

# Corporate Governance – Concepts and Issues

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## Introduction

Corporate governance is a process that aims to allocate corporate resources in a manner that maximizes value for all stakeholders – shareholders, investors, employees, customers, suppliers, environment and the community at large and holds those at the helms to account by evaluating their decisions on transparency, inclusivity, equity and responsibility. The World Bank defines governance as *the exercise of political authority and the use of institutional resources to manage society's problems and affairs*.

Corporate governance is the set of processes, customs, policies, laws, and institutions affecting the way a corporation (or company) is directed, administered or controlled. Corporate governance also includes the relationships among the many stakeholders involved and the goals for which the corporation is governed. In contemporary business corporations, the main external stakeholder groups are shareholders, debt holders, trade creditors, suppliers, customers and communities affected by the corporation's activities. Internal stakeholders are the board of directors, executives, and other employees.

There are many different models of corporate governance around the world. These differ according to the variety of capitalism in which they are embedded. The Anglo-American "model" tends to emphasize the interests of shareholders. The coordinated or multi-stakeholder model associated with Continental Europe and Japan also recognizes the interests of workers, managers, suppliers, customers, and the community.

## Legal environment

Corporations are created as legal persons by the laws and regulations of a particular jurisdiction. These may vary in many respects between countries, but a corporation's legal person status is fundamental to all jurisdictions and is conferred by statute. This allows the entity to hold property in its own right without reference to any particular real person. It also results in the perpetual existence that characterizes the modern corporation. The statutory granting of corporate existence may arise from general purpose legislation (which is the general case) or from a statute to create a specific corporation, which was the only method prior to the 19th century.

In addition to the statutory laws of the relevant jurisdiction, corporations are subject to common law in some countries, and various laws and regulations affecting business practices. In most jurisdictions, corporations also have a constitution that provides individual rules that govern the corporation and authorize or constrain its decision-makers. This constitution is identified by a variety of terms; in English-speaking jurisdictions, it is usually known as the Corporate Charter or the [Memorandum and] Articles of Association. The capacity of shareholders to modify the constitution of their corporation can vary substantially.

## Codes and guidelines

Corporate governance principles and codes have been developed in different countries and issued from stock exchanges, corporations, institutional investors, or associations (institutes) of directors and managers with the support of governments and international organizations. As a rule, compliance with these governance recommendations is not mandated by law, although the codes linked to stock exchange listing requirements may have a coercive effect. For example, companies quoted on the London, Toronto and Australian Stock Exchanges formally need not follow the recommendations of their respective codes. However, they must disclose whether they follow the recommendations in those documents and, where not, they should provide explanations concerning divergent practices. Such disclosure requirements exert a significant pressure on listed companies for compliance.

One of the most influential guidelines has been the 1999 OECD Principles of Corporate Governance. This was revised in 2004. The OECD guidelines are often referenced by countries developing local codes or guidelines. Building on the work of the OECD, other international organizations, private sector associations and more than 20 national corporate governance codes, the United Nations Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) has produced their Guidance on Good Practices in Corporate Governance Disclosure. This internationally agreed benchmark consists of more than fifty distinct disclosure items across five broad categories:

- Auditing
- Board and management structure and process
- Corporate responsibility and compliance
- Financial transparency and information disclosure
- Ownership structure and exercise of control rights

The World Business Council for Sustainable Development WBCSD has done work on corporate governance, particularly on accountability and reporting, and in 2004 released Issue Management Tool: Strategic challenges for business in the use of corporate responsibility codes, standards, and frameworks. This document offers general information and a perspective from a business association/think-tank on a few key codes, standards and frameworks relevant to the sustainability agenda.

In 2009, the International Finance Corporation and the UN Global Compact released a report, 'Corporate Governance - the Foundation for Corporate Citizenship and Sustainable Business', linking the environmental, social and governance responsibilities of a company to its financial performance and long-term sustainability.

Most codes are largely voluntary. An issue raised in the U.S. since the 2005 Disney decision is the degree to which companies manage their governance responsibilities; in other words, do they merely try to supersede the legal threshold, or should they create governance guidelines that ascend to the level of best practice. For example, the guidelines issued by associations of directors, corporate managers and individual companies tend to be wholly voluntary but such documents may have a wider effect by prompting other companies to adopt similar practices.

