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Corporate Governance and Corporation during Global Regime

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Abstract:

This paper portrays a picture of Corporate Governance in India during global regime. Corporate Governance is stretched to the extent that it is distressed and has been unable to cope with the demands placed on it. While the focus of this paper has been on the financial services sector, and particularly on banks, many of the recommendations would equally be valid to other organisations which have a major societal impact, including for example corporations that play a major part in the critical national and international infrastructure of the national and global economies. The re-balancing of responsibilities would help to ensure that such organisations remain focused on the needs of society as a whole rather than simply on the investor and executive management interests. This paper proposes innovative new mechanisms that can enable corporations (and other) boards to discharge their Corporate Governance responsibilities with the required due and diligent care. The ultimate purpose of these new mechanisms is a change of culture in the board room, especially in the banking industry, which in essence underwrites the entirety of our economic system. To support this innovation, the paper also advocates the professionalization of management in the corporate sector by means of the creation of an international professional management association.

Keywords: EMH, CSR

I. INTRODUCTION

Corporate governance refers to the framework of rules and regulations that shape the extent to which shareholders and other stakeholders can exercise oversight and control over a company. The conditions for corporate governance in India have played an important role over the years, shaping success as well as failure. The dominant model in the region is based on close relationships between corporations, banks and governments, leading to a strong commitment by multiple stakeholders to the survival and growth of companies. Accounting tends to be highly non-transparent. This situation was further aggravated by the barriers to mergers and acquisitions, both legal and due to business practices and the nature of stakeholder. Before the crisis took hold in 1997, there were, in fact, relatively few mergers and acquisitions in the region. Insufficient oversight by banks and regulatory authorities, and the lack of transparency and accountability to shareholders, gave corporations an inordinate amount of discretion in their business decisions, and they were often backed by political support. As a result, a good number of ill-advised investments worked their way into company's portfolios. These bad investments have intensified the restructuring that will be required, as there is little hope that such dubious projects can, or should, be made viable. The commitment made by the crisis economies to liberalising trade and investment will, in fact, put further pressure on companies to jettison weak investments. Much of the contemporary interest in corporate governance is concerned with mitigation of the conflicts of interests between stakeholders. Ways of mitigating or preventing these conflicts of interests include the processes, customs, policies, laws, and institutions which have impact on the way a company is controlled. An important theme of corporate governance is the nature and extent of accountability of people in the business. There has been renewed interest in the corporate governance practices of modern corporations, particularly in relation to accountability, since the high-profile collapses of a number of large corporations during 2001-2002, most of which involved accounting fraud. Corporate scandals of various forms have maintained public and political interest in the regulation of corporate governance.

II. PRINCIPLES OF CORPORATE GOVERNANCE

Corporate governance principles and codes have been developed in different countries and issued from stock exchanges, corporations, institutional investors, or associations (institutes) of directors and managers with the support of governments and international organizations. As a rule, compliance with this governance, recommendations is not mandate by law, although the codes linked to stock exchange listing requirements may have a coercive effect. However, they must disclose whether they follow the recommendations in those documents and, where not, they should provide explanations concerning divergent practices. This internationally agreedbenchmark consists of more than fifty distinct disclosure items across five broad categories: auditing board and management structure and process, corporate responsibility and compliance, financial transparency and information disclosure. The aim is to promote global corporate governance standards. This document offers general information and a perspective from a business association/think-tank on a few key codes, standards and frameworks relevant to the sustainability agenda.

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The major principles are as follows:

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 openly and effectively communicating information and by encouraging shareholders to participate in general meetings.

Interests of other stakeholders. Organizations should recognize that they have legal, contractual, social, and market driven obligations to non-shareholder, stakeholders, including employees, investors, creditors, suppliers, local communities, customers, and policy makers.

Role and responsibilities of the board: The board needs sufficient relevant skills and understanding to review and challenge management performance. It also needs adequate size and appropriate levels of independence and commitment.

Integrity and ethical behaviour: Integrity should be a fundamental requirement in choosing corporate officers and board members. Organizations should develop a code of conduct for their directors and executives that promotes ethical and responsible decision making.

Disclosure and transparency: Organizations should clarify and make publicly known the roles and responsibilities of board and management to provide stakeholders 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.

Corporate Governance Models aroundthe World

There are many different models of corporate governance around the world. These differ according to the variety of capitalism in which they are embedded. The Anglo-American model tends to emphasize the interests of shareholders. The coordinated or multi-stakeholder model associated with Continental Europe and Japan also recognizes the interests of workers, managers, suppliers, customers, and the community. The Indian approach is drawn from the Gandhi and principle of trusteeship and the directive principles of the Indian Constitution, but this conceptualization of corporate objectives is also prevalent in Anglo-American and most other jurisdictions.

