

Corporate Governance



Dr. P. Chattopadhyay

FCMA, PhD

The Concept of Corporate Governance

Beginning at the beginning, it has to be underscored that the *clou* of corporate governance is that it is external to the management system of an enterprise, a corporate enterprise for that matter. Its point of stress is security of funds employed in the business rather than the quality of deployment of the funds. The contexture of ethical governance is naturally more relevant for the corporate enterprise than for any other form of enterprise. The concept of corporate governance has come into vogue as an antidote to the numerous instances of malpractices in which managers of different well-known corporations indulged in different countries such as the USA, UK, Germany, Italy, France, Netherlands and India. The contents of corporate governance can be traced to the reports of the Cohen Commission published in early 1978 and the Treadway Commission in 1987 which had almost all the elements envisaged in the format of corporate governance which came as an external regulatory device to keep companies on course. The name corporate governance was brought into currency by the World Bank in 1989 and it owed its origin to the Greek word *Kubernan*, meaning steering. The corporate world in different countries widely accepted the term as a series of corporate governance reports directly or indirectly laid down the criteria and contents in codes of corporate governance practices that companies were desired to put into effect. While in most countries the initiative was taken by the industry associations and various regulatory bodies, a specific law, the Sarbanes-Oxley Act 2002, (Sarbox) was enacted in the USA, laying down quite stringent corporate conduct rules and regulations overtly intended to put errant corporate managers under leash. While signing the Corporate Responsibility Bill, President George Bush underlined that Corporate misdeeds will be found and will be punished. This law authorizes new funding for technology at the Securities and Exchange Commission to uncover wrongdoing. The SEC will now have the administrative authority to bar dishonest directors and officers from ever again serving in positions of corporate responsibility. The

penalties for obstructing justice and shredding documents are greatly increased. Corporate crime will no longer pay. CEOs who profit by betraying the public trust will be forced to return those gains to investors. And the maximum for common types of fraud has quadrupled from five to 20 years.” (Refer to. <http://www.Whitehouse.gov/news/releases/2002/07/print/20020730.html>).

Initial Hullabaloo

The Act created a furore in the corporate world in the USA for knowing and judging what was to be done to get over the hurdle. Curiously, while the management was gasping for breath running helter-skelter in dealing with various requirements, the big four audit firms had a bonanza of sorts in terms of hefty fees for deciphering and interpreting various provisions in the Sarbanes Oxley Act, 2002 and the governance codes. In the United States alone, billions of dollars accrued to the big audit firms for the interpretational exercises alone for ensuring compliance. Non-compliance within a specified date meant heavy penalties; as long as the likely penalties were more than the cost of compliance, management would have considered the cost acceptable. Even in other countries, including Europe and India, requirements of good governance practices and reporting engaged both official and unofficial attention. Many committees and commissions examined and re-examined the various issues concerned with developing the codes of good governance, though in effect these were only a rehash of the Cadbury Committee Report. Corporate laws have accommodated these elements and the regulatory bodies have translated these elements into operational terms. Consideration and reconsideration of different provisions followed in the light of practical nuances, with a number of amendments to the earlier codes so that they could be immediately relevant and purposeful. USA was lucky to have a de facto institution in the persona of Eliot Spitzer, the New York Attorney General, who single-handedly and speedily brought to trial several errant corporate top and

lower level managers as also individuals and organizations for getting inside information leading to misconduct.

Code of Governance

The functions of governance of a company entails observance of a Code of Conduct by a corporate entity reflected through the actions of its Board of Directors and others managing its affairs. The code of conduct calls for observance in order to protect the interests of the shareholders, the public, the State, the employees and the creditors. The code of conduct underscores the need to disclose to all those affected by the company's operations in a transparent manner the various aspects of its internal affairs covering its financial, administrative, operational and other issues as also the extent to which external supervision ensures that the company abides by the dictates of efficient use of the resources at its command, embracing both the security and the utilization aspects. Supervision, accountability, fairness in dealings with both the internal and external elements and due observance of the ethical standards and transparency in the practices to be followed by the companies, thus provide the fundamental standpoints of corporate governance as framed from time to time. The codes framed by the industry and trade associations have given apparent primacy to protection of minority shareholders, maximization of shareholder value and propriety of dealings with the stock market and customers as also the guidelines enounced by regulators. Short-termism willy-nilly came to occupy the centre-stage as alleged by several commentators, in different countries. A company is a perpetual entity and it is accorded the status of citizenship under company law. Its major focus is therefore on healthy sustenance in the long term. A company is a social institution and as such, all its activities centre logically on what is considered social good whose focus is quite large and goes far beyond the concept of corporate social responsibility. Many issues are involved in all this, only some of which are underscored in the following paragraphs so that joint companies are both incorporated and run as companies—as public property, rather than private.

