

Good Governance & Good Performances & Some Corporate Governance Issues

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The topic of Corporate Governance generally acquires significance under two situations. First, when there has been a string of companies collapsing due to bad governance and second, when there are regulatory changes to enforce corporate governance. Companies genuinely committed to high standards of financial propriety, ethics and disclosure are likely to be practicing good corporate governance. There is generally a direct correlation between good governance and good performance. Ira Milstein, director of the Yale Centre for Corporate Governance said, *"Good governance leads to good performance. One may not be able to prove that empirically, but I can demonstrate that bad governance leads to bad performance."*

A research study by a leading International Bank based on an assessment of the governance of the FTSE 350 companies using 50 differently weighted corporate governance standards found a clear link between the corporate governance and share price performance of the companies. During the four and a half year period investigated, the top 20% of the companies in terms of governance structure and behavior outperformed those in the bottom 20% by over 32%. A number of financial irregularities and accounting scandals across the globe have made regulators think of new ways to ensure transparency, integrity and accountability. Corporate Governance Codes are constantly being revised. Today, more than any time in our history,

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boardroom discussion is focused on issues of governance, accountability and disclosure. The voice of shareholder activism is getting louder and louder and the focus of regulators perhaps is getting more and more intense.

The future course of Corporate Governance is an increasing trend towards convergence. As companies get listed in multiple stock exchanges and carry out operations across several jurisdictions with cross-border financial flows, the need for some commonly understood standards of governance is inevitable. Global capital logically flows to where it is best protected and bypasses where protection is limited or non-existent. Companies with high quality governance mechanisms have a better quality of financial reporting and can get external financing at a cheaper cost, which means overall better performance.

In the Indian context, there is sufficient evidence that we have performed rather well on corporate governance - both on the Corporate regulatory and regulatory front. Governance Association, which ranks 10 Asian countries on Corporate Governance parameters over the last five years, India has consistently ranked among the top three along with Singapore and Hong Kong. To our country's credit, efforts to devise a corporate governance code were not prompted by any serious macro economic collapse but rather intent to follow global best practices. Early initiatives on corporate governance principles, which commenced in 1996-97 came from CII, an industry association, which was followed up by the Regulators. Kumar Mangalam Birla Committee Report in 1999 was the first regulatory measure towards structured Corporate Governance Practices. World over, such

initiatives have been the reverse way around. To the credit of our regulators, they have continued to keep a vigilant eye on corporate governance issues.

Perhaps the most far-reaching legislation in the history of the corporate world has been the enactment of the Sarbanes-Oxley Act (SOX). Prior to SOX, under US laws, the CEO was not required to sign the company's financial statements. SOX made the CEO and the CFO responsible for not only the robustness of the financial statements, but also for having an effect on internal controls and financial reporting. In India, the Companies Act laid the responsibility of financial statements on the Board of Directors. The board is responsible for the "true and fair" position of the Books of Accounts and Financial Statements.

Clearly, the drivers of change in corporate governance standards in India have predominantly emanated from one set of players - the foreign institutional investors (FII). In India, mutual funds play a passive role in corporate governance. Insurance companies and banks are somewhat more active than mutual funds as they do attend shareholder meetings and vote. FIIs tend to exercise their ownership rights more actively, and a sign of satisfaction of the level of corporate governance in India is the fact that FII growth here has been explosive with currently there being over 1,000 registered FIIs. A growing number of Investors believe that active promotion of good corporate governance in investee companies increases shareholder value in the long term. Companies with active, interested and involved shareholders are more likely to achieve superior long-term returns than those without.

Let's look at the issue of independent directors. In a comparison between the 50 largest companies in India and United States, it was observed that in the US all the 50 top companies have a majority of independent boards. In comparison, in India percentage of such companies was found to be below 60. Increasingly, Indian companies need directors who can bring skill and experience to the table and knowledge of international markets with particular functional backgrounds. Corporate India is not finding it easy to find qualified, suitable candidates for non-executive directorships and the shortage of qualified independent directors is causing widespread concern. With the governance spotlight on independent directors, here are a few observations and feedback from global independent directors of their changing role, which Corporate India needs to take cognizance of:

A. The Performance and health of the company

Independent directors tend to focus primarily on financial matters, reflecting short-term corporate performance, Majority directors today feel that they need to focus on the longer term health of their companies. On the flip side, there are directors that complain about receiving too much information just a day before the meeting or no information at all and major items are tabled at meetings- these are again danger signs of poor governance. Thus, the challenge for independent directors lies in being able to extract 'relevant information' from the company in time but without being burdened with the details.

