

CORPORATE GOVERNANCE – LAW & POLICY PERSPECTIVES

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Corporate Governance is a system by which companies are directed and controlled. Corporate Governance mainly aims at total transparency integrity and accountability of Company affairs.

Corporate Governance aims to achieve best interest to all stake holders. Stake holders are the term coined with the development of corporate governance. Previously everything used to look from the view point of shareholders.

Stake holders are persons who are directly or indirectly connected to company. The stakeholders may be internal or external.

Internal stake holders may be promoters, members, workmen, executive's etc. external stake holders may be customer, Lenders, Dealers, vendors, bankers, community, government etc.

As it is well known that, even through a company is a person in the eye of law, its personality has certain limitations as to perform certain functions. It is only a juristic person existing only in the eye of law and not capable of taking certain decisions, which are hallmark of natural persons. Decision making and running the affairs of the company is one of such thing that a company cannot do on its own as a person.

As can be seen from the above the progress and prosperity of the company mainly depends upon its directors and collective decisions in the form of Board.

Since entire focus is on Board of Directors collectively and directors individually, Corporate Governance mainly concerned with establishment of a system where by the directors are entrusted with responsibilities and duties relating to directions of corporate affairs.

It aims to achieve at total transparency, integrity and accountability among directors while performing their functions, which in turn requires the principle of commitment to values, ethical business conduct and a high degree of feeling responsibility.

The important aspect to be noted here is that the principles of commitment to values, ethical business conduct and a high degree of feeling responsibility are virtues to be self generated and cannot be brought by enacting legislation.

Thus looking from a broader point of view Concept of corporate Governance extends beyond corporate laws.

Thus the main concept of corporate governance is business prosperity with back drop of ethical code of conduct which ultimately results in Nations overall growth.

The Emergence of Corporate Governance:

It seems the word emergence is not justifiable entirely in the context of Corporate Governance. The same can be verified from the fact that there exist prosperous companies even prior to the much talked Corporate Governance and various reports of Corporate Governance. Thus these codes are inherent characteristic of all healthily organizations even in the past.

The reason for the above may be the primary virtues of ethnicity values as to transparency accountability are self embodied in the people if yester years or there exists good control over their functioning. As the days passes by these virtues tend to degrade and there arises a necessity to a code of conduct in some form to control them.

Likewise, as and when the society witnesses and evil, it responds to counter it by way of on its own or through the channel of rulers. In modern era these rulers are in the form Kings/crowns in some cases, democratic governments in some cases.

If we view Corporate Governance in this context, our thoughts will definitely revolve round the failure of companies due to lack of ethical management in some cases, due to lack of persons having proper knowledge to guide in some cases and most importantly due to persons who can be termed as intelligent criminals who played tricks with them and public.

Thus, the concept of Corporate Governance, which is there in embodied form was invoked worldwide due to same incidents/debacles, which effected economy of countries.

Some of the examples are as hereunder:

To start with U.K. where form most of our industrial culture adopted the scandal of pension funds of the Max well communication group created havoc in the minds of workers

where in millions sterling pounds were disappeared from pension funds. Notable business giants like Polly Peck and BCCI collapsed.

Likewise in South Africa the report of King committee chaired by Mervyn King produced its main code on Corporate Governance.

In India, the episode of Big Bull Harshad Mehta and scandals by Khetan Parekh are alarming incidents.

If we go counting like this the fact going to be emerged is that in the end of 20th century i.e. during the period 1980-1999, there emerged so many codes all over the world most importantly to counter the debacles/incidents which effected their economic very badly.

CORPORATE GOVERNANCE- Defined:

Cadbury committee, UK has defined corporate governance as follows:

“(it is) the system by which companies are directed and controlled”.

The Kumar Mangalam Birla Committee constituted by SEBI observed that

“Strong corporate governance is indispensable to resilient and vibrant capital market and is an important instrument of investor protection. It is the blood that binds the views of transparent corporate disclosure and high quality accounting practices. It is the muscle that moves a viable and accessible financial reporting structure”.

N.R. Narayana Murthy committee on corporate Governance Constituted by SEBI has observed that

“Corporate Governance is 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 and corporate in the management of a company”.

