**Corporate Governance**

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**What is corporate governance?**

**Corporate governance**has a broad scope. It includes both social and institutional aspects. It is the system by which companies are directed and managed. It influences how the objectives of the company are set and achieved, how risk is monitored & assessed, & how performance is optimized.

**√**Corporate governance is the system of principles, policies, procedures, and clearly defined responsibilities and accountabilities used by stakeholders to overcome the conflicts of interest inherent in the corporate form.

**√**Corporate governance is the interaction between various participants (Shareholder, Board of Director and Company Management) in shaping corporation’s performance and the way it is proceeding towards.

**√**Corporate governance affects the operational risk and, hence, sustainability of a corporation. The quality of a corporation’s corporate governance affects the risks and value of the corporation.

[](https://taxguru.in/wp-content/uploads/2018/12/Corporate-Governance-Defined.png)

**2. WHY GOOD CORPORATE GOVERNANCE IS IMPORTANT?**

Corporate Governance is intended to increase the accountability of your company and avoid massive disasters before they occur. Failed energy giant Enron, and its bankrupt employees and shareholders, is a prime argument for the importance of solid Corporate Governance. Well- executed Corporate Governance should be similar to a police department’s internal affairs unit, weeding out and eliminating problems with extreme prejudice.

The Need, Significance or Importance of Corporate Governance is listed below.

1. **Changing Ownership Structure: -**

In recent years, the ownership structure of companies has changed a lot. Public financial institutions, mutual funds, etc. are the single largest shareholder in most of the large companies. So, they have effective control on the management of the companies. They force the management to use corporate governance. That is, they put pressure on the management to become more efficient, transparent, accountable, etc. They also ask the management to make consumer-friendly policies, to protect all social groups and to protect the environment. So, the changing ownership structure has resulted in corporate governance.

1. **Importance of Social Responsibility**

Today, social responsibility is given a lot of importance. The Board of Directors has to protect the rights of the customers, employees, shareholders, suppliers, local communities, etc. This is possible only if they use corporate governance.

1. **Growing Number of Scams**

In recent years, many scams, frauds and corrupt practices have taken place. Misuse and misappropriation of public money are happening everyday in India and worldwide. It is happening in the stock market, banks, financial institutions, companies and government offices. In order to avoid these scams and financial irregularities, many companies have started corporate governance.

**d. Indifference on the part of Shareholders**

In general, shareholders are inactive in the management of their companies. They only attend the Annual general meeting. Postal ballot is still absent in India. Proxies are not allowed to speak in the meetings. Shareholders associations are not strong. Therefore, directors misuse their power for their own benefits. So, there is a need for corporate governance to protect all the stakeholders of the company.

**e. Globalization**

Today most big companies are selling their goods in the global market. So, they have to attract foreign investor and foreign customers. They also have to follow foreign rules and regulations. All this requires corporate governance. Without Corporate governance, it is impossible to enter, survive and succeed in the global market.

**f. Takeovers and Mergers**

Today, there are many takeovers and mergers in the business world. Corporate governance is required to protect the interest of all the parties during takeovers and mergers.

**g. SEBI**

SEBI has made corporate governance compulsory for certain companies. This is done to protect the interest of the investors and other stakeholders.

**3. NEED OF CORPORATE GOVERNANCE**

Corporate Governance is needed to create a corporate culture of transparency, accountability and disclosure.

**a. Corporate Performance**: Improved governance structures and processes ensure quality decision-making, encourage effective succession planning for senior management and enhance the long-term prosperity of companies, independent of the type of company and its sources of finance. This can be linked with improved corporate performance- either in terms of share price or profitability.

**b. Enhanced Investor** **Trust:** Investors consider corporate governance as important as financial performance when evaluating companies for investment. Investors who are provided with high levels of disclosure and transparency are likely to invest openly in those companies. The consulting firm McKinsey surveyed and determined that global institutional investors are prepared to pay a premium of up to 40 percent for shares in companies with superior corporate governance practices.

**c. Better Access to Global Market**: Good corporate governance systems attract investment from global investors, which subsequently leads to greater efficiencies in the financial sector.

**d. Combating Corruption**: Companies that are transparent and have sound system that provide full disclosure of accounting and auditing procedures, allow transparency in all business transactions, provide environment where corruption would certainly fade out. Corporate Governance enables a corporation to compete more efficiently and prevent fraud and malpractices within the organization.

