PUBLIC ENTERPRISES AND CORPORATE GOVERNANCE

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CORPORATE GOVERNANCE

Corporate governance is the set of processes, customs, policies, laws, and institutions affecting the way a corporation (or company) is directed, administered or controlled. Corporate governance also includes the relationships among the many stakeholders involved and the goals for which the corporation is governed. In simpler terms it means the extent to which companies are run in an open & honest manner.

It is a part and parcel of development agenda of any developed or developing economy. The essence of corporate governance lies in strenuous co-operative efforts on the part of its constituents towards a common goal, viz., to improve and strengthen economic efficiency of the company. It requires harmonizing their diverse interests by preventing asymmetry of benefits across various stakeholders especially between the owner-managers and rest of the shareholders.

DEFINITION OF CORPORATE GOVERNANCE …

1. **Shleifer and Vishny**, Corporate governance deals with the way suppliers of finance assure themselves of getting a return on their investment.

2. **Standard and Poor** view corporate governance, as "the way a company is organized and managed to ensure that all financial shareholders (shareholders and creditors) receive their fair share of a company's earnings and assets."

3. **The Kumar Mangalam Committee** set-up by Indian SEBI observed that "the fundamental objective of corporate governance is the enhancement of shareholders' value keeping in view the interests of other stakeholders".

4. **President of world Bank, Mr. J. Wolfensohn**, viewed Corporate governance as "promoting corporate fairness, transparency and accountability"

5. **Narayana Murthy Committee** set-up by Indian SEBI felt that Corporate governance is about openness, integrity and accountability".

6. **Sir Adrian Cadbury**, "Corporate governance is defined as holding the balance between economic and social goals and also between individual and communal goals.."

7. **Cadbury Committee report, experts at OECD** have classified "Corporate Governance concepts as "the system by which business corporations are directed and controlled".

DEFINITION OF CORPORATE GOVERNANCE…

It can be inferred that corporate governance is that branch of Public Administration and Management which helps to exploit scarce resources by aligning diverse interests of market participants democratically. It involves scientific application of modern tools and techniques of planning, implementing, directing, controlling and co-ordinating unique tasks in a fair, responsible, transparent, accountable and ethical manner to accomplish the outcomes in consonance with pre-determined goals and objectives of shareholders, stakeholders, corporations and the society.

The sum total of all these definitions is that Corporate governance has to be responsible, accountable, ethical, fair, open and transparent and for the overall growth and development of an enterprise and the economy of developed, developing and transient societies.

IMPORTANCE OF CORPORATE GOVERNANCE

- Corporate governance ensures that a properly structured Board, capable of taking independent & objective decisions is at the helm of affairs of the company. This lays down the framework for creating long-term trust between the company & external providers of capital.
- It improves strategic thinking at the top by inducting independent directors who bring a wealth of experience & a host of new ideas.
- It rationalizes the management & monitoring of risk that a corporation faces globally.
- Corporate governance emphasizes the adoption of transparent procedures & practices by the Board, thereby ensuring integrity in financial reports.
- It inspires & strengthens investors‟ confidence by ensuring that there are adequate number of nonexecutive & independent directors on the Board, to look after the interests & well-being of all the stakeholders.
- Corporate governance helps provide a degree of confidence that is necessary for the proper functioning of a market economy, as it contemplates adherence to ethical business standards.
- Finally, globalization of the market place has ushered in an era wherein the quality of corporate governance has become a crucial determinant of survival of corporate.

FEATURES OF CORPORATE GOVERNANCE

Corporate Governance has a significant number of inherent characteristics. It includes:

1. Accomplish strategic objectives and goals as per expectations, aspirations and desires of shareholders including other stakeholders.
2. Comply with statutory and regulatory obligations for improved performance.
3. Commitment for survival, growth and overall development of the enterprise.
4. Endeavor for high return on investments.
5. Maximization of shareholders and stakeholders' wealth.
6. Upholding tenets of business ethics, transparency, fairness and accountability.
7. Evolving institutional structure with little concern on one size does not fit all' philosophy.
8. Minimize conflict of interests among various constituents.
9. Disciplining and controlling bad management.
10. Emphasis on societal and economic concerns.

