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Present scenario of Corporate Governance

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ABSTRACT *As Indian companies compete globally for access to capital markets, many are finding that the ability to benchmark against world-class organizations is essential. For a long time, India was a managed, protected economy with the corporate sector operating in an insular fashion. But as restrictions have eased, Indian corporations are emerging on the world stage and discovering that the old ways of doing business are no longer sufficient in such a fast-paced global environment.*

INTRODUCTION

" Corporate governance …And economic development are intrinsically linked. Effective corporate governance systems promote the development of strong financial systems- irrespective of whether they are largely bank-based or market-based –which, in turn, have an unmistakably positive effect on economic growth and poverty reduction"

Corporate Governance

While corporate governance can be defined in a variety of ways, it generally refers to the mechanisms by which company directors are held accountable for corporate conduct and performance. In principle, good practice in the way in which boards are structured and how directors apportion accountability should facilitate good corporate performance by ensuring that a company is managed in the best interests of its owners. Although improved governance practices and procedures cannot provide a foolproof safeguard against deliberate fraud or financial collapse, many investors see their existence as evidence of sound management practice within a company. Corporate scandals such as those relating to A hold and Parma at in Europe, and Enron and WorldCom in the US have prompted much global debate about corporate governance. Governments, financial authorities and shareholder bodies have in turn initiated a plethora of inquiries, new legislation and revised codes of practice. Internationally, the Organization for Economic Cooperation and Development (OECD) updated its Principles of Corporate Governance in 2004. The US has opted for high profile legislative action with the Sarbanes-Oxley Act while European and Asian countries have mainly moved to strengthen voluntary codes. Numerous national updates have taken place over the past five years, including changes to the codes in Indonesia and Slovenia in 2007, as well as changes to codes in Austria, Finland, Germany, Italy, Jamaica, Lebanon, Norway, Portugal, Spain, Sri Lanka, Thailand and the UK in 200656. National codes can vary significantly in quality. In some countries, especially where codes have only recently been adopted, there remains a discrepancy between code recommendations in principle and corporate governance standards in practice. National differences are mainly caused by different approaches to company law and regulation. For example, Asian companies normally adopt a different board structure to the Western model. However in 2004 the Tokyo Stock Exchange (TSE) announced plans to toughen disclosure rules to force executives to certify company financial statements and bring reporting requirements in Japan closer to those in the US57. The Japanese Commercial Code was revised © EIRIS 56 Changes have also been made to countries' company codes outside those covered by EIRIS. Full details of revisions and newly released codes can be found here in 2005 to allow firms to introduce a new corporate governance system, called the Board with Committees. In addition, in May 2006 the Company Law, which emphasizes the strengthening of corporate governance, was instituted enabling Japanese companies to adopt more Western board structures. Japan has made such allowances in order to satisfy the governance structure expectations of Western investors, although other Asian countries and emerging markets may not adopt the same flexibility. Historically Western board structures have been perceived to be more effective because of independence of the board. The concept that separation of powers is desirable to increase accountability is an underlying principle of most Western codes. For instance, non-executive directors who do not participate in the day to day management of a company are considered especially helpful in exercising the critical monitoring and oversight role that all directors have over the operations of a company. Non-executive directors are perceived to be more effective at this role because they are independent from direct involvement with and influence by the company.

Because a lot of the pressure for improved corporate governance arises from US and UK based investors, some indicators, such as the requirement for independent directors on audit committees, do not translate as readily to countries with different company governance models. For example Germany and Austria, which incorporate elected employee representation at director level within their systems of dual supervisory and management boards, because employees are not regarded as independent directors. Not all national codes insist on fully independent non-executive directors, so certain countries are expected to perform at a lower level than others against this indicator. It is noteworthy though that even in countries where board structures place less emphasis on the independence of directors, there is a strong push towards separating the roles of the chair and chief executive within boards of directors, with the exception of the US.

EIRIS's research on governance seeks to answer four fundamental questions:

- Is there more than 33% of independent non- executives on the board?
- Does the company disclose the remuneration of its directors?
- Does the company separate the roles of chair and chief executive?
- Does the audit committee comprise a majority of independent directors?58

It should be noted that not all investors would necessarily want to apply all the different indicators. National differences in economic structure and reporting requirements mean that the more governance indicators considered or required by an investor, the greater the degree of variation the investor will find between countries. If an investor was interested in applying all the various elements, Ireland, Netherlands and the UK would score best overall with more than 70% of all companies in these countries meeting the four core elements, whilst less than 2% of Japanese companies would meet all four core criteria.

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Corporate governance in India
- The Indian corporate scenario was more or less stagnant till the early 90s.
- The position and goals of the Indian corporate sector has changed a lot after the liberalization of 90s.
- India's economic reform programme made a steady progress in 1994.
- India with its 20 million shareholders, is one of the largest emerging markets in terms of the market capitalization.

