corporate governance system to function effectively. Accountants and auditors are the primary providers of information to capital market participants. The directors of the company should be entitled to expect that the management prepares the financial information in compliance with statutory and ethical obligations, and rely on auditors' competence.
Current accounting practice allows a degree of choice of method in determining the method of measurement, criteria for recognition, and even the definition of the accounting entity. The exercise of this choice to improve apparent performance (popularly known as creative accounting) imposes extra information costs on users. In the extreme, it

can involve non-disclosure of information.
One area of concern is whether the accounting firm acts as both the independent auditor and management consultant to the firm they are auditing. This may result in a conflict of interest, which places the integrity of financial reports in doubt due to client pressure to appease the management. The power of the corporate client to initiate and terminate management consulting services and, more fundamentally, to select and dismiss accounting firms contradicts the concept of an independent auditor. The Enron collapse is an example of misleading financial reporting. Enron concealed huge losses by creating illusions that a third party was contractually obliged to pay the amount of any losses. However, the third party was an entity in which Enron had a substantial economic stake. In discussions of accounting practices with Arthur Andersen, the partner in charge of auditing, views inevitably led to the client prevailing.
Though investment norms are liberalized, India's Generally Accepted Accounting practices (GAAP) and their educational syllabuses for accountants remain way behind when compared with the accounting standards in developed countries.

ROLE OF THE AUDITORS

However, good financial reporting is not a sufficient condition for the effectiveness of corporate governance if users don't process it, or if the informed user is unable to exercise a monitoring role due to high costs. A system of good Corporate Governance promotes relationship of accountability between the principal actors of sound financial reporting- the board, the management and the auditor. It holds the management accountable to the board and the board accountable to the shareholders. The Audit Committee's role flows directly from the board oversight function. It acts as a catalyst for effective financial reporting.
The score card of the auditors in this regard is not so much satisfactory in the pre-globalisation era. Though the law provides enough check and balance to ensure the independence of the auditors to enable them to maintain professional objectivity in performing their duties, the role of auditors are still way behind the standard. One of the reasons cited for this situation is that the auditors do not want to bite the hands which feed them. According to the Companies Act, the shareholders are the appointing authority of the auditors. However in practice, the amorphous shareholders never propose the name of auditors to the annual general meeting. It is only the management which proposes the name to the AGM and thence, to the annual general meeting by the Board. The intimacy of the relationship to the management is vastly stronger than to the shareholders.
The present day auditor's duty is complete with a mere attachment of a note. They are not interested in the welfare of the shareholders. Perhaps, for the fear of not being reappointed by clients, some auditors may hesitate to state their observations. Their contention is that the auditors are expected only to express the opinion of the truth of the financial statements prepared by the management and they are not supposed to carry out a proprietary audit. Small group dynamics tend to make them agree with each other and to forget their role representing outside interests. Though the auditing professionals are not prepared to let the MNC Audit firms, they have assimilated some of the practices of the MNC firms. In the pre-globalisation era, qualified reports were very rare to find, even if it is needed for a sample study purpose. Now, qualified reports have started appearing regularly, thanks to the change in the role perception of the auditors and their perception about their independence.

ROLE OF THE GOVERNMENT

The government role is highly significant in corporate governance. Though companies are following the code of corporate governance, the government has to check the practices of companies with regular intervals. The Government need to intervene in the matters if any major policy is changed by any company. It is the duty of the government to encourage healthy environment to mobilize large amount of investment from the investors. The Government is also need to constitute committees to improve the accountability of the management. The Ministry of Corporate Affairs has to initiate required actions. Corporate growth is determined by the corporate governance practices to a greater extent. To support a healthy corporate growth, the government needs to play the role of watchdog. Making amendments time to time to the acts is one of the important duties of the government.
All parties to corporate governance have an interest, whether direct or indirect, in the effective performance of the organization. Directors, workers and management receive salaries, benefits and reputation, while shareholders

receive capital return. Customers receive goods and services; suppliers receive compensation for their goods or services. In return, these individuals provide value in the form of natural, human, social and other forms of capital.

CONCLUSION

The corporate world should build confidence among the investors and other stockholders through transparent managerial practices. The corporate performance should always be positive. Healthy competition is to be encouraged always. All levels of people such as the executives and employees should adhere to the code of ethics in the organization. The board should always consider the interests all interested groups. The organizations should strive hard to satisfy their customers both internal and external. The directors, executives and other decision makers should have to develop new vision, creativity and innovative skills to manage organizations in a changing global economy. The board of directors should draw up a code of ethics and statement of business practices by publishing them internally and externally, and set a role model by living up to these in practice.

Ethics play an important role in good corporate governance. Ethical behavior is required for executives and employees of any organization. If unethical practices are to be reduced, executives say that the top management must lead the way. The people at the top must follow principles, and must unmistakably reveal their ethical attitude, not only verbally, but also by forceful action. As a help in correcting unethical practices, most executives should have a written code of ethics for their industry.

Finally, corporate governance will succeed if everybody feels their responsibility.

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