The Institute of Company Secretaries of India has also defined the term corporate governance as under:

“Corporate Governance is the application of best management practices, compliance of law in true letter and spirit and adherence ethical standards for effective management and distribution of wealth and discharge of social responsibility for sustains development of all stake holders”

The CII code (the confederation of Indian Industry) defined corporate governance as:

“Corporate Governance deals with laws, procedures practices and implicit rules that determine a company’s ability to take informed managerial decisions vis-à-vis its claimants in
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particular its shareholders creditors, customers the state and employees. There is a Global consensus about the objective of “Good” corporate Governance; maximizing long- term shareholder value”.

1.2 Important aspects of Corporate Governance:

An analysis and study of all the above cited reports on Corporate Governance reveals the following important aspects:

- I. Corporate Governance is a voluntary ethical code of business of companies.
- II. Corporate Governance is a process of structuring. Operating and controlling a company with specific aims of fulfilling its long term strategic goals by encompassing a sound monitoring system over the functional and compliance aspects.
- III. Corporate Governance is not just corporate management, it is a fair, efficient and transparent administration to meet well defined objectives.

1.3 Objectives of Corporate Governance:

Good Governance is important to the very existence of a company. It inspires and strengthens investor’s confidence by ensuring company’s commitment to higher growth and profits. It seeks to achieve following objectives.

1. Fundamental objective is “enhancement of Share holders value, keeping in view the interest of other stakeholders”.
2. Constitution of properly structured Board which can take independent and objective decisions at the right point of time.
3. A balanced composition of Board, which includes adequate number of Non-executive and independent Directors, who will look after the well being of all stakeholders.
4. Adoption of transparent procedures by the board and obtaining adequate information before arriving at decisions.
5. Effective implementation machinery to the good of stakeholders.
6. Effective communication procedures to keep the shareholders informed about relevant developments.
7. The overall attempt of the Board should be to take the organization forward, maximize long- term values and shareholders wealth.

1.4 Factors influencing Quality of Governance:

Science, the Corporate governance aims to achieve at high standards of ethical values, standards, it is going to be influenced by so many factors.

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1.5 Some of the important factors are discussed below:

Quality of governance mainly rests on the shoulders of Board, Management and committees constituted there in

1.6 Quality of Governance depends on the followings factors:

i. Integrity of Management:

Integrity of the management is fundamental and foremost aspect for the success of corporate governance. A Board with low level integrity tend to misuse the trust reposed by shareholders.

ii. Ability of the Board

The effectiveness of board depends upon the collective ability in terms of sharing and skill among members.

iii. Adequacy of the process:

The process of collecting information reviewing plans and performance of company should be adequate to take timely and proper steps.

iv. Commitment level of individual board members:

The quality of a board depends on the commitment of individual members to tasks which they are expected to perform as board members.

v. Financial Reporting:

Accuracy and transparency in financial statements and disclosure, internal controls and independence of auditors.

vi. Participation of stake holders determines the number of new ideas being generated in optimum utilization of resources and for improving the administrative structure and the process.

vii. Quality of corporate Reporting:

The quality of corporate reporting depends on the transparency and timeliness of corporate communication with share holders. This helps the shareholders in making economic decisions and in correctly evaluating the management in its stewardship function.

1.7 Salient Features of Corporate Governance:

Requirements under the listing agreement

1.8 Mandatory Requirements:

1. Brief Statement on Company's Philosophy on code of Governance:
2. Board of Directors

- i. Composition and category of directors, for example, promoter, executive, non-executive, independent non executive, nominee director, which institution represented as lender or as equity investor.
- ii. Attendance of each director at the board meeting and the last AGM.
- iii. Number of other Boards of Board Committees in which he/she is a member or chairperson.
- iv. Number of Board meetings held, dates on which held.

3. Audit Committee:

- a. Brief description of terms of reference
- b. Composition, name of members and chairperson
- c. Meeting and attendance during the year

4. Remuneration Committee:

- a. Brief description of terms of reference
- b. Composition, name of members and chairperson
- c. Attendance during the year
- d. Remuneration policy
- e. Details of remuneration to all the directors, as per format in main report.

5. Shareholders Committee:

- a. Name of non – executive director heading the committee
- b. Name and designation of compliance officer
- c. Number of share holder's complaints received so far
- d. Number not solved to the satisfaction of share holders
- e. Number of pending complaints

6. General Body Meeting:

- a. Location and time, where last three AGMs held
- b. Whether any special resolutions passed in the previous 3 AGMs
- c. Whether any special resolutions passed last year through postal ballot details of voting pattern.
- d. Person who conducted the postal ballot exercise
- e. Whether any special resolution is proposed to be conducted through postal ballot
- f. Procedure for postal ballot

7. Disclosures:

- a. Disclosures on materially significant related party transactions that may have potential conflict with interests of company at large.
- b. Details of non – compliance by the company, penalties, strictures imposed on the company by stock Exchange or SEBI or statutory authority, on any matter related to capital markets, during last three years.
- c. Whistle blower policy and affirmation that no personnel has been denied access to the audit committee
- d. Details of compliance with mandatory requirements and adoption of the non – mandatory requirements.

