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Enablers of Good Corporate Governance
Softer Instruments and Practices beyond the Law

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Abstract

Corporate governance today is part of the business discourse world ever. It is now widely accepted that quality corporate governance is a prerequisite to ensure that corporate entities function with integrity and responsibility. Corporate governance norms are evolving and are taking roots thanks to heightened concern world over regarding the need for checks and balances on corporate entities and the compulsion of protecting the interest of the multiple stakeholders.

Corporate governance system as it exists and as it is practiced today has three dimensions – they are 1. Corporate governance philosophy/ theory, 2. Corporate governance practice and 3. Corporate governance law. In this article, an attempt has been made to identify key instruments which can act as enablers of quality governance. The instruments covered are: 1. Code of conduct, 2. Whistle Blower Policy, 3. Website, 4. Board and Committee Meeting Protocols, and 5. Compliance Culture.

While this may not a comprehensive list of instruments and practices needed for good corporate governance, putting in place these mechanisms, it is believed, will certainly enhance the effectiveness of governance process. Further, it is suggested that the board and its committees must watch out to include whatever else can help in its journey of building excellence in corporate governance.

Key words: *Corporate governance, Code of conduct, Whistle blower policy, Board and Committee Meeting protocols, Compliance culture*

Introduction:

Corporate Governance (CG) has become the flavour of the times we live in. A spate of scandals world over, acceleration in the pace and spread of globalisation, the rise of institutional investors as major players in global finance and capital market, global financial crisis and growing pressure on the governments to act and put in place quality governance norms and practices backed by appropriate legal frameworks are some of the main factors contributing to emergence of corporate governance as a field of academic discourse and as a public policy issue.

Corporate governance refers to the system of rules, practices and processes by which a company is directed and controlled. Corporate governance essentially involves balancing the interests of a company's many stakeholders, such as shareholders, management, customers, suppliers, financiers, government and the community. Since corporate governance also provides the framework for attaining a company's objectives, it encompasses practically every sphere of management, from strategy formulation and internal controls to performance measurement and corporate disclosure.

Importance of Corporate Governance

1. Adoption of good corporate governance principles and practices improves access to financing for a company as it is considered imperative for investment decisions.
2. A company having better corporate governance can have better valuation as investors are willing to pay a higher premium for it.
3. It lowers the cost of capital for a company by reducing the risk and thus creating higher company valuation.
4. It has significant bearing on a company's ability to allocate resources efficiently and attain long term sustainability.
5. It can improve a company's performance through effective management in asset utilization, improved labour guidelines, and other policy improvements.
6. Good corporate governance reduces the risk of financial crisis in a country.

Good and Bad Governance

Bad corporate governance can cast doubt on a company's reliability, integrity or obligation to shareholders. Tolerance or support of illegal activities can create scandals like the one that rocked Volkswagen AG in 2015. Companies that do not cooperate sufficiently with auditors or do not select auditors with the appropriate scale can publish spurious or noncompliant financial results. Bad executive compensation packages fail to create optimal incentive for corporate officers. Poorly structured boards make it too difficult for shareholders to oust ineffective incumbents. Corporate governance became a pressing issue following the 2002 introduction of the Sarbanes-Oxley Act in the United States, which was ushered in to restore public confidence in companies and markets after accounting fraud bankrupted high-profile companies such as Enron and WorldCom.

Good corporate governance creates a transparent set of rules and controls in which shareholders, directors and officers have aligned incentives. Most companies strive to have a high level of corporate governance. For many shareholders, it is not enough for a company to merely be profitable; it also needs to demonstrate good corporate citizenship through environmental awareness, ethical behavior and sound corporate governance practices.

Corporate Governance in India
– Provisions of Companies Act, 2013

Though late, India has also now realized that good Corporate Governance is one of the keys to explore the real worth of an organization and to protect the interest of multiple stakeholders involved. The essence of its key ingredients such as Company's Philosophy, Transparency & Disclosure, Board Framework, Stakeholder Interest Protection and Risk Management are being felt now. Unlike the Companies Act, 1956, the new law includes various initiatives to enhance the quality of governance of corporate entities and to inculcate the features of good governance in such organizations.

Salient features of new law

- Initiatives towards Transparency & Disclosure
- Strengthening Board Framework
- Stakeholder interest protection
- Risk Management
- Corporate Social Responsibility

Enablers of Good Corporate Governance

1. **Code of conduct**
2. **Whistle Blower Policy**
3. **Website**
4. **Board and Committee Meeting Protocols**
5. **Compliance Culture**

1. Code of conduct:

Building excellence in CG cannot be organized in the boardroom alone. It has got to envelop the entire organization. Involvement of the employees at all levels is facilitated by designing and implementing enabling processes. In fact, an appropriate setting must be designed, which governs the approach and behavior of the organization. Organizational behavior is the sum of the approach and behavior of all the employees in the organization. Hence a three-pronged approach, outlined below, can be followed.

a) Designing code of conduct
b) Communication
c) Monitoring of conduct

A comprehensive code of conduct must be drafted. The code of conduct should broadly lay down a framework regarding which the employees at all levels would address **their roles, responsibility and accountability frames.** In fact, a code of conduct is about how they will operate on a day to day basis. The overarching theme of code of conduct would be
a) integrity – financial and intellectual,

b) commitment to scrupulous compliance of the rules, regulations, guidance and directions and so on.

c) protecting and enhancing the enterprise value – guarding the interest of all the stakeholders, and

d) total accountability – professionalism.

