



Class: TY BSc

Subject : Professional Ethics

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Chapter: Unit 2 - Chapter 1

Chapter Name: Corporate governance

Today's Agenda

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1 Definition of Corporate Governance



"Corporate Governance is concerned with the way corporate entities are governed, as distinct from the way business within those companies is managed. Corporate governance addresses the issues facing Board of Directors, such as the interaction with top management and relationships with the owners and others interested in the affairs of the company"

- Robert Ian (Bob) Tricker

1.1 Need for CSR



Corporate social responsibility (CSR) promotes a vision of business accountability to a wide range of stakeholders, besides shareholders and investors. Key areas of concern are environmental protection and the wellbeing of employees, the community and civil society in general, both now and in the future.

Some of the drivers pushing business towards CSR include:

- The shrinking role of government
- Demands for greater disclosure
- Increased customer interest
- Growing investor pressure
- Competitive labour markets
- Supplier relations

1.2 Positive outcomes of CSR

1. Company benefits:

- Improved financial performance;
- Lower operating costs;
- Enhanced brand image and reputation;
- Increased sales and customer loyalty;
- Greater productivity and quality;
- More ability to attract and retain employees;
- Reduced regulatory oversight;
- Access to capital;
- Workforce diversity;
- Product safety and decreased liability.

2. Benefits to the community and the general public:

- Charitable contributions;
- Employee volunteer programmes;
- Corporate involvement in community education, employment and homelessness programmes ;
- Product safety and quality.

3. Environmental benefits:

- Greater material recyclability;
- Better product durability and functionality;
- Greater use of renewable resources;
- Integration of environmental management tools into business plans, including life-cycle assessment and costing, environmental management standards, and eco-labelling .

1.3 Need for Corporate Governance

- Transparency, accountability and disclosure
- Corporate Performance
- Enhanced Investor Trust
- Better Access to Global Market
- Easy Finance from Institutions
- Enhancing Enterprise Valuation
- Reduced Risk of Corporate Crisis and Scandals
- Combating corruption

1.4 Examples



Are you aware of any company that adopted the CSR policy?

1.4 Examples of Corporate Governance

Volkswagen AG, a German company, was and still is one of the biggest vehicle manufacturers in the world. It resorted to unfair means to profit off the environment. Volkswagen was involved in an emissions scandal, popularly known as “Dieselgate”.

