INTRODUCTION TO CORPORATE GOVERNANCE

TYBIM - Cassia Lopes

What Is Corporate Governance?

Corporate governance is the system of rules, practices, and processes by which a firm is directed and controlled. Corporate governance essentially involves balancing the interests of a company's many stakeholders, such as shareholders, senior management executives, customers, suppliers, financiers, the government, and the community.

Since corporate governance provides the framework for attaining a company's objectives, it encompasses practically every sphere of management, from action plans and internal controls to performance measurement and corporate disclosure.

KEY TAKEAWAYS

- Corporate governance is the structure of rules, practices, and processes used to direct and manage a company.
- A company's board of directors is the primary force influencing corporate governance.
- Bad corporate governance can cast doubt on a company's operations and its ultimate profitability.
- Corporate governance covers the areas of environmental awareness, ethical behavior, corporate strategy, compensation, and risk management.
- The basic principles of corporate governance are accountability, transparency, fairness, responsibility, and risk management.

DEFINITION :

James D. Wolfensohn (Ninth President World Bank) “Corporate Governance is about promoting corporate fairness, transparency and accountability”.

Understanding Corporate Governance

Governance refers specifically to the set of rules, controls, policies, and resolutions put in place to direct corporate behavior. A board of directors is pivotal in governance. Proxy advisors and shareholders are important stakeholders who can affect governance.

Communicating a firm's corporate governance is a key component of community and investor relations. For instance, Apple Inc.'s investor relations site outlines its corporate leadership (its executive team and board of directors). It provides corporate governance information including its committee charters and governance documents, such as bylaws, stock ownership guidelines, and articles of incorporation.

Most companies strive to have exceptional corporate governance. For many shareholders, it is not enough for a company merely to be profitable. It also must demonstrate good corporate citizenship through environmental awareness, ethical behavior, and sound corporate governance practices.

Benefits of Corporate Governance

- Good corporate governance creates transparent rules and controls, provides guidance to leadership, and aligns the interests of shareholders, directors, management, and employees.
- It helps build trust with investors, the community, and public officials.
- Corporate governance can provide investors and stakeholders with a clear idea of a company's direction and business integrity.
- It promotes long-term financial viability, opportunity, and returns.
- It can facilitate the raising of capital.
- Good corporate governance can translate to rising share prices.
- It can lessen the potential for financial loss, waste, risks, and corruption.
- It is a game plan for resilience and long-term success.

BUSINESS ETHICS - AN IMPORTANT DIMENSION TO CORPORATE GOVERNANCE

Business Ethics –

The concept came into existence in 60’s in the USA which denotes fundamental or principle values in business. When business practices and more associated with consumers then most of the consumer centric corporations in US showed concerns about business environment, social values. It directs ultimately to the welfare of the society as a whole.

ETHICS

The word “Ethics’ means fundamental values or moral rights. It emphasies values or character that leads to the category of the segment or group or society of the segment, or group or society as a whole. It studies what is right or wrong in leading a good Life based on certain concrete assumptions. Such assumptions are interchangeable. In reality there is a difference between ethics and morality. Morality is one of the aspects of ethics and study of ethics will enhance the outcome of morality. Morality basically consist on what is right or wrong through a process of justification or valid reasoning. So ethics follow the process of justification whereas morality gives us an idea or attempt of moral judgement.

DEFINITION OF BUSINESS ETHICS

a) Andrew Crave : “Busines ethics is a study of business situations, activities and decisions where issues of right and wrong are addressed.”

b) Robert Ginner: “Busines ethics may be defined as those principles, practices and philosophies that are concerned wih moral judgements and good conduct as they are applicable to business.”

c) Krik O Hanson : “Busines ethics is the study of standards of business behaviour which promote Human Welfare and the good.”

d) Investopedia : “Busines ethics is the study of proper business policies and practices regarding potentially controversial issues such as Corporate Governance, insider trading bribery, discrimination, Corporate Social responsibilities.

