A Strategic Framework to Manage Ethical Dilemma in Corporate Governance

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INTRODUCTION

Current accounting practices don't provide companies a high degree of choice to adopt varied methods of measurement and criteria to recognize organization resources. Moreover even if auditors exercise this choice it imposes higher costs, which are sometimes unaffordable. But contrary to it, adoption of globalization practices in the last decade has not only heightened business risk but is compelling Indian companies to adopt international norms of transparency and good corporate governance. In corporate sector, both ownership and management are mutually divorced, whereby shareholders delegate decision making right to managers and they themselves take a back seat. Managers act as an agent of the shareholders to manage organization resources with their best potential, synchronizing shareholders' interest, which ultimately leads to developing a strong network of relationship of accountability between Board of Directors and managers. As a result, Indian companies have started paying great attention to the issue of corporate governance that focuses on laying down minimum standards and defining the role of various players operating in an organization system. Ready to relearn the vibrant strategies, organizations are making strong efforts to draw a framework of rules, regulations, system and processes, which can ignite performance. Corporate governance as defined by Organization for Economic Cooperation and Development (OECD), "Exercising control in a society in relation to the management of its resources for social and economic development". Legal system, accounting standards, policies and patterns of equity ownership have a strong bearing on organization performance. Striving for growth, organizations around the world have started adopting corporate governance principles and regulations that are consistent with their functional areas and give convincing answers to investor's doubts as board of directors have given some core responsibilities to the managers where the most pressurizing job is to add value to clients. Corporate governance helps to foster effective risk management whereby Board members clearly understand their role to exercise sound judgment about the organization affairs. Board members are possessed with strong powers through which they authorize management to carry out strategies that have been approved, except in some exceptional situations Board members formulate code of conduct that stipulate the conditions under which the management is required to take prior approval from Board before entering into any commitment. The widely held perception about corporate governance that it results in making organization system more transparent, leads to a belief that no organization can exist in future with significant progress unless they make this agenda a primary concern. Investors have become more aware and more concerned about their ethical rights. So, if investors are not confident with the level of disclosure and reporting standards, then capital will flow out somewhere else.

CORPORATE GOVERNANCE: BRIDGING THE GAP

In a complex system of organization, many participants influence its working and performance. However, the most dominant are directors, managers, shareholders and auditors etc, which have put a challenge in front of organizations to embrace standardized code of conduct. Corporate governance provides the mechanism through which organization affairs are monitored by its Board, that ensure long term sustainable growth of organization.

- ***Directors***

Board of directors have a key role in corporate governance because its their responsibility to develop directional plans, appoint executive management, decide their remuneration, taking feedback about operational performance, legal compliance and finally ensuring accountability of the organization to its shareholders, but performance of this role is dependent upon their ability to access information.

- ***Auditors***

Auditors are mainly recognized for their requirement because of legal compliance. Beside their role of liasioning between board and management, they assist board in its oversight responsibility.

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- ***Managers***

Appointed by Board members, they are considered to be pillars behind the success of an organization. Managers possess varied skills and expertise, which helps them in taking appropriate decisions for all business matters. Having authority to manage organization, managers are expected to encourage the culture of honesty and open communication.

Sound governance practices require active participation on the part of all participants because all of them have major contribution in organization performance but none is sufficient alone. Hence, effective governance requires integration of roles played by different participants.

- Establish well-articulated corporate strategy through which performance of each individual towards overall achievement can be measured.
- Design a hierarchy of authority and responsibility with adequate checks and balances.
- Understand conflict of interest by ensuring that management implements policies in congruence with organization objectives.
- Develop an effective information system that can provide straightforward explanation to the shareholders.
- Providing sufficient incentives to the management in the form of promotion or remuneration for developing a framework of transparent organization system.
- Recognizing the importance of audit process is not sufficient but organization should ensure independence of auditors.