Designing the code of conduct is a very involved and evolutionary process, and the organization must seek views and opinion at all levels. Once the draft of the code of conduct is finalized, it should be placed before the board for approval. The code should be subjected to periodical review, preferably yearly, regarding experiences gained during its implementation.

The code, once finalized, should be widely circulated. It must be uploaded on the website so that the employees can refer to it as when required. In fact, the communication should not be restricted to the circulation of the code. There can be meeting where the details of the code, its importance and implications can all be discussed. Examples should be enumerated of how the observance of the code is going to enhance or protect the value of the enterprise and consequences thereof on their own welfare. Communication related to the code cannot be a onetime affair. It must be reinforced periodically. In fact, it might be useful to organize a cadre of champions who would keep the dialogue ongoing.

It is not only important that an organization has a code of conduct, but it must have a mechanism to enforce it as well. Any deviation from the code of conduct must be taken cognizance of and dealt with appropriately. In acts of serious delinquency exemplary action must be taken.

The whole process of code of conduct must work tri-dimensionally:

1. **Educative**
2. **Preventive**
3. **Prescriptive**

Education would mean instilling in the minds and heart, why and how of strict conformance to the code of conduct: how will it benefit the organization and in turn the people in the organization.

Prevention would envisage motivating people to observe the code of conduct in both letter and spirit. The exemplary punishment must deter the employees from venturing into misconduct, and misadventure is but one motivation, although real motivation follows from benefits that flow with full compliance. This can be a factor in monetary compensation as well as for rise in hierarchy. The board must create processes by which it can review the observance of the code of conduct and direct, wherever necessary, to ensure that the organization is deeply involved in reaping the benefits of institutionalizing the code of conduct.

Prescription would entail exemplary punishment to defaulters in non-observance of the code, which should send shivers down the spine of those on the sidelines of less than full compliance with the code of conduct. This can be organized through the creation of a system of monitoring of code. In the absence of monitoring, which should include dealing with delinquencies, the very purpose of setting up code would be defeated. Excellence in corporate governance cannot be built without a pragmatic and sagacious code of conduct and robust monitoring mechanism of its implementation.

2. Whistle Blower Policy:

For effective corporate governance, companies are urged to concentrate on two areas: first, to create a strong ethical compass to guide the organization – the code of conduct and second, to establish a comprehensive framework of internal controls to foster a culture of accountability. **Ernst Young's one of the annual surveys of global fraud has rated whistle blowing mechanism (WBM) above external audits as the second most effective means of detecting corruption.** People are now prepared to acknowledge that whistle blowing is about good corporate citizenship.

Whistle blower policy provides employees, customers and vendors an avenue to raise concerns, in line with the commitment to the highest possible of ethical, moral and legal standards in business conduct. It also provides necessary safeguards for the protection of employees from reprisals or victimization, for whistle blowing in good faith.

Most regulators across geographies have enshrined in the regulations the setting up of a whistle blower policy as an obligation. The SEBI in its latest amendment to clause 49 of the listing agreement, which has now become a regulation by name SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, has made whistle blower policy compulsory, which states:

> The company may establish a mechanism for employees to report to the management concerns about unethical behaviour, actual or suspected fraud or violation of the company's code of conduct or ethics policy. This mechanism could also provide for adequate safeguards against victimization of employees who avail of the mechanism and provide for direct access to the Chairman of the Audit committee in exceptional cases. Once established, the existence of the mechanism may be appropriately communicated within the organization.

This suggests that, primarily, whistle blower's allegations should be placed before the management and can be brought before the audit committee wherever needed. I suggest similar formation, while making audit committee's door always open to approach with or without contacting/ communicating to the management.

So does the Indian Companies Act incorporate. It is the duty of the board through the audit committee to design and approve whistle blower policy – a policy which is potent and encourages employees to bring to the notice of the audit committee serious financial irregularities that occur in the organization. Although the formulation and approval of whistle blower policy is easier, its implementation and encouraging employees to fearlessly bring to the notice of the audit committee and the board any dealings that are not ethical and affect the financial soundness of the company and/or alienate the interest of stakeholders, must be systematically encouraged.

It is desirable to outline the procedure for dealing with complaints in the policy. The section of the protection of whistle blower should also be specified along with how false and frivolous complaints will be dealt. More important, however, is the use of this mechanisms to get feedback from the ground level in the organization to plug loopholes in the systems and processes.