A Company as a Company

To guarantee that a company functions as a company, discrete legislations have been enacted in all countries with a large number of sections overtly dealing with all relevant aspects of their functioning while active surveillance mechanisms have been at place that oversee the observance of these provisions in practice. The Certificate of Incorporation—in effect the birth certificate of a company, the Memorandum of Association—the charter of its existence, and the Articles of Association—the distribution of powers and responsibilities related to internal management—are all working documents that guide and regulate the day to day operations of a company in regard to its internal operations and its dealings with the

external world. In addition to the laws, there are regulatory bodies and professional institutions to ensure thorough compliance with what constitutes acceptable behaviour of the company in action. For instance, while the statutory auditors assess the veracity of the figures presented in the accounts, the secretarial auditors seek to ensure compliance with different legal requirements of maintenance of books, recording of proceedings of the Board meetings, the Annual General Meetings and other records.

In short, corporate governance underlines the external projections of measures for ensuring truth, fairness and transparency of corporate operations on one hand and corporate accountability on the other. The quality of the governance systems in place remains under the scanner through various mechanisms which are in the main externalized, in the sense that while corporate managers seek to achieve the strategies, objectives and policies in the long and the short run, corporate governance attempts to ensure that the corporate responsibilities are properly discharged in the best interest of not only the corporation as such but also the society at large. The functions of a corporation are manifold which are sought to be performed with different primary and secondary responsibilities in view; for, the State, the shareholders, the management, the creditors, suppliers, other employees and the community at large that the company seeks to subserve in different capacities—mainly as an agent of economic progress are but one side of the coin. The other side relates to the internal administration of the company for developing the capabilities that make all this possible. It is thus imperative that the corporation remains on track while it strives to achieve its avowed objectives.

Managerial Deviance in Corporations

Since the company is a product of the law, it has the status of Caesar's wife. The company as an incorporeal entity cannot commit any crime. The managers who are responsible for conducting the state of affairs of the company are directly responsible for all acts supposedly on behalf of the company but those going the interests of the company. Ethical considerations thus apply to the managers more than to the company. Absence of a clear understanding of this position is at the root of many a misconception, like for example 'lifting the veil', that has come to rule the roost. The numerous instances of managerial misdemeanance that have come to light in different countries have centred on the following, among others:

- i. Accounting misclassification involving fraudulent reporting;
- ii. Excessive concern for showing profit when there was none, through various means such as inflation of gains and deflation or even total sidetracking of losses;
- iii. Magnification of profitability in quarterly reports duping unsuspecting shareholders and regulatory bodies;

COVER THEME

- iv. Indulging in unacceptable practices such as creating a cobweb of inter-connected organizations and having dubious transactions for showing an operational picture more attractive than reality;
- v. Insider trading practices leading to artificially jacking up share prices in collusion with the reputed share analysts who are prodded to draw a rosy picture in the face of an impending doom;
- vi. Influencing the auditors, or even colluding with them, so that no unfavourable reports or unclean certificates are given on the annual financial statements, as indeed happened in the case of M/S Satyam Computers, nicknamed Indian Enron;
- vii. One could add to the aforesaid list the tendency of members of the upper echelons of management of companies to have disproportionately high remuneration and perks irrespective of whether the corporation was doing well or otherwise;
- viii. Rampant mis-utilization by the top, and even middle management, of the privilege of accesses to sensitive records and facts bypassing many of the regulatory measures for personal gain, monetary and otherwise; and
- ix. Risky bets, political infighting, lax government regulations and bad decision making—wreaking havoc on the world financial system, felling Lehman Bros., Bear Stearns, Goldman Sachs and Merrill Lynch almost Overnight (Cf. *House of Cards: How Wall Street Gamblers Broke Capitalism*, Penguin, 2009).