PRINCIPLES OF CORPORATE GOVERNANCE

The Governance Principles have been formulated and reformulated after rigorous s by the **OECD in six key areas**, namely:

1. rights of shareholders
2. interests of stakeholders
3. role of board
4. disclosure and discrepancy
5. basis governance framework
6. Integrity and ethical behavior

PRINCIPLES OF CORPORATE GOVERNANCE

Some of the commonly accepted principles can however, be identified as:

1. ***Sustainable long-term vision***: Optimizing performance, profitability and returns.
2. ***Shareholders rights and responsibilities***: Corporate charter, majority voting standards, shareholder activism, access to Director's nomination.
3. ***Stakeholder's claims***: Parity to all legitimate stakeholders with regard to legal and other obligations.
4. ***Accountability***: Board's responsibility to shareholders, Director's easy access to Management, Independent Board with outside Directors, Board oversight committees, separate position of CEO and Chairman.
5. ***Transparency***: Transparent, fair and timely disclosures, regularity in governance reporting.

PRINCIPLES OF CORPORATE GOVERNANCE

6. ***Executive and Directors' remuneration***: Structure and component of remuneration, incentives, peer analysis, severance agreements, retirement plans, pay for non-executive Directors.
7. ***Corporate culture***: Code of ethics and conduct, whistle-blowers' mechanism compliance with laws.
8. ***Integrity in Financial Reporting***: Adherence to International Financial Reporting Standards (IFRS), Audit Committee oversight, related party transactions.
9. ***Robust Independent Audit***: Independent auditors' role enhanced reporting to shareholders, auditors' rotation, non-audit fee, internal audit mechanism.
10. ***Risk oversight***: Appropriate risk management policies, procedures, reporting and decision-making protocols.

11. ***Corporate Responsibility***: Environmental, social and governance issues, sustainable development, human rights violations, political and charitable contributions.

ADVANTAGES OF CORPORATE GOVERNANCE

In a Global Village, corporations no longer exist for generating profit for those who contribute their capital. These have to shun its erstwhile orthodox centralized decision-making structures; ought to be vision-mission driven; and beneficial to the greatest number of shareholders including various stakeholders. Such an environment takes concrete shape only when irrespective of the size of an enterprise, the corporates religiously follow "**Corporate Governance Mantra**" in the right earnest. Acting as a Barometer, Good Corporate Governance is of immense significance to the very existence of an enterprise and the society as a whole due to its inherent benefits such as:

ADVANTAGES OF CORPORATE GOVERNANCE…

1. Minimizes concentration of power in hands of management.
2. Incidence of waste, corruption and mismanagement are curtailed.
3. Businesses become sustainable
4. Encourages development of entrepreneurship.
5. Promptly resolves governance issues
6. Helps in brand formation. Attracts and retains talent human capital.
7. Improves corporate ethics and values.
8. Introduces intellectual honesty and integrity.
9. Contributes towards company's competitiveness.
10. Reduces chances of perceived risks.

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ADVANTAGES OF CORPORATE GOVERNANCE…

11. Acts as a key driver to financial transparency.
12. Well-designed reporting and accounting standards bring in increased investments.
13. Pressurize organization to comply with statutory and regulatory obligations.
14. Encourages activism to whistle-blower mechanism.
15. Facilitates in raising domestic and external capital at cheap rates.
16. Leaves a positive impact on share price. Leads to higher market valuation.
17. Shifts emphasis on compliance with substance rather than form.
18. Encourages better profit margins. Ensures efficient use of scare resources.
19. Allows easy asset diversification through mergers and acquisitions.
20. Provides sufficient freedom to management to innovate
21. Improves strategic planning by inducting outside directors who experience.
22. Builds confidence of prospective shareholders and stakeholders.

DISADVANTAGES OF CORPORATE GOVERNANCE

1. **Easily Corruptible-Corporate** governance needs a certain level of government oversight to avoid increasing levels of corruption. The lack of governmental oversight in corporate governance lead to a misallocation of credit that actually worked against competition.
2. **Family-Owned Companies-** Corporate governance works at its best when shareholders and board members are able to make objective decisions that are in the best interest of the company. According to Ibis Associates, a business planning firm, family-run corporations (founding family members own controlling share of the company), such as Ford and Wal Mart, lose objectivity in business making decisions due to the familys financial investment in the business performance and the emotional ties associated with building a worldwide corporation from the ground up.
3. **Costs of Monitoring**- To effectively govern a publicly traded corporation, shareholders must speak with one voice and have enough votes to allow that voice to have any real weight. This requires individuals that have a collective vision for the company to pour more money into that company to gain a controlling share
4. **No Government Support**
5. **Insider Trading**