Corporate governance of India has undergone a paradigm shift
- In 1996, Confederation of Indian Industry (CII), took a special initiative on Corporate Governance.
- The objective was to develop and promote a code for corporate governance to be adopted and followed by Indian companies, be these in the Private Sector, the Public Sector, Banks or Financial Institutions, all of which are corporate entities.
- This initiative by CII flowed from public concerns regarding the protection of investor interest, especially the small investor, the promotion of transparency within business and industry

SEBI and Clause 49
- SEBI asked Indian firms above a certain size to implement Clause 49, a regulation that strengthens the role of independent directors serving on corporate boards.
- On August 26, 2003, SEBI announced an amended Clause 49 of the listing agreement which every public company listed on an Indian stock exchange is required to sign. The amended clauses come into immediate effect for companies seeking a new listing.

Clause 49
- Clause 49, which has recently been revised by the SEBI, of the listing agreement between listed companies and the stock exchanges is all set to enhance the corporate governance (CG) requirements, primarily through increasing the responsibilities of the Board, consolidating the role of the Audit Committee and making management more accountable
- These changes are aimed at moving Indian companies rapidly up the evolutionary path towards business processes and management oversight techniques.

The major changes to Clause 49
1. Independent Directors —1/3 to ½depending whether the chairman of the board is a non-executive or executive position
2. Non-Executive Directors ----The total term of office of non-executive directors is now limited to three terms of three years each
3. Board of Directors-----The board is required to frame a code of conduct for all board members and senior management and each of them have to annually affirm compliance with the code.
4. Audit Committee----Financial statements and the draft audit report /reports of management discussion and analysis of financial condition and result of operations/ reports of compliance with laws and risk management/ management letters and letters of weaknesses in internal controls issued by statutory and internal auditors/ appointment, removal and terms of remuneration of the chief internal auditor.
5. Whistleblower Policy ----This policy has to be communicated to all employees and whistleblowers should be protected from unfair treatment and termination.
6. Subsidiary Companies-----50% non-executive directors & 1/3 & ½independent directors depending on whether the chairman is non-executive or executive.
7. Disclosures----Contingent liabilities./Basis of related party transactions./Risk management/ . Proceeds from initial public offering/ . Remuneration of directors.
8. Certifications----reviewed the necessary financial statements and directors' report; established and maintained internal controls,disclosed to the auditors and in formed the auditors and audit committee of any significant changes in internal control and/or of accounting policies during the year.

Why is corporate governance important?
Corporate governance refers to the way that Boards oversee the running of a company by its managers, and how Board members are held accountable to shareowners and the company. This has implications for company behavior not only to shareowners but also to employees, customers, those if naming the company, and other stakeholders, including the communities in which the business operates. Research shows that responsible management of environmental, social and governance issues creates a business ethos and environment that builds both a company's integrity within society and the trust of its shareowners.

Code of Business Conduct and Corporate Governance
Discussions of integrity and ethics are still common topics in nearly all business publications today. But these discussions are not new to Work stream -- integrity and ethics have always been a significant part of the way we conduct business at Work stream. Operating with a strong sense of integrity is critical to maintaining trust and credibility with our customers, partners, employees, and investors. We also owe it to ourselves to maintain this focus on business ethics within the company. Our continued emphasis on the Work stream culture ultimately allows us to focus on our business goals and still be consistently rated one of the best places to work in our industry. Our code has traditionally embodied such rules regarding individual and peer responsibilities, as well as responsibilities to our employees, customers, suppliers, shareholders, the public and other stakeholders, and includes:

- Prohibiting conflicts of interest (including protecting corporate opportunities)
- Protecting Work stream's confidential and proprietary information and that of our customers' and vendors'
- Treating Work stream's employees, customers, suppliers and competitors fairly
- Protection and proper use of company assets
- Compliance with laws, rules and regulations (including insider trading laws)
- Encouraging the reporting of any unlawful or unethical behavior

The information below are those portions of our code of conduct, which address the issues listed above.

Independent directors
According to the EIRIS methodology, a non-executive is not considered independent if he/she has served the same company for a long period (over ten years), has close family relationships with executive directors of the company, represents a major shareholder/supplier/customer of the company, has a close consultancy or advisory relationship or contract with the company, or is otherwise employed by the company or one of its subsidiaries at any level within the previous three years.

