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A conceptual framework on corporate governance in organizations

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Abstract
In recent years there have been an innumerable initiatives undertaken by the organizations and the policy makers to bring about systems, structures and the tangible outcomes in all facets in the organizations. Corporate Governance is a major driver in present day where there is a need to align the organization interest with that of the stakeholders. Definitely, Corporate Governance has been a key driver for the business to realize their entities in the context of Institutional Social Responsibility.

Keywords: Governance, Impact, Committee, Corporate Fraud.

Introduction

1.1 Corporate Governance - Defined

Corporate Governance may be defined as a combination of systems, processes and principles which makes sure that a company is governed in the combined interest of all stakeholders. The system directs and controls the organisation. Today, the organizations are proactive in promoting corporate fairness, transparency and accountability. In other words, 'good corporate governance' is simply 'good business'.

1.2 Corporate Governance in Business

- Adequate disclosures and effective decision making to achieve corporate objectives;
- Transparency in business transactions;
- Statutory and legal compliances;
- Protection of shareholder interests; and
- Commitment to values and ethical conduct of business.

Corporate governance is realigning 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 conferring the just and fair conduct of business at the behest of the stakeholders. In the process, asymmetry of benefits among the stakeholders is prevented, especially between the owner-managers and the rest of the shareholders.

It is about commitment to values, about ethical business conduct and about making a distinction between personal and corporate funds in the management of a company. Ethical dilemmas arise from conflicting interests of the parties involved. In this regard, managers make decisions based on a set of principles influenced by the values, context and culture of the organization. Ethical leadership is good for business as the organization is seen to conduct its business in line with the expectations of all stakeholders.

1.3 Corporate Governance and Stakeholders

The aim of "Good Corporate Governance" is to ensure commitment of the board in managing the company in a transparent manner for maximizing long-term value of the company for its shareholders and all other partners. It integrates all the participants involved in a process, which is economic, and at the same time social.

The corporate governance aims to enhance shareholders' value and protect the interests of other stakeholders by improving the corporate performance and accountability. It enhances the stakeholders' wealth while the interests of the other stakeholders is not compromised. It generates an environment of trust and confidence amongst those having competing and conflicting interests.

It is integral to the very existence of a company and strengthens investor's confidence by ensuring company's commitment to higher growth and profits.

1.4 Objectives of Corporate Governance

- A properly structured board capable of taking independent and objective decisions is in place at the helm of affairs;
- The board is balanced as regards the representation of adequate number of non-executive and independent directors who will take care of their interests and well-being of all the stakeholders;
- The board adopts transparent procedures and practices and arrives at decisions on the strength of adequate information;
- The board has an effective machinery to subserve the concerns of stakeholders;
- The board keeps the shareholders informed of relevant developments impacting the company;
- The board effectively and regularly monitors the functioning of the management team;
- The board remains in effective control of the affairs of the company at all times.

The overall endeavor of the board should be to take the organisation forward so as to maximize long term value and shareholders' wealth.

1.5 Corporate Governance- A Global Perspective

Over the years a number of organizations have been involved in preparing various guidelines and principles of corporate governance. Due to the financial scandals and corporate collapses, there is generally the desire for transparency and accountability which will increase investors' confidence. The Nigerian situation has been influenced by developments in the United Kingdom, the United States and by the OECD research on corporate governance. Various codes emanating from these countries through various committees are therefore discussed below;

1) United Kingdom

A large body of research and work has emerged from the UK, which has been in the forefront of setting up various working parties and committees to address a number of governance issues. Some of the major reports from the UK include;

- The Cadbury Report (1992)
- The Greenbury Report (1995)
- The Hempel Report (1998)
- The Higgs Report (2003); and
- The Combined Code on Corporate Governance (2003).

a) The Cadbury Report (1992)

The Committee to report on "The Financial Aspects of Corporate Governance" was set up in May 1991 by the Financial Reporting Council, the London Stock Exchange and the accountancy profession. The Committee's Report came to be known as "The Cadbury Report" after the Chairman Sir Adrian Cadbury. The terms of reference were to consider a number of issues in relation to financial reporting and accountability. The recommendations included increasing the numbers and powers of non-executive directors (who should be independent); the separation of the posts of CEO and Chairman, and the setting up of sub-committees to independently monitor and judge management.

b) The Greenbury Report (1995)

The Study Group on Directors' Remunerations was set up in 1995 in response to public and shareholder concerns about directors' remuneration. The Group focused on large public companies and was chaired by Sir Richard Greenbury. This included preparing annual reports to shareholders with full disclosure of remuneration policies for executive directors and other senior executives; and the length of service contracts and compensation when these were terminated.

c) The Hampel Report (1998)

The Committee on Corporate Governance was set up following the recommendations of the Cadbury and Greenbury Committees to review the implementations of their findings in 1995. The Committee consulted with a broad range of organizations and individuals. These findings were presented in 1998 as "The Hampel Report" (Sir Ronald Hampel being the Chairman). The terms of reference in addition to the review of the Cadbury and Greenbury Codes included reviewing the role of directors (executive and non-executive), shareholders, and auditors in corporate governance issues.