In the United States, corporations are directly governed by state laws, while the exchange (offering and trading) of securities in corporations (including shares) is governed by federal legislation. Many U.S. states have adopted the Model Business Corporation Act, but the dominant state law for publicly-traded corporations is Delaware, which continues to be the place of incorporation for the majority of publicly-traded corporations. Individual rules for corporations are based upon the corporate charter and, less

authoritatively, the corporate bylaws. Shareholders cannot initiate changes in the corporate charter although they can initiate changes to the corporate bylaws.

US expansion after World War II through the emergence of multinational corporations saw the establishment of the managerial class. According to Lorsch and MacIver "many large corporations have dominant control over business affairs without sufficient accountability or monitoring by their board of directors." Over the past three decades, corporate directors' duties in the U.S. have expanded beyond their traditional legal responsibility of duty of loyalty to the corporation and its shareholders.

In the first half of the 1990s, the issue of corporate governance in the U.S. received considerable press attention due to the wave of CEO dismissals (e.g.: IBM, Kodak, Honeywell) by their boards. The California Public Employees' Retirement System (CalPERS) led a wave of *institutional* shareholder activism, as a way of ensuring that corporate value would not be destroyed by the now traditionally cozy relationships between the CEO and the board of directors.

In 1997, the East Asian Financial Crisis saw the economies of Thailand, Indonesia, South Korea, Malaysia and The Philippines severely affected by the exit of foreign capital after property assets collapsed. The lack of corporate governance mechanisms in these countries highlighted the weaknesses of the institutions in their economies. In the early 2000s, the massive bankruptcies (and criminal malfeasance) of Enron and WorldCom, as well as lesser corporate scandals, such as Adelphia Communications, AOL, Arthur Andersen, Global Crossing, Tyco, led to increased political interest in corporate governance. This is reflected in the passage of the Sarbanes-Oxley Act of 2002.

## **Parties to corporate governance**

The most influential parties involved in corporate governance include government agencies and authorities, stock exchanges, management (including the board of directors and its chair, the Chief Executive Officer or the equivalent, other executives and line management, shareholders and auditors). Other influential stakeholders may include lenders, suppliers, employees, creditors, customers and the community at large.

The agency view of the corporation posits that the shareholder forgoes decision rights (control) and entrusts the manager to act in the shareholders' best (joint) interests. Partly as a result of this separation between the two investors and managers, corporate governance mechanisms include a system of controls intended to help align managers' incentives with those of shareholders. Agency concerns (risk) are necessarily lower for a controlling shareholder.

A board of directors is expected to play a key role in corporate governance. The board has the responsibility of endorsing the organization's strategy, developing directional policy, appointing, supervising and remunerating senior executives, and ensuring accountability of the organization to its investors and authorities.

All parties to corporate governance have an interest, whether direct or indirect, in the financial performance of the corporation. Directors, workers and management receive salaries, benefits and reputation, while investors expect to receive financial returns. For lenders, it is specified interest payments while returns to equity investors arise from dividend distributions or capital gains on their stock. Customers are concerned with the certainty of the provision of goods and services of an appropriate quality; suppliers are concerned with compensation for their goods or services, and possible continued trading relationships. These parties provide value to the corporation in the form of financial, physical,

human and other forms of capital. Many parties may also be concerned with corporate social performance.

A key factor in a party's decision to participate in or engage with a corporation is their confidence that the corporation will deliver the party's expected outcomes. When categories of parties (stakeholders) do not have sufficient confidence that a corporation is being controlled and directed in a manner consistent with their desired outcomes, they are less likely to engage with the corporation. When this becomes an endemic system feature, the loss of confidence and participation in markets may affect many other stakeholders, and increases the likelihood of political action.

## **Ownership structures**

Ownership structure refers to the types and composition of shareholders in a corporation. Researchers often "measure" ownership structures by using some observable measures of ownership concentration or the extent of inside ownership.

### **Family ownership**

In many jurisdictions, family interests dominate ownership structures. It is sometimes suggested that corporations controlled by family interests are subject to superior oversight compared to corporations "controlled" by institutional investors (or with such diverse share ownership that they are controlled by management). A recent study by Credit Suisse found that companies in which *"founding families retain a stake of more than 10% of the company's capital enjoyed a superior performance over their respective sectorial peers."* Since 1996, this superior performance amounts to 8% per year.