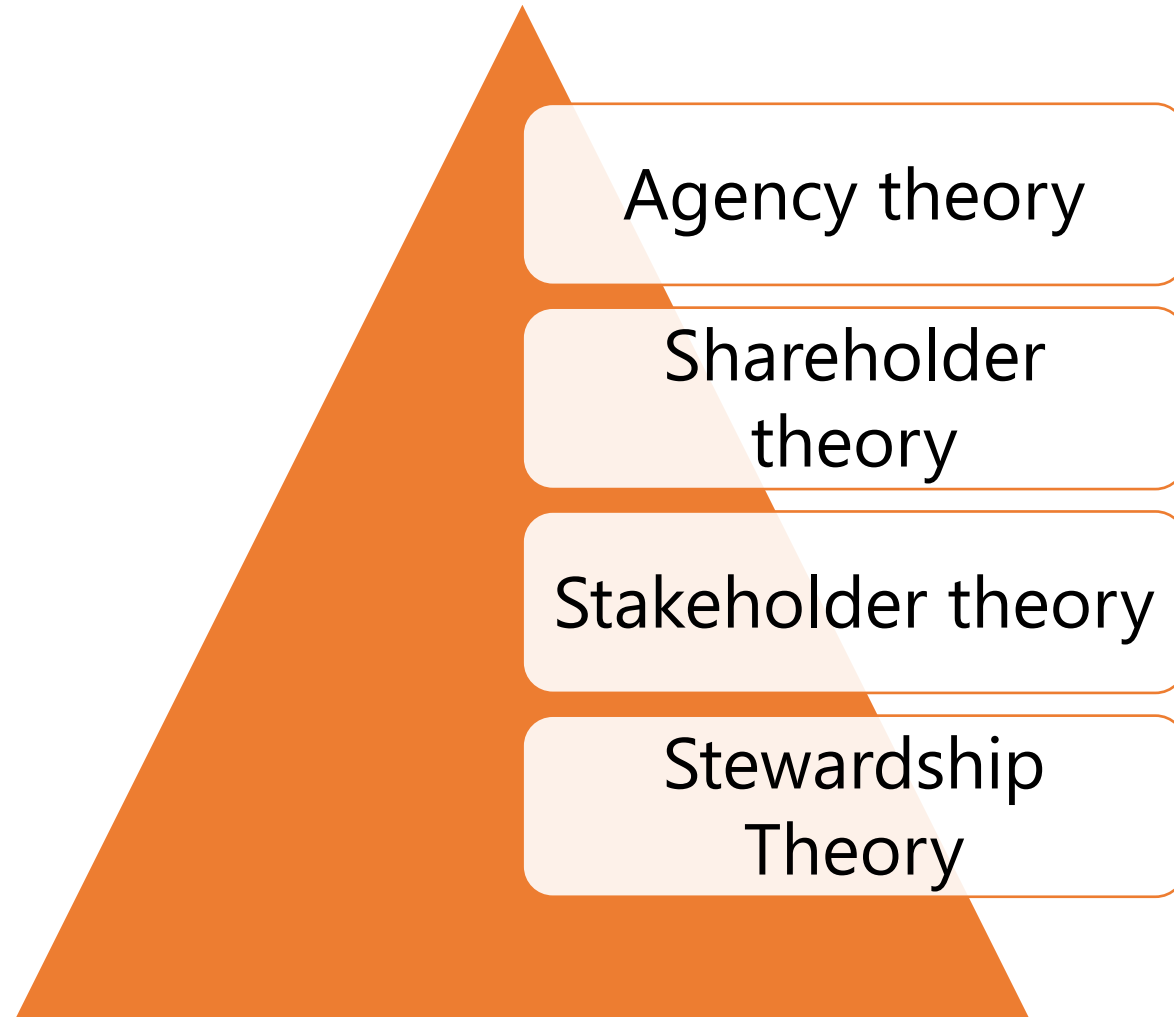
The United States Environmental protection Agency (EPA) issued a notice of the violation of the Clean Air Act in September 2015 to Volkswagen, which is when the scandal began.

Further investigation revealed that Volkswagen had deliberately rigged engine emission equipment in its cars to manipulate pollution test results in America and Europe. As of 1st June 2020, the Dieselgate scandal has cost Volkswagen \$33.3 billion.



<https://www.youtube.com/watch?v=AsPmJdlrBil>

2 Theoretical perspectives



2 Theoretical perspectives

1. Agency Theory

According to this theory, managers act as 'Agents' of the corporation. The owners or directors set the central objectives of the corporation. Managers are responsible for carrying out these objectives in day-to-day work of the company. Corporate Governance is control of management through designing the structures and processes.

2. Stockholder/shareholder Theory

According to this theory, it is the corporation which is considered as the property of shareholders/ stockholders. They can dispose of this property, as they like. They want to get maximum return from this property.

3. Stakeholder Theory

According to this theory, the company is seen as an input-output model and all the interest groups which include creditors, employees, customers, suppliers, local-community and the government are to be considered. From their point of view, a corporation exists for them and not the shareholders alone.

2 Theoretical perspectives

4. Stewardship Theory

The word 'steward' means a person who manages another's property or estate. Here, the word is used in the sense of guardian in relation to a corporation, this theory is value based. The managers and employees are to safeguard the resources of corporation and its property and interest when the owner is absent. They are like a caretaker. They have to take utmost care of the corporation. They should not use the property for their selfish ends.

3 Corporate citizenship

The Securities and Exchange Board of India (SEBI) had set up a Committee under the Chairmanship of Kumar Mangalam Birla to promote and raise standards of corporate governance.

- These recommendations, aimed at improving the standards of Corporate Governance, are divided into mandatory and non-mandatory recommendations.
- The said recommendations have been made applicable to all listed companies with the paid-up capital of Rs. 3 crores and above or net worth of Rs. 25 crores or more at any time in the history of the company.