d) The Higgs Report (2003)

In 2002 the UK Government appointed Derek Higgs to review the role of non-executive directors. The final report "Review of the Role and Effectiveness of Non-Executive directors" was published in 2003. The terms of reference included undertaking a review to assess the population of non-executive directors, their appointment; their independence and effectiveness, accountability and remuneration.

e) The Combined Code of Corporate Governance (2003)

The Combined Code originally issued in 1998 drew together the recommendations of Cadbury, Greenbury, and Hampel reports (Mallin 2004, p.23). The new Combined Code (2003) incorporates a number of key issues as addressed by the Higgs Report (2003) relating to corporate governance principles; the role of the board and chairman; the role of non-executive directors and audit and remuneration committees.

These recommendations include a revised Code of Principles of Good Governance and Code of Best Practice; relating to the recruitment, appointment and professional development of non-executive directors.

1) OECD

The OECD Principles of Corporate Governance were first published in 1999. These principles were intended to provide guidelines in assisting governments in improving the legal, institutional and regulatory framework that underpins corporate governance. In addition they provided guidance for stock exchanges, investors, companies, and other parties.

The principles cover the following areas:

a) Ensuring the basis for an effective corporate governance framework;
b) The rights of shareholders and key ownership functions;
c) The equitable treatment of shareholders;
d) The role of stakeholders in corporate governance;
e) Disclosure and transparency; and
f) The responsibilities of the board.

2) Australia

Australia adopted a similar format and referred to the original OECD principles (1999) in its introduction when it issued its Standards in June 2003. The standards are non-prescriptive guidelines, aimed at providing companies, government entities and not-for-profit organizations with governance frameworks.

The Australian Corporate Governance Standards consists of 5 standards as listed below:

- AS 8000-2003 Good governance principles
- AS 8001-2003 Fraud and corruption control
- AS 8002-2003 Organization codes of conduct
- AS 8003-2003 corporate social responsibility
- AS 8004-2004 Whistleblower protection for entities.

3) United States

The US has also produced a large volume of works especially since the collapse of such well-known business icons as Enron and WorldCom. The Sarbanes-Oxley Act 2002, and the NYSE Corporate Accountability and Listing Standards 2002 were issued in response to the need for "improved" regulation. The NYSE Listing Standards Committee was set up to canvas comments from such organizations as the Business Roundtable Corporate Governance Taskforce. The Business Roundtable (BRT) is an association of executive officers of leading corporations. The BRT had released its own updated "Principles of Corporate Governance" in May 2002.

1.6 Evolution of Corporate Governance in India

The first initiative at introducing Corporate Governance in a structured manner in India was by the industry through its association, the confederation of Indian industry (CII) in 1998. It was a voluntary set of recommended Governance norms that companies could adopt in order to be seen as well run companies. However, in order to ensure the more wide spread adoption of Corporate Governance norms, it is necessary to have a certain statutory compliance value and therefore, SEBI under took the second initiative in Corporate Governance by introducing the code formed by a committee under the chairmanship of a leading industrialist Kumarmangalam Birla, in 1999. The recommendation of this committee contained new provisions in line with global development such as incorporating a management discussion and analysis report as part of the annual report, emphasizing on the formation of board committees, and advocating the role of independent directors.

These proposals were introduced by SEBI in 2000 for companies by amending the listing agreement that companies enter in to stock exchanges.

SEBI's mandate, however, extends only to companies listed on stock exchanges and comprehensive adoption of Corporate Governance norms for all companies can be brought about in India only through the legislative rule. Therefore, a third set of Corporate Governance proposal was carried out by the of company affairs (now the Ministry of Corporate Affairs).

On the basis of the recommendations of the Naresh Chandra Committee in December 2002, it made recommendation pertaining to two key aspect of Corporate Governance: Financial and Non-financial disclosures, and independent auditing and board oversight of management, as also a series of recommendation regarding statutory auditors.

The fourth initiative on Corporate Governance in India has again carried out by SEBI on the basis of the Naranya Murthy Committee, which was set up to review clause 49, and suggest measure to improve Corporate Governance standards. This was done in the wake of Enron Scandal in United States in order to evaluate the adequacy of existing clause 49, and to further improve existing practices in order to enhance the transparency an integrity of India's Stock Market's and to ensure compliance with Corporate Governance codes in substance and not merely in form. The changes suggested reflect the global norms of Corporate Governance in Anglo-Saxon countries, which operate under a different business environment then prevalent in India.

1.7 Major Challenges to Corporate Governance Reforms in India

1. Power of the dominant share holder(s);
2. Lack of incentives for companies to implement Corporate Governance reform measures (no direct correlation between putting expensive governance systems and corresponding returns);
3. Under developed external monitoring systems;
4. Shortage of real independent directors; and
5. Weak regulatory oversight including multiplicity of regulators.