### **Institutional investors**

Many years ago, worldwide, investors were typically individuals or families, irrespective of whether or not they acted through a controlled entity. Over time, markets have become largely *institutionalized*: investors are largely institutions that invest the pooled funds of their intended beneficiaries. These **institutional investors** include pension funds (also known as superannuation funds), mutual funds, hedge funds, exchange-traded funds, and financial institutions such as insurance companies and banks. In this way, the majority of investment now is described as "institutional investment" even though the vast majority of the funds are for the benefit of individual investors.

The significance of institutional investors varies substantially across countries. In developed Anglo-American countries (Australia, Canada, New Zealand, U.K., U.S.), institutional investors dominate the market for stocks in larger corporations. While the majority of the shares in the Japanese market are held by financial companies and industrial corporations, these are not institutional investors if their holdings are largely with-one group.

The largest pools of invested money (such as the mutual fund 'Vanguard 500', or the largest investment management firm for corporations, State Street Corp.) are designed to maximize the benefits of diversified investment by investing in a very large number of different corporations with sufficient liquidity. The idea is this strategy will largely eliminate individual firm financial or other risk and. A consequence of this approach is that these investors have relatively little interest in the governance of a particular corporation. It is often assumed that, if institutional investors pressing for will likely be costly because of "golden handshakes") or the effort required, they will simply sell out their interest.

## **Popularly espoused principles of corporate governance**

**Rights and equitable treatment of shareholders:** Organizations should respect the rights of shareholders and help shareholders to exercise those rights. They can help shareholders exercise their rights by effectively communicating information that is understandable and accessible and encouraging shareholders to participate in general meetings.

**Interests of other stakeholders:** Organizations should recognize that they have legal and other obligations to all legitimate stakeholders.

**Role and responsibilities of the board:** The board needs a range of skills and understanding to be able to deal with various business issues and have the ability to review and challenge management performance. It needs to be of sufficient size and have an appropriate level of commitment to fulfill its responsibilities and duties. There are issues about the appropriate mix of executive and non-executive directors.

**Integrity and ethical behavior:** Ethical and responsible decision making is not only important for public relations, but it is also a necessary element in risk management and avoiding lawsuits. Organizations should develop a code of conduct for their directors and executives that promotes ethical and responsible decision making. It is important to understand, though, that reliance by a company on the integrity and ethics of individuals is bound to eventual failure. Because of this, many organizations establish Compliance and Ethics Programs to minimize the risk that the firm steps outside of ethical and legal boundaries.

**Disclosure and transparency:** Organizations should clarify and make publicly known the roles and responsibilities of board and management to provide shareholders with a level of accountability. They should also implement procedures to independently verify and safeguard the integrity of the company's financial reporting. Disclosure of material matters concerning the organization should be timely and balanced to ensure that all investors have access to clear, factual information.

### **Mechanisms and controls**

Corporate governance mechanisms and controls are designed to reduce the inefficiencies that arise from moral hazard and adverse selection. For example, to monitor managers' behavior, an independent third party (the external auditor) attests the accuracy of information provided by management to investors. An ideal control system should regulate both motivation and ability.

### **Internal corporate governance controls**

Internal corporate governance controls monitor activities and then take corrective action to accomplish organizational goals. Examples include:

**Monitoring by the board of directors:** The board of directors, with its legal authority to hire, fire and compensate top management, safeguards invested capital. Regular board meetings allow potential problems to be identified, discussed and avoided. Whilst non-executive directors are thought to be more independent, they may not always result in more effective corporate governance and may not increase performance. Different board structures are optimal for different firms. Moreover, the ability of the board to monitor the firm's executives is a function of its access to information. Executive directors possess superior knowledge of the decision-making process and therefore evaluate top management on the basis of the quality of its decisions that lead to financial performance outcomes, *ex ante*. It could be argued, therefore, that executive directors look beyond the financial criteria.

**Internal control procedures and internal auditors:** Internal control procedures are policies implemented by an entity's board of directors, audit committee, management, and other personnel to provide reasonable assurance of the entity achieving its objectives related to reliable financial reporting, operating efficiency, and compliance with laws and regulations. Internal auditors are personnel within an organization who test the design and implementation of the entity's internal control procedures and the reliability of its financial reporting.

**Balance of power:** The simplest balance of power is very common; require that the President be a different person from the Treasurer. This application of separation of power is further developed in companies where separate divisions check and balance each other's actions. One group may propose company-wide administrative changes, another group review and can veto the changes, and a third group check that the interests of people (customers, shareholders, employees) outside the three groups are being met.

