



Corporate governance and its role in strengthening the Indian economy

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Abstract

Corporate Governance is “the system by which companies are directed and controlled”. It is the set of processes, customs, policies, laws and institutions by which corporation are directed, administered and controlled. It also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. It involves regulatory and market mechanism, and the roles and relationships between a company’s management, its board, its shareholders and other stakeholders. The principal stakeholders are the shareholders, management and the board of directors. Other stakeholders include employees, suppliers, customers, banks and other lenders, regulators, the environment and the community at large. Corporate governance consist two elements: first is the long term relationship which has to deal with the checks and balances, incentives for manager and communications between management and investors. Second is the transactional relationship which involves dealing with disclosure and authority.

Keywords: corporate governance, economy disclosure, authority

Introduction

Principles of corporate governance

The concept of corporate governance is multi-faceted and involves lot of dimensions. Therefore it covers several principles by which corporate business are expected to operate to assure proper governance. These are:

- 1. Rights and equitable treatment of shareholders:** organization 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.
- 2. Interests of other stakeholders:** organization should recognize that they have legal, contractual, social, and market driven obligation of non-shareholder stakeholders, including employees, investors, creditors, suppliers, local communities, customers, and policy makers.
- 3. Role and responsibilities of the board:** the board needs sufficient relevant skills and understanding to receive and challenge management performance. It also needs adequate size and appropriate levels of independence & commitment.
- 4. Integrity and ethical behavior:** 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.
- 5. Disclosure and transparency:** organization 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.

These principles are universal in application and try their level best to provide comprehensive coverage along with complete protection.

Main characteristics of good corporate governance

Several organizations have popped up in recent years to help adopt and implement good corporate governance principles. The organization for Economic Co-operation and Development (OECD), the World Bank, the International Finance Corporation, the U.S. commerce and State Departments, and numerous other organizations have been encouraging governments and firms to adopt and implement corporate codes of conduct and good corporate governance principles.

The center for International Private Enterprise (2002) lists some of the main attributes of good corporate governance. These include.

1. Reduction of risk;
2. Stimulation of performance;
3. Improved access to capital markets;
4. Enhancement of marketability of goods and series;
5. Improved leadership; and
6. Demonstration of transparency and social accountability.

The list is by no means exhaustive. However, it does summarize some of the most important benefits of good corporate governance.

Mechanisms and controls of corporate governance

Corporate governance mechanisms and controls are designed to reduce the inefficiencies that arise from moral hazard and

adverse selection. For example, to monitor manager's behavior, an independent third party (that is the external auditors) attests the accuracy of information provided by management to investors. An ideal control system should regulate both motivation and ability.

Internal corporate governance controls

1. Monitoring by the board of directors;
2. Internal control procedures and internal auditors;
3. Balance of Power;
4. Remuneration;
5. Monitoring by large shareholders and/or monitoring by banks and other large creditors.

External corporate governance controls

External corporate governance controls encompass the controls external stakeholders exercise over the organization. Example includes:

1. Competition.
2. Debt covenants.
3. Demand for and assessment of performance information.
4. Government regulations.
5. Managerial labour market.
6. Media pressure; and Takeover.

Codes and guidelines 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 government and international organizations.

One of the most influential guidelines has been the 1999 OECD (Organization of Economic and Corporate Development) principles of corporate governance. This was revised in 2004. The OECD guidelines are often referenced by countries developing local codes or guidelines. Building on the work of the OECD, other international organizations, private sector associations and more than twenty national corporate governance codes, the United Nations intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) has produced their guidance on good practices in corporate governance disclosure. This internationally agreed benchmark consists of more than fifty distinct disclosure items across five broad categories:

1. Auditing;
2. Board & Management structure and process;
3. Corporate responsibility and compliance;
4. Financial transparency & information disclosure;
5. Ownership structure and exercise of control rights.

The investor-led organization International Corporate Governance Network (ICGN) was set up in 1995 which has evolved into a global membership organization of over five hundred leaders in corporate governance in fifty countries, with institutional investors representing assets under management of around US\$ 18 trillion. The purpose of ICGN is to promote a network for the exchange of views and information about corporate governance issues internationally and for the development of corporate governance guidelines.

The World Business Council for Sustainable Development (WBCSD) is a CEO-led, global association of some two hundred companies dealing with business and sustainable development. The council provides a platform for companies to explore sustainable development, share knowledge, experience and best practices, and to advocate business position on these issues in a variety of forums, working with governments, non-governmental and intergovernmental organizations. In 2009 the International Finance Corporation and the UN Global Compact released a report, corporate governance – the foundation for corporate citizenship & sustainable business, linking the environmental, social and governance responsibilities of a company to its financial performance and long – term sustainability. In Asian countries, the Asian Corporate Governance Association (ACGA) is working with investors, companies and regulators in the implementations of effective corporate governance practices. The association was founded in 1999 with a belief that corporate governance is fundamental to the long-term development of Asian economies and capital markets.

Importance of corporate governance in strengthening the economy

Corporate governance has become an important topic in strengthening the economy in recent years. Directors, owners, and corporate managers have started to realize that there are benefits that can accrue from having a good corporate governance structure. Good corporate governance helps to increase share price and makes it easier to obtain capital.

The presence of an active group of independent director on the board contributes a great deal towards ensuring confidence in market. Corporate governance is known to be one of the criteria that foreign institutional investors are increasingly depending on when deciding on which companies to invest in. It is also known to have a positive influence on the share price of the company. Having a clean image on the corporate governance front could also make it easier for companies to source capital at more reasonable costs. Corporate governance is a key element in enhancing investor confidence, promoting competitiveness, and ultimately improving economic growth. It is at the top of the international development agenda. The positive effect of good corporate governance on different stakeholders will ultimately result in a strengthened economy, and hence good corporate governance is a tool for socio-economic development.

International investors are hesitant to lend money or buy shares in a corporation that does not subscribe to good corporate governance principles. Transparency, independent directors, and a separate audit committee are especially important. Some international investors will not seriously consider investing in a company that does not have these things. The positive effect of good corporate governance on different stakeholders ultimately is a strengthened economy, and hence good corporate governance is a tool for socio-economic development.

Conclusion

Corporate governance is a term for a central rule-making structure that develops laws and processes for carrying out an organization's mission and goals. The structure generally

consists of a group of people with shared interest in the organization's success. The arguments are levelled on corporate governance as only being financial, economic and commercial process, however, this process is not purely a economic concept or tool. Though a business is a commercial activity generating profit therefore the emphasis must have been given on commercial or economic aspect of the business in the initial stages of the concept but with time corporate governance has been moulded and adequate emphasis on social aspect has also been placed. Presence of various social interest groups in parties of corporate governance and in-depth coverage of social objectives in objectives of corporate governance also proves the point that this concept as on date is no longer a purely economic tool but now it is a mix of economic-social effort and it is target towards bringing social economic discipline in the arena of business.

It is also important to note that the corporate governance is evolutionary; implying that corporate governance practices will evolve in the light of the changing circumstances of a company and must be tailored to meet those circumstances. Corporate governance practices are also bound to be flexible enough to adapt influences of both domestic and international development. Thus the governance of companies is more important for world economic growth than the government of countries.

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