III. MECHANISMS AND CONTROLS

Corporate governance mechanisms and controls are designed to reduce the inefficiencies that arise from moral hazard and adverse selection. For example, to monitor managers' behaviour, an independent third party (the external auditor) attests the accuracy of information provided by management to investors. An ideal control system should regulate both motivation and ability.

Internal corporate governance controls

Internal corporate governance controls monitor activities and then take corrective action to accomplish organizational goals. For example

Monitoring by the board of directors: The board of directors, with its legal authority to hire, fire and compensate top management, safeguards invested capital. Regular board meetings allow potential problems to be identified, discussed and avoided. Whilst non-executive directors are thought to be more independent, they may not always result in more effective corporate governance and may not increase performance. Different board structures are optimal for different firms. Moreover, the ability of the board to monitor the firm's executives is a function of its access to information. Executive directors possess superior knowledge of the decision-making process and therefore evaluate top management on the basis of the quality of its decisions that lead to financial performance outcomes. Internal control procedures are policies implemented by an entity's board of directors, audit committee, management, and other personnel to provide reasonable assurance of the entity achieving its objectives related to reliable financial reporting, operating efficiency, and compliance with laws and regulations.

Balance of power: The simplest balance of power is very common; require that the president be a different person from the treasurer. This application of separation of power is further developed in companies where separate divisions check and balance each other's actions. One group may propose company-wide administrative changes; another group review and a third three groups are being met.

Remuneration: Performance-based remuneration is designed to relate some proportion of salary to individual performance. It may be in the form of cash or non-cash payments such as share and share options, superannuation or other benefits. Such incentive schemes, however, are reactive in the sense that they provide no mechanism for preventing mistakes or opportunistic behaviour, and can elicit myopic behaviour.

Monitoring by large shareholders and/or monitoring by banks and other large creditors: Given their large investment in the firm, these stakeholders have the incentives, combined with the right degree of control and power, to monitor the management

External corporate governance controls

External corporate governance controls encompass the controls external stakeholders exercise over the organization. Examples include: competition, debt covenants, demand for and assessment of performance information regulations, government regulations, managerial labour market, media pressure, takeovers

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Problems of Corporate Governance

Demand for information: In order to influence the directors, the shareholders must combine with others to form a voting group which can pose a real threat of carrying resolutions or appointing directors at a general meeting.

Monitoring costs: A barrier to shareholders using good information is the cost of processing it, especially to a small shareholder. The traditional answer to this problem is the efficient market hypothesis (in finance, the efficient market hypothesis (EMH) asserts that financial markets are efficient), which suggests that the small shareholder will free ride on the judgments of larger professional investors.

Supply of accounting information: Financial accounts form a crucial link in enabling providers of finance to monitor directors. Imperfections in the financial reporting process will cause imperfections in the effectiveness of corporate governance. This should, ideally, be corrected by the working of the external auditing process

Importance of Corporate Governance in Corporation

Good governance is of course important in every sphere of the society whether it be the corporate environment, or general society or the political environment. Good governance levels can, for example, improve public faith and confidence in the political environment. When the resources are too limited to meet the minimum expectations of the people, it is a good governance level that can help to promote the welfare of society. And of course a concern with governance is at least as prevalent in the corporate world. Good governance is essential for good corporate performance and one view of good corporate performance is that of stewardship and thus just as the management of an organisation is concerned with the stewardship of the financial resources of the organisation , so too would management of the organisation be concerned with the stewardship of environmental resources. The difference however is that environmental resources are mostly located externally to the organisation. Stewardship is concerned with the resources of society as well as the resources of the organisation. As far as stewardship of external environmental resources is concerned then the central tenet of such stewardship is that of ensuring sustainability. Sustainability is focused on the future and is concerned with ensuring that the choices of resource utilisation in the future are not constrained by decisions taken in the present. Often company's main target is to become global – while at the same time remaining sustainable – as a means to get competitive power. But the most important question is concerned with what will be a firm's route to becoming global and what will be necessary in order to get global competitive power. There is more than one answer to this question and there are a variety of routes for a company to achieve this. Corporate governance can be considered as an environment of trust, ethics, moral values and confidence – as a synergic effort of all the constituents of society – that is the stakeholders, including government; the general public etc; professional/service providers – and the corporate sector.. Although there is an accepted link between good corporate governance and corporate social responsibility, the relationship between the two is not clearly defined and understood. Thus many firms consider that their governance is adequate because they comply with the combined code of corporate governance, which came into effect in 2003.