Figure 1: Percentage of companies with more than 33% independent directors
N=1996 Figure 1 shows a wide degree of variation in the proportion of independent directors from one country to another. The UK and Switzerland lead the list with both having over 95% of companies with more than 33% independent directors. The proportion of companies with independent non-executive directors on boards of directors is lowest in Germany (2%), Japan (6%) and Austria (9%). A combination of legislative and cultural differences affects the two extremes. As noted above, laws in

Austria and Germany require employee representation on the supervisory board for all companies above a set size, directly limiting the possibility for many companies to have fully independent boards. In Japan, a combination of a large number of conglomerate structures and companies domi-

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nated by particular families or owners means that a lot of directors are not considered independent because they may be perceived as representing a particular set of shareholders. A preference for continuity also means that more Japanese directors tend to serve longer than ten years and are therefore excluded from counting as independent. In the US, since 2004 both the New York Stock Exchange and the Nasdaq Stock Market have introduced new listing rules that establish a stricter, more detailed definition of independence for directors and require that a majority of board members be independent. In other countries as well, great efforts have been exerted to strengthen board independence, particularly regarding board composition, leadership, and committees. In the area of board composition, the corporate governance codes in Australia, New Zealand, Canada, Finland, Sweden and the UK now recommend majority-independent boards. Variations in performance between these countries may be explained by a number of factors including the different pace of development and implementation of governance codes, different levels of cross ownership and different levels of employee representation.

Director's Remuneration

Figure 2: Percentage of companies disclosing directors' remuneration N=1996

Most countries perform well in this area, with 92% of the nearly 2,000 companies analyzed disclosing their directors' remuneration and in the worst case, three quarters of Greek companies disclosing directors' remuneration. A high level of media and public interest in this issue, often backed by calls for increased transparency and the threat of shareholder resolutions on remuneration issues, ensures a wide tendency towards disclosure across all the countries covered by EIRIS. Globally, even in countries such as Japan, Canada and Greece, where less than 90% of companies currently disclose remuneration, there is general trend of shareholder and media pressure encouraging companies to disclose as fully as possible on directors' pay levels. The European Commission published new guidelines in October 2004 which are designed to improve transparency and increase information for shareholders on the remuneration of companies' directors59. In particular, these seek to give shareholders more influence over these matters at shareholder meetings.

Separation of chair and chief executive

Separation of the chair and chief executive roles is generally recommended to provide greater independent board leadership. Many investors advocate separation to help embed independence in the decision making process and reinforce control procedures.

Figure 3: Percentage of companies separating the roles of CEO and Chair N=1996

Separation of roles is common, with above 90% compliance in a wide range of countries, including countries where the legal structure requires a two-tier board, such as Austria, Germany and the Netherlands and those with a unitary structure such as Australia, New Zealand and the UK. In countries with a two-tier board structure such as Austria, moves to strengthen good practice are focused on encouraging more independence by, for example, ensuring that companies do not habitually appoint a

© EIRIS former CEO to chair their supervisory board. In general the splitting of roles is becoming more prevalent, and there is a trend towards separation in all countries with the exception of the US. Indeed, Singapore and Hong Kong, which do not score well against the majority of issues covered, have 81% and 70% of companies respectively separating the roles. Reasons commonly given by companies for resisting the splitting of the roles of chair and chief executive usually relate to the particular history of ownership and/or growth of a particular company, for instance where it is still led by the founder-owner or their family. Globally, the percentage of US companies with a

split leadership structure remains lowest of the countries being compared, at around 30%. The importance of a country's corporate governance guidelines is clearly demonstrated as the following three examples show: in the Netherlands, guidelines stipulate the separation of chair and CEO and 100% of companies separate the role. In Canada, the corporate governance code calls for companies to have an independent lead director, although specifies nothing about separating the roles of chair and CEO; yet 87% do separate them. The US guidelines do not offer any guidance relating to either an independent lead director or separating the roles of chair and CEO, and only 30% of companies separate the positions. In the wake of recent scandals, shareholders have been pushing for more US companies to divide the two roles, which they hope would better protect against mismanagement and rogue behaviour. However, although some companies have responded, separation of the roles is still not widely adopted amongst US companies. Many US companies have resisted calls for them to split the roles of chair and CEO because they believe that such a division of power would harm their business development. In response to shareholder concerns, some companies appoint a lead independent director to liaise with the CEO/chair and to chair some sessions of the board without the presence of management. In summary, the varied pressures of legal and regulatory requirements in different countries elicit varying responses from companies. Although the majority of companies in all countries disclose the remuneration of directors, the pattern is slightly more varied for the level of independence of directors and separation of chair and CEO. However, worldwide the approach to corporate governance seems to be converging as corporate governance code and governance practices are becoming increasingly similar in large part due to investor pressure.

Conclusion

As Indian companies compete globally for access to capital markets, many are finding that the ability to benchmark against world-class organizations is essential. For a long time, India was a managed, protected economy with the corporate sector operating in an insular fashion. But as restrictions have eased, Indian corporations are emerging on the world stage and discovering that the old ways of doing business are no longer sufficient in such a fast-paced global environment.