FEATURES OF BUSINESS ETHICS

a. Ethical Values

b. Code of conduct

c. Subjective Term

d. Protection of Interest of the Stakeholders

e. Respect with dignity

f. Proper set-up

g. Based on Principles

h. Universal Applications

i. Self Discipline

j. Different Approach from CSR

k. Different from Business Law practices

a. Ethical Values :- Morality is the soul of business ethics. Modern world is more aware about the rights, duties, buying, selling process is legal awareness has increased tremendously; so business world has tried its level best to attain the welfare of the society therefore business render its activities on self conscious 'ethical' values.

b. Code of conduct :- Morality and quality judgement are the core factors for conduct of business activities. Ethical business will lead the foundation for moral business. Self check and self control are other two parameter which will carry out company's mission successfully.

c. Subjective Term :- Ethics differs from business to business. Its perceptions are based on moral and social grounds while conducting the business. There are no concreate rules and regulations for business activities. The soul aim is to attain welfare of the society as a whole.

d. Protection of the Interest of the Stakeholders :- Every business should give priority to the Society's Welfare. After attaining the interest of the society, it has social binding to protect the interest of macro environmental factors such as Stakeholders government, suppliers etc.

e. Respect with dignity :- Business should not discriminate society on the grounds of income, class, creed, religion etc. Ethical business should create confidence in the society about opinions, equality etc.

f. Proper set-up :- Business community is bound by social, ethical rules and regulations within the legal framework they should operate administer their business policies. The ultimate aim is to achieve the interest of the society.

g. Based on Principles :- Like code of conduct, professional ethics business communities are based on legal, social, cultural, environmental principles. Once principles are laid down properly, it will be easy to pursue plans and policies of business effectively and efficiently

h. Universal Applications :- Business operations in the world are more or less based on Standard Operating Procedure (SOP). Irrespective of size of business, plans, policies, legal frame work etc. are generally based on proper code of conduct; In some cases business ethics may differ from country to country because of the forces of macro environmental factors.

i. Self Discipline :- Initially business system was mainly focused to the general welfare of the Stakeholders but afterwards awareness respect to social attitude, environmental aspects human relations etc. was very much inculcated among business communities. Ultimately at one point of time majority business communities started taking precautionary measures about business and concerned aspect of awareness.

j. Different approach from CSR CSR is mainly associated with the functioning of administrative aspects of the enterprise whereas business ethics are mainly focusing on motivational and behavioural aspects. This goes on changing as social and environmental factors gets changed.

k. Different from Business Law :- Ethics provides set of guidelines based upon value judgement and morality. As business laws stress on fair conduct of 4 business practices which is mandatory whereas practices of ethical business is optional. Apart from this ethics are abstract in general and laws are expressed and published in proper format.

NEEDS AND IMPORTANCE OF BUSINESS ETHICS

Need & importance of Business Ethics. Real need of business ethics is felt in recent years following are the points which will stress out need & importance of business ethics :-

1. Survival :- Business needs to follow moral values and ethics for its survival and growth. Unethical gains are for short term they are not viable or fruitful for survival. To make business prosporous, ethical values and its implementation is essentials.

2. Consumer rights :- Implementation of consumers rights itself is an ethical way of conducting the business. This gives strength of individual consumer against the powerful business. Implementation of consumer rights will get control on unethical malpractices in business such as food adulteration, malpractices on weights and measurement.

3. Welfare of the Society :- Ethical business always profect societal interest. Production of goods and services are produced delivered with the intention of social welfare, business will always protect consumer interest by taking possible efforts by producing eco friendly products.

4. Protection of S.S.I. & Cottage Industry:- In India SSI and Cottage Industry plays on active role. To safeguard the interest of SSI and cottage industries big business units should handle their business operations ethically so as to safeguards the interest of SSI & cottage industries.