Corporate Governance and Corporate Social Responsibility

The activities of a corporation impact upon the external environment and therefore such an organisation should be accountable to a wider audience than simply its shareholders. This is a central tenet of both the concept of corporate governance and the concept of corporate social responsibility. There are a wide variety of stakeholders who justifiably concerned with those activities, and are affected by those activities. Whereas other stakeholders have not just an interest in the activities of the firm but also have a degree of influence over the shaping of those activities. This influence is so significant that it can be argued that the power and influence of these stakeholders is such that it amounts to quasi-ownership of the organisation. Central to this social contract is a concern for the future which has become manifest through the term sustainability. The term sustainability has become ubiquitous both within the discourse globalisation and within the discourse of corporate performance. Sustainability is of course a controversial issue and there are many definitions of what is meant by the term. At the broadest definitions sustainability is concerned with the effect which action taken in the present has upon the options available in the future. If resources are utilised in the present then they are no longer available for use in the future, and this is of particular concern if the resources are finite in quantity. Thus sustainability – one of the most important subject of the present – requires a very different understanding of the concept of stewardship and therefore a very different understanding of the Governance mechanisms which safeguard such stewardship. In the modern world the scope of governance has been significantly extended although understanding of this, and the concomitant governance codes, has often not expanded as quickly or as extensively. Not only does such sustainable activity however impact upon society in the future; it also impacts upon the organisation itself in the future. Thus good environmental performance by an organisation in the present is in reality an investment in the future of the organisation itself. This is achieved through organisation to operate in the future in a similar way to its operations in the present and so to undertake value creation activity in the future much as it does in the present. Financial management also however is concerned with the management of the organisation's resources in the present so

that management will be possible in a value creation way in the future. Thus the internal management of the firm, from a financial perspective, and its external environmental management coincide in this common concern for management for the future. Good performance in the financial dimension leads to good future performance in the environmental dimension and vice versa. Thus there is no dichotomy between environmental performance and financial performance and the two concepts conflate into one concern. This concern is of course the management of the future as far as the firm is concerned. Similarly the creation of value within the firm is followed by the distribution of value to the stakeholders of that firm, whether these stakeholders are shareholders or others.

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Similarly good environmental performance leads to increased welfare for society at large, although this will tend to be expressed in emotional and community terms rather than being capable of being expressed in quantitative lead to increased motivation. Such increased motivation will inevitably lead to increased productivity, some of which will benefit the organisations, and also a desire to maintain the pleasant environment which will in turn lead to a further enhanced environment, a further increase in welfare and the reduction of destructive aspects of societal engagement by individuals. The more enlightened recognise that there is a clear link between governance and corporate social responsibility and make efforts to link the two. Often this is no more than making a claim that good governance is a part of their CSR policy as well as a part of their relationship with shareholders. It is recognised that these are issues which are significant in all parts of the world and a lot of attention is devoted to this global understanding. Most analysis however is too simplistic to be helpful as it normally resolves itself into simple dualities: rules-based versus principles-based or Anglo-Saxon versus Continental

All corporations are concerned with their important stakeholders and make efforts to satisfy their expectations. Thus a concern with employees and customers is apparent in all corporations, being merely a reflection of the power of those stakeholder groupings rather than any expression of social responsibility. Similarly in some organisations a concern for the environment is less a representation of social responsibility and more a concern for avoiding legislation or possibly a reflection of customer concern. Such factors also apply to some expressions of concern for local communities and society at large. For CSR though this concern has become formalised, often through the development of a balanced scorecard and such things as customer or employee satisfaction surveys. Most organisations have progressed through this stage also, with such activity being embedded into normal ongoing business practice.

Some companies have been practicing social and environmental reporting for 15 years but for many it is more recent. Now most companies – certainly most large companies – provide this information in the form of a report. Over time these reports have become more extensive and more detailed with a broader range of measures of social and environmental performance being included. So most organisations have reached this stage of maturity also. The problem with this stage though is that at the moment there are no standards of what to report and so organisations tend toreport different things, thereby hindering comparability. Organisations such as Accountability, with its AA1000 standard, and the Global Compact have sought to redress this through the introduction of a standard but none have gained universal acceptance. Consequently it is probably true to state that this is the current stage of development for most organisations.