B. Time spent at meetings

Here there is a bit of a paradox - on one hand a significant number of directors feel that too much time is spent on onerous issues like compliance and compensation of top management, at another level, independent directors feel they need to divide their meeting time between meeting of the Board and having an interface with senior employees where they can get a real feel for the performance of the business. There is also merit in having the external auditors meet up exclusively with the audit committee, atleast once every six months.

C. Issue on succession planning

Corporate succession should not be viewed as a one-off agenda item, but must be looked at continually. This is definitely a sensitive issue and becomes touchier especially if the board is pleased with the current CEO. There has to be an understanding that CEOs cannot be permanent fixtures and there has to be someone waiting in the wings. As painful as it may be, directors now recognize that a succession plan is crucial to the continuity of the organization.

D. Board evaluation

Not too many directors are comfortable with the idea of being evaluated. No one wants to get a bad-report card and that too from one's peers. But as a director aptly put it, "evaluation hurts, but it is a great help." It is only

through an evaluation exercise that the mere 'board sitters' can be distinguished from the 'board contributors'.

E. CEO compensation

While full disclosures of senior management compensation are a welcome step, some CEO compensation packages are indeed eyebrow raising. Often, questioning the CEO's compensation package was found to be very sensitive issue. Executive compensation should be closely aligned with the long-term interests of the shareholders and with corporate goals and strategies. It should include significant performance-based criteria related to long-term shareholder value and should reflect upside potential and downside risk.

F. There is no one-hat-fits-all strategy

Independent directors in India need to develop their own strategy to add value while working on the Boards in our country. Anglo-Saxon Corporate governance model cannot be freely mirrored for a country like ours where values and existing environments are different. For instance, in our country, large portion of public listed companies are families dominated, where family own a majority stake or wield decisive influence. Appointment and remuneration of director is determined by shareholders, thus effectively the decision making rests with the family. It is hard to see independent director getting appointed or reappointed without family's nod. Independent director has to therefore continuously strive to keep a balance and ensure that minority interest is protected through good governance practices.

Gone are the days of when being an independent director was a cozy job, Directors today are more aware of the risk to their reputation and as also of the financial and prosecution risks. This brings in the point on protection against future financial liabilities under the "Directors and Officers Policies". It is hoped that proposed changes in Corporate Laws will also try and address the issue of excessive risks to which independent directors are currently exposed.

Another area of importance is the role of the audit committee. While the revised clause 49 enhances the role of the audit committee, it has substantially increased its workload as well. Further, companies need to guard against audit committees evolving into 'mini-boards' where the roles of the audit committee and main board may become confused. Clearly the relationship between the audit committee and the main board is delicate. World over observers have recognized that legislation and regulation have a limited role in enforcing the spirit of corporate governance. Sheer compliance may not warrant better governance and it is only those companies, which look to adopt measures that go above and beyond their governance obligations, which would be rewarded by the Street. In the long run, the companies that will command a premium will be those driven by self motivated governance agendas. It is a matter of pride that many of India's leading corporates have chosen to follow this path and it augurs well for Corporate India as we aim to achieve and attain our global aspirations.

Value based organizations have demonstrated that even the so-called soft concepts can be extremely powerful; Money can't buy reputation or integrity; both have to be earned. Organizations based on strongly held shared

values amongst its customers and its employees have been able to professionalise and develop their market potential through strong brand loyalty and relationship building with their constituents.

The Companies are to be built on very strong building blocks, which are based on a clearly established corporate commitment to transparency and integrity in all its relationships, internal and external. These values permeate into everything the Corporate does, as well as the manner in which things get done. Methodology is as important, if not more so, than the final product. This approach is needed to be reflected in every corporate's product development, its relationships with its constituents- its shareholders, investors, lenders, suppliers and customers.

Conclusion

Governance is about governing: it is not merely about ownership; even an owner has to learn to govern. Good governance implies that the organization is run for the optimal benefit of all its stakeholders. I would say that ethics have a major role to play in realizing value for your efforts, but what is ethics? I would articulate a one line definition of ethics - "don't do something that you would be ashamed of if it becomes public". And it is not too difficult to achieve this reality. There is no pillow as soft as a clear conscience. Tell the truth and you won't have to remember the lies. It is such a simple concept.