**Remuneration:** Performance-based remuneration is designed to relate some proportion of salary to individual performance. It may be in the form of cash or non-cash payments such as shares and share options, superannuation or other benefits. Such incentive schemes, however, are reactive in the sense that they provide no mechanism for preventing mistakes or opportunistic behavior, and can elicit myopic behavior.

In publicly-traded U.S. corporations, boards of directors are largely *chosen* by the President/CEO and the President/CEO often takes the Chair of the Board position for his/herself (which makes it much more difficult for the institutional owners to "fire" him/her). The practice of the CEO also being the Chair of the Board is known as "duality". While this practice is common in the U.S., it is relatively rare elsewhere. It is illegal in the U.K.

## External corporate governance controls

External corporate governance controls encompass the controls external stakeholders exercise over the organization. Examples include:

- Competition
- debt covenants
- demand for and assessment of performance information (especially financial statements)
- government regulations
- managerial labour market
- media pressure
- takeovers

## Systemic problems of corporate governance

**Demand for information:** In order to influence the directors, the shareholders must combine with others to form a voting group which can pose a real threat of carrying resolutions or appointing directors at a general meeting.

**Monitoring costs:** A barrier to shareholders using good information is the cost of processing it, especially to a small shareholder. The traditional answer to this problem is the efficient market hypothesis), which suggests that the small shareholder will free ride on the judgments of larger professional investors.

**Supply of accounting information:** Financial accounts form a crucial link in enabling providers of finance to monitor directors. Imperfections in the financial reporting process will cause imperfections in the effectiveness of corporate governance. This should, ideally, be corrected by the working of the external auditing process.

## **Financial reporting and the Independent Auditor**

The board of directors has primary responsibility for the corporation's external financial reporting functions. The Chief Executive Officer and Chief Financial Officer are crucial participants and boards usually have a high degree of reliance on them for the integrity and supply of accounting information. They oversee the internal accounting systems, and are dependent on the corporation's accountants and internal auditors.

Current accounting rules allow managers some choice in determining the methods of measurement and criteria for recognition of various financial reporting elements. The potential exercise of this choice to improve apparent performance increases the information risk for users. Financial reporting fraud, including non-disclosure and deliberate falsification of values also contributes to users' information risk. To reduce these risks and to enhance the perceived integrity of financial reports, corporation financial reports must be audited by an independent external auditor who issues a report that accompanies the financial statements (see financial audit). It is One area of concern is whether the auditing firm acts as both the independent auditor and management consultant to the firm they are auditing. This may result in a conflict of interest which places the integrity of financial reports in doubt due to client pressure to appease management. The power of the corporate client to initiate and terminate management consulting services and, more fundamentally, to select and dismiss accounting firms contradicts the concept of an independent auditor. Changes enacted in the United States in the form of the Sarbanes-Oxley Act (following numerous corporate scandals, culminating with the Enron scandal) prohibit accounting firms from providing both auditing and management consulting services. Similar provisions are in place under clause 49 of SEBI Act in India.

## **Executive Remuneration/Compensation**

Research on the relationship between firm performance and executive compensation does not identify consistent and significant relationships between executives' remuneration and firm performance. Not all firms experience the same levels of agency conflict, and external and internal monitoring devices may be more effective for some than for others.

Some researchers have found that the largest CEO performance incentives came from ownership of the firm's shares, while other researchers found that the relationship between share ownership and firm performance was dependent on the level of ownership. The results suggest that increases in ownership above 20% cause management to become more entrenched, and less interested in the welfare of their shareholders. Some argue that firm performance is positively associated with share option plans and that these plans direct managers' energies and extend their decision horizons toward the long-term, rather than the short-term, performance of the company.

Even before the negative influence on public opinion caused by the 2006 backdating scandal, use of options faced various criticisms. A particularly forceful and long running argument concerned the interaction of executive options with corporate stock repurchase programs. Numerous authorities determined options may be employed in concert with stock buybacks in a manner contrary to shareholder interests. A combination of accounting changes and governance issues led options to become a less popular means of remuneration as 2006 progressed, and various alternative implementations of

buybacks surfaced to challenge the dominance of "open market" cash buybacks as the preferred means of implementing a share repurchase plan.