Addressing Right Issues

In the circumstances, Corporate Governance Codes have sought to address these issues on the basis of devising systems that could effectively oversee the operations which embraced strengthening internal control systems, assessing the nature and effectiveness of statutory audit by way of appointing audit committees, looking after the shareholders' interest, strengthening the Board functions through induction of independent directors and above all, underlining the truth and fairness of the recording of liabilities and, in the process, of asset valuation. Company managers are required to explain their standpoints vis-a-vis the observations made by these committees and both these sides become a part of the governance reports annexed to the annual reports. The stock exchanges have been showing much greater sensitivity in the scrutiny of the periodical reports submitted by the listed companies ensuring that errant management is taken to task and prompt corrective action initiated. Unfortunately, a large chunk of the corporate sector remains outside the focus of the governance codes. This is because of preponderance of non-listed companies and a dominant position of the private limited companies. Listing with the stock exchanges is a phenomenon that has been grossly misunderstood. It needs emphasis in this context that once companies are incorporated and have become functional,

their linkage with the proceedings in the stock exchanges is minimal; the share capital remains unaffected irrespective of what goes on in the stock exchanges. Apart from the initial subscription, companies have nothing much to do with them. Shareholders, in general, have come to depend more on market capitalization than on dividend; in fact for distribution of dividend, shareholders on the 'record date' are those who are entitled receive it. The number of times a share changes hands is numerous. The prevalent approaches before infusion of globalism were to rely more on dividend which would come mainly at the year-end, at times even half-yearly. These approaches saved India's bourses from a crash experienced in other countries of the West and even East.

The Counter Measures

The components of corporate governance comprise the counter measures that seek to straighten both the tracks and the activities on these tracks. The measures contemplated in these components are essentially reactive in nature based as they are in the nature of deviance that came to notice in different corporations. It has not been considered that the shenanigans deployed by the tricksters have not always been of the same types. Many of them have been beyond the imagination of either the law or the regulatory bodies, while the time taken in tracking the miscreants down has been considerable. Literally the authorities became wiser after the event while the intricacies of deceit required a lot of time to unfold. Some of the trickeries required high level expertise to understand and decipher while the others were quite simple and easily apprehended. Many of the tricksters were highly reputed people while others had criminal record behind them. In some cases the slips were known but hardly any action was taken by the corporate authorities till it was too late. A cat and mouse game has been more than visible but the irresponsible actions of management and others have multiplied without bounds—often in collusion with outsiders. Corporate governance codes underscore both the non-negative aspects and the positive aspects of the measures contemplated. It is in these circumstances that a close look at what constitutes corporate governance becomes relevant with particular reference to the fact that the corporation is a social institution and the shareholders or managers are not owners of corporate property as long as the corporation is a going concern. It is necessary to understand and appreciate that a corporation has a discrete interest of its own—discrete from all others indicated earlier. Corporate managerial misdemeanor seriously dents the character of distinctiveness of its identity marked by perpetual succession and collectivization of capital. Corporate perpetuity has to be healthy to be real and meaningful. No doubt, this fact makes a serious case for developing responsive culture and values. This issue is indeed central to all considerations regarding the quality and character of corporate governance in practice. Questions regarding the efficacy of the governance codes have been raised in many quarters as to whether

the elaborate codes have in fact been able to realize their objectives. The visible impact of all the regulatory paperwork has not been as desired despite the volume and the frequency of amendments. Corporate governance is, however, not synonymous with corporate management; it seeks exercise surveillance over the whole gamut of management functions to keep them on track.