CORPORATE GOVERNANCE MODELS

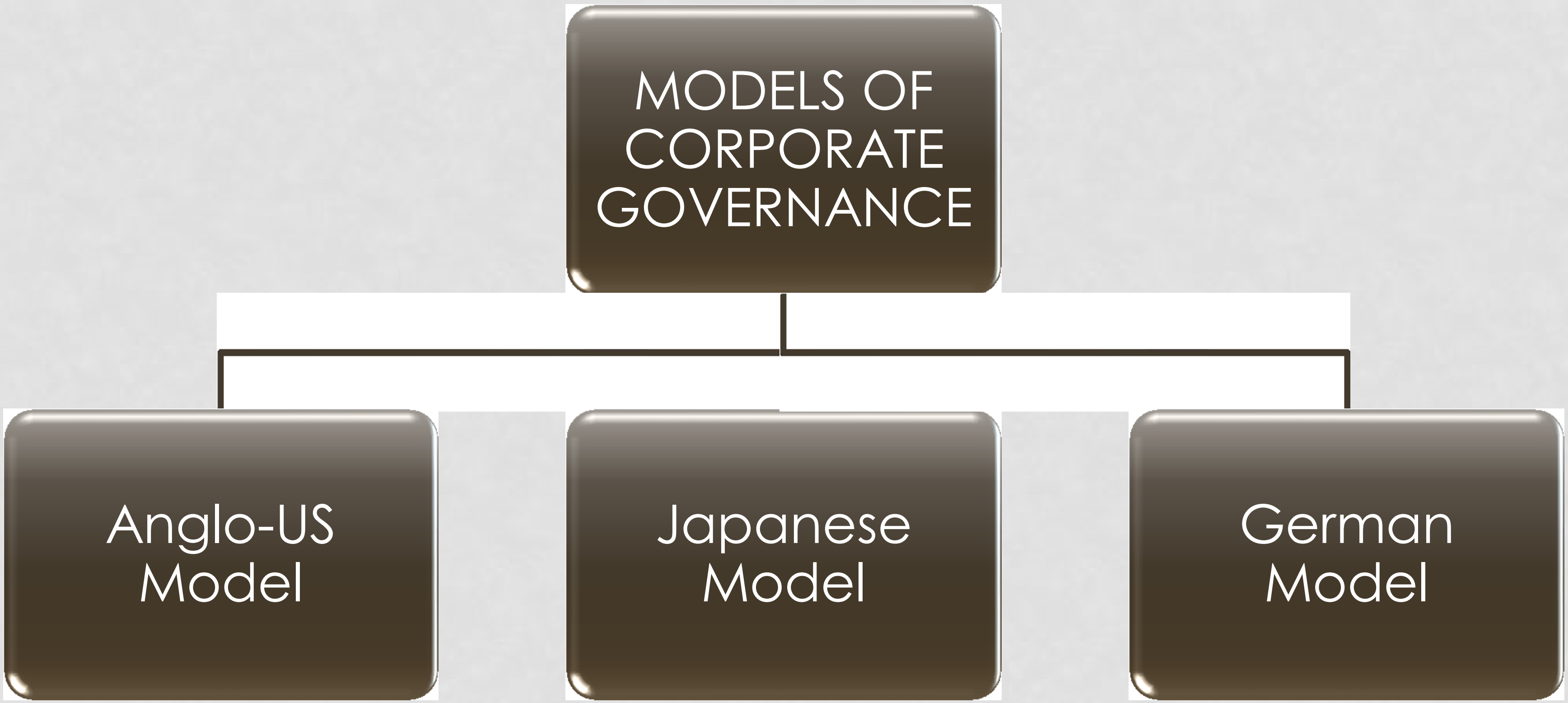
Designing a governance model mechanically and applying it in any system is neither sound proposition nor workable. Instead, it is a dynamic process and is determined by taking into consideration a country's peculiar conditions and circumstances By and large, the Government is the deciding factor in shaping the formal institutional and regulatory mechanisms of governance framework. In general, the governance models differ due to a variety of factors such as de-facto realities corporate environment in a country especially in terms of key players, its history, culture and ethnic grouping; ownership structure, capital market; legal and regulatory framework; disclosure requirements; macro-stabilisation policy; interaction among constituents; articles of Association, etc. These distinct features cause differentiation between different systems, jurisdictions and financial markets

CORPORATE GOVERNANCE MODELS…

Incidentally, it may be pertinently mentioned that more than a decade back, it increasingly felt that as the countries all over the globe depended too American capital, these would ultimately converge with US Corporate model. But, this premise no longer holds good today. On the contrary, one of the following three Models (either exclusively or in conjunction with other*) have been adopted by majority of the countries. These are:

1. **Anglo-US Model**
2. **Japanese Model**
3. **German Model**

CORPORATE GOVERNANCE MODELS…



CORPORATE GOVERNANCE MODELS…

Anglo-US Model:

- The Anglo-American System is prevalent in U.K., U.S.A., Australia, Canada, New Zealand, South Africa, Singapore and some other Commonwealth countries such as India.
- It follows unitary board Structure
- This model tends to focus more on the interests of shareholders including institutional shareholders who are in no way affiliated the company.
- The Board is dominated by Non-executive directors who hold key positions in Audit Committee and Remuneration Committee.
- There is a clear cut separation of ownership and management to minimize the conflict. The chief executive Officer holds position of Chairman as well (exception being U.K.) while professionals typically run the company affairs.
- Their performance is monitored by means of market-based rewards and penalties and fully developed legal framework
- The capital market being vibrant, allows quick mergers, acquisitions and hostile takeovers

CORPORATE GOVERNANCE MODELS…

Japanese Model:

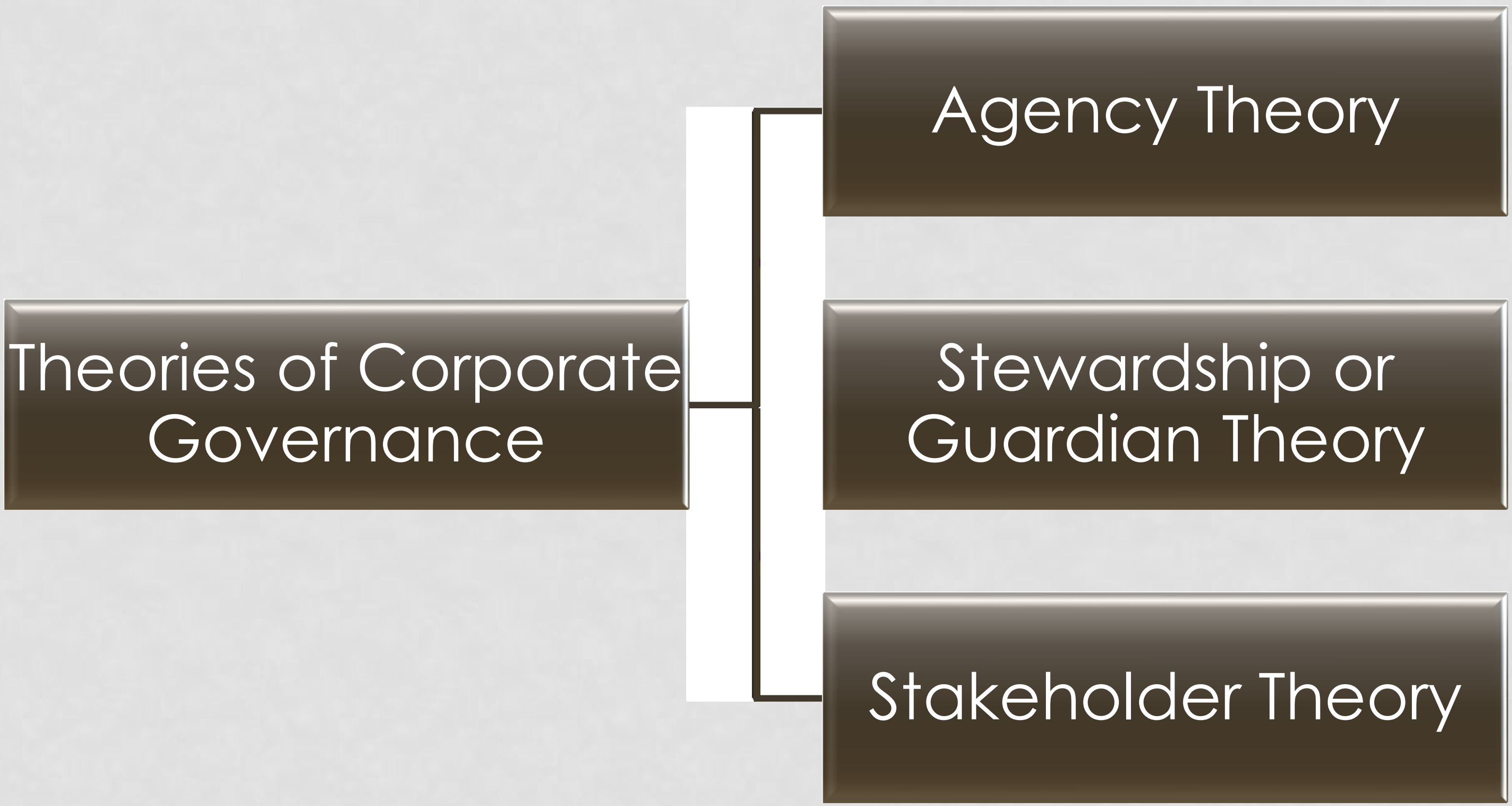
- The Japanese framework is designed to support and promote industrial or business groups linked by trading relationships (Keiretsu)
- The ownership structure is mainly in hands of affiliated lending banks (known as Main Banks) and company shareholders who appoint Board of Directors and the President.
- The board comprise solely of insiders.
- The President is obliged to consult both the Supervisory Board and Executive Management on policy decisions.
- the complicated procedure for exercising shareholders' votes act as a stumbling block receiving low levels of inputs from the outside shareholders.