8. Means of Communication:

- i. Quarterly result
- ii. News papers wherein results normally published
- iii. Any web site, where displayed
- iv. Whether it also display official news releases
- v. The presentations made to institutional investors or to the analysis

9. General Shareholders Information:

- a. AGM: date, time and venue
- b. Financial year
- c. Date of Book Closure
- d. Dividend payment date
- e. Listing on Stock exchanges
- f. Stock code
- g. Market price data: high, low during each month in last financial year
- h. Performance in comparison to broad-based indices such as BSE senses, CRISIL, Index etc.
- i. Registrar and Transfer Agents
- j. Share Transfer System
- k. Distribution of Shareholding
- l. Dematerialization of shares and liquidity
- m. Outstanding GDRs/ADRs/warrants or any convertible instruments, conversion date and likely impact on equity

- n. Plant locations
- o. Address for correspondence

1.9 Non-Mandatory Requirements:

1. The Board

A non-executive Chairman may be entitled to maintain a Chairman's office at the company's expense and also allow reimbursement of expenses incurred in performance of his duties.

Independent Directors may have a tenure not exceeding, in the aggregate, a period of nine years, on the Board of a Company.

2. Remuneration Committees:

- i. The board may set up a remuneration committee to determine on their behalf of the shareholders with agreed terms of reference, the company's policy on specific remuneration packages for executive directors including pension rights and any compensation payment.
- ii. To avoid conflicts of interest, the remuneration committee, which would determine the remuneration packages of the executive directors may comprise at least three directors, all of whom should be non-executive directors, the Chairman of committee being an independent director.
- iii. All the members of the remuneration committee could be present at the meeting
- iv. The Chairman of remuneration committee could be present at the Annual general Meeting, to answer the shareholder queries. However, it would be up to the Chairman to decide who should answer the queries.

3. Shareholders Rights:

A half – yearly declaration of financial performances including summary of the significant events in last six months, may be sent to each household of shareholders.

4. Adult Qualifications:

Company may move towards a regime of unqualified Financial Statement.

5. Training of Board Members:

A company may train its Board Members in the business model of the company as well as the risk profile of the business parameters of the company their responsibilities as director, and the best way to discharge them.

6. Mechanism for Evaluating Non-Executive Board Members:

The performance evaluation of non-executive directors could be done by a peer group comprising the entire Board of directors, excluding the director being evaluated, and peer group

evaluation could be the mechanism to determine whether to extend/continue the terms of appointment of non-executive directors.

7. Whistle Blower Policy:

The company may establish mechanism for employees to report to the management concern about unethical behavior, actual or suspected fraud or violation of the company's code of conduct or ethics policy. This mechanism could also provide for adequate safeguards against victimization of employees who avail of the mechanism and also provide for direct access to the chairman of the Audit committee in exceptional case.

1.11 Legal and Ethical Compliance Mechanisms

The difficulty with legal compliance mechanisms is that many abuses that have enraged the public are entirely legal, for example, companies can file misleading accounting statements that are in complete compliance with generally accepted accounting principles (GAAP) France et al (2002) point out that law regulating companies are ambiguous, that juries have a hard time grasping abstract and sophisticated financial concepts (for example, special-purpose entities or complex derivatives),

Based upon in-depth interviews with 30 graduates of Harvard MBA program, Badaracco and Webb(1995) revealed several disturbing patterns, First, young managers received explicit instructions from their middle-manage bosses or felt strong organizational pressures to do things that they believed were sleazy, unethical, or sometimes illegal. Second legal compliance mechanisms (corporate ethics programs, codes of conduct, mission statement, hot lines, and so on) provided little help in such environments. Third, many of the young managers believed that their company's executives were out-of-touch on ethical issues: either they were too busy or because they sought to avoid responsibility. Finally, the young managers resolve the dilemmas they faced largely on the basis of personal reflection and individual values, not through reliance on corporate credos or company loyalty.