3.1 Summary of the report

- The Board should have an optimum combination of Executive and Non Executive Directors with not less than 50 per cent of the Board consisting of non-executive directors.
- Non-executive Chairman, at least one-third of the Board should consist of independent directors and in the case of an executive Chairman, at least half of the Board should consist of independent directors
- **"Independent directors are directors who apart from receiving director's remuneration do not have any other material pecuniary relationship or transactions with the company, its promoters, its management or its subsidiaries, which in the judgment of the board may affect their independence of judgment."**
- Board meetings should be held at least four times in a year, with a maximum time gap of four months between any two meetings
- A director should not be a member in more than 10 committees or act as Chairman of more than five committees across all companies in which he is a director.

3.1 Summary of the report

- Financial Institutions should appoint nominee directors on a selective basis and nominee director should have the same responsibility
- Non-executive Chairman should be entitled to maintain Chairman's office at the expense of the company and also allowed reimbursement of expenses incurred in performance of his duties.
- Audit Committee - which a qualified and independent audit committee should be set up by the board of a company
 - It should have minimum three members, all being non-executive directors, with the majority being independent, and with at least one director having the chairman of the committee should be an independent director;
 - The chairman should be present at Annual General Meeting to answer shareholder queries;
 - The audit committee should invite such of the executives, as it considers appropriate (and particularly the head of the finance function) to be present at the meetings of the committee but on occasions it may also meet without the presence of any executives of the company. Finance director and head of internal audit and when required, a representative of the external auditor should be present as invitees for the meetings of the audit committee;

3.1 Summary of the report

- The Company Secretary should act as the secretary to the committee.

Frequency of Meeting

- The audit committee should meet at least thrice a year. One meeting must be held before finalization of annual accounts and one necessarily every six months.
- The quorum should be either two members or one-third of the members of the audit committee, whichever is higher and there should be a minimum of two independent directors.

Powers of Audit Committee

- To investigate any activity within its terms of reference.
- To seek information from any employee.
- To obtain outside legal or other professional advice.
- To secure attendance of outsiders with relevant expertise, if it considers necessary.

3.1 Summary of the report

Functions of the Audit Committee

- Oversight of the company's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.
- Recommending the appointment and removal of external auditor, fixation of audit fee and also approval for payment for any other services.
- Reviewing with management the annual financial statements before submission to the board

Remuneration committee

- At least three directors, all of whom should be non- executive directors, the chairman of committee being an independent director
- All members should be present at the meeting
- These recommendations are non mandatory
- The board of directors should decide the remuneration of non-executive directors.
- The Corporate Governance section of the Annual Report should make disclosures about remuneration paid to Directors in all forms including salary, benefits, bonuses, stock options, pension and other fixed as well as performance linked incentives.

3.1 Summary of the report

Shareholders/Investors' Grievance Committee of Directors

The Board should set up a Committee to specifically look into share holder issues including share transfers and redressal of shareholders' complaints.

- General Body Meetings - Details of last three AGMs should be furnished
- Disclosures - Details of non-compliance by the company including penalties and strictures imposed by the Stock Exchanges, SEBI or any statutory authority on any matter related to capital markets during the last three years must be disclosed to the shareholders.
- Means of communication - Half-yearly report to be sent to each household of shareholders, details of the mode of dissemination of quarterly results and presentations made to institutional investors to be disclosed and statement of Management Discussion and Analysis to be included in the report.
- General shareholder information - Various specified matters of interest to be included in the Annual Report.
- Auditor's Certificate on Corporate Governance - There should be an Auditor's certificate on corporate governance in the Annual Report as an annexure to the Director's Report.
- Companies should consolidated accounts in respect of all subsidiaries in which they hold 51 per cent or more of the capital.
- Information like quarterly results, presentation made by companies to analysts may be put on company's web-site or may be sent in such a form so as to enable the stock exchange on which the company is listed to put it on its own web-site.

