Building a robust model for Corporate Governance

Atul Sobti
Director General
Standing Conference of Public Enterprises[1]

Peter Drucker once said, "Leaders in every single institution and in every single sector have two responsibilities. They are responsible and accountable for the performance of their institutions, and that requires them and their institutions to be concentrated, focused, limited. They are responsible also, however, for the community as a whole."

The twin responsibility, as pointed out by Drucker, forms the cornerstone for corporate governance, and it has gained immense prominence in recent times. Corporate Governance is the foundation on which the organisations, institutions are operated in a transparent, ethical, and fair way.

The Organisation for Economic Co-operation and Development (OECD) highlights the importance of corporate governance as, "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."

Corporate Governance, as a concept, is not new to India. One can trace it back to the ancient India where the scriptures outline good governance models for a king, which in the modern context could be replaced by the Board. For example, Vedas highlights eight qualities for good governance, viz. *Sathyam* – Truth; *Tapah* – Austerity; *Damah* – Sense Control; *Samah* – Tranquility of mind; *Dharma* – Righteousness; *Danam* – Charity; Daya – Mercy; *Nyasa* – Renunciation.

In the modern context, the Cadbury Committee Report in 1991 formed the basis of the principals of corporate governance. The committee developed a Code of Corporate Governance, known as 'Code of Best Practice,' focusing on Board of Directors, Non-executive Directors, Executive Directors, Reporting and Control. Realizing its importance, the Securities and Exchange Board of India (SEBI) issued guidelines on corporate governance which covered issues like composition of Board of Directors, Audit Committee and its functions, remuneration of Directors, Board procedure, etc. through Kumar Mangalam Birla Committee. Subsequently, in October 2004, SEBI issued the revised Clause 49 of the listing agreement for listed companies.

Although there are no set principles in law to guide corporate governance across the globe, India has set up a good corporate governance model for both, public and private sector enterprises as inclusion to various regulations and mandates. The various legislations include compliance with SEBI LODR (Listing Obligations and Disclosure Requirements) Regulations, 2015 (as amended up to date), that guides the organizations to appoint Independent Directors on their Board, set up Audit Committees and follow elaborate disclosure norms. As per the financial reporting systems provided by The Institute of Chartered Accountants of India (ICAI), all enterprises should adhere to the accounting standards setup for ensuring transparency. Further, The Companies Act provides for guidelines and regulations with respect to functions of directors and independent directors, their roles and responsibilities, their performance evaluation systems etc. These regulations are apart from the regulatory authorities and boards set up in various sectors, like TRAI for telecom and IRDA for insurance sectors. While, the above regulations are common for all types of corporate enterprises, the corporate governance practices in Public Sector Enterprises (PSEs) goes beyond following these statutory guidelines and requirements, and includes parliamentary accountability, MoU System with the administrative ministry/ department, Comptroller and Auditor General of India (C&AG) Audit, Vigilance Administration by the Central Vigilance Commission (CVC), Right to Information Act, Integrity Pact Agreement, and Guidelines on Corporate Governance by the Department of Public Enterprises (DPE).

However, despite of attention of global Governments and policy makers on the subject and presence of many guidelines, the issues of corporate frauds across the globe have shown a growth. Does this mean, we are not doing enough or we need to do something more? The answer to this question is that adhering to good corporate governance principles goes beyond the statutory laws and guidelines.

The business environment has seen a paradigm shift in terms of investor's involvement. Hard questions are pressed upon the organizations and organizations in return feel the need to give prominence to the investors maintaining the interest of the organization. Saying that, at the end of the day the mantle falls on the board members to protect the stakeholders and they should primarily be looking for long term value.

In order to create long term value, we need to have board members with expertise. Pre-requisite qualities for a board member could be threefold, i.e., having right expertise, should have time commitment, and possess a strong will.

The quality of board, therefore, is the primary concern in terms of establishing effective governance mechanism. Therefore, it becomes very important to have effective board in place to synthesize all the opportunities available for sustainable development of an organization and in turn, competitiveness.

The role of independent directors on the boards is also very crucial to the organizational health. By the virtue of being an independent watchdog, protecting the interests of stakeholders, especially minority stakeholders, it becomes important that the appointment of independent directors on the boards of enterprises should go through a stringent process to ensure that the independent directors possess requisite experience and expertise to add value to the board of a particular enterprise. There is also a need to develop a uniform evaluation model of the performance of the independent directors.

Moving beyond the need for strengthening the board of enterprises, the current corporate governance mechanism, although covers a wide array of governance concerns, falls short on numerous parameters to benchmark the standards. Benchmarking of standards becomes critical for organizations where they could improve upon the existing tools and practices. Therefore, by establishing measuring tools to monitor corporate governance standards in enterprises could help in identifying strengths and weakness in the existing model. It would also help the investors, rating agencies, and regulators gaze a clear picture of an organisation.

The measuring parameters could be based on the corporate governance guiding principles of OECD[2], which includes,

- Promoting transparent and fair markets, and the efficient allocation of resources
- Protecting and facilitating the exercise of shareholders' rights and ensure the equitable treatment of all shareholders, including minority and foreign shareholders
- Providing sound incentives throughout the investment chain and provide for stock markets to function in a way that contributes to good corporate governance
- Recognising the rights of stakeholders established by law or through mutual agreements and encouraging active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises
- Ensuring timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company
- Ensuring the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders

The aim is to touch upon every aspect of governance and develop parameters. Once the parameters are evolved, we could move ahead with quantifying the parameters.

It is time to realise that the world has seen a drastic shift in terms of stakeholder activism. The stakeholders, today, are more vigilant about the boardroom activities. Therefore, the aim should be establishing a cohesive governance model, where both boardroom and stakeholders work in tandem to build organisations that work in the larger interest of economy, society, and environment.

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1 Standing Conference of Public Enterprises (SCOPE), being the apex body of Public Sector Enterprises (PSEs), understands the importance of having a robust corporate governance mechanism. Therefore, it has been working with its stakeholders and policy makers to empower PSEs on various issues of governance. It has also been organizing programmes to help PSEs adopt best corporate governance practices.

2 Source: G20/OECD Principles of Corporate Governance