CORPORATE GOVERNANCE MODELS…

German Model:

- This model is prevalent in Germany, Holland and to some extent in France.
- It has two tier board namely, supervisory board (representing labour/employees and shareholders in 50:50 ratio) and Management Board (entirely comprising of inside executives)
- No one can serve simultaneously on both the Boards.
- It is the Supervisory Board which appoints and monitors performance of Management Board.
- As regards ownership structure, the three German Banks hold long-term substantial financial stakes as the entrepreneurs prefer bank financing over equity financing.
- Although shareholders own the company, they neither evince keen interest nor dictate terms in governance process. The stakeholder are rare events claims are taken into account in top management decisions.
- Hostile takeover are rare incident.

THEORIES OF CORPORATE GOVERNANCE



THEORIES OF CORPORATE GOVERNANCE…

Agency Theory:

- Agency theory to corporate governance has its origin in field of Economics. It was strongly advocated as early as in 1776 by Adam Smith. His premise was that the shareholders' representatives, namely, the company's Directors were not likely to be as careful with other people's money as with their own. There are two main actors in and the Managers/professionals or the Agents theory: shareholders, the so-called owners or the principals.
- Inspite of divergent interests of the owners and the management, Agency theory strives to institutionalize that corporate governance is primarily concerned with the control of managers by the shareholders

THEORIES OF CORPORATE GOVERNANCE…

Stewardship or Guardian Theory:

- Stewardship theory is an alternative to Agency approach. It has its roots in Sociology and Psychology. It has been deeply influenced by scholarly work of modern management thinkers like McGregor, Maslow, Argyris, Likert and the like.
- The main thesis of the theory is that managers are always loyal to the company and are keenly interested in achieving high performance. They are the guardians or the stewards, although they do not own any company's resources. As trustworthy stewards and known for their credibility and personal reputation, they oversee the operations and look after the property and interests of the company when the owner is absent. The owners on their part however, provide the Managers with a meaningful environment.

THEORIES OF CORPORATE GOVERNANCE…

Difference between Agency and Stewardship theory:

The two theories to corporate governance differ substantially on account of several behavioural, psychological, Motivational and Situational factors. These are:

1. The Agency theory permits behavioural pattern as individualistic, opportunistic and self-serving. On the other hand, collectivism, pro-organizational and trust worthiness are the dominant patterns of Stewardship theory.
2. Managers in Stewardship theory pursue and follow the owners' pre-determined objectives as compared to their own-objectives in Agency approach.
3. Agency theory avoids both risks and risk-taking while Stewardship approach feels pleasure to manage them efficiently.

THEORIES OF CORPORATE GOVERNANCE…

5. The Stewardship theory relies more on high order intrinsic needs and intangible rewards (opportunities for growth, affiliation, achievement, self-actualization as compared to focus on extrinsic and tangible awards in the agency theory.
6. In Stewardship approach, a Manager has to identify himself with the organization and continuously commit for achieving the goals, tasks and assignments to the best of his capabilities. In contrast, Managers in Agency theory remains in low ebb so far as value commitment is concerned.
7. Agency theory resorts to Institutional power (coercise, legitimate and reward mechanism) for accomplishment of organizational goals. On the other hand, personal power sustained over a long spell, is the preferred choice to achieve the desired goals.
8. Stewardship theory rests on long lasting participative and involvement-oriented mechanisms whereby once the Managers are entrusted with challenging responsibilities, it empowers them to develop self-control of their behaviour.In contrast, Agency theory resorts to short-term control devices for achieving the given tasks.

THEORIES OF CORPORATE GOVERNANCE…

Stakeholder Theory:

- Any business enterprise owes a special duty to its shareholders who substantially invest capital to run its affairs. The corporate law also confers them a pre-eminent position due to their extraordinary status and power of control. In addition, the enterprise concerned is responsible to safeguard interests of other individuals/groups who play a vital role directly or indirectly in its smooth operations.
- There is no unanimity as to who should constitute as a genuine stakeholder. The list stretches right from employees, customers, suppliers, creditors, pressure groups, regulators, media, society at large, Government and of course, shareholders unlimited and unimaginable category of individuals/groups such as, terrorists, prisoners, blackmail, thieves and so on.

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