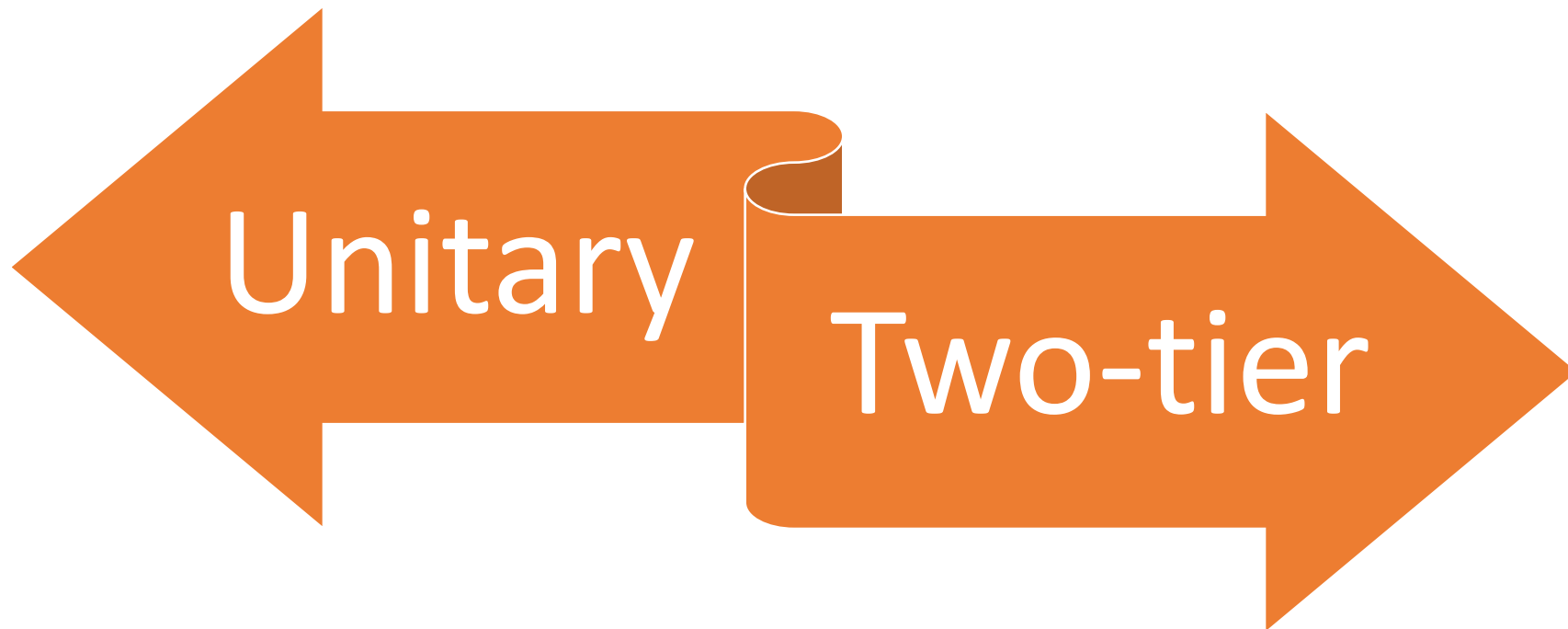
3.1 Summary of the report

- Shareholders to use the forum of General Body Meetings for ensuring that the company is being properly stewarded for maximizing the interests of the shareholders.
- A board committee under the chairmanship of a non-executive director should be formed to specifically look into the redressing of shareholder complaints like transfer of shares, non-receipt of balance sheet, non-receipt of declared dividends etc.
- Half-yearly declaration of financial performance including summary of the significant events in last six-months, should be sent to each household of shareholders.

The institutional shareholders should:

Take active interest in the composition of the Board of Directors Be vigilant Maintain regular and systematic contact at senior level for exchange of views on management, strategy, performance and the quality of management. Ensure that voting intentions are translated into practice. Evaluate the corporate governance performance of the company.

3.2 Types of Board



4 Strategies for corporate governance

Role of board of directors

All listed companies should make a statement about their compliance with the Code in their report and accounts as well as give reasons for any areas of non-compliance. It is divided into four sections:

1. Board of Directors:

- (a) The board should meet regularly, retain full and effective control over the company and monitor the executive management.
- (b) There should be a clearly accepted division of responsibilities at the head of a company, which will ensure a balance of power and authority, such that no one individual has unfettered powers of decision.
- (c) Where the chairman is also the chief executive, it is essential that there should be a strong and independent element on the board, with a recognized senior member, that is, there should be a lead independent director.
- (d) All directors should have access to the advice and services of the company secretary, who is responsible to the Board for ensuring that board procedures are followed and that applicable rules and regulations are complied with

4 Strategies for corporate governance

2. Non-Executive Directors:

- (a) The non-executive directors should bring an independent judgment to bear on issues of strategy, performance, resources, including key appointments, and standards of conduct.
- (b) The majority of non-executive directors should be independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgment, apart from their fees and shareholding.