CORPORATE GOVERNANCE: A PORTAL TO LUCIDITY

Although in India, organization failures due to poor governance is a hot topic of discussion and main reason attributed to this fact is lack of shareholders concern. But it is true that corporate Governance has done little to improve the contribution of board. If anything, the attention has been switched from building larger and better cakes to applying the boardroom icing to existing cakes in recommended ways. (Thomas, Colin). After the hectic traveling of executive life, Board members accept the wrong assumption that reward of directorship is acknowledging the end of a long successful career than beginning of a new one. Thus directors start taking responsibility very lightly; enjoying the prestige it gives. This situation leads to make the presence of a CEO stronger and very slowly the Board members' role starts disappearing.

Board members have got rights to change the overall culture of the organization but they exercise this authority very rarely as managers are overconfident about their abilities and start dominating the board. This phenomenon leads to complete absence of negotiation between Board and managers, resulting conflicts in organization. Corporate governance provides incentive to developing a code of conduct with expected standard of behavior.

Conflicting interest that arises when integrity of financial statement is doubtful affects the overall credibility of the regulatory system. To resolve it, organizations are expected to review their approach, to ensure that whatever they are doing is of real relevance to the shareholders. Organizations all over the world are acknowledging the need to strengthen governance practices as poor governance not only promotes corruption but also encourages reputation risk. These ethical issues suggest pool of systematic procedures that try to sort out relationship between all the counter parties.

- ***Equitable treatment***

Corporate governance provides all of its players comprehensive range of benefits, which ensure building confidence among stakeholders as they become more willing to lend funds to organizations adopting widely accepted practice of governance.

- ***Transparency***

Emerging global markets have not left management with alternatives other than to clean up their vision and strive for openness and honesty in their operation and create pool of their talent that can effectively meet director's expectations.

- ***Complete disclosure***

Apart from bringing transparency in disclosure of organization affairs, good governance practices provides a framework of code of conduct that is adopted to add value to a wide spectrum of clients.

- ***Information integrity***

Most of the empirical evidences have proved that well governed companies achieve higher market valuation besides attracting capital flows from global markets, as financial communities believe it to be a prelude to make organization independent and accountable.

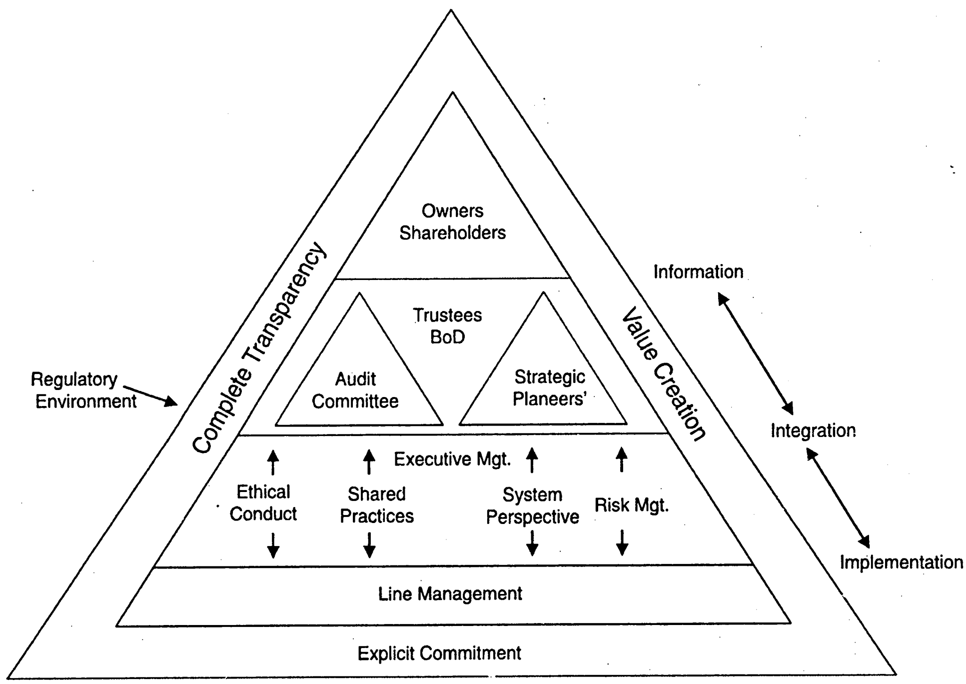
- ***Ethical demand***

Ethical code of conduct fosters a compliance programme that develops integrated reporting system for prediction of future financial success.