Although the accounting profession has always had a strong focus on internal controls, recent spectacular business failures, which have undermined auditors, credibility in their reporting function, have eroded public confidence in the accounting and auditing profession. Brief et al (1997) found that 87% of accountants surveyed were willing to misrepresent financial statement in at least one case when presented with seven financial reporting dilemmas.

They are part of the problems we are witnessing today in the wider society, sports, business, government and politics, education, and so on. Many of us, however, are concerned about the lack of ethics in the business world, particularly in the financial system, since there are greater incentives for unethical conduct. As a result of many scandals, there has been a renewed interest and focus on legal compliance of May scandals, there has been a renewed interest and focus on legal compliance mechanisms. and bans several types of non-audit committees on critical accounting policies and practices, information on alternative treatments of financial information, and bring to attention any material written communications with management

Ironically, Weisul and Merritt (2002) in surveying 1100 college students on 27 US campuses found that although the students were disturbed by recent corporate scandals (some 84% believed that the US is having a business crisis and 77 % think CEOs should be held personally responsible for it), 59% of the same students admitted that they had cheated on a test and only 19% say they would report a classmate who cheated. Although a necessary component of corporate governance, legal compliance mechanisms have clearly proven to be inadequate, they lack the moral firepower to restore confidence and the ability to rebuild trust in the corporation. Termes (1995) compares ethical compliance mechanisms (virtues) versus legal compliance mechanisms(codes) and concludes that the ethical functioning of financial institutions cannot be trusted to the imposition of codes of ethical conduct but the only way in which companies can be ethical is for people to be ethical.

1.12 Ethical Compliance Mechanisms:

Trevino et al (1999) study found that specific characteristics of legal compliance programs matter less than broader perceptions of the program's orientation toward values and ethical aspirations. They found that what helped the most are consistency between policies and actions as well as dimensions of the organization's ethical climate such as ethical leadership, fair treatment of employees, and open discussion of ethics. On the other hand, what hurts the most is an ethical culture that emphasizes self- interest and unquestioning obedience to authority, and the perception that legal compliance programs exist only to protect top management from blame. With respect to the issues of ethical leadership, Collins (2001) examined the character traits of effective business leaders in the culture of eleven companies that transformed themselves from good solid business into great companies that produced phenomenal and sustained returns for their stockholders. Every one of the companies he

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profiled during the critical period in which it was changing from good to great has what he termed “Level 5” leadership which was his top ranking for executive capabilities.

Byrne (2002) pointed out that following the abuses of recent times, executives are learning that trust, integrity, and fairness do matter and are crucial to the bottom line. Corporate leaders and entrepreneurs somehow forgot that business is all about values and are now paying the price in a downward market with a loss of investor confidence. Byrne (2002) also noted that in the post- Enron, post-bubble world, the realization that many companies played fast and loose with accounting rules and ethical standards and which allowed performance to be disconnected from meaning corporate values, is leading to a re- evaluation of corporate goals, values and purpose.

There is little doubt that corporate culture contributed to and is at the heart of the recent scandals and transgressions. Hansen (2004) doubts whether legal compliance mechanisms alone can show the way to business probity and points out the need to ask some basic questions: Are Sarbanes-Oxley and the mandated reforms being made likely to achieve the desired goal? Will corporations be prompted merely to offer empty clichés in their public embrace of integrity (e.g. some corporations might think that rewriting their value statement in a larger font size might somehow translate into a more impassioned ethical commitment)? Hansen (2004) also points out that more explicit recognition of the role of culture in an organization may be forthcoming since the challenge is to ascertain whether a corporation’s compliance program is merely a “paper program” or whether it was designed and implemented in an effective manner.

At the core of the current debate over corporate governance is the issue whether managers of corporations should serve the interests of shareholders or the interest of all stakeholders (employees, creditors, suppliers, customers, community, shareholders). This issue is related to a more fundamental question of the nature and purpose of the firm. Two essentially different models of corporate governance can be identified: the model based on the maximization of shareholder value and the model of social responsibility. Ambrosia and Toth (1998), using a natural ethical framework, show that the latter is more coherent with human nature as the natural law perspective posits the primacy of ethics over politics, law and economics. Economics cannot be divorced from ethics anymore than law, politics, education can (Arjoon and Gopaul, 2003). The shareholder wealth maximization model deflects attention

from the ethical questions and the concern for values. Related to the first principle of natural law ethics (do good and avoid evil) is virtue ethics.