There is a possibility that disgruntled employees will use this as a handle to create an atmosphere of ill will and disturbance. Hence it must be ensured that while all genuine complaints are dealt with effectively and people behind those complaints are protected, the incidence of irrelevant, biased and motivated complaints is reduced to the minimum, if not eliminated altogether. To make it happen, the audit committee and the board will have to get involved in the process little more deeply and make sure that this does not lead to the organization being disadvantaged because anything which is not correct but getting pitchforked will bring alienation in the organization. This is what happens in the public-sector organizations or state owned enterprises and even government departments. Finding the right balanced is a very difficult task. However, it can be achieved substantially by the involvement and attention of the audit committee and the board. **It is our belief that the whistle blower mechanism if used well can be a value and credibility enhancer.**

3. Website:

Transparency is the biggest defense against misdemeanors and incorrect reporting. Even though most of the companies in India and in other countries do have a website, in many cases, it is neither updated nor user friendly. It is important that the website contains all the possible information and data that any investor, analyst, customer or employee would like to know and it can be made public.

Whatever information and / or communications are sent to stock exchanges and regulatory bodies must be simultaneously uploaded on the website. Storing the data in an organized manner is essential so that it becomes user-friendly. Anybody in need of information can see, download and take a copy of such information.

4. Board and Committee Meeting Protocols:

It is important that the company creates a set of protocols for holding board meeting and the meetings of the committees of the board. These protocols begin with the way the notices of the meeting will be issued and the agendas will be prepared and circulated. It will also include broadly the people who can attend the meetings, what kind of instruments and gadgets will be used in the meeting and how an atmosphere will be created for an undisturbed flow of discussions.

The board and committee meetings must be in an environment where nobody, unless invited by the chairman of the meeting, enters the room. All arrangements of refreshment, paper submission, etc. must be completed before hand. This is important not only for maintaining decorum and facilitating undisturbed discussions, but also for the reasons of secrecy.

5. Compliance Culture:

It is the responsibility of the capital market regulator, sector regulator and any other authority, such as in the case of India, Ministry of Company Affairs, Government of India, to regulate the market and protect the interest of the investors. In the case of Indian capital market, regulators such as SEBI and other financial regulators have added the responsibility of developing the respective markets.

To discharge their obligations, every regulator including SROs issue legislations, rules, regulations, directions and guidance, compliance of some of which is obligatory and some other discretionary. In the case of listed companies in India, the corporate governance norms have been specified as conditions in the listing agreement for continued listing in addition to what is specified in the Companies Act. The Indian Companies Act has been comprehensively revised in 2013, and most of the provisions have been made applicable from 1 April 2014.

In addition, the stock exchanges have issued guidelines for compliance. Every company has to necessarily comply with all the applicable class of legislations, regulations, rules, directions and guidance. Any lapse in the compliance is taken not of and dealt with appropriately.

To ensure that the company undertakes the job fully and faithfully, it must develop a culture which envelops the entire organization. There are several companies which are using software developed by some consulting accounting and legal firms. Many of the users feel that it serves them well.

However, there is no substitute to creating culture of compliance in letter and spirit and effective monitoring of the compliance. In fact, there is a need to create an environment where all the three formats- proactive, co-active and reactive- work so that compliance does not become the casualty of confusion and fragmented/disturbed ownership.

In most jurisdictions, the company secretary has been designated to be the chief officer for corporate governance compliance. However, the ultimate responsibility of compliance devolves on the shoulders of the Board of Directors. Even otherwise, to leave the compliance completely to company secretary without an effective oversight of the board is dangerous. Unfortunately, this is what is happening in most boards, and complete reliance is placed only on the certificate presented to the board.

It is imperative for the board to lay down the systems and processes as to how compliance will be ensured. In the case of need, expert advice can be sought. These systems and processes must be reviewed at least once in a year by the governance committee of the board. Non-compliance is a reputational risk in addition to the penalties by the regulators. Furthermore, the substance of compliance of corporate governance norms pave the way for the building excellence in corporate governance. Moreover, this routine exercise can be converted into value-enhancing process.

Conclusion:

It is now widely accepted that quality corporate governance is a necessity to ensure that corporate entities function with integrity and responsibility. Corporate governance norms are evolving and are taking roots thanks to heightened concern world over regarding the need for checks and balances on corporate entities and the compulsion of protecting the interest of the multiple stakeholders.

Corporate governance system as it exists and as it is practiced today has three dimensions – they are 1. Corporate governance philosophy/ theory, 2. Corporate governance practice and 3. Corporate governance law. In this article, an attempt has been made to identify key instruments which can act as enablers of quality governance. The instruments covered are: 1. Code of conduct, 2. Whistle Blower Policy, 3. Website, 4. Board and Committee Meeting Protocols, and 5. Compliance Culture.

This may not be a comprehensive list of building enablers for good corporate governance. Hence, the board and its committees must watch out to include whatever else can help in its journey of building excellence in corporate governance.

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