Corporate Governance

Corporate governance refers to the set of systems, principles and processes by which a company is governed. They provide the guidelines as to how the company can be directed or controlled, such that it can fulfill its goals and objectives in a manner that adds value to the company & is also beneficial for all stakeholders in the long term.

Definition: according to Anazett, corporate governance means, a system of law and sound approaches by which corporations are directed and controlled focusing on the internal and external corporate structures with the intention of monitoring the actions of management and directors and thereby mitigating agency risks which may stem from the misdeeds of corporate officers.

2. India’s SEBI Committee on Corporate Governance defines as “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 and corporate funds in the management of a company.”

3. According to Subramanian Swami, Corporate Governance can be defined as ways of bringing the interests of investors and managers into line and ensuring that firms are run for the benefit of investors.

4. According to Bob Tricker, it is concerned with the relationship between the internal governance mechanisms of corporations and society’s conception of the scope of corporate accountability.

Importance of Corporate Governance

Good corporate governance ensures that the business environment is fair and transparent and the companies can be held accountable for their actions. Weak corporate governance leads to waste, mismanagement, and corruption. It is also important to remember that although corporate governance has emerged as a way to manage modern joint stock corporations. It is equally significant in state owned enterprises, cooperatives and family businesses.

The essence of good corporate is ensuring trustworthy relations between the corporation and its stakeholders. Following are the importance of corporate governance.

1. Economic benefit: There is evidence that good corporate governance produces direct economic benefit to the organization. A study conducted at the Georgia State University, published in December 2004, found that public companies with independent boards of directors have higher returns on equity, higher profit margins, larger dividend yields and larger stock repurchases.

2. Effective Decision Making: Good corporate supports effective decision making based on accountability, clear communication, understanding the roles and responsibilities across the organization, management information systems and high standards of conduct.

3. Delivering Quality Services: Organizations with good corporate governance have capacity to maintain high quality services. Poor governance fail to detect or anticipate serious service and financial failures.
4. Legal Requirements: SEBI has made corporate governance mandatory for certain companies. This is done to protect the interest of the investors and other stakeholders.

5. Shareholder Value: The fundamental objective of corporate governance is to enhance the shareholders' value and protect the interest of other stakeholders by improving the corporate performance and accountability.

6. Reduction in Scams: 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 other partners. This helps reduction in scams.

**Major factors for Good Corporate Governance**

Since 1900 several factors enabled a marked increase in the frequency and scale of corporate disasters and scandals. These factors are:

1. Globalization: Markets are global and connected as never before. Natural boundaries and limits that existed before globalization, no longer exist. Therefore problems can reach and spread far wider than in earlier times.

2. Technology: The modern scale of technologies increases the scale of potential damage of corporate wrong doing. For e.g. In the field of manufacturing, commodities, machinery, transport, construction, IT, web etc., the technology has change the face of organization.

3. Population: Volumes and densities of populations everywhere have increased since 1900. Where corporate scandals and disasters happen, the potential to affect vast number of people has never been greater.

4. Free market: Governments for free market has encouraged the development of unregulated major risk taking in organization. Most corporations are run in an extremely selfish and greedy manner. Short term gain and the enrichment of directors and senior staff continue to drive corporate strategy and decision everywhere.

**The Fundamental Principles of Corporate Governance**

The important fundamental principles are as follows;

1. Transparency: Transparency means accurate, adequate and timely disclosure of relevant information to the stakeholders. Without transparency, it is impossible to make any progress towards good governance. It also creates immense shareholder value. The company is a trustee of the investor's money and this responsibility in turn demands full disclosure. Corporations in India must learn to work with transparency. It is essential ingredients to maximize their wealth. Transparency and disclosure are the key pillars of corporate governance because they provide all the stakeholders with information necessary to judge whether their interests are being taken care of.

2. Accountability: Corporate governance has to be a top down approach. Chairman, Boards of Directors and Chiefs Executives must fulfill responsibilities to make corporate governance a reality in Indian industry. In companies with good governance accountability is not just bottom up but also follows the reverse order.
3. Merit based Management: A strong board of directors is necessary to lead and support merit based management. The board has to be an independent, strong and non-partisan body where the motive should be decision making through business prudence. Corporate governance ensures that long term strategy, objectives and plans are established and the proper management structure is in place to achieve those objectives. Thus, corporate governance involves the broad parameters of reporting system, accountability and control.

The Need for Corporate Governance

To sustain and develop industries on healthy lines there is an imperative need of good corporate governance. The genesis of corporate governance lies in business scams and failures. Loss of confidence in reports and accounts of companies and the audit statements attached to them, business scams and collapse of business giants, all these things together bring in forefront the need for good corporate governance. Why corporate governance has become more important for economic development and more important policy issues in many countries, the reasons are as follows;

1. Privatization: Privatization has raised corporate governance issues in sectors that were previously in the hands of the state. Firms have gone to public markets to seek capital and mutual societies and partnerships have converted themselves into listed corporations.

2. Liberalization: Due to technological progress, the allocation within and across countries of capital among competing purposes has become more complex. This makes good governance more important and more difficult.

3. Mobilization of Capital: The mobilization of capital gives rise to increase the size of firms and increase the role of financial intermediaries. The role of institutional investors is growing in many countries. Many economies are moving away from ‘pay as you go’ systems. This increased the need for good corporate governance.

4. Reshaping of local and global financial landscape: Programs of delegation and reform have reshaped the local and global financial landscape. Long standing institutional corporate governance arrangements are being replaced with the new institutional arrangements.

5. Increase in international financial integration: International financial integration has increased. Trade and investment flows are also increasing. This has led to many cross border issues in corporate governance. Cross border investment has been increasing.

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