3. Executive Directors:

There should be full and clear disclosure of directors' total emoluments and those of the chairman and highest-paid directors, including pension contributions and stock options, in the company's annual report, including separate figures for salary and performance-related pay.

4. Financial Reporting and Controls:

It is the duty of the board to present a balanced and understandable assessment of their company's position, in reporting of financial statements, for providing true and fair picture of financial reporting. The directors should report that the business is a going concern, with supporting assumptions or qualifications as necessary. The board should ensure that an objective and professional relationship is maintained with the auditors.

4 Strategies for corporate governance

Role of Auditors

1. The Report recommended for the constitution of Audit Committee with a minimum of three non executive members majority of whom shall be independent directors.
2. The Report recommended that a professional and objective relationship between the board of directors and auditors should be maintained, so as to provide to all a true and fair view of company's financial statements. Auditors' role is to design audit in such a manner so that it provide a reasonable assurance that the financial statements are free of material misstatements.
3. The Report recommended for rotation of audit partners to prevent the relationships between the management and the auditors becoming too comfortable.

4 Strategies for corporate governance

Rights & Responsibilities of Shareholders

1. The Report emphasizes on the need for fair and accurate reporting of a company's progress to its shareholders.
2. The Report placed importance on the role of institutional investors/ shareholders and encouraged them to make greater use of their voting rights and take positive interest in the board functioning. Both shareholders and boards of directors should consider how the effectiveness of general meetings could be increased as well as how to strengthen the accountability of boards of directors to shareholders.

4 Strategies for corporate governance

Developments in India:

Recommendation I - Frequency of Board meetings

Recommendation II - Board Composition

Recommendation III - No. of directorships

Recommendation IV - Role, Responsibilities, Qualifications of Non-executive Directors

Recommendation V - Remuneration of non-executive directors

Recommendation VI - Disclosure of attendance record for reappointment

Recommendation VII - Key information to the Board

Recommendation VIII - Audit Committee

Recommendation IX - Disclosure on shareholder information

Recommendation X - Consolidated Accounts

Recommendation XI - Compliance certificate

Recommendation XII - Disclosure relating to Global Depository Receipts (GDR)

Recommendation XIII - Funding

Recommendation XIV - Nominee Director

Recommendation XV - Disclosure of Ratings

Recommendation XVI - Default on fixed deposits by company

5 Challenges and implementation

- A corporation should be fair and transparent to its stakeholders in all its transactions. This has turn imperative in present's globalized business world where corporations need to access global pools of capital need to attract and retain the good human capital from various parts of the world. Unless a corporation embraces and demonstrates ethical conduct, it'll not be capable to succeed.
- What's **Corporate Governance** it's known fact that vital necessities of success of any association lingers on its ability to mobilize and use all kinds of resources to meet the objects easily set as part of the planning process.
- Corporate governance is about ethical conduct in business. Ethics is concerned with the law of values and principles that enables a person to choose between right and wrong. Further, ethical dilemmas arise from clashing interests of the parties involved.
- It's enough possible that in the effort at arriving the best possible financial results or business results there could be attempts at doing things which are verging on the illegal or indeed illegal. There's also the possibility of grey areas where an act isn't illegal but considered unethical. These raise moral issues.
- Strong corporate governance is essential to flexible and vibrant capital markets and is an important instrument of investor protection.