## **The new role of corporate governance – principles versus rules**

The basic reason for failure of corporate governance regulation is that this was based on a box ticking approach of compliance. This encourages companies using their ingenuity in HNTGC – How Not To Get Caught. Human ingenuity is so powerful that we always find excuses to beat the system. In fact our manhood depends on our ability to defy rules. You become a master only by transcending rules which most read as transgressing rules. The basis reason is that rules are devised to meet a certain situation and not supposed to be permanent. Hence the tendency to interpret them to suit your own convenience. Principles on the other hand are North Star fixed for all times with no scope for ambivalence. A strategy for sustainability requires we apply a principle-based approach to corporate governance.

The basic purpose of corporate governance is to hold those in power to account. So accountability is the key to corporate governance. There are 6 principles that have to be satisfied to ensure accountability. These are 6 Ds – Diversity in composition of the board and differentiating the gene pool and gender; encouragement of Dialogue as opposed to monologue; valuing Dissent, Dispersion of authority (separation of chairman and CEO is one example), disruption of status quo (critical to counter cosiness) and fostering a culture of full disclosure to build trust.

## **Corporate governance services**

Assist boards and leaders in implementing legal, regulatory and best-practice governance standards, including the Belgian Code and the new remuneration codes.

We introduce corporate governance measures that make a real difference to your organisation by:

- improving board effectiveness
- improving risk and control oversight at board level
- optimizing audit committee and remuneration committee structures
- reviewing remuneration policies and practices

We can help corporate groups to improve their internal governance while ensuring their subsidiary boards meet their regulatory obligations.

## **Corporate Governance-compliance Issues**

**Governance, Risk Management, and Compliance** or **GRC** is the umbrella term covering an organization's approach across these three areas. Being closely related concerns, governance, risk and compliance activities are increasingly being integrated and aligned to some extent in order to avoid conflicts, wasteful overlaps and gaps. While interpreted differently in various organizations, GRC typically encompasses activities such as corporate governance, enterprise risk management (ERM) and corporate compliance with applicable laws and regulations.

**Governance** describes the overall management approach through which senior executives direct and control the entire organization, using a combination of management information and hierarchical management control structures. Governance activities ensure that critical management information reaching the executive team is sufficiently complete, accurate and timely to enable appropriate



management decision making, and provide the control mechanisms to ensure that strategies, directions and instructions from management are carried out systematically and effectively.

**Risk management** is the set of processes through which management identifies, analyses, and where necessary responds appropriately to risks that might adversely affect realization of the organization's business objectives. The response to risks typically depends on their perceived gravity, and involves controlling, avoiding, accepting or transferring them to a third party. Whereas organizations routinely manage a wide range of risks (e.g. technological risks, commercial/financial risks, information security risks etc.), external legal and regulatory compliance risks are arguably the key issue in GRC.

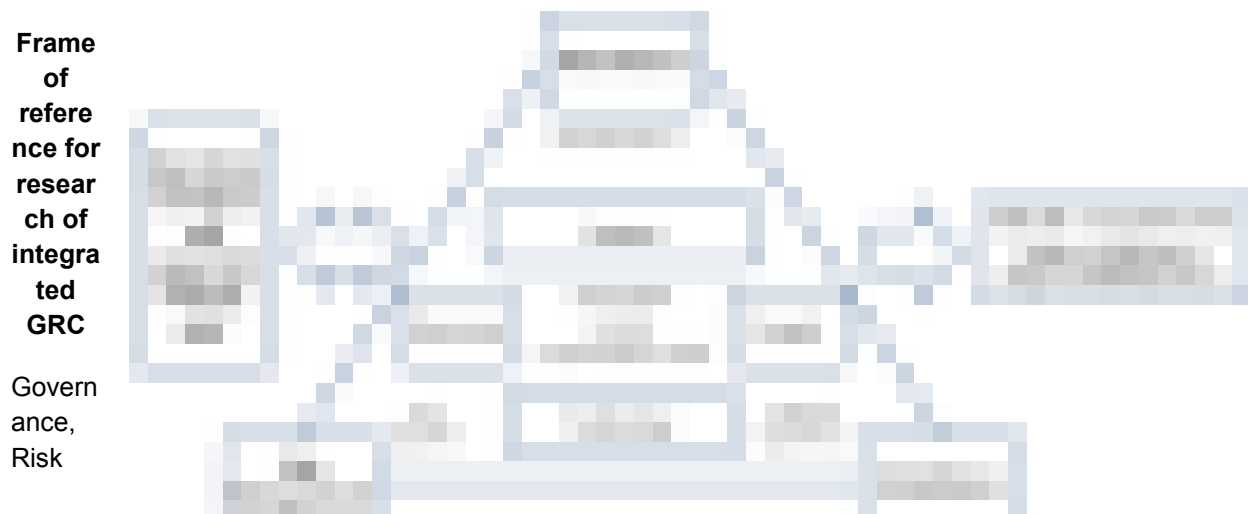
**Compliance** means conforming with stated requirements. At an organizational level, it is achieved through management processes which identify the applicable requirements (defined for example in laws, regulations, contracts, strategies and policies), assess the state of compliance, assess the risks and potential costs of non-compliance against the projected expenses to achieve compliance, and hence prioritize, fund and initiate any corrective actions deemed necessary.