The Cadbury Report

Report on the Financial Aspects of Corporate Governance, December 1, 1992, chaired by Sir Adrian Cadbury set the pace for similar measures to keep the company managements virtually in the leash, through bringing into play codes of corporate practices and conduct that were designed to apply centripetal forces to counter those overtly centrifugal. The Cadbury Committee underlined that every public company should be headed by an effective board which can both lead and control the business. Within the context of the UK unitary board system, this means a board made up of a combination of executive directors, with their intimate knowledge of business, and of outside, non-executive directors, who can bring a broader view to the company's activities, under a chairman who accepts the duties and responsibilities which the post entails. On the appointment of non-executive directors on the board of a listed public company, the Committee was quite emphatic to point out that the process of selection must be objective. Given the importance of their distinctive contribution, the Committee avers that the non-executive directors should be selected with the same impartiality and care as senior executives and that their appointment should be a formal selection process, which will reinforce the independence of non-executive directors and make it evident that they have been appointed on merit and not through any form of patronage.

Nomination Committee a la Cadbury Committee

The Committee regards it as good practice for a nomination committee to carry out the selection process and to make proposals to the board. The Committee further states that companies have to be able to bring about changes in the composition of their boards to maintain their vitality. Non-executive directors may lose something of their independent edge, if they remain on a board for too long. Furthermore, the make-up of a board needs to change in line with new challenges. Therefore, the Committee recommends that non-executive directors should be appointed for specific terms. Their Letter of Appointment should set out their duties, term of office, remuneration and its review. Reappointment should not be automatic, but a conscious decision by the board and the director concerned. The Committee stresses that the board of directors should meet regularly, with due notice of the issues to be discussed supported by the necessary paperwork, and should record

its conclusions. The Committee recommends that boards should appoint remuneration committees, consisting wholly or mainly of non-executive directors and chaired by a non-executive director, to recommend to the board the remuneration of the executive directors in all its forms, drawing on outside advice if necessary. Executive directors should play no part in decisions on their own remuneration. Membership of the remuneration committee should appear in the Directors' Report. Regarding the audit committee, the Cadbury Committee observes that since 1978, the New York Stock Exchange has required all listed companies to have audit committees composed solely of independent directors and the 1978 report of the American Treadway Commission concluded that audit committees had a critical role to play in ensuring the integrity of US company financial reports. While experience of audit committees in this country (UK) is shorter, it is encouraging, and around two-thirds of the top UK listed companies now have them in place. Experience in the United States has shown that, even where audit committees might have been set up mainly to meet listing requirements, they have proved their worth and developed into essential committees of the board. Similarly, recently published research in the United Kingdom concludes that the majority of companies with audit committees are enthusiastic about their value to their business. They offer added assurance to the shareholders that auditors, who act in their behalf, are in a position to safeguard their interests, taking care of the centrifugal forces that lark both within and outside the corporate organization under different garbs and complexions. Some recent instances have, on the contrary, proved that this reliance on auditors was misplaced.

The Audit Committee as Contemplated by the Cadbury Committee

The Committee therefore recommends that all listed companies should establish an audit committee. It is further recommended that:

- a. audit committees should be formally constituted to ensure that they have a clear relationship with the boards to whom they are answerable and to whom they should report regularly. They should be given written terms of reference which deal adequately with their relationship, authority and duties, and they should meet at least twice a year;
- b. there should be a minimum of three members which should be confined to the non-executive directors of the company and a majority of the non-executives serving on the committee should be independent. Membership of the committee should be disclosed in the annual report;
- c. the external auditor of the company should normally attend audit committee meetings, as should also the finance director; as the board as a whole is responsible for

COVER THEME

- the financial statements, other board members should also have the right to attend; the committee should have a discussion with the external auditors, at least once a year, without executive board members present, to ensure that there are no unresolved issues of concern;
- d. the audit committee should have explicit authority to investigate any matters within its terms of reference, the resources which it needs to do so, and full access to information; the committee should be able to obtain external professional advice and to invite outsiders with relevant experience if necessary;
 - e. the audit committee's duties should be determined in the light of the company's needs but should normally include:
 - a. making recommendations to the board on the appointment of the external auditor, audit fee and any question of resignation or removal;
 - b. review of the half-year or annual financial statements before submission to the board;
 - c. discussion with the external auditor about the nature and scope of the audit, co-ordination where more than one audit firm is involved, any problems or reservations arising from the audit, and matters which the external auditor wishes to discuss without the executive members present;
 - d. review of the external auditor's management letter;
 - e. review of the company's statement on internal control systems prior to endorsement by the board; and
 - f. review of significant findings of internal investigations
 - f. where an internal audit function exists, the audit committee should ensure that it is adequately resourced and has appropriate standing within the company; the external audit programme to be reviewed by the audit committee, and the head of the head of the internal audit should normally attend its meetings;
 - g. the Chairman of the audit committee should be available to answer questions about its work at the Annual General Meeting.