IV. GLOBAL PERSPECTIVES

The 2008 financial crisis has shown us that good governance is related to good corporate performance and the sound management of a company. Earlier we have described this as stewardship and in doing so we have extended the definition of such stewardship beyond that of merely preserving the assets of the owners of the business and entrusted to the managers. This is the basic accounting principle upon which agency theory is based, in the modern environment though the definition of stewardship has to be extended to cover all aspects of the business and all stakeholders to that business – a much broader definition with significant implications for governance. This is absolutely essential for sustainability and any concern for the future operations of both the organisation and the global economy in which it is operating. Good governance therefore is extended in meaning and this book is concerned with the extension of that meaning and the implications for the operating of a company in an increasingly global environment. Moreover, it demands an understanding of the cultural context in which a firm is operating and there are considerable regional differences which it is important to understand. At this point however we simply which to signify that good governance, as depicted through the concept of stewardship, has been extended in meaning and that the firm must also consider, alongside the stewardship of its
own resources, the stewardship of both societal resources and of environmental resources located external to the organisation. This of course implies changes to operational practice as well as changes to governance requirements. Of equal concern is the question of corporate social responsibility – what this means and how it can be operationalised. Thus we argue that a global framework does not exist but in our increasingly globalised world it is something which would be beneficial to international interactions and will inevitable emerge. Furthermore we argue that different cultures have something to offer in the development of this global framework.

Diversity in Corporate Governance Regime

As far as the changing social and political environments in which corporations operate are concerned, rather than focusing on the actual political changes underlying the developments in corporate governance regulation, the mainstream corporate governance literature seems more preoccupied with bridging the space between corporate governance issues and the broadening societal apprehension of the shareholder value perception of the modern corporation, so as to safeguard the general thrust of the system. The question of how to account for the differences in corporate governance systems and regulation continues to be a central issue for social sciences. Here, comparative political economy research offer fruitful research perspectives that moves beyond the legal approaches in important ways.

The modern corporation The emergence and subsequent rise to dominance of the modern corporation marked a new stage in capitalist development. Marx noted that the joint-stock corporation facilitated 'tremendous expansion in the scale of production and enterprises which would be impossible for individual capitals', while also acknowledging the creation of privateownership of corporations in that 'at the same time, enterprises that were previously government ones become social'. The increasing scale of economic production indeed transcended the dimensions of the 'traditional' family-owned capitalist firm and government agencies. However, the organizational form of the modern corporation did not

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come about as the inevitable outcome of economic processes, in which it emerged as the most efficient, that is, transaction cost-minimizing, and way of organizing production. Rather, the modern corporation was a creation of the state. Its organizational form, as well as its purpose, that is, in which interest it should be run, is continuously sustained by the legal framework provided through the state.

Shortcomings

Company performance, by any standards, has been poor. Even the best performing corporations have seen enormous reductions in their profitability and in their corporate value.

Shareholder value, far from being delivered over the long term, has been destroyed on an enormous scale, and in many cases eliminated.

The confidence that is needed "for the proper functioning of a market economy" has been substantially eroded in so far as inter-banking lending is still at very low levels, and trust is not being easily restored.

The cost of capital has increased to the extent that the sole providers of capital for the restructuring of many banks have been either national governments or sovereign wealth funds.

V. RECOMMENDATIONS

As a matter of policy, boards should be encouraged to take a broad based view of Corporate Governance which encompasses the totality of their role. In addition those who maintain codes of Corporate Governance should ensure that a broad based view is incorporated into their respective codes. This may require changes in the law, which should be consistent across territories and it may also require considerable further work in developing appropriate guidance to assist boards and individual directors to discharge these duties.

VI. CONCLUSION

It can be concluded that present situation shows three major structural weaknesses: over-capacity, insufficient technological capability; and an unfavourable environment for corporate sector. The dichotomous structure; large industries co-exist with small firms which are Labour-intensive and sometimes low-technology, and there are insufficient linkages between the two. The build-up of excess capacity was facilitated by lack of transparency in domestic financial markets and large inflows of foreign capital. Potential problems were disregarded because of the countries 'outstanding past performance, and because of the fact that the countries in the region could drag each other down just as they had helped each other to perform in the first class of the development league for so long. Improved corporate governance is not, however, a development panacea .In the financial sector, close attention must also be given to measures the strengthen of the banking sector and a country's financial institutions as a whole. In the real sector, close attention must also be given to competition policy andto sector-specific regulatory reform. Such attention is important for all developing,transition and emerging-market economies.

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