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Research Paper

Commerce

Corporate Governance Practices - Emerging Trends

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ABSTRACT

In the last few years, the subject of corporate governance has come to the force. The governance mechanism in each country and corporate is shaped by various factors like political, economic and social history, legal framework, values and ethics of the promotes, managerial practices etc., The Business entities, Banks, Corporations financial institutions around the world are increasingly relying on corporate governance as means to achieve highest standards to raise the confidence level of people. The terms "corporate governance" has now become common parlance but its usage has not been very consistent, as the corporate have assimilated the concept in their own way based on their values and ethics. Good corporate governance practice would assist the corporate to develop a credible opinion on its management quality and responsiveness towards the interest of all its financial stakeholders. Improved perception of investors may in turn influence its valuation and facilitate rising of funds at favorable terms. The corporate governance practice in the financial sector also improves the comfort level of the statutory authorities and regulators. It can also be used as a check to determine the relative standing of the company with respect to the benchmarks of best corporation practices in the industry. This alone can help the corporate to survive in the globalized era.

Introduction

In the last few years, the subject of corporate governance has come to the force. The governance mechanism in each country and corporate is shaped by various factors like political, economic and social history, legal framework, values and ethics of the promotes, managerial practices etc., The Business entities, Banks, Corporations financial institutions around the world are increasingly relying on corporate governance as means to achieve highest standards to raise the confidence level of people.

The terms "corporate governance" has now become common parlance but its usage has not been very consistent, as the corporate have assimilated the concept in their own way based on their values and ethics.

Basic Concept

Corporate governance is a set of system and processes to ensure that a company is managed to suit the best interests of all stakeholders. The stakeholders may be internal stakeholders (promoters,members,workmen and executives) and external stakeholders(shareholders,customers,lenders,dealears,venders,bankers,community,

government and regulators)

According to Cadbury committee on financial aspects of corporate governance, it is the system by which companies are directed and controlled.

Corporate governance is a voluntary ethnical code of business of companies with total transparency, integrity and accountability of the management.

It is system of making management accountable to the stakeholders for effective management of the companies, in the interests of the company and also with adequate

concern for ethics and values . It is inclusive of the structures, process cultures, and systems through which the company sets out its objectives defines the means of attaining that objectives and monitoring its performance.

It is generally understood to mean the system that defines the distribution of rights and responsibilities among different participants in the corporation, such as the board, managers, shareholders and other stakeholders, and spells out rules and procedures for making decisions in corporate affairs.a

Need for Corporate Governance

This subject of corporate governance has attracted so much attention due to some fundamental reasons. The pressure for good corporate governance in the financial sector arises from fundamental, long-term changes in the environment mentioned below.

- ⇨ Globalization has increased the freedom, opportunities and economic power of the corporate in the financial sector.
- ⇨ Domestic liberalization has, similarly, enable local corporate and companies to expand and globalize.
- ⇨ Privatization of state owned enterprises puts huge assets in the hands of the new private management.
- ⇨ Accessibility to technology know-how means to run corporate made many entrepreneurs jump into creation of new business entities.
- ⇨ Appearance and expose of scandals in the form of suppression of crucial financial information diversion of funds misuse of facilities hampers the interest of all stakeholders.
- ⇨ As we live in a more volatile and inter- linked world, effects are instantaneous. If one letter of Credit fails, it may affect other countries and the institutions with greater national and international attention.
- ⇨ Liberalization and deregulation the word over has given sufficient freedom to operate. This resulted in markets becoming free and more complex .As greater freedom implies greater responsibilities it is necessary to have transparency.
- ⇨ What happens in a particular corporation is a concern of all .Fear of contagion and systemic implication is a cause for concerns. Relatively small and isolated events in financial institutions, has affected a lot of institutions, including some several times larger.

Aims of corporate governance

Economics is indicative of the profit earning capacity. However, profits must be earned with ethnical means with due consideration to environmental effects. This would lead to harmonization of conflicting interests of various stakeholders. Corporate governance aims in bringing this harmonization in the following way.

- ⇨ It holds the balance between economic and social goals and between individual and commercial goals.
- ⇨ It ensures efficient use of resources and accountability for the stewardship of those resources.
- ⇨ It aligns the interest of individuals, corporations and society.
- ⇨ It helps corporations and those who own and manage them to adopt internationally acceptable governance standards, which will assist them to achieve their corporate aims and attract investment.
- ⇨ It encourages and strengthens the economy and discourages fraud and mismanagement.
- ⇨ It ensures openness and disclosure and thereby enhances public confidence.

Corporate Governance – Different perspective

The literature on corporate governance covers a variety of aspects, Important among them are protection of shareholders' rights ,enhancing shareholders' value. Board issues including its composition and role, disclosure requirements, the integrity of accounting practices , the control systems ,in particular the internal control systems, in particular the internal control systems , insider trading etc as for as financial sector is concerned. These factors can however be broadly classified under two different perpectives.viz.