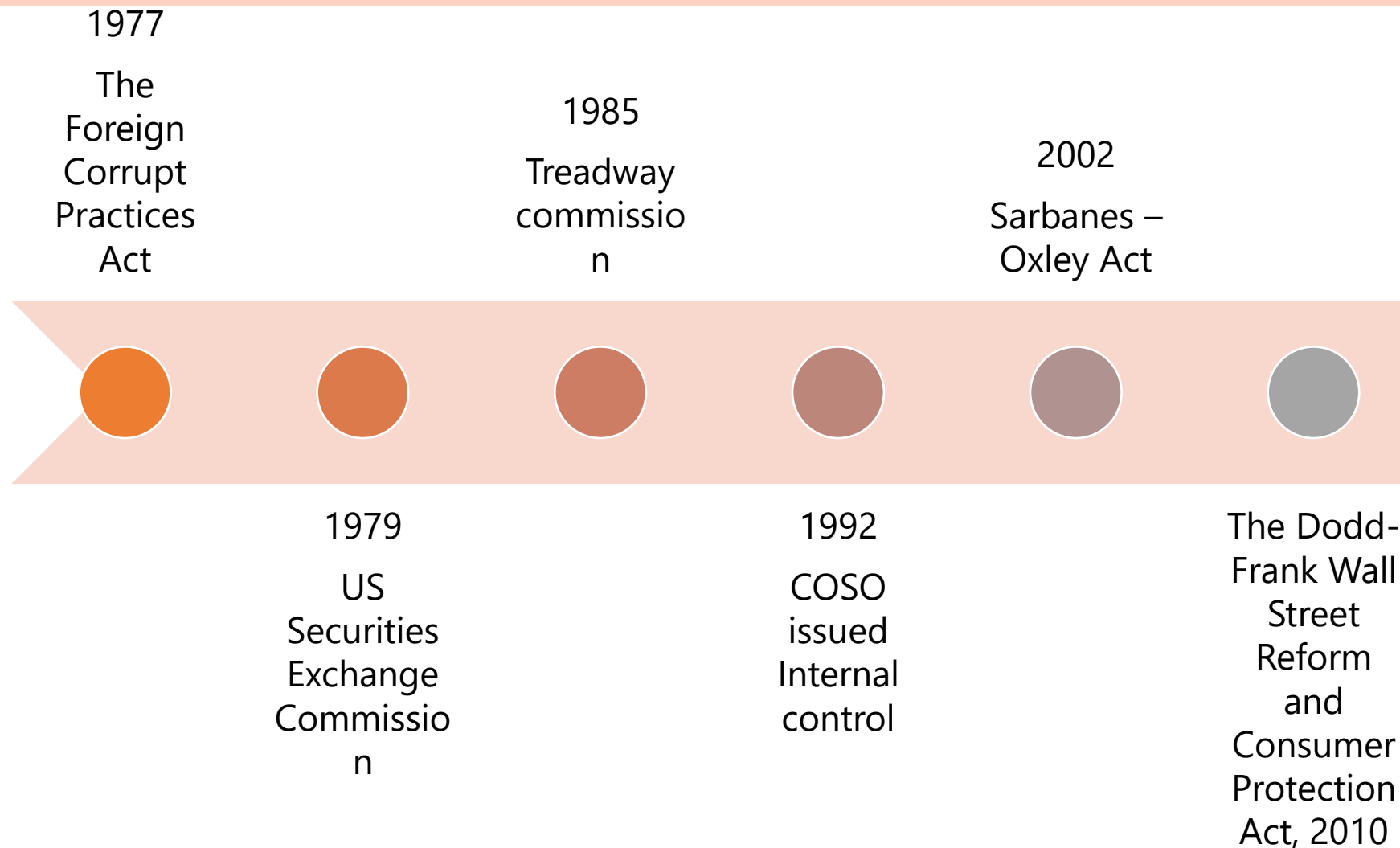
5 Challenges and implementation

- The quick migration of four elements across national borders. These are:
 - Physical capital in terms of plant and machinery;
 - pecuniary capital;
 - Technology; and
 - Labor.
- Companies raise capital from market and investors suffered due to unscrupulous guidance that performed much worse than past reported figures. Numerous corporates didn't pay heed to investors grievances.
- The board of directors and the elderly position administration of an enterprise- walking their talk. It's by walking their talk that the top administration can earn credibility. This also has a direct bearing on the morale of an organization.
- When it comes to the hardware aspect of corporate governance, we go into the issue of a law, which becomes a reference point for actions. But the sad fact in our country is that even though there's a lot of talk about corporate governance, when it comes to reality, nothing big happens.

