Unit: 4

# Introduction to corporate Governance

## conceptual framework of corporate Governance

A corporate governance framework comprises set of rules, practices and processes that defines how a company is governed.

This framework is designed to balance the instrests of an organisation's many stakeholders, including shareholder, management, customer, suppliers, financiors, government and the community.

### components of the framework

Rules and Regulations:

Legal and regulatory framework, including company laws and securities regulations that provide the foundation for corporate governance.

Internal controls:

Systems and processes within the company that monitor and control its operations ensuring compliance with laws and ethical standard.

Board of Directors:

The body responsible for overseeing the company's Strategy and performance, representing the instrest of Shareholder and ensuring accountability.

Shareholder Rights

Protecting the right of shareholders, including the right to vote, receive information, and participate in company decisions.

Shareholder engagement:

Recognizing and considering the instrest of all stakeholders, including Employees, customers, Suppliers and the community.

Benefits of Good corporate Governance:

Increased investor confidence

Reduced Risk

Improved Reputation

Enhanced long-term Sustainability.

# Theories of corporate Governance

## Agency theory:

As the same suggests, in the agency theory, the owner of the company hires the agent, that is, the manager or director, to manage the affairs of the company and the owner. The problem arises when the person so appointed works for self-instrest and to secure his basic salary and does not work to increase the profit and life of the company. When the agent is appointed, there is delegation of power, and there is separation of power and control from the hands of the owner. The agent is responsible for the decision taken and the working of the company.

principle → Hires → Agent → work in self Instrest.

## Stewardship Theory:

This theory was introduced by Donaldson and Davis (1989). Stewards in the company basically means the directors or the managers of the company. According to this theory, as a Steward as a Steward, when managers are given the power to work in the instrest of the company, they work responsible for the organisational success and balanced growth of all the stakeholders. The work in the instrest of all the stakeholders to maximize their wealth.

Shareholder → Empowers the trust - stewords.

Steward → organisational success → shareholder.

3) Resource Dependency Theory.

For efficient working of any firm resources are required. The firm's director has the responsibility to bring and make efforts to bring resources to the firm. These resources can be information skill suppliers, buyers, dealers, social group etc to secure and enhance the organisational functioning, performance and its success.

Directors → Bring in resources → organisational success.

4) Stakeholders theory:

According to this theory, the manager should take steps in the instrest to secure good governance to improve the relationship and interaction between the various stakeholder involved such as investors, workers, board of director shareholders, general public, regulatory bodies, Business partners, Employees etc. This theory implies that the directors responsible and accountable to a wide range of stakeholder involved in the company.

This theory primarily focuses on balancing the instrest of all Stakeholders whist making any managerial decision and that nobody's instrest is kept above the other's and is not given supermacy and the decision are taken in the long run instrest of the company.

5) Transaction cost theory:

The transaction cost theory is the expenses incurred while having the thing from one place to another or conducting an economic transaction. The transaction cost can be monetary, extra time or inconveniznce caused. The company worker by making contracts and each contract brings with it the compliance requirements and some transaction costs. This theory suggests that the company's decision should be such that it works to achieve the optimum organisational structure. It should be economically efficient so that the cost of exchange is minimized.

6) political Theory:

This theory appeals to righteousness. The manager should gain the shareholders trust and votes rather than purchasing the voting power. This theory focuses on the government's political influence in the working of the company that the political power significantly influences corporate governance.

Models of corporate Governance:

Anglo-American model:

This model typically involves numerous independent investors or shareholder who invest their money in the company but have minimal involvement in it's operations.

A significant portion of the shareholder are institutional investors

The board of directors is a unified body accountable to the shareholder with minimal bureaucratic layers.

Management personnel are often recruited from the industry's top talent and their compensation reflects their high level of expertise

Executive compensation is closely tied to performance, with a focus on short term metrics to evaluate success.

Shareholder maintain regular contact with the board and are provided with frequent opportunites to express their approval or disapproval.

Contiental European Model:

This model prevalent in countries like Germany, France and the Netherlands differ significantly from the Anglo-American model. It is a shareholder oriented approach, where the instrest of various shareholder including employees, customer and the community are considered alongside those of shareholder.

This model often features a dual-board of systems, consisting of a management board responsible for day-to-day operation and a supervisory board that oversees and monitors the management board.