N.B. Specific directions have been given for appointing separate audit committees for better surveillance qualities. All these recommendations were made in good faith, with little or no anticipation of different ways in which deliberate *corporate deviance* was gathering momentum in England and elsewhere, high-level planning and execution marking the letting loose of the shenanigans.

Effectiveness of Separate Audit Committees

The Committee has stressed that boards should appoint audit committees, rather than aiming to carry out their functions themselves. A separate audit committee enables the board to delegate to a sub-committee a thorough and detailed review

of audit matters, it enables the non-executive directors to contribute an independent judgment and play a positive role in an area for which they are particularly fitted, and it offers the auditors a direct link with the non-executive directors. The ultimate responsibility of the board for reviewing and approving the annual report and the accounts and the half-year report remains undiminished by the appointment of an audit committee, but it provides an important assurance that a key area of a board's duties will be rigorously discharged. Properly constituted audit committees are therefore considered to be an important step in raising standards of corporate governance. However, their effectiveness depends in no small measure on having a strong chairman who has the confidence of the board and of the auditors, and on the quality of the non-executive directors. Membership of an audit committee is a demanding task that requires commitment, training and skill. The directors concerned need to have sufficient understanding of the issues to be dealt with by the committee to take an active part in its proceedings. This is a reason why committees should, if it is appropriate and within their authority, be able to invite outsiders with relevant experience to attend meetings. The Committee insists that external auditors should be present at the board meeting when the annual report and accounts are approved and preferably when the half-yearly report is considered as well. Indeed this insistence comes from intimate knowledge of what goes on in the board meetings. This, however, presupposes that auditors perform true to their calling and they have the ability and experience to decode the possible trickeries.

The Greenbury And other Reports

While the Cadbury Committee addressed concerns in corporate performance and financial reporting with key recommendations focussing on control and reporting functions of boards, taking a perspective on board performance and governance, the explicit stress being on financial stakeholders, the Greenbury report (1995)—on directors' remuneration dealt with issues related to the large remuneration packages that had been awarded to some directors. The Greenbury report specified the information that should be made available by the company in its annual report. The report, in particular, has required the linking of executive directors' remuneration to company performance and to disclosure, in the annual report, of the directors' remuneration packages including pension entitlements. It may be mentioned in the above context that the Cadbury and Greenbury Committees made observations that called for review and integration for consolidation, easier comprehension and better applicability by way of evolving a set of principles and codes. Hampel Committee directed its efforts to this end resulting in the 'Combined Code of the Committee on Corporate Governance', published in 2000 which incorporated the recommendations from both the

Cadbury and Greenbury Committees. A new Combined Code was published in July 2003, that highlighted the role and effectiveness of non-executive directors with further emphasis on formal, rigorous and transparent procedures for appointing new directors. The Combined Code required that the board should have both executive and non-executive directors. The directors should be provided with quality information in a timely manner to enable them to fulfill their responsibilities. Appraising executive directors on an annual basis by the board and assessing the performance of its directors and committees, with a provision for regular intervals for the re-election of directors and their remuneration in the cases of executive directors, depending on their performance on the basis of objective criteria. All of the above and subsequently appointed Committees—such as the Turnbull Committee, Higgs Committee and Sir Robert Smith Committee—had in view the need for companies' effective compliance of the Codes prescribed, and in their turn, the Codes of Governance have all this while remained under a continued scanner to make them up to date, practical and workable, dealing as they did, with such issues as independent directors, independence of auditors, ways of making the audit committees more effective, disaggregation of the roles of company Chairman and CEO, manning the boards with adequate number of independent, non-executive, directors and sensitive, responsive and adequate disclosure of performance details with periodicity indicated by SEC, SEBI and others. It may be recalled in the above context that separating the roles of Chairman and CEO is not new or novel; theories of organization stressed long back that Board constitution could be of two types, namely, Policy Board and Functional Board. The former type has been under focus in the Corporate Governance format. In the earlier scheme of things, the Board was supposed to be concerned with gauging the business environment, formulation of policies, which are but guidelines for managerial action, and the responses that the organization should generate to combat the externalities. The aura of Ordway Tead, and of the enunciations in his *Art of Administration*, has given way to executives donning the colours of Board members. Functional Boards came into vogue much later than Policy Boards and the Managing Director was in the earlier regime supposed to be the liaison between the Board and the management.