Widespread interest in GRC was sparked by the US Sarbanes-Oxley Act and the need for US listed companies to design and implement suitable governance controls for SOX compliance, but the focus of GRC has since shifted towards adding business value through improving operational decision making and strategic planning. It therefore has relevance beyond the SOX world.

Governance, Risk, and Compliance or "GRC" is an increasingly recognized term that reflects a new way in which organizations are adopting an integrated approach to these aspects of their business.

## GRC Research

A publication review carried out in 2009 found that there is hardly any scientific research on GRC as of today. The authors went on to derive the first scientifically grounded GRC short-definition from an extensive literature review. Subsequently the definition was validated in a survey among GRC professionals. "GRC is an integrated, holistic approach to organisation-wide governance, risk and compliance ensuring that an organisation acts ethically correct and in accordance with its risk appetite, internal policies and external regulations through the alignment of strategy, processes, technology and people, thereby improving efficiency and effectiveness." The authors then translated the definition into a frame of reference for GRC research.



Management and Compliance are the core *disciplines* of GRC. Each of the disciplines consists of the four basic *components* of GRC: strategy, processes, technology and people. The organization's risk appetite, its internal policies and external regulations constitute the *rules* of GRC. The disciplines, their components and rules are now to be merged in an integrated, holistic and organization-wide (the three main *characteristics* of GRC) manner – aligned with the (business) operations that are managed and supported through GRC. In applying this approach, organizations long to achieve the *objectives* of GRC: ethically correct behaviour, and improved efficiency and effectiveness of any of the elements involved.

## **GRC Market Segmentation**

A GRC program can be instituted to focus on any individual area within the enterprise, or a fully integrated GRC is able to work across all areas of the enterprise, using a single framework.

A fully integrated GRC uses a single core set of control material, mapped to all of the primary governance factors being monitored. The use of a single framework also has the benefit of reducing the possibility of duplicated remedial actions.

When reviewed as individual GRC areas, the three most common individual headings are considered to be Financial GRC, IT GRC, and Legal GRC.

Financial GRC relates to the activities that are intended to ensure the correct operation of all financial processes, as well as compliance with any finance-related mandates.

IT GRC relates to the activities intended to ensure that the IT (Information Technology) organization supports the current and future needs of the business, and complies with all IT-related mandates.

Legal GRC focuses on tying together all three components via an organization's legal department and Chief Compliance Officer.

Analysts disagree on how these aspects of GRC are defined as market categories. Gartner has stated that the broad GRC market includes the following areas:

- Finance and Audit GRC
- IT GRC Management
- Enterprise Risk Management.

They further divide the IT GRC Management market into these key capabilities. Although this list relates to IT GRC, a similar list of capabilities would be suitable for other areas of GRC.

- Controls and policy library
- Policy distribution and response
- IT Controls self-assessment and measurement
- IT Asset repository
- Automated general computer control (GCC) collection
- Remediation and exception management
- Reporting
- Advanced IT risk evaluation and compliance dashboards

## **GRC Product Vendors**

The distinctions between the sub-segments of the broad GRC market are often not clear. With a large number of vendors entering this market recently, determining the best product for a given business problem can be challenging. Given that the analysts don't fully agree on the market segmentation, vendor positioning can increase the confusion.

Due to the dynamic nature of this market, any vendor analysis is often out of date relatively soon after its publication.