Here employees have a significant role in governance. It reflects the cultural emphasis on social partnership and collaboration between labour and management.

continental companies typically operate with a two tier board structure. Executive board Supervisory board.

clear Separation of powers

Large number of director

3) Japanese model:

In Japan, corporate Governance is characterised by a focus on stable relationship with Shareholder and enduring relationship with Suppliers including employees, customer Suppliers and financial institutions. ~~It~~ also called as relationship - based" or Networks oriented governance.

Japanese companies typically have a board of directors that includes executive director from within the company and Smaller number of outside director.

chinese model:

chinese Model Governance boards have taken a distinctive approach in Several ideas, including board structure, shareholders rights, disclosure and trasperancy, corporate Social responsibility, the role of directors, and executive compensation.

features:

China has adopted a two-tier based system similar to the harman model featuring a Supervisory board and a board of director.

Shareholder have the right to elect director and vote at Shareholder meeting.

Disclosure and Transperancy.

Indian Model:

India's corporate Governance model is influenced by its colonical history, diverse culture and rapidly growing economy. The Indian model reflects a hybrid approach incorporating elements of both the Anglo-American and continental European model.

features:

Stakeholder management

Transperancy

Decision making.

Middle Eastern model:

It is characterised by a strong emphasis on family ownership. Inslamic principles and state involvement in the Economy.

African model:

corporate Governance practices in Africa are diverse and reflect the content is varied cultural, economic and political contexts.

Board committees:

Board committees in corporate Governance are sub - group of the board of directors that focuses on Specific areas of responsibility like financial reporting, risk management, or executive compensation.

common Types of Board committees:

Audit committee:

oversees the financial reporting and auditing, ensuring compliance with regulation and Standards.

Nomination and Remuneration committee:

Handles the nomination of board members including independent directors. and sets the compensation for executive leadership.

Risk Management committee

Formulates and implements the company's CSR policy, ensuring its commitment to social and environmental issues

CSR - Corporate Social Responsibility

~~Shareholder~~ Stakeholder Relationship committee:

Focus on addressing shareholder grievances and building strong relationship with stakeholders.

Investment committee:

Responsible for developing and overseeing the company's investment strategy and approving major transaction.

Governance committee:

Support the board in its governance functions, promoting healthy development and functioning of the board and its committee.

Corporate Governance Reform:

Corporate Governance reform are deliberate changes to a company's governance structure, policies and practices aimed at enhancing transparency, accountability and fairness.

Key aspects:

Board Independence:

Ensuring that board member are independent of management and act in the best instrest of the company and its shareholder.

Transparency and Disclosure:

Requiring companies to provide clear and accurate information about their financial performance.

Shareholder empowerment:

Giving shareholder more power to influence company decision, such as through voting rights and the ability to nominate director.

Effective risk management:

Implementing robust risk management system to identify, assess and mitigate potential risks.

Ethical conduct and compliance:

Establiship clear ethical guidelines and ensuring compliance with laws and regulation.

Executive compensation:

Designing compensation policies that align executive incentives with the long-term interest of the company and its shareholder.

Corporate Social Responsibility:

Incorporating environmental, social and governance factor into corporate decision making.

Board Training and Development:

Providing ongoing training and development opportunities for board of members to enhance their knowledge and skills.

Major corporate scandals in India and Abroad:

In India:

Harshad Mehta Scam (1992)

A major stock market scam involving fraudulent manipulation of bank receipts and stamp paper, causing a market crash and losses of around Rs. 5000 crores.

Satyam Computer Services Scandal: (2009)

Satyam admitted to satisfying revenues, margins, and cash balances to the tune of 50 billion rupees.

Saradha chit fund Scam

A chit fund Scam that resulted in widespread losses for investors.

Sahara fraud case:

Another major fraud case involving Sahara group and its real estate ventures.

Internationally:

Lehman Brothers:

A major financial collapse stemming from the Subprime mortage crisis involving misrepresentation of a sets and insufficient capital to cover their debt.

Bernie madoff:

A massive scheme perpetrated by Berland L. madoff resulting in billions of dollars in losses for investors.