Disclosure Issues

With respect to disclosure of financial details, the Code clearly required that the board should take the responsibility to present a balanced and understandable assessment of the company's position and prospects. It was also underscored that an effective internal control system should be sustained to protect shareholder investment and company assets. The companies should use their AGMs as a means of communication with investors and engaging their fruitful participation in the proceedings. In the USA, UK and other

advanced countries, a critical role is played by the stock market analysts, the institutional shareholders, the mutual funds and also the knowledgeable retail shareholders not only by studying the performance details minutely and offering comments but also by participating in voting on different issues that call for such action. The conditions prevailing in the developing countries are rather different as brought to the fore in different contexts. An additional factor that works against exercise of rational choice relates to the imperfect market conditions made more so by the prevailing dominance of family control underscoring veiled operations, secrecy and inefficient practices in different spheres of industry and business. This kind of approaches has been noticed in China and South Korea as also in Japan. Contrarily, in the USA and the UK as also in different European countries, the prevailing operational phenomena in companies have remained under watch and several Committees have sought to bring to the fore the existing inadequacies and suggest ways of dealing with them. This has meant that several Committees have been appointed over time to go into various connected issues. The relevant authorities have also been anxious to integrate the findings of the individual Committees into a set of combined codes, which have themselves been re-examined and revised to properly align them with current concerns and requirements. The process is still on, even though the critics allege that a fault-free governance system has till now eluded the reform seekers. It will thus be interesting to refer to their main contentions and recommendations as they mainly address different concerns of relevance for good governance, but not necessarily for good management. The former relates to security of funds deployed and the propriety of managerial action, while the latter concentrates on profitability, competitiveness and innovation, projecting into the future. So far, these issues have not had the required attention of the powers that be.

Discrete Contexture

It may appear that many of the issues raised are repetitive in nature; they indeed are, but their operational contextualities are discrete as they address the typical conditions and prevalent practices in each country, within the framework of the corporate laws and the regulatory measures in force during the period under consideration. Country-differences and the operating systems in vogue have thus come in the way of evolving an internationally acceptable and harmonious Code of Corporate Governance, synchronous and compatible with the tenets of GAAP, GAAS and IFRS, accommodating not only the internal management control systems but also disclosure of relevant information. Incidentally, all these technicalities have assumed the character of discrete *specialism*, engaging the attention of experts in different countries including our own. Alongside all this, managers in different organizations in almost all countries have complained that so many regulatory measures

COVER THEME

have made fun with their very purport while missing their targets by miles. An elaborate discussion on these questions is beside the point here. It is, however, relevant to point out that there is a raging debate on some of these issues especially with reference to their cost-effectiveness in the specific context of the numerous instances of corporate deviance reported from different countries, despite the measures to identify, chase and bring the miscreants under leash, on one hand, and to foreclose the deviant designs, on the other. There is an important issue that seems to have been underplayed all this while. It relates to the fact that corporate governance is more concerned with the security of investments than with the deployment of funds for profit. Mention of this aspect so far has been no better than casual. It is axiomatic that managers 'make the future today' and in so doing, managers have to face the risks and uncertainties attending on the *decisioning* phenomena, the strategic format that they have to prepare to combat market belligerence, produce goods and services in anticipation of demand and go whole hog for innovating for staying ahead of competition. Dependence on chance is a part of the game and environmental scanning and response management would call for undertaking risk in dealing with uncertainty of outcome of decisions turned into management, tactics, policies and strategies.