A. Corporation's perspective
B. Public policy perspective

A. Corporation's perspective
Corporate governance is about maximizing value to stakeholders subject to meeting the corporation's financial and other legal and contractual obligations. The inclusive definition stresses the need for board of directors to balance the interest of share holders with those of other stake holders like employees,costomers,suppliers,investors and communities in order to achieve long term sustained value for the corporation.

B. Public policy perspective
Corporate governance is about nurturing enterprises while ensuring accountability in the exercise of power and patronage by firms for larger public goodness. The role of public policy is to provide firms with incentives and discipline to minimize the divergence between private and social returns and to protect the interest of stakeholders.

These two perspectives provide a framework for corporate governance that reflects interplay between internal incentives which defines the relationships among the key players in the corporation and external forces like policy, legal.regulatory and market that together govern the behavior and performance of the firm.

Corporate Management and Corporate Governance
There is a growing recognition of the difference between corporate governance and corporate management and the need to align corporate management with corporate governance.

Corporate governance is concerned with the values, vision and visibility. It is about the values orientation of the organization, ethnical norms for its performance, the direction of development and social accomplishment of the organization and the visibility of its performances and practices. Corporate management is concerned with efficiency of resource use, value addition and wealth creation within the broad parameters of the corporate philosophy established by corporate governance. There has to be a continuous endeavor to understand the difference and align these two for greater transparency.

Compelling Reasons for Corporate Governance
All well governed corporate organizations should recognize the importance of good business ethics and take cognizance of the environmental and social interests of the communities in which they operate. While the corporate governance principles incorporate code that are intended to project interests of the shareholders they are also expected to give due importance to safeguarding interests of the stakeholders like employees, creditors ,suppliers, customers, environment,etc.Effective co-operation of all the stakeholders is essential for creating wealth for the shareholders and building financially sound corporations. Happening in the past have fallen short of this basic requirement in the financial sector. Few compelling reasons for corporate governance in financial sector are:

⇨ Inadequacies and failures of existing system-leading to need for norms and codes to remedy them.

⇨ Deficiencies in the accounting standards _ when became evident after many companies in their eagerness to increase earnings and accelerate growth, exploited the weakness in accounting standards to show inflated profits and understate liabilities.

⇨ Financial crises in the Asian Market – highlighted the need for improved level of corporate governance as the lack of it in certain countries has been responsible for collapse of many corporations.

⇨ Differing interest – the interest of those who have effective control over a firm can differ from the interest of those who supply the firm with external finance.

⇨ Mismanagement – loss suffered by the investors and bankers on account of unscrupulous management of the companies which gave raised capital from the market at high valuation.

⇨ Suppression of facts – allotment of promoter's shares on preferential prices, disproportionate to market valuation of shares leading to further dilution of wealth of minority shareholders

⇨ Inadequate attention – to the basic procedures for shareholders' service – delay in transfer of shares, dispatch of share certificates and dividend warrants, no timely dissemination of information to investors

Corporate governance attempts to remedy the above problems and promotes the adoption of globally acceptable practices.

Drivers for corporate Governance in India
Two sets of factors have contributed to the development of corporate governance. These factors have acted as drivers for growth of corporate governance .They are:

1. Necessary factors
A. Mandatory requirement resulting from recommendation of the Birla
Committee on corporate governance set up by SEBI
B. Liberalization efforts of the government with associated regulatory requirement
C. Transparency demanded by the foreign investors, collaborators and buyers in respect of functioning of Indian corporate
D. Keenness shown by the Indian investors in this front

2. Facilitating factors
A. Growing awareness and enthusiasm in corporate Indian to embrace good corporate governance
B. Keenness exhibited by many caption of industry, corporate leaders and top executives to usher in corporate governance.

Corporate Governance Framework
Economic theory identified four factors of production namely land, Labour, Capital and organization/ Entrepreneurship .These four factors constitute the wheel of business. Maximizing the shareholders' wealth was considered as the primary objective of a business organization .During recent years this view of business has been undergoing a change. Shareholder's wealth can be maximized at the cost of others. Hence, the ideal of optimization came into force. It is now widely recognized that there are many stakeholders and it is important that there is proper balancing in the interests of various stakeholders (Sheeler and sillampa 1977). The following are the stakeholders for any business enterprise:

a) Customers
b) Employees
c) Suppliers
d) Government
e) Society
f) Shareholders

Each stakeholders group has its own requirements. Their happiness comes from satisfaction of their needs any corporate body that attempts to meet the aspirations and happiness of these stakeholders will be able to move towards a state of openness and transparent governance keeping interest of all of them.