5. Mutual benefits:- B. E. benefits business and society. By rendering ethical services for the society business firms gain goodwill and reputation. Society also recognises the importance of fair & ethical business practices.

6. Growth and Expansions:- B. E. encourages for growth and expansion of business. It enables for the firm to gain reputation and goodwill, trust and confidence of micro and macro environmental forces.

7. Decision making:- After adopting /accepting to implement ethical practices, it will enable the business firms to incorporate ethical values based on moral consideration for eco-social environment. It ultimately 5 leads to quality improvement and economies of scale in operation system.

8. Boosting Economy:- Ultimately incorporating ethical practices in business will lead to increment in overall productivity which inturn leads to increase in national income. Acceleration in economy will enhance more circulation of goods and services more economic fluctuations will result in positive income and its distribution.

FAIR AND UNFAIR BUSINESS PRACTISES

What Is an Unfair Trade Practice?

Unfair trade practices refer to the use of various deceptive, fraudulent, or unethical methods to obtain business. Unfair business practices include misrepresentation, false advertising or representation of a good or service, tied selling, false free prize or gift offers, deceptive pricing, and noncompliance with manufacturing standards. Such acts are considered unlawful by statute through the Consumer Protection Law, which opens up recourse for consumers by way of compensatory or punitive damages. An unfair trade practice is sometimes referred to as "deceptive trade practices" or "unfair business practices."

KEY TAKEAWAYS

- Unfair trade practices refer to businesses using deceptive, fraudulent, or otherwise unethical methods to gain an advantage or turn a profit.
- Consumer Protection Law, as well as Section 5(a) of the Federal Trade Commission Act, protects consumers from unfair business practices.

Understanding Unfair Trade Practices

Unfair trade practices are commonly seen in the purchase of goods and services by consumers, tenancy, insurance claims and settlements, and debt collection. Most states' unfair trade practices statutes were originally

enacted between the 1960s and 1970s. Since then, many states have adopted these laws to prevent unfair trade practices. Consumers who have been victimized should examine the unfair trade practice statute in their state to determine whether they have a cause of action.

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In the United States, unfair trade practices are addressed in Section 5(a) of the Federal Trade Commission Act, which prohibits “unfair or deceptive acts or practices in or affecting commerce.” It applies to all individuals engaged in commerce, including banks, and sets the legal standard for unfair trade practices, which may be deemed unfair, deceptive, or both. Below are lists of unfair and deceptive practices as per the rule:

Unfair Practices

An act is unfair when it meets the following criteria:

- It causes or is likely to cause substantial injury to consumers.
- It cannot be reasonably avoided by consumers.
- It is not outweighed by countervailing benefits to consumers or to the competition.

Deceptive Practices

An act or practice is deceptive when it meets the following criteria:

- A representation, omission, or practice misleads or is likely to mislead the consumer.
- A consumer’s interpretation of the representation, omission, or practice is considered reasonable under the circumstances.
- The misleading representation, omission, or practice is material.

THEORETICAL BASIS OF CORPORATE GOVERNANCE

Theories of Corporate Governance.

There are many theories of corporate governance which addressed the challenges of governance of firms and companies from time to time. The Corporate Governance is the process of decision making and the process by which decisions are implemented in large businesses is known as Corporate Governance. There are various theories which describe the relationship between various stakeholders of the business while carrying out the activity of the business.