CORPORATE EXCELLENCE MODEL (CEM)

The foundation for developing and maintaining an effective governance system is to resolve some sensitive issues by giving realistic answers to growing needs of societal commitments. Real time information system that can prove to be cost effective solution; having the capability to analyze organization performance is required that can oversight risk profile of the organization and is consistent with autonomy in decision-making. Corporate governance mechanism is designed to reduce the inefficiencies that arise from improper control system and lack of accountability.

Figure 1: Effective Governance Model (EGM)



EGM suggests a formalized approach that is concerned with holding a balance between economic and social goals or between individual and communal goals. Environment trends demand promoting understanding of organization activities through information disclosure with the spirit of fairness because managers may use tactic to manipulate results. Adopting internationally accepted norms of governance, organizations are endeavoring to become familiar with board objectives, simultaneously encouraging board members to participate actively in formulation of organization policies. On the other side, even Board members have realized that they must not be lured by the recognition and financial benefits provided by status but keep independent decision making a priority.

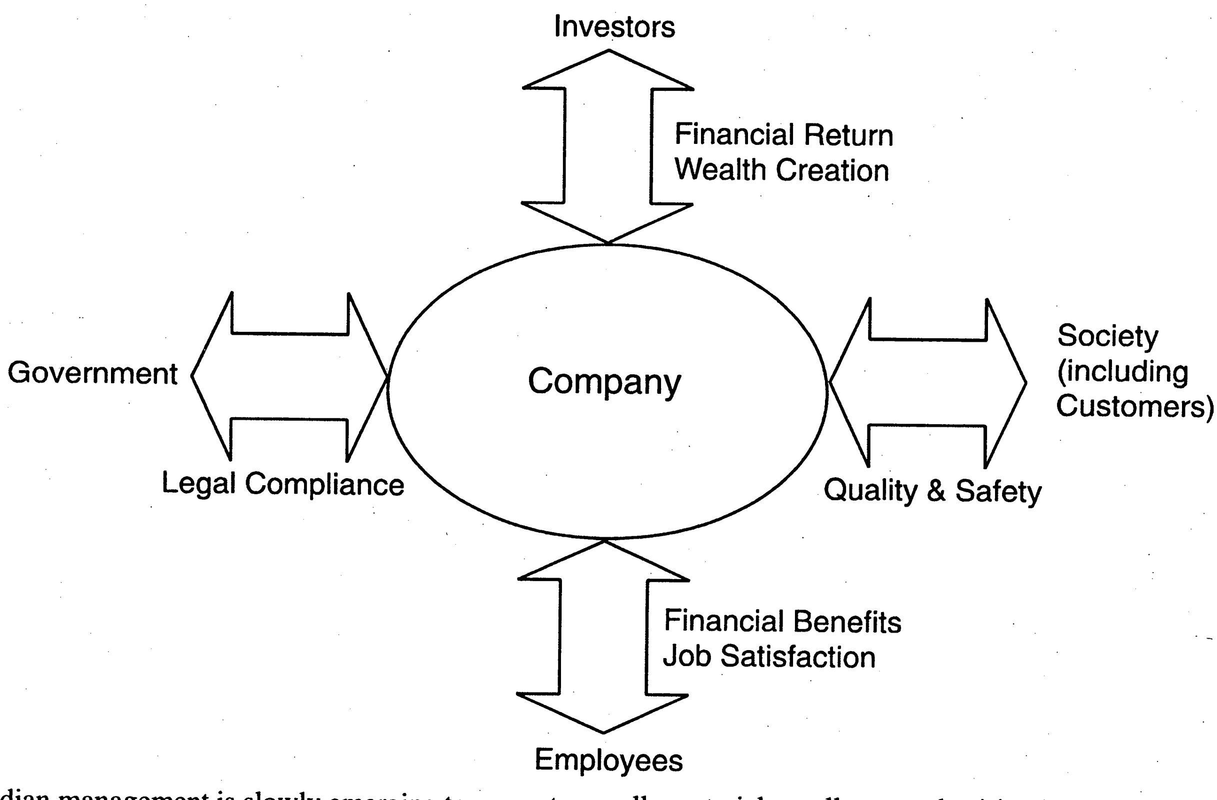
Indian organizations are quiet unfortunate to understand the fact that corporates who do not promote the culture of independent oversight are putting their reputation in danger. Corporate excellence model ostensibly focuses on integration of system to promote legitimate pleasure and grasp new opportunities. Top management is the key component of corporate governance and Board members provide checks and balances to senior managers but simultaneously they add strength to the corporate governance when they understand their duty of loyalty towards shareholders. (www.oecd.com). It has been now widely recognized that outstanding performance, higher profits and extended reach- nothing act as a safeguard for a company when good governance and ethics are at back burners. (Aggarwal, V. K)