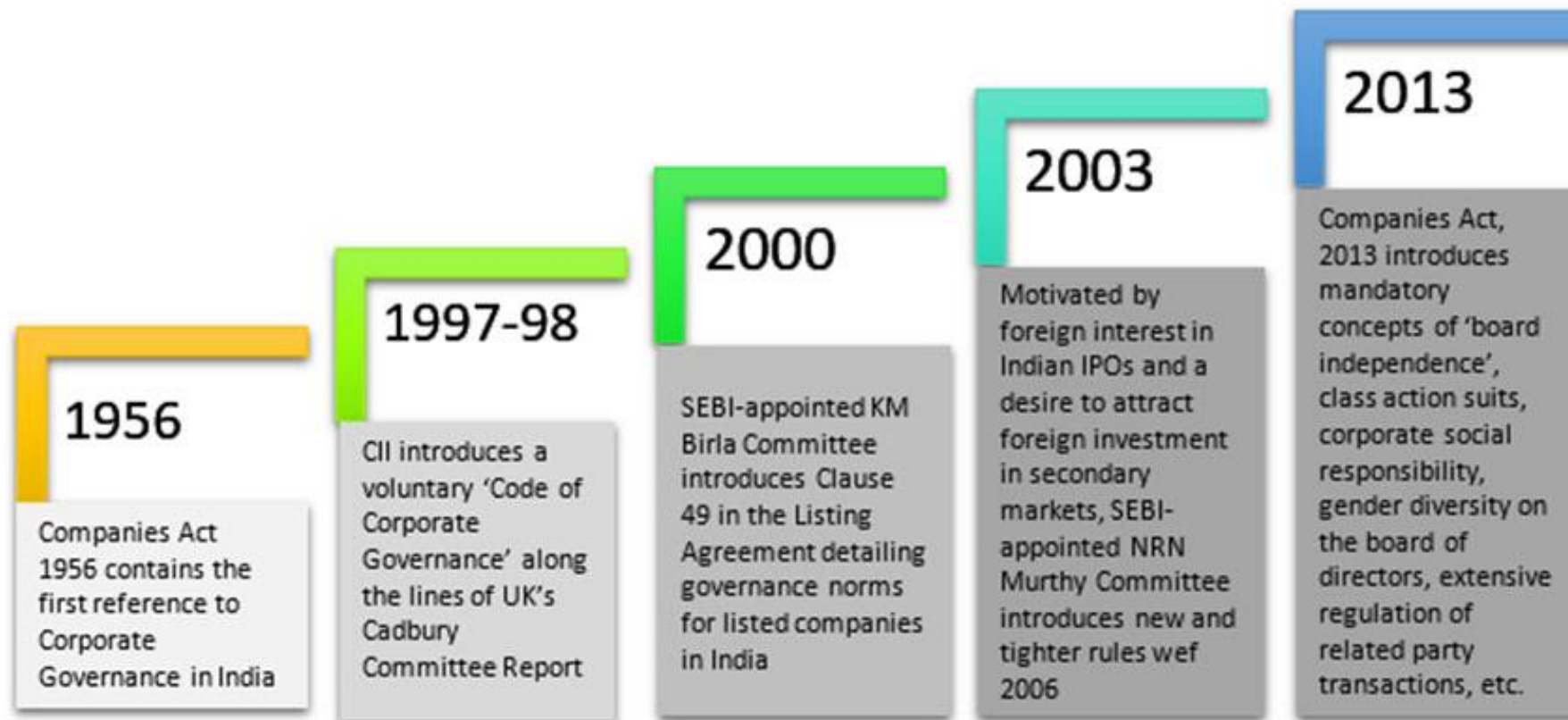
5 Challenges and implementation

- In the Indian context lack of clarity that leads to corrupt or illegal actions.
- Maybe the most important challenge we face towards better corporate governance is the mindset of the people and the organizational culture. This change will have to come from within.
- Another important aspect is to realise that eventually the spirit of corporate governance is more important than the form. Substance is more important than style. Values are the substance of commercial governance and these will have to be definitely articulated and systems and procedures devised, so that these values are practiced.
- We then come to a common moral problem in running enterprises. One can have practices which are legal but which are unethical. In fact, numerous a time, tax planning exercises may border on the fine razor's edge between the rigorously legal and the patently unethical.