Broadly, the vendor market can be considered to exist in 3 segments:

- Integrated Governance, Risk & Compliance Solutions (Multi-Governance Interest, Enterprise Wide)
- Domain Specific GRC Solutions (Single Governance Interest, Enterprise Wide)
- Point Solutions to Governance, Risk or Compliance (Relate to Enterprise Wide Governance or Enterprise Wide Risk or Enterprise Wide Compliance but not in combination.)

Integrated governance, risk and compliance solutions attempt to unify the management of these areas, rather than treat them as separate entities. An integrated solution is able to administer one central library of compliance controls, but manage, monitor and present them against every governance factor. For example, in a domain specific approach, three or more findings could be generated against a single broken activity. The integrated solution recognizes this as one break relating to the mapped governance factors.

Domain specific governance, risk and compliance vendors understand the cyclical connection between governance, risk and compliance within a particular area of governance. For example, within Financial Processing - that a risk will either relate to the absence of a control (need to update governance) and/or the lack of adherence to (or poor quality of) an existing control.

Point Solutions to Governance, Risk & Compliance are marked by their focus on addressing only one of these areas (Governance or Risk or Compliance). In some cases of limited requirements, these solutions can serve a viable purpose. However, because they tend to have been designed to solve domain specific problems in great depth, they generally do not take a unified approach and are not tolerant of integrated governance requirements. Information systems will address these matters better if the requirements for governance, risk and compliance management are incorporated at the design stage, as part of a coherent framework.

There has been renewed interest in the corporate governance practices of modern corporations since 2001, particularly due to the high-profile collapses of a number of large corporations, most of which involved accounting fraud. Corporate scandals of various forms have maintained public and political interest in the regulation of corporate governance. In the U.S., these include Enron Corporation and MCI Inc. (formerly WorldCom). Their demise is associated with the U.S. federal government passing the Sarbanes-Oxley Act in 2002, intending to restore public confidence in corporate governance. Comparable failures in Australia are associated with the eventual passage of the CLERP 9 reforms. Similar corporate failures in other countries stimulated increased regulatory interest (e.g., Parmalat in Italy).

## **Issues in Corporate Governance**

- Asymmetry of power
- Asymmetry of information
- Interests of shareholders as residual owners
- Role of owner management

- Theory of separation of powers
- Division of corporate pie among stakeholders

### **Current status on corporate governance**

- Insistence on forms and structures
- Overarching regulations
- Regulatory overkill
- Lack of adequate number of strong, independent directors
- Large liabilities for companies and officers

### **Current status on corporate governance**

- Governance and performance
- Good governance leads to good performance
- It creates an open and transparent system
- It improves communication and breaks down systematic barriers to flow of information
- Good governance allows decision making based on data. It reduces risk
- Good governance helps in creating a brand and creates comfort for all stakeholders and society

### **Does performance depend on governance?**

Short term performance does not necessarily depend on governance

Market asymmetries are responsible for this. However, this increases risk. This also creates barrier to long term growth

We all know what happened to Enron?

### **Does performance depend on governance?**

Medium to long term performance requires governance

Most companies which have grown in the last 25 years have outstanding performance and have good governance structure

A good governance structure treats all stakeholders fairly

Governance alone cannot ensure performance

### **Governance and Performance - issues**

Is governance a luxury that can be afforded only by the performing companies?

Do strategies and tactics need to change to accommodate governance with performance?

Is there a time-lag between governance and performance?

Are stakeholders concerned about “performance” or “promised performance”?

### **Governance and Performance measurement – issues**

Is governance behavior motivated by legislation?

Do standards vary with jurisdictions or do you adopt the best option?

Do you choose the right thing to do irrespective of whether it's mandatory or not?

Is performance evaluation limited to valuation metrics?

Is it only ROE, Net margin, growth, shareholder wealth creation?

Do performance measures need to be holistic?

We need to encompass all stakeholders

Governance is an enabler for holistic performance

How do managers better understand governance requirements?

Do we need market research for governance requirements?

## **Investing in Corporate Governance**

Companies need to invest in good governance

Corporate governance has a direct bearing on business performance and thereby ROI

Leverage the power of IT

On average, businesses with superior governance practices generate 20 percent greater profits than other companies.

## **Conclusion**

The above background paper covers the basic concepts of Corporate Governance, as they have emerged, mainly during the last two decades; it is intended as background study for the Global convention on Corporate Governance and Sustainability challenges.

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