CG: A HOLISTIC APPROACH

Owing to the worldwide consciousness, organizations have realized that key challenge facing them is to perform their sacred obligations. Indian tradition particularly has an obsessive attachment to ethical values and has developed an impressive philosophy for their business operations congruent with social needs. No discussion on business ethics and corporate governance can be complete without specific mention of warning signs for which directors should be watchful as they strengthen their ethical awareness, decision making & corporate governance oversight and that red flag is ethical complacency. (Driscoll & Hoffman)

This ethical approach looks for a moral framework within which different players are required to watch their actions (Figure 2). Among them mainly it is the directors who should keep ethics always in the forefront in their list of obligations. This ethical pressure on directors requires them to concentrate on current practices and give themselves permission to openly express their personal values. It has been cynically said that ethics, corporate social responsibility, high standard credos, codes & idealistic mission standards are in direct proportion to the prosperity of a company and inversely proportion to severity of competition it faces. (Theophane). Value based organizations that are relying on the preposition of shared values among its shareholders; employees, customers etc are able to develop their market potential through strong brand loyalty.

Figure 2: Corporate Governance: A Holistic Approach



Indian management is slowly emerging to promote equally material excellence and spiritual enrichment both in individual and collective life, "Atmano mokshartham, Jagat hitaya cha", which means all work is an opportunity for doing good to the world and thus gaining materially and spiritually in our life. (Sherlakar.S.A). But still Indian organizations need a proper platform to adopt internationally accepted governing practices. In a recent study conducted on corporate social responsibility in India, it was found that the public by and large, thinks that Indian companies are not considered socially responsible although a few established names famous for philanthropic model of social development programme are mentioned frequently. (CSR World survey report 2002)

Hot discussions on ethical issues have concluded that governance practices increases the likelihood that the enterprise will satisfy legitimate claims of all stakeholders and fulfill its environmental and social responsibility. Human resource is most inevitable part of business so they are expected to behave in a right manner toward each other. Members of the Board should value not only their customer but bring a sense of ethical togetherness in the whole constituents of business environment It never Demands any undue restraint upon freedom of human reasoning, freedom of thoughts, feeling and will of the man governed by it. In fact, it encourages and strengthens practical aspects of corporate philosophy. (kala, S.P)

INFORMATION INTEGRATION: INDIAN SCENARIO

India's legal framework for corporate governance is found in Indian Companies Act 1956 and Clause –49 of SEBI's requirement for listed companies. SEBI particularly has been proactive in keeping corporate governance rules and regulations in line with best practices around the world. In year 2002, SEBI updated its listing requirements and reforms ordinate by SEBI are laid out in Clause –49 which specify companies listing requirement (mandatory and non-mandatory) with Indian stock exchange that pertains to corporate governance.

There are many provisions in Indian corporate legislation that aim to protect shareholders and investors from unscrupulous management of their companies. Companies Act itself regulates inter corporate investment either in equity or by way of loan between companies. Particularly in case of listed companies, SEBI regulations require quality results to be disclosed, potential risk factors to be included in documents containing public offering etc.

Recently provisions of Clause –49 have been changed to incorporate some best practices laid down in Sarbanes Oxley Act (U S). Latest reforms prescribed by clause-49 forces companies to adopt the norms non-compliance of which would result in de-listing of the company. Among the most important requirement includes:

- More independent directors on board
- Audit committee
- Code of conduct for BoD
- Larger role of audit committee
- Mandatory risk arrangement
- Certification by the CEO of internal audit control

In addition to above mentioned mandatory requirement, Clause-49 provides a list of non mandatory requirement which promote governance practices such as creating board level remuneration committee, training of board, conducting board member evaluation etc.