Theories of Corporate Governance

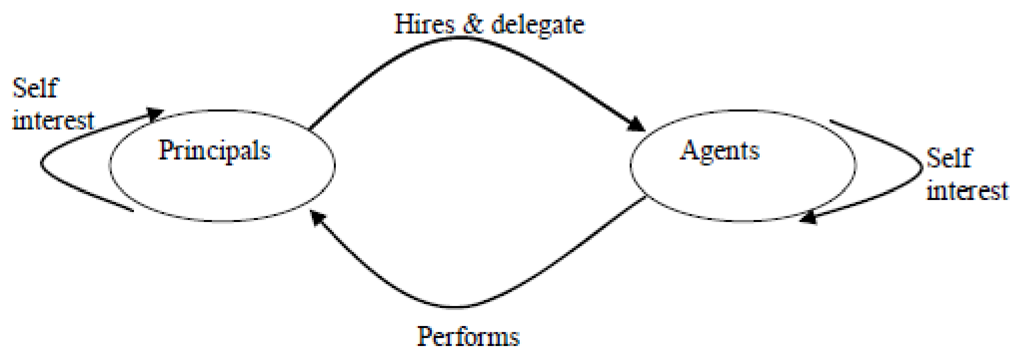
The following are the theories of corporate governance:

- Agency Theory
- Stewardship Theory
- Resource Dependency Theory
- Stakeholder Theory
- Transaction Cost Theory
- Political Theory

Agency Theory

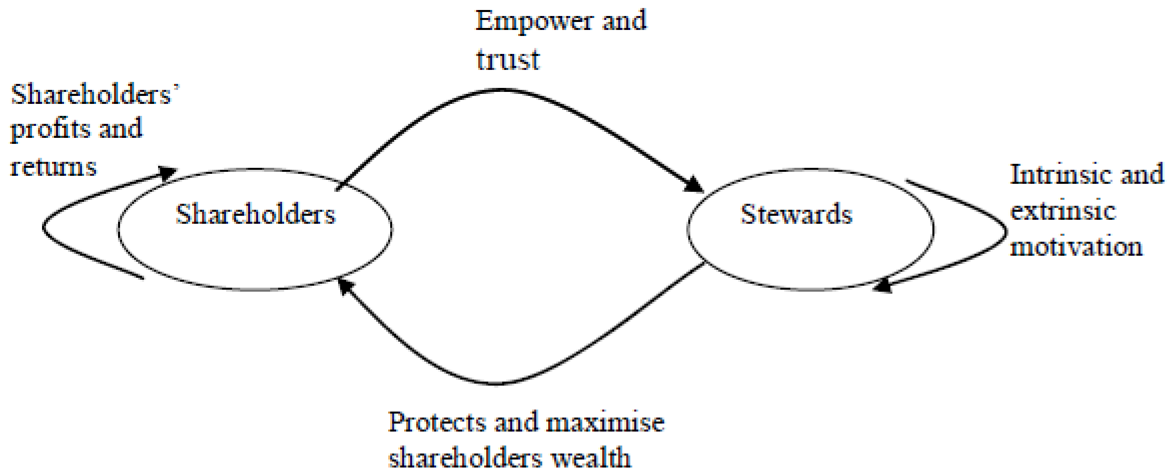
Agency theory defines the relationship between the principals (such as shareholders of company) and agents (such as directors of company). According to this theory, the principals of the company hire the agents to perform work. The principals delegate the work of running the business to the directors or managers, who are agents of shareholders. The

shareholders expect the agents to act and make decisions in the best interest of principal. On the contrary, it is not necessary that agent make decisions in the best interests of the principals. The agent may be succumbed to self-interest, opportunistic behavior and fall short of expectations of the principal. The key feature of agency theory is separation of ownership and control. The theory prescribes that people or employees are held accountable in their tasks and responsibilities. Rewards and Punishments can be used to correct the priorities of agents.