1.8 Legal Framework

The important legislations for regulating the entire corporate structure and for dealing with various aspects of governance in companies are Companies Act, 1956 and Companies Bill, 2004. These laws have been introduced and amended, from time to time, to bring more transparency and accountability in the provisions of Corporate Governance. That is, corporate laws have been simplified so that they are amenable to clear interpretation and provide a framework that would facilitate faster economic growth.

Secondly, the Securities Contracts (Regulation) Act, 1956, Securities and Exchange Board of India Act, 1992 and Depositories Act, 1996 have been introduced by Securities and Exchange Board of India (SEBI), with a view to protect the interests of investors in the securities markets as well as to maintain the standards of corporate governance in the country.

1.9 SEBI and Corporate Governance

SEBI has laid out Corporate Governance provision that are intended to ensure a minimum standard of Corporate Governance among listed companies in India. This is issued as a part of the listing agreement that each listed company signs with the Stock Exchange under the title 'clause 49', which remains the most significant Corporate Governance reforms and has helped establish a new Corporate Governance regime. The clause 49 reforms included detailed rules regarding the role and structure of the corporate board and internal controls.

These norms lay down the criteria for the-

- Appointment of independent directors in the board.
- Appointment, composition and powers of the audit committee.
- Functioning of the investors' grievances redressal committee.
- Composition that can be paid to the non-executive directors.
- Adherence to an internal control of conduct by the board of directors and other top executives.

- Disclosure of accounting policies, contingent liabilities, related party transactions, and IPO proceed utilization.
- Certification by the CEO/CFO on the adequacy of the internal control system, and the correctness of the reported financials.
- Whistle-blower policy

1.10 Benefits and Limitations

The concept of corporate governance has been attracting public attention for quite some time. It has been finding wide acceptance for its relevance and importance to the industry and economy. It contributes not only to the efficiency of a business enterprise, but also, to the growth and progress of a country's economy. Progressively, firms have voluntarily put in place systems of good corporate governance for the following reasons:

- Several studies in India and abroad have indicated that markets and investors take notice of well managed companies and respond positively to them. Such companies have a system of good corporate governance in place, which allows sufficient freedom to the board and management to take decisions towards the progress of their companies and to innovate, while remaining within the framework of effective accountability.
- The credibility offered by good corporate governance procedures also helps maintain the confidence of investors – both foreign and domestic – to attract more long-term capital. This will ultimately induce more stable sources of financing.
- A corporation is a congregation of various stakeholders, like customers, employees, investors, vendor partners, government and society. Its growth requires the cooperation of all the stakeholders. Hence it imperative for a corporation to be fair and transparent to all its stakeholders in all its transactions by adhering to the best corporate governance practices.
- Good Corporate Governance standards add considerable value to the operational performance of a company by:

1. Improving strategic thinking at the top through induction of independent directors who bring in experience and new ideas;
2. Rationalizing the management and constant monitoring of risk that a firm faces globally;
3. Limiting the liability of top management and directors by carefully articulating the decision making process;
4. Assuring the integrity of financial reports, etc.

It also has a long term reputational effects among key stakeholders, both internally and externally.

- Also, the instances of financial crisis have brought the subject of corporate governance to the surface. They have shifted the emphasis on compliance with substance, rather than form, and brought to sharper focus the need for intellectual honesty and integrity. This is because financial and non-financial disclosures made by any firm are only as good and honest as the people behind them.
- Good governance system, demonstrated by adoption of good corporate governance practices, builds confidence amongst stakeholders as well as prospective stakeholders. Investors are willing to pay higher prices to the corporates demonstrating strict adherence to internally accepted norms of Corporate Governance.
- Effective governance reduces perceived risks, consequently reduces cost of capital and enables board of directors to take quick and better decisions which ultimately improves bottom line of the corporates.
- Adoption of good corporate governance practices provides long term sustenance and strengthens stakeholders' relationship.
- A good corporate citizen becomes an icon and enjoy a position of respects.
- Potential stakeholders aspire to enter into relationships with enterprises whose governance credentials are exemplary.
- Adoption of good corporate governance practices provides stability and growth to the enterprise.

Effectiveness of corporate governance system cannot merely be legislated by law neither can any system of corporate governance be static. As competition increases, the environment in which firms operate also changes and in such a dynamic environment the systems of corporate governance also need to evolve. Failure to implement good governance procedures has a cost in terms of a significant risk premium when competing for scarce capital in today's public markets.

1.11 Board Composition

The company's board shall have an optimum combination of Executives, Non-Executives and Independent Directors in line with the requirement of the provision of the Companies Act, 1956 and Articles of Association of the company. Independent Directors are eligible for sitting fees for attending the Board and Audit committee meetings. The Sitting fess plus travelling expenses on actual shall be within the prescribed limits of Companies Act, 1956 and as decided by way of passing a Board resolution. The Non-Executive independent director of the company are not eligible for any compensation in whatever manner unless approved by the Board and other regulatory requirement.

1.12 Conclusion

The thinking behind corporate governance has been that the organizations understand their responsibilities in various fronts. The Corporate Governance tends to bring transparency and the audit is conducted independently. It actually has evolved over the years to bring functional discipline among the organizations and is hereto stay.

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