SEBI Act and Companies Act Must be Endowed With More Teeth.

There is an overt, serious, contrast in the pulls that corporate governance implies at one end of the spectrum and the pushes that innovative steps generate at the other end. These pulls and pushes tend to bring the thrusting enterprises into a sleeping state, affecting performance. Excessive stress on independent directors and chairmen has also mired corporate operations into deceitful practices just to skirt the requirements of the governance system. A recent research study revealed that many of the so-called independent directors are not independent at all; quite a few of them do not have the requisite qualifications and experience; several of them are too old for sustained workload and intellectual alertness that corporate governance implies; and, in many cases, their contribution has added only questionable value [Cf *The Statesman*, Kolkata, 21 May, 2009, p.7]. Corporate governance tenets matter only for the listed companies, and listing with the stock exchanges and SEBI is not compulsory. SEBI has lacked necessary teeth for stalling practices considered undesirable. Unless the SEBI Act is amended to equip it with necessary powers, the regulator would not be in a position to cleanse the Augean Stable, that the Indian corporate sector in fact is. The likelihood of throwing the baby with bathwater cannot also be ruled out altogether in the said circumstances. The regulator has so far been only chasing miscreants but has lacked teeth to foreclose malpractices affecting corporate governance

system envisaged under Clause 49 of the Listing Agreement. Clauses such as those related to delisting if a company has not earned profits for three years consecutively, also appear out of line insofar as the regulatory body must inquire—even inspect—why the company has failed to earn profit, especially when the externalities are not bellicose; the management must be changed in such a case. It is relevant to mention in the above context that the Companies Act and the SEBI Act must be made more responsive in this respect, considering that there are large stakes involved in corporate affairs apart from those of shareholders and employees. In this regard it may also be underlined that dealings in the stock exchanges and the Initial Public Offerings should not be mixed up. They call for discrete ways of dealing with the typicality of each.

Revival of the Office of the Controller of Capital Issues

Greater effectiveness may ensue if IPOs are brought under the control of the Controller of Capital Issues, an institution that existed earlier, but was abolished during the liberalization regime. The revival is called for in view of the repetitive scams that could not be prevented by the existing institutional set-up with limited powers given to the second level institutions and absence of necessary orientation. Equipping the CCI with adequate powers and its readiness for taking expeditious action could stall many of the scams that occurred during the last two decades or more. Even the IPO of Reliance Power has offered quite a few object lessons with reference to unloading of shares subscribed by institutional investors under the book building process, while the earlier system of subscribing to shares in four doses i.e., application, allotment, first call and final call, warranted reconsideration, more so for the retail investors. This would mean that with the span of focus being smaller, greater depths could be explored by both SEBI and CCI. While the major concern in such a case may be the listed companies with SEBI, the CCI would have only IPOs as its major focus. On the other hand, SEBI's span of focus could be expanded with all public limited companies required compulsorily to be listed for submitting themselves to the scrutiny by the regulator with powers to initiate inquiry suo motto. Scams with regard to both IPOs and the stock markets have surfaced during the last two decades. A passive approach has so far ruled the scene that requires total change. Giving primacy to the shareholders is illogical because shareholders do not own corporate property, as long as the company is a going concern. Corporate property is public property and the state has a direct stake and immediately relevant role in protecting it. The corporate citizen has a right to function as one, free from the numerous shackles of the law and the regulations, despite its incorporeal character. A good Corporate Governance system can hardly ignore or undermine the question of a company's deriving sustenance from its operations, which is a whole world of problems and

prospects in itself. Ensuring the right corporate culture and integrity is very much an internal matter of the management and men, and can hardly be infused by official diktat. And the company is a perpetual being which cannot die as a natural course; it can only be killed according as laid down in law, i.e., dissolution. Thus, under the obtaining scheme of things, the convergence of good corporate governance, on one hand, and innovative, effective, management, on the other, do not appear to be automatic and consonant. Many of the steps taken by SEBI and those contemplated under the Companies Act do not appear to be quite in the fitness of things as these measures contemplate chasing miscreants rather than catching them in the act. Where speed is crucial, a lot of time is invariably taken for deciphering questionable practices and for taking appropriate corrective and preventive action.