**e. Easy Finance from Institutions**: Several structural changes like increased role of financial intermediaries and institutional investors, size of the enterprises, investment choices available to investors, increased competition, and increased risk exposure have made monitoring the use of capital more complex thereby increasing the need of Good Corporate Governance.

**f. Enhancing Enterprise Valuation**: Improved management accountability and operational transparency fulfill investors’ expectations and confidence on management and corporations, and in return, increase the value of corporations.

**g. Reduced Risk of Corporate Crisis and Scandals**: Effective Corporate Governance ensures efficient risk mitigation system in place. A transparent and accountable system makes the Board of a company aware of the majority of the mask risks involved in a particular strategy, thereby, placing various control systems in place to facilitate the monitoring of the related issues.

**h. Accountability:** Investor relations are essential part of good corporate governance. Investors directly/ indirectly entrust management of the company to create enhanced value for their investment. The company is hence obliged to make timely disclosures on regular basis to all its shareholders in Corporate Governance is integral to the existence of the company. Lesson 3 Conceptual framework of Corporate Governance 47 order to maintain good investor’s relation. Good Corporate Governance practices create the environment whereby Boards cannot ignore their accountability to these stakeholders.

[](https://taxguru.in/wp-content/uploads/2018/12/Board-and-Management.png)

**4. CORPORATE GOVERNANCE PRINCIPLES**

**Principal 1. Governance structure:**

All Organizations should be headed by an effective Board. responsibilities and accountabilities within the organization should be clearly identified.

**> Principal The structure of the board and its committees :**

The board should comprise independent minded directors. It should include an appropriate combination of executive directors, independent directors and non-independent non-executive directors to prevent one individual or a small group of individuals from dominating the board’s decision taking. The board should be of a size and level of diversity commensurate with the sophistication and scale of the organization. Appropriate board committees may be formed to assist the board in the effective performance of its duties.

**>Principal Director appointment procedure:**

There should be a formal, rigorous and transparent process for the appointment, election, induction and re-election of directors. The search for board candidates should be conducted, and appointments made, on merit, against objective criteria (to include skills, knowledge, experience, and independence and with due regard for the benefits of diversity on the board, including gender). The board should ensure that a formal, rigorous and transparent procedure be in place for planning the succession of all key officeholders.

**> Principal Director’s duties, remuneration and performance:**

Directors should be aware of their legal duties. Directors should observe and foster high ethical standards and a strong ethical culture in their organization. Each director must be able to allocate sufficient time to discharge his or her duties effectively. Conflicts of interest should be disclosed and managed. The board is responsible for the governance of the organization’s information, information technology and information security. The board, committees and individual directors should be supplied with information in a timely manner and in an appropriate form and quality in order to perform to required standards. The board, committees and individual directors should have their performance evaluated and be held accountable to appropriate stakeholders. The board should be transparent, fair and consistent in determining the remuneration policy for directors and senior executives.

**> Principal Risk governance and internal control:**

The board should be responsible for risk governance and should ensure that the organization develops and executes a comprehensive and robust system of risk management. The board should ensure the maintenance of a sound internal control system.

**> Principal Reporting and integrity:**

The board should present a fair, balanced and understandable assessment of the organization’s financial, environmental, social and governance position, performance and outlook in its annual report and on its website.

**> Principal Audit:**

Organizations should consider having an effective and independent internal audit function that has the respect, confidence and cooperation of both the board and the management. The board should establish formal and transparent arrangements to appoint and maintain an appropriate relationship with the organization’s auditors.

**> Principal Relations with share holders and other key shareholder:**

The board should be responsible for ensuring that an appropriate dialogue takes place among the organization, its shareholders and other key stakeholders. The board should respect the interests of its shareholders and other key stakeholders within the context of its fundamental purpose.

**5. BENEFITS OF CORPORATE GOVERNANCE**

**> The Benefits to Shareholders**

√ Good CORPORATE GOVERNANCE can provide the proper incentives for the board and management to pursue objectives that are in the interest of the company and shareholders, as well as facilitate effective monitoring.

√ Better CORPORATE GOVERNANCE can also provide Shareholders with greater security on their investment.

√ Better CORPORATE GOVERNANCE also ensures that shareholders are sufficiently informed on decisions concerning fundamental issues like amendments of statutes or articles of incorporation, sale of assets, etc.

**> The Benefits to the National Economy**

√ Empirical evidence and research conducted in recent years supports the proposition that it pays to have good CORPORATE GOVERNANCE. It was found out that more than 84% of the global institutional investors are willing to pay a premium for the shares of a well-governed company over one considered poorly governed but with a comparable financial record.