IF the organization cares for the customers (provides products at the right price and right type of quality) then customers feel happy. Employee's happiness comes from the proper remuneration for their contributions. Suppliers feel happy if payments are made in time and there is transparency and honesty in the organization in dealing with suppliers. Society feels happy if organization is Eco- friendly and is not polluting the environment. Government feels happy if organization pays its taxes honestly. Shareholders feel happy if they get 'proper' return on their capital. Thus a good corporate citizen has to strive to keep every one associated with in a satisfied state.

Given above perspective, a stakeholders Happiness Index (SHI) can be created and corporate can be rated on the basis of this index. The following table is given below provides a basis for developing this index;

Sl No Stakeholders Happiness Index Parameters for

Developing
Happiness Index

1. Customer SHI (C) Quality, price service, Complaints handling
2. Employees SHI (E) Job satisfaction, Career Opportunities, ESOPs
3. Suppliers SHI (Su) payments Systems Transparency and honest In awarding contracts
4. Society SHI (So) Efforts taken to prevent Pollution, philanthropic Contributions
5. Government SHI (G) payment of taxes
6. Shareholders SHI (Sh) Fair return on capital Invested

On the basis of the happiness index for individual stakeholders, we can develop a Total stakeholder's happiness index (TOSHI) through a multiplicative formula as given below:

TOSHI=SHI (C) * SHI (E) * SHI (Su) * SHI (So) * SHI (G) * SHI (SU)

Corporate within the same industry can be rated on the basis of TOSHI. Such information would induce a sense of accountability on the part of corporate. If Total Stakeholders happiness index is to be improved, corporate should earn high points on a 'corporate reputation scale'.

Balasubramaniam and Kimber (2000) have suggested a model of corporate reputation wherein four aspect of corporate reputation have been identified as Product/Service Reputation, Business Reputation, Credibility in financial markets and social Reputation. In their framework, product/service reputation is based on 'the way the products services provided by the organization are accepted in the market place". Business reputation is concerned with "relationship with suppliers, employees, government bodies and other members in the industry: Social reputation relates to environmental and social concern of the corporate.

We can discern between the Corporate Reputation framework suggested by Balasubramaniam and Kimber and the 'stakeholders' happiness framework suggested by Athreya (2000) the stakeholders' happiness framework identified four major requirements for an "ideal corporate citizen'. In its relationship with customer, the key idea is Total service. Its obligation towards shareholders is in terms of wealth creation of the shareholders. Its obligation towards employees is through fulfilling aspirations. Its obligation towards society is in terms of return to society.

From the above model, it can be observed that the corporate reputation model and the stakeholder's happiness model are inter – related .High corporate reputation would also ensure high stakeholders happiness. Sharma [1996] provides framework managerial qualities wherein four qualities prescribed are a following:

a) Transcendental Values
b) The Ethnical Dimension
c) Concern for people
d) Pursuit of profit

This frame –work can also provide us a conceptual foundation for managerial action on the part of the managers, to improve corporate reputation and stakeholders' happiness.

Corporate Governance Rating Model for Financial Industries

More recently ICRA has developed a new product- Corporate Governance Rating (CGR) for the Indian market .CGR would indicate the relative level to which an organization accepts and follows the codes and guidelines of corporate governance practices. This is based on the core principles of corporate governance practices such as Fairness, Transparency, accountability and Responsibility. The codes and standards includes amongst others a) the ownership structure , b) Management Structure including board level issues , c) Quality of financial reporting and other disclosures and do fulfillment of interests of the financial stakeholders.

CGR rating would fall between, CGRI, indicating highest level of corporate governance to CGR6 indicating poor Level of corporate governance. While evaluating an organization on the CGR scale of 1-6 it is considered whether the codes and guidelines have just been followed for statutory compliance or the organization has implemented the concept of corporate governance in sprit as well. This differs from credit rating is a current opinion on the relative ability of issuer to meet its debt obligations as per terms. whereas, a CGR is a current assessment of various company practices and procedures relative to the codes and standards of corporate governance .While a CGR can affect the attractiveness of a company to potential investors (debt or equity), CGR is not intended to be opinion on specific financial obligation , credit quality, capital market valuation or operational performance . CGR is not an audit, a rating or a financial advice nor is it a recommendation to take any financial decision; Also CGR is not to be interpreted as indicators of statutory compliance.

Conclusion

Good corporate governance practice would assist the corporate to develop a credible opinion on its management quality and responsiveness towards the interest of all its financial stakeholders. Improved perception of investors may in turn influence its valuation and facilitate rising of funds at favorable terms. The corporate governance practice in the financial sector also improves the comfort level of the statutory authorities and regulators. It can also be used as a check to determine the relative standing of the company with respect to the benchmarks of best corporation practices in the industry. This alone can help the corporate to survive in the globalized era.

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