Conclusion:

Failure in corporate governance is a real threat to the future of every corporation. With effective corporate governance based on core values of integrity and trust (reputational value) companies will have competitive advantage in attracting and retaining talent and generating positive reactions in the marketplace – if you have a reputation for ethical behavior in today’s marketplace it engenders not only customer loyalty but ethical behavior in today’s marketplace it engenders not only customer loyalty but employee loyalty. Effective corporate governance can be achieved by adopting a set of principles and best practice.

A great deal depends upon fairness, honesty, integrity and the manner in which companies conduct their affairs. Companies must make a profit in order to survive and grow, however, the pursuit of profits must stay within ethical bounds Companies should adopt policies that include environmental protection, whistle blowing ethical training programs and so on. Such compliance mechanisms help develop and build corporate image and reputation, gain loyalty and trust from consumers and heightens to employees. Ethical compliance mechanisms contribute to stability and growth since it instills confidence; management, leadership, and administration are essentially ethical tasks. Virtues are powerful means to personal betterment and bring about social reform because of its strong appeal to reason, it diffuses passion, prejudice, pride and self- interest and is a civilizing force in bringing about justice.

Ethics is truly an essential ingredient for business success and it will continue to serve as the blue print for success in the 21st century. Many of our traditional role models have fallen, and so it is more important for us to set a strong ethical example for future generations. Some answers to the following questions can serve as a basis for future research endeavors. Were the recent scandals in the US and elsewhere the result of corporate greed and collusion, or were companies driven by market forces which they were unable or unwilling to resist? Do we need a radical overhaul of corporate governance and codes or can companies to relied upon t regulate themselves? Are business collectively contributing to the problems, albeit unwittingly or through ignorance? Do the solutions lie outside liberal capitalism?

Perhaps it is most appropriate to close by the following remark which succinctly captures the aspects of corporate governance as discussed in this paper,
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“An adequate corporate strategy must include noneconomic goals. An economic strategy is humanized and made attainable in a living organization by deciding on the character the company is to have, the values it espouses, and its relationships to its customers, employees, communities, and shareholders. Although codes of ethics, ethical policy for specific vulnerabilities and disciplined enforcement are important, they do not contain in themselves the final emotional power of commitment. One the scope of strategic decision is thus enlarged, its ethical component is no longer at odds with a decision right for many reasons.”

1.14. Need for the Study:

Corporate Governance is the set of policies that are created for deciding a company's performance and direction. It is an overview of rules and regulations for the people in-charge of an incorporated firm. They are the ones who agree to take responsibility towards the shareholders.

Corporate Governance is a board term is today's business environment.

The legal outfits of corporate governance can be customized to fit the meticulous choice of each wearer.

The paper will discuss corporate governance from India's point of view. It will analyze the barriers that an emerging economy like India has to face. In addition, it will explain why it is important for any country to follow good corporate governance practices. In the next section, it will look at how corporate governance became an inseparable part of Indian Economy.

1.16 Objectives of the Study:

The specific objectives of the present study are:

- To systematically analyze the law and policy promoting good corporate governance in India.
- To explore comprehensive legal regime addressing national and international concerns of corporate governance
- To examine, analyze and evaluate the problems of corporate governance to protect the interest of various stake holders.
- To examine judicial trend towards good corporate governance.
- To understand the problems in evolving and implementing the policy of corporate governance to protect the interest of various stake holders.

1.17 Hypotheses:

Keeping the above objectives in mind, the following Hypotheses are framed for the study.

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1. Lack of proper implementation of the Laws relating to corporate governance leads to various scams.
2. Need to have a comprehensive Legislation to address the problems pertaining to good corporate governance.
3. Need to have proper government control over the corporate governance for protecting the interest of various stake holders.

1.18 Methodology and selection of the sample:

In tune with the objectives of the study, the Researcher adopted doctrinal approach. Apart from analytical and historical methods, the researcher adopted socio legal research wherever necessary.

The study is both conceptual and empirical. Conceptual in the sense of study explores the evolutionary aspects of corporate governance law and policy perspectives examine of it. It is empirical as primary data are collected to examine the operational mode. The researcher conducted extensive survey and collected information from the respondents. The research tools applied are:

1. Workers interview schedule
2. Employers interview schedule, and
3. Questionnaire for the promoters, Members, Workmen, Executive, Customers, Landers, Dealers, Community

The information collected from the respondents is summarized and presented in simple tabular analysis. The hypotheses of the study are tested on the basis of the information collected from the respondents.

The researcher adopted both Doctrinal and Non- Doctrinal methods of research to collect the necessary data.