At a pragmatic level, the central issues behind designing these requirement is to determine the extent of shareholding that can enable the group to exercise appropriate control because most of the Indian companies have acknowledged this fact that process of determining optimal locus of control for channelising authority and responsibility arrangement to the desired level are not only expensive but above that its difficult to monitor. The central issue for corporate governance is therefore determining extent of shareholding that can enable the group to gain control. Clause-49 mandates many of the improvements through its listing requirements that have encouraged many companies to voluntarily accept governing practices. " Indeed many companies have been passing in the requirement through 2005, predictable to the deadlines looming large, some companies say they are not ready yet".

Major drawback that Indian companies encounter is that promoters retain control of companies by owning significant ownership stake. Promoters are having mainly feudalistic attitude who create an impression that the consumer of their product as well as smaller shareholders obtain value addition as a result of their benevolence. Beside this, political pressure is also one of the discouraging force in the way of corporate governance mechanism. Considering recent amendments in various byelaws and corporate sectors big impression for corporate governance, Confederation of Indian Industrial code has provided that for the independence of directors, at least 30% of board should comprise of industrial non executive directors, if chairman is non-executive and 50% of the board if chairman is executive director.

US ACTION AGENDA: THE WINDS OF CHANGE

Corporate governance is a multi-faceted process, which focuses on inevitable issues in every organization including accountability and fiduciary duties. Acknowledging this fact that corporate governance practices have become imperative, countries worldwide are on their way to restructure their regulatory framework. Code of corporate governance envisages adherence to the highest standard of honesty and ethical conduct in dealing with conflict interest. In United States attempts have been made to identify a more encompassing control or governance structure keeping the nature of ownership in perspective (Whingttington,G). Security exchange commission (SEC), in USA regulates various practices in order to protect investors, maintain fair and orderly efficient markets and facilitate capital formation.

In reaction to spate of financial crisis by Enron and WorldCom, US economy has recognized the significance of corporate governance practices and to rebuild the public confidence they have enacted special ordinance in the face of Sarbanes Oxley Act in 2002. Recently in March 2006, CED committee on Economic Development released a policy statement, " The state of corporate America after Sarbanes Oxley suggested that although regulations of Sarbanes Oxley are quiet beneficial but not sufficient to restore trust in business" and they suggested that in order to snatch public confidence:

- Make audit committee more autonomous & vigorous.
- Ensure that users understand that financial information are based on judgement
- Taming excessive executive compensation
- Using independent nominating committee to select and appraise directors.

The new corporate governance code suggested by Sarbanes Oxley in US state that a director is not independent if he accepts compensation from the company in excess of $ 60,000 during fiscal year other than compensation from the board. If companies are concerned about best practices, why do not they adopt above practices that will remove many critical issues (Kumar, Sateesh). Besides American traditions provide that shareholders should not be entitled to entire value generation since they do no contribute anything to it after providing finance. Shareholders have three main functions i.e. representation, Direction and Oversight. Creditors particularly have heir lien over the assets of company. Board members frame policies and management adheres to it. Firm performance has been found to be positively associated with share option plans that direct managers energy and extend their decision horizons.

CONCLUSION

The concerns of shareholders over administration has lead to increased appetite for corporate governance reforms as this is the mechanism which is used to monitor whether outcomes are in accordance with plans and accordingly individuals are motivated to align their actual behavior with overall participant. Even some research studies have proved that relationship between share ownership and firm performance was dependent on the level of ownership. In its "global investor opinion survey" of over 200 institutional investors updated in 2002, Mckinsey found that 80% of respondents would pay a premium for well-governed companies. To improve corporate governance, heads of the organizations need to take initiative to create a pool of talent that can efficiently meet their expectations. Thus, it is high time to unravel complexities in organization relationships and corporate governance should be accepted as key mantra to unlock new prescriptions and successfully add greater value to wide spectrum of stakeholders.

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