Enron:

A 2001 accounting Scandal involving the fraudulent hiding of debts and manipulation of financial Statement.

world com:

It 2002 accounting scandal where the company fraudulently inflated its assets by nearly 11 billion.

Volkswagen Emission scandal (2015)

VW used software in its vehicles to cheat on emission tests, leading to widespread fines and legal consequences.

common Governance problem noticed in various corporate failure:

common governance problem lending to corporate failure include lack of transperancy, weak boards, conflict of instrest, poor risk management and ethical failure.

1) Transperancy and Accountability

Lack of Transperancy:

Companies failing to disclose relevant information leading to a lack of clarity in their operations and decisions.

Lack of Accountability:

when those in positions of power are not held responsible for their actions.

2) Board of Director and oversight

Board of failure:

A board that lacks diversity (fails to provide effective oversight)

weak oversight

Insufficient monitoring of management actions and decisions can lead to risk being overlooked and potentially executing into major problem.

Conflict of Instrest

When board members or executives prioritize personal instrest over the company's, it can compromise decision making and lead to ethical lapees.

Risk Management

Poor Risk management

Inadequate identification assessment and mitigation of risks can expose Companies to unforeseen challenges and failure.

Ingnoring Reputation Risks:

Failing to recognize the importance of maintaining a strong reputation and license to operate can lead to serve consequences especially in industries heavily reliant on public trust.

4) Ethical failure:

Fraud and corruption:

Ethical behaviours, such as accounting fraud, embezzlement or bribery, can erode investor confidence and lead to legal and financial problems.

Poor Ethical culture:

A lack of a strong ethical culture within an organisation can create an environment where unethical behaviour is more likely to occur.

Other contributiong factors:

Difficulty in Raising Capital

Lack of Board Diversity

communication issue

Lack of independent Director

poor leadership Ethos and culture.

codes & Standards on corporate Governance

It refers to the set of guidelines and best practices that govern the behavior's and operation of corporation.

These codes ensure transperancy, accountability and fairness in a company's dealing with its stakeholders, including Shareholders employes, customer and the community at large.

Board Composition and Effectiveness:

Guidelines on the size, diversity, independence and function of the board of directors.

Executive compensation:

Principles governing how senior executives are remunarated. This includes linking compensation to performance, both short term and long-term and ensuring that compensation structure aligns with the instrest of shareholder.

Risk management and Internal.

Standards for the establishment of robust internal control mechanism and risk management system. There guidelines help ensure that the company identifies evaluates and manages risk effecticly to Safeguard Shareholder investment and Company issue.

Audit Function:

This might includes guidelines on the Selection and rotation of auditors, the Scope of their work and the reporting structure that supports transperancy and accountability.

Disclosure and Transperancy:

Requirement for the disclosure of financial and non-financial information. ensuring that shareholders and the public have access to accurate. comprehensive and timely information about the company's activities.

Shareholders Right:

Ensuring that all shareholders, including minority ones, receive fair treatment and their right are protected.

Corporate responsibility & Ethics:

Guidance on corporate social responsibility environmental stewardship, ethical business conduct and relationship with stakeholders.

Stakeholder Instrests:

Recognition and balancing of the instrest of various stakeholder, including employees, customers, suppliers and communities alongside those of shareholder.

Standards of corporate Governance:

Standards of corporate Governance encompases the set of formal rules, best practices and expectations that guide the behaviour and processes of corporation to ensure they are managed in a way that is accountable, transparent, fair and responsible.

Board Responsibilities:

These standards delineate the role and duties of board of directors.

corporate Ethics and culture:

Corporate governance standards often include a strong emphasis on ethics and integrity.

Risk management:

Standards for risk management are established This includes financial risks, operational risk, strategic risk, compliance risk and reputational risks.

Audit practices:

Robust audit practices are fundamental involving both internal and external audit.

Transperancy and disclosure:

clear and timely disclosure of all material matters regarding the corporation is a cornerstone of good corporate governance.

Stakeholder Relations:

Good governance standards recognize that companies have responsibilities to a range of stakeholder, including employees, suppliers, customer and communties in which they operate.

Executive Compensation:

Compensation policies for executive and directors should be clearly defined, transparent and linked to the long-term performance and sustainability of the company.

Shareholder Right:

Protecting the right of shareholders, particularly minority shareholder is fundamental.