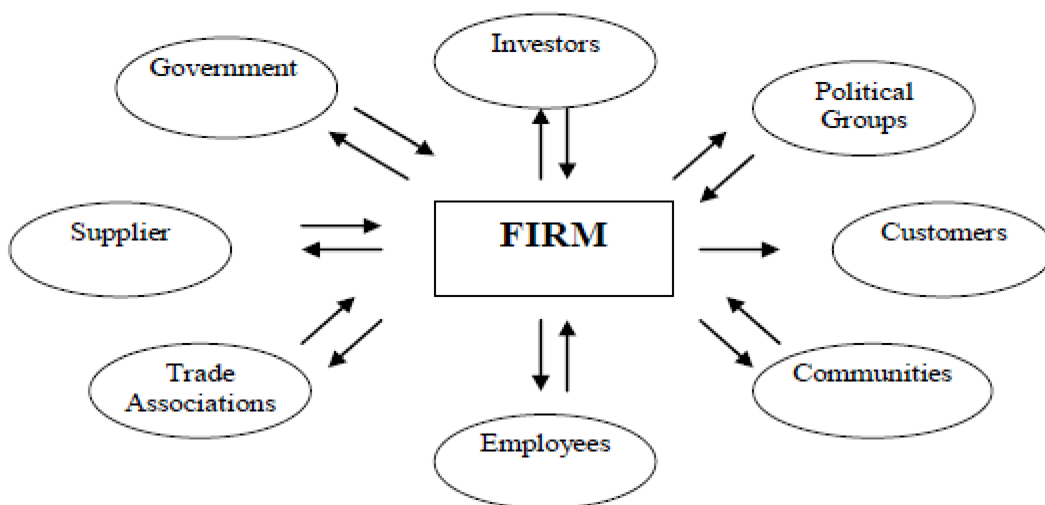
Stewardship Theory

The steward theory states that a steward protects and maximises shareholders wealth through firm Performance. Stewards are company executives and managers working for the shareholders, protects and make profits for the shareholders. The stewards are satisfied and motivated when organizational success is attained. It stresses on the position of employees or executives to act more autonomously so that the shareholders' returns are maximized. The employees take ownership of their jobs and work at them diligently.



Stakeholder Theory

Stakeholder theory incorporated the accountability of management to a broad range of stakeholders. It states that managers in organizations have a network of relationships to serve – this includes the suppliers, employees and business partners. The theory focuses on managerial decision making and interests of all stakeholders have intrinsic value, and no sets of interests is assumed to dominate the others



Resource Dependency Theory

The Resource Dependency Theory focuses on the role of board directors in providing access to resources needed by the firm. It states that directors play an important role in providing or securing essential resources to an organization through their linkages to the external environment. The provision of resources enhances organizational functioning, firm's performance and its survival. The directors bring resources to the firm, such as information, skills, access to key constituents such as suppliers, buyers, public policy makers, social groups as well as legitimacy. Directors can be classified into four categories of insiders, business experts, support specialists and community influentials.

Transaction Cost Theory

Transaction cost theory states that a company has number of contracts within the company itself or with market through which it creates value for the company. There is cost associated with each contract with external party; such cost is called transaction cost. If transaction cost of using the market is higher, the company would undertake that transaction itself.

Political Theory

Political theory brings the approach of developing voting support from shareholders, rather by purchasing voting power. It highlights the allocation of corporate power, profits and privileges are determined via the governments' favor.

CORPORATE GOVERNANCE MECHANISM

Effective corporate governance is essential if a business wants to set and meet its strategic goals. A corporate governance structure combines controls, policies and guidelines that drive the organization toward its

objectives while also satisfying stakeholders' needs. A corporate governance structure is often a combination of various mechanisms.

Internal Mechanism

1. The foremost sets of controls for a corporation come from its internal mechanisms. These controls monitor the progress and activities of the organization and take corrective actions when the business goes off track. Maintaining the corporation's larger internal control fabric, they serve the internal objectives of the corporation and its internal stakeholders, including employees, managers and owners. These objectives include smooth operations, clearly defined reporting lines and performance measurement systems. Internal mechanisms include oversight of management, independent internal audits, structure of the board of directors into levels of responsibility, segregation of control and policy development.