Imperatives of Assessing Governance Quality

The convergence of the two issues at present impacts only distantly, if they are not at loggerheads in their present avatars. It would be an interesting and instructive area of inquiry, country-wise, industry-wise and area-wise, highlighting the cost-benefits. The details of costs of the independent directors and chairman, the work done by them and the benefits accruing from their activities are not disclosed in the annual reports. The corporate governance report as an appendix to the annual report reads not as much to vindicate the purport behind it as to add rather unpurposive detail regarding the particulars of the independent members, the number of meetings held and attended by individual members and the fees given to them. No indication is available regarding the work done by them letting the companies benefit from their expertise and experience. It may be pointed out at the end that excepting the nomenclature, none of the issues raised in corporate governance was unknown before. As an antidote to errant management behaviour, governance codes have fallen on their faces, while the hullabaloo has grown both in spread and impact. The Sarbox, on the contrary, has jerked the other end of the stick that took for granted that business success and staying ahead of competition were easy and automatic. The choking of managerial vitality and creativity has been an easy outcome. The actual quality of corporate governance has hardly shown much perceptible improvement, if one were to go by the repetition of the deviant practices in companies surfacing in different countries. The rhetoric and volume apart, a systematic examination of the quality of the prevailing corporate governance systems has been few and far between, leave aside the required transparency in such assessment.

The Contents of Corporate Governance

That the contents of corporate governance are designed to oversee the functions of corporate management is attested by the excessive dependence on the independent directors, the imposition of the audit committee on the usual system

of internal audit and statutory audit, and various other committees intended to stall drainage of funds to unwanted channels. First things first. The independence of the much vaunted independent directors has been seriously called to question in the face of tall claims about their utility in practice. Empirical evidence, educed by research firm Prime Database, Mumbai, with regard to the companies under clause 49 of the listing agreement concerning SEBI and the stock exchanges, as alluded earlier, suggests some interesting facts:

“Nearly seventy per cent of all independent directors are ‘home’ members who are natural allies of the promoters and are not independent in any sense”. The observation is based on a close study of the profiles of independent directors of 2244 companies listed with the Bombay Stock Exchange. Only 15 per cent of these independent directors are capable of adding value. 48% of these independent directors, numbering 6443, are above the age of 60. As many as 1380 of the independent directors are above the age of 70, 199 are past 80 and 8 are past 90”. The efficacy of the contribution of independent directors can be imagined. The conditions obtaining in other countries may not be as bad. The second issue is equally disconcerting. The Sarbanes-Oxley Act, 2002 in fact does contain provision for audit of the internal controls. All this undermined the work of the internal auditors in the face of good work done by the internal auditors. For instance, Sherron Watkins and Cynthia Cooper did report to the Audit Committee of Enron and WorldCom respectively that everything was not in order in the two reputed corporations and that implosion was only a matter of time. Unfortunately, no action was taken on these reports, nor was it possible for the miscreants to undo the mischief committed by those at the helm. When top management was jerked into action, it was too late and things were out of their hands. On the other hand, these ladies were subject to insult and ignominy with a tacit threat of losing their jobs. Both Kenneth Lay and Bernard Ebbers were indicted for their misdemeanour. Kenneth Lay died of heart failure and Ebbers was found weeping in the court room. The case of the ‘Enron of India’, Satyam Computer Services, has also brought to light many an inadequacy in accounting and audit systems and practices that require a thorough overhaul. In fact, such reforms would be tantamount to virtually reinstating the status that accounts and audit were given at the outset, when the generally law on companies was enacted in England. Audit surveillance was never thought of as a matter of routine, insofar as it was expected to safeguard the interest of all the involved parties—insiders and outsiders—including the company itself. As stated earlier, the company as an acknowledged citizen does have an interest of its own, for nurturing and cultivating its healthy perpetuity, derived from generation of surplus from its operations. Short-termism is anachronistic to the corporate concept. The once celebrated corporations in different countries were led to apply for insolvency. Yesterday’s flourish became today’s nightmare. What a pity!