√ The adoption of CORPORATE GOVERNANCE principles – as good CORPORATE GOVERNANCE practice has already shown in other markets – can also play a role in increasing the corporate value of companies.

Proponents of corporate governance say there’s a direct correlation between good corporate governance practices and long-term shareholder value. Some of the key benefits are:

* High performance Boards of Directors;
* Accountable management and strong internal controls;
* Increased shareholder engagement;
* Better managed risk; and
* Effectively monitored and measured performance.

**7. FIVE GOLDEN RULES OF CORPORATE GOVERNANCE**

As we have iterated, this part of the report explains our view of best corporate governance practice and the holistic approach by which we believe an organization can ensure that a state of good corporate governance exists, or is brought into being if its existence is uncertain. It takes the view that there is an over-riding moral dimension for running a business and that the standard of governance will depend on the moral complexion of the operation.

The business’s morality or ethic must permeate the entire operation from top to bottom and embrace all stakeholders best corporate governance practice is an integral part of good management practice also permeating the entire operation, and not an esoteric specialism addressed by lawyers, auditors and sociologists.

The principles of this approach are therefore framed in relation to the conventional way of looking at how a business should be properly run.

Our Five Golden Rules of best corporate governance practice are:

**1. Ethics**: clearly ethical practices applied to the business

**2. Align Business Goals**: appropriate goals, arrived at through the creation of a suitable stakeholder participation in decision making model

**3. Strategic management**: an effective strategy process which incorporates stakeholder value

**4. Organisation**: an organisation suitably structured to give effect to the good corporate governance

**5. Reporting**: reporting systems structured to provide transparency and accountability.

This approach recognizes that the interests of different stakeholders carry different weight, but it does not, by any means, suggest that those with a majority interest matters and the rest don’t. On the contrary, best corporate governance practice dictates that all stakeholders should be treated with equal concern and respect.

For obvious reasons, although the methodology we will propose involves taking major stakeholders into greater account when formulating strategy, it is designed to generate all round support because of the fact that every stakeholder, no matter how small, is given the opportunity to express a view, through the continuous monitoring of stakeholder perceptions.

The regulatory approach to the subject would regard governance as something on its own, to do with ensuring a balance between the various interested parties in a company’s affairs, or more particularly a way of making sure that the chairman or chief executive is under control, producing transparency in reporting or curbing over-generous remuneration packages etc.

The essence of success in business is:

* having a clear and achievable goal
* having a feasible strategy to achieve it
* creating an organization appropriate to deliver
* having in place a reporting system to guide progress.

Best corporate governance practice is about achieving the stakeholders’ goal, and delivering success in an ethical way. Hence it follows that it must entail a holistic application of good management.

**Case law:**

**CYRUS MISTRY’S w.r.t. TATA GROUP**

**Details:**

Mistry who was dismissed as Tata Sons chairman on October 24 by its board alleged **“lack** **of corporate governance”**and “failure on the part of directors to discharge the fiduciary duty” owed to shareholders of Tata Sons and other Group companies. Following Mistry’s e-mail, proxy advisory firms feel that the reporting and governance structures between Tata Trusts, Tata Sons and other operating companies needs to be clearly defined. The e-mail seems to be suggesting that Ratan Tata regards Tata group as a fiefdom, and Independent Directors aren’t truly independent and assertive. Minority investors of listed operating companies need the reassurance that Tata Sons is just the dominant shareholder, and one individual isn’t running the whole group, said Shriram Subramanian, founder and managing director of In Govern Research Services.

Mistry’s e-mail has alleged that despite making losses of Rs 1000 crore, Tata’s low-cost Nano has not been shut down due to emotional reasons and also due to the fact that it will “stop the supply of the Nano gliders to an entity that makes electric cars and in which Ratan Tata has a stake”.

Mistry also said that the amendments to articles of association of Tata Sons have created a flux in the decision-making process. “I have often presented to the trustees, before and after Tata Sons board meetings. This has created alternative power centres without any accountability or formal responsibility….” Mistry added. Apart from this, Mistry has alleged that the conduct of two directors of Tata Sons-Nitin Nohria and Vijay Singh has “created the added risk of contravening insider trading regulations”. Both Nohria and Singh could not be contacted.

J N Gupta, managing director of Stakeholders Empowerment Services (SES) said that governance issues raised by Mistry if true will not only impact the shareholders but will also hit the Tata brand. He said Mistry’s e-mail has raised important questions on the independence of the independent directors and their conduct on all the boards of Tata firms.