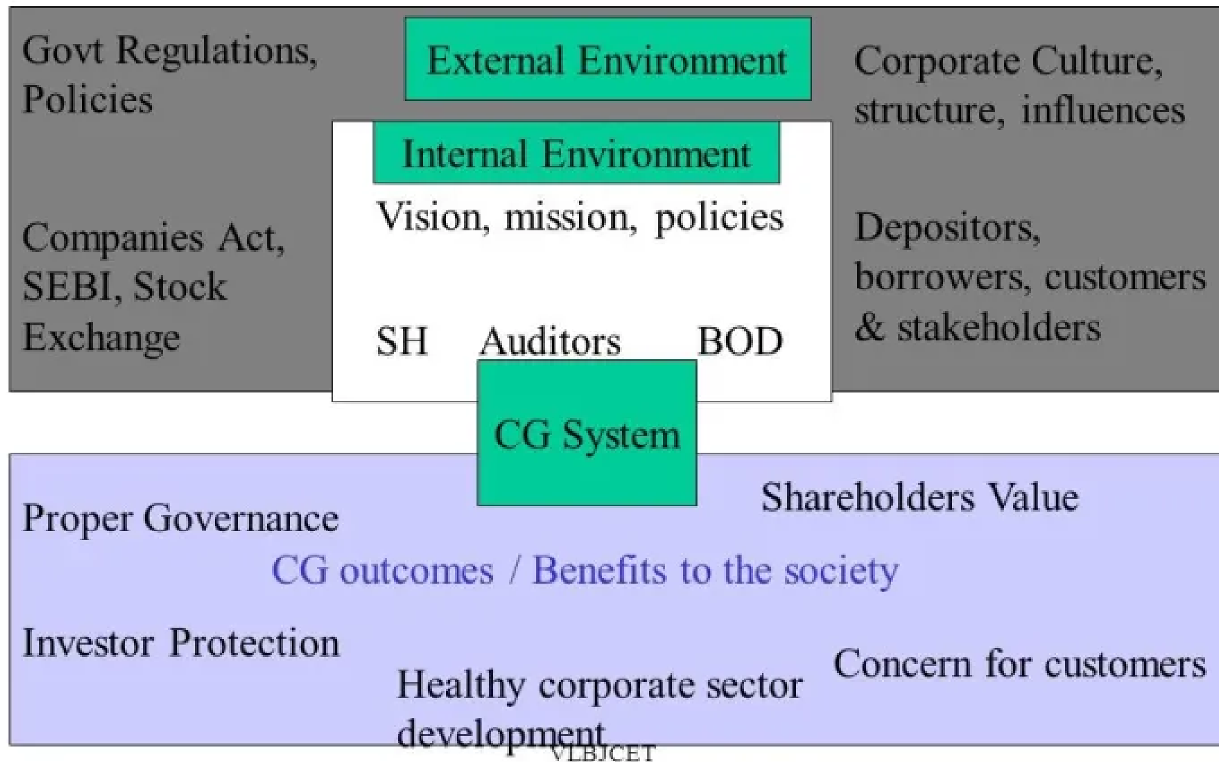
External Mechanism

1. External control mechanisms are controlled by those outside an organization and serve the objectives of entities such as regulators, governments, trade unions and financial institutions. These objectives include adequate debt management and legal compliance. External mechanisms are often imposed on organizations by external stakeholders in the forms of union contracts or regulatory guidelines.

External organizations, such as industry associations, may suggest guidelines for best practices, and businesses can choose to follow these guidelines or ignore them. Typically, companies report the status and compliance of external corporate governance mechanisms to external stakeholders.

INDIAN MODEL OF GOVERNANCE

In India there are mainly three types of companies’ viz. private companies, public companies and public sector undertakings. Each of these companies has distinct kind of shareholding pattern. Thus the corporate governance model in India is a mix of Anglo-American and German Models.