6 Evolution of corporate governance in US



6 Evolution of corporate governance in India



7 Structure of Board

Lead Independent Director

- Acts as the principal liaison between the independent directors of the Board and the Chairman of the Board
- Develops the agenda for and preside at executive sessions of the Board's independent directors
- Advises the Chairman of the Board as to an appropriate schedule for Board meetings, seeking to ensure that the independent directors can perform their duties responsibly while not interfering with the flow of Company operations
- Advises the Chairman of the Board as to the quality, quantity and timeliness of the information submitted by the Company's management that is necessary or appropriate for the independent directors to effectively and responsibly perform their duties
- Recommends to the Board the retention of advisors and consultants who report directly to the Board
- Assists the Board and Company officers in better ensuring compliance with and implementation of the Governance Guidelines;
- Serves as Chairman of the Board when the Chairman is not present; and
- Serves as a liaison for consultation and communication with shareholders.

7 Structure of Board

Chairman

- setting the Board agenda, ensuring that Directors receive accurate, timely and clear information to enable them to take sound decisions,
- ensuring that sufficient time is allowed for complex or contentious issues, and encouraging active engagement by all members of the Board;
- taking the lead in providing a comprehensive, formal and tailored induction programme for new Directors, and in addressing the development needs of individual Directors to ensure that they have the skills and knowledge to fulfill their role on the Board and on Board Committees;
- evaluating annually the performance of each Board member in his/her role as a Director, and ensuring that the performance of the Board as a whole and its Committees is evaluated annually.
- Holding meetings with the non executive Directors without the executives being present;
- ensuring effective communication with shareholders and in particular that the company maintains contact with its principal shareholders on matters relating to strategy, governance and Directors' remuneration

7 Structure of Board

Chief Executive Officer

His key role is leading the long term strategy and its implementation, it further includes:

- Developing implementation plan of action to meet the competition and keeping in mind –
- the long term existence of the company
- Adequate control systems
- Monitoring the operating and financial outcomes against the set plan
- Remedial action
- Keeping the Board informed

7 Structure of Board

Separation of role of Chief Executive Officer and Chairman

- Increases the effectiveness of the company's board
- Board / Chairman's job – to monitor and evaluate company's performance
- CEO – represents the management team
- Roles are separate – CEO is far more accountable

ICSI Recommendations to strengthen Corporate Governance suggests that there should be clear demarcation of the roles and responsibilities of the chairman of the board and that of the Managing Director/ CEO

7 Structure of Board

Company Secretary

Section 2(45) of the Companies Act, 1956 defines the term 'secretary' to mean a company secretary within the meaning of Section 2(1)(c) of the Company Secretaries Act, 1980 and includes any other individual possessing the prescribed qualifications and appointed to perform the duties which may be performed by a secretary under the Companies Act, 1956 and any other ministerial or administrative duties. Every company in India having a paid-up capital of not less than rupees five crore (limit increased from rupees two crore to five crore in 2009) shall be required to appoint a whole-time company secretary. Under Section 5 of the Companies Act, the company secretary has also been included in the category of the officer of the company and shall be considered to be in default in complying with any provisions of the Companies Act, 1956.

8 Role of Capital Market

- It is an important and efficient conduit to channel and mobilize funds to enterprises, and provide an effective source of investment in the economy.
- It also provide a medium for risk management by allowing diversification of risk in the economy.
- It plays a major role in encouraging the adoption of stronger corporate governance principles.
- It plays a critical role in mobilizing savings for investment in productive assets, with a view to enhancing a country's long-term growth prospects.
- It also tends to improve information quality as it plays a major role in encouraging the adoption of stronger corporate governance principles

9 Corporate Governance Rating



A corporate governance rating refers to the status of a company with respect to the adoption of corporate governance practices.

Few credit rating agencies in India:

1. Credit rating Agency (CRA)
2. Credit Rating Information Services of India Limited (CRISIL)
3. Credit Analysis and Research Limited (CARE)
4. ICRA
5. SMERA
6. ONICRA
7. FITCH India