“SEBI (Securities and Exchange Board of India) may have to examine the allegations of insider trading in his (Cyrus Mistry’s) e-mail. Governance at present is lip service be it in India or the US. Independent directors typically take up such roles for monetary compensation. And independence is a character that the law cannot infuse. Law can only infuse fear,” said Gupta.

Experts feel that the boardroom battle between Ratan Tata and Cyrus Mistry and the corporate governance issues emanating from this dispute will hurt corporate India.

“The way the events have unfolded, it seems that it is a case of oppression of minority shareholders and the board has failed to perform its duties. It is a palace coup because some independent directors were appointed in the last six months. The right thing would have been to follow correct corporate norms and value systems by appointing a committee to look at all the allegations and counter allegations and then take a decision,” said Mohandas Pai, chairman of Manipal Global Education.

**Case Law:**

**REEBOK INDIA SUFFERS A MAJOR SCAM**

**Details:**

Reebok India, owned by Adidas AG, alleged a Rs.870 crore fraud by its former managing director (MD) Subhinder Singh Prem and former Chief Operating Officer (COO) Vishnu Bhagat, in a criminal complaint filed at the Gurgaon police’s Economic Offence Wing in May, 2012. In March 2013, Adidas, the parent company, announced a 153 million Euros loss on account of the Reebok India episode.

The two were accused of criminal conspiracy and fraudulent practices including stealing products by setting up “secret warehouses”. There has been a grave failure of corporate governance as well since the company has also alleged that the former officials fudged accounts and indulged in fictitious sales causing a multi-crore dent to the company. In its FIR, Reebok has said that it carried out an internal investigation after certain fraudulent activities were noticed – which again points to the importance of internal checks for malpractices and corruption.

Gurgaon police had arrested Singh and Bhagat along with three others — Sanjay Mishra, Prashant Bhatnagar and Surakshit Bhat. Allegedly, these individuals have been siphoning off funds by creating ghost distributors across the country and generating forged bills over the last five years.

**JUDGEMENT**

Agencies probing the alleged Rs 870 crore corporate fraud in the operation of Reebok India have detected a systemic “mismanagement” in the business planning and running of the company.

The Income Tax department has alleged tax evasion of Rs 140 crore in the case. The IT department’s first goal is to ensure that the company later does not claim any “bad debt”. A bad debt is that amount that is owed to a business or individual and has to be written off by the creditor as a loss because the debt cannot be collected because of a host of reasons.

As soon as the scam came to light, affairs of the company came under close government scrutiny. While the IT department documents investigated the accounts and imports of the firm, the Serious Fraud Investigation Office is probing the entire governance affairs of the company under Section 235 of the Companies Act. A forensic audit was conducted by the German arm of Ernest & Young – which revealed many falsifications of documents and books.

It is interesting to note that accounting officials of the firm and the auditors were not held liable for their “deliberate” or “mistaken oversight” in identifying the irregularities in the account books which led to the alleged financial irregularities.

**CASE LAW:**

**KINGFISHER AIRLINES LOSES LICENSE TO FLY**

**Details:**

The financially troubled Kingfisher Airlines lost its flying permit after a deadline to renew its suspended license expired. The Directorate General of Civil Aviation (DGCA) has suspended Kingfisher Airlines license to fly till further orders pursuant to Clause 15 (2) of Schedule XI of the Aircraft Rules, 1937, after the airline failed to deliver a viable financial and organizational revival plan.

The debt-ridden carrier was grounded since October 2012 after repeated strikes by workers over unpaid wages. Kingfisher owes various public sector banks $1.4bn (£870m) in debts and has been trying to raise funds after lenders refused to give fresh loans.

**JUDGEMENT**

The airline now owes money to staff, airports, tax authorities and its lenders and may have to be liquidated.

**CONCLUSION**

It is evident from above that it is essential that good governance practices must be effectively implemented and enforced preferably by self-regulation and voluntary adoption of ethical code of business conduct and if necessary through relevant regulatory laws and rules framed by Govern­ment or its agencies such as SFBI, RBI.

The effective implementation of good governance practices would ensure investors confidence in the corporate companies which will lead to greater investment in them ensuring their sustained growth. Thus, good corporate governance would greatly benefit the companies enabling them to thrive and prosper.

Further, in the context of liberalization and globalization there is growing realization in the emerging economies including India that a country’s business environment must be maintained and operated in a manner that is conducive to investors’ confidence so that both domestic and foreign investors are induced to make adequate investment in corporate companies. This will be conducive to rapid capital formation and sustained growth of the economy.