GOOD CORPORATE GOVERNANCE

Good corporate governance helps to build an environment of trust, transparency and accountability necessary for fostering long-term investment, financial stability and business integrity, thereby supporting stronger growth and more inclusive societies. Good corporate governance means that the processes of disclosure and transparency are followed so as to provide regulators and shareholders as well as the general public with precise and accurate information about the financial, operational and other aspects of the company. Corporate governance is a term that means many

things and the bottom line for good corporate governance is the dual aim of pursuing profits and doing so in a transparent and accountable manner.

OBLIGATIONS TOWARDS SOCIETY AND STAKEHOLDERS

Obligations towards owners or shareholders

In the case of sole trader ship and partnership concerns, the owners can

look after their interest themselves. Where as in the case of the company,

the directors have the following responsibilities towards the shareholders:

1. ***Reasonable Dividend:*** shareholders are a source of funds for the company. They Management and Society expect a high rate of dividend on the money invested by them and also the maximization of the value of their investment in the company.
2. ***Protection of assets:*** The assets of the company are purchased with shareholders funds. Therefore the company is responsible to safeguard these assets.
3. ***Information:*** It is the responsibility of the management to keep the shareholders informed about the financial position as well as the progress of the company.

Obligations towards Customers

Customer's satisfaction is the ultimate aim of all economic activity.

Therefore, it is, theduty of management

1. To make goods of the right quality available to the right people at the right time andplace and at reasonable prices.
2. The business should not indulge into unfair practices such as black marketing, hoarding, adulteration etc.
3. To provide prompt and courteous service to customers.
4. To handle customers grievances carefully.
5. To distribute the goods and services properly so that the customers do not face any difficulty in purchasing them.
6. To produce goods which meet the needs of the customer who belong to different classes, tastes and with different purchasing power.

Obligations towards Employees

Employees should be treated as human beings and their co-operation must be achieved for the realization of organizational goals. The business should fulfil the following obligations towards their employees.

1. ***Fair wages:*** Business should pay reasonable salaries so that their employee's may lead a good life and satisfy their needs.
2. ***Adequate benefits:*** Employees should be provided benefits like housing, insurance cover, medical facilities and retirement benefits.
3. ***Good Working Conditions:*** Good working conditions are necessary to maintain the health of the workers. Therefore they must be provided with good working conditions.
4. ***Opportunity for Growth:*** Business should give their employees opportunity to develop their capabilities through training and education.

5. ***Recognition of Worker's Rights:*** The business should recognize the worker's right to fair wages, to form trade unions, to collective bargaining etc.
6. ***Co-operation:*** The business must win the co-operation of the workers by creating the conditions in which workers are willing to put forward their best efforts towards the common goals of the business.

Responsibility towards Suppliers

The business must create healthy relations with the supplier. Management should deal with them judiciously. They should be provided with fair terms and conditions regarding price, quality, delivery of goods and payment.

Obligations towards Government

It is the duty of every business enterprise to manage its affairs according to the laws affecting it. It should pay taxes and other dues honestly. It should not encourage corruption,black marketing and other social evils. It should discourage the tendencies of concentration of economic power and monopoly and should encourage fair trade practices.

Obligation towards Society

Every business owes an obligation to the society at large. The following are the important obligations of business towards society.

1. ***Socio-Economic Objectives:*** A business should not indulge in any practice which is not fair from social point of view. The business should use the factors of production effectively and efficiently for the satisfaction of the needs of the society.
2. ***Employment Opportunities:*** It is the responsibility of management to help increase direct and indirect employment in the area where it is functioning.
3. ***Efficient use of Resources:*** The resources at the command of business belongs to the society. Therefore, the business should make the best possible use of the resources at its disposal for the well being of the society.
4. ***Business Morality:*** The business should not indulge into anti-social and unfairtrade practices such as adulteration, hoarding and black marketing.
5. ***Improving local environment:*** Business should take preventive measures against water and air pollution. It can develop the surrounding area for the well being of the employees and the general public. A business can also contribute to the advancement of local amenities.