Corporate Social Responsibility
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Lecture - 35
Why Corporate Governance?

Welcome back to the MOOC course on Corporate Social Responsibility. My name is Aradhna Malik and I am helping you with this course and in the previous lecture we talked about a few theories of corporate governance. Now in this class we have talked about we started the module on corporate governance, so the first lecture in this module was what is corporate governance then we discussed some theories, in this class we are going to continue that discussion and talk about why corporate governance is important. So, let us see what we have seen here why corporate governance.

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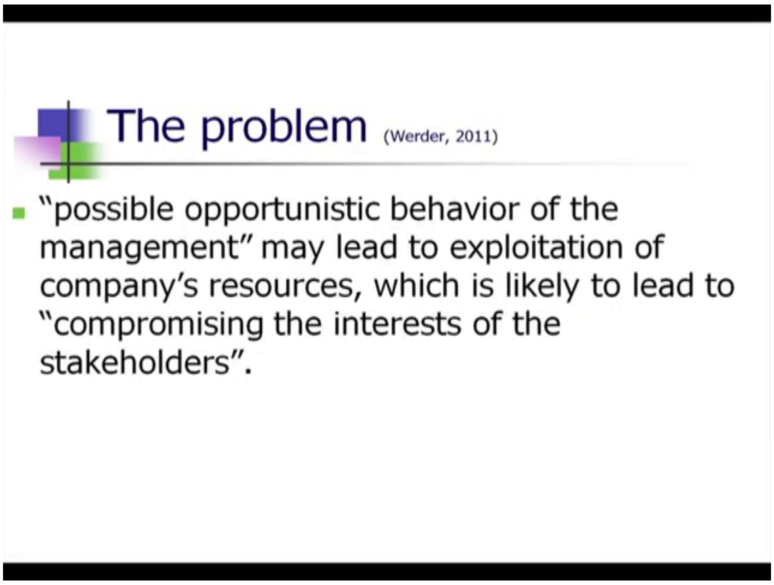

Now in the previous class we were talking about the agency problem which means where the people who own the company the shareholders are different from the managers, from the management the people who run the company are not the same people as the once who own the company and that problem then continues and, so the big problem here is the possible opportunistic behaviour of the management. So, we are not talking about unethical behavior we are just talking about maximization of personal interests which means then both the shareholders and the management try to maximize their own output from the organization in terms of perfect asset connection etcetera.

Now when the control goes to the management board constitutes the management and the management then starts running the company then both have a tendency to maximize their interest or maximize what they get out of the organization which may lead to or has the potential to lead to exploitation of the company's resources which is likely to lead to compromising the interests of the stakeholders. So, both are trying to maximize their profits and in the end people who may not have a financial stake in the organization maybe affected negatively.

Now, that is where the need for corporate governance and having transparent and accountable systems in place and starts coming up.

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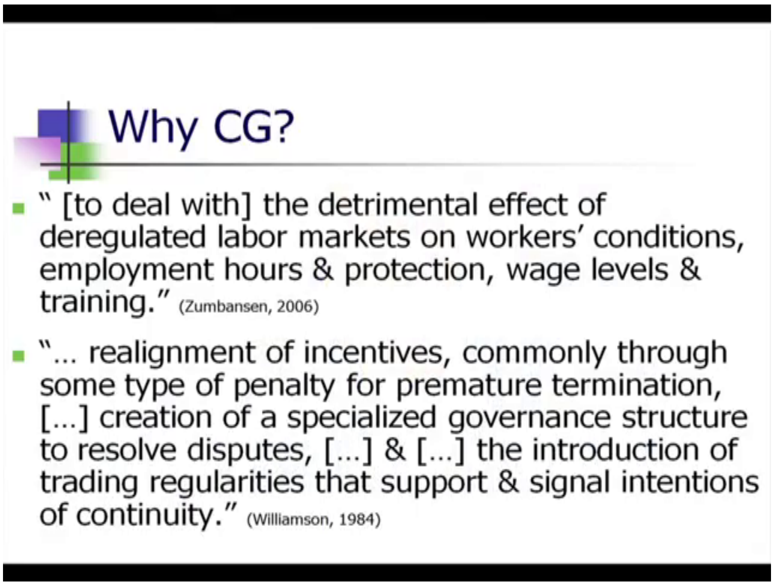

Why corporate governance? To deal with the detrimental effect of deregulated labour markets on workers conditions employment hours and protection wage levels and training. So, some system needs to be put in place to get the nuts and bolts of the management in place. Realignment of incentives commonly through some type of penalty for premature termination, creation of a specialized governance structure to resolve disputes, the introduction of trading regularities that support and signal intentions of continuity.

So some management structure has to be put in place some form and shape of how things are to be done has to be put in place in order to ensure that one complies with the loss, one takes care of the workers, one takes care of contracts that may terminate prematurely. Some penalty has to be instituted disputes; some mechanism has to be put in place to deal with the disputes that occur as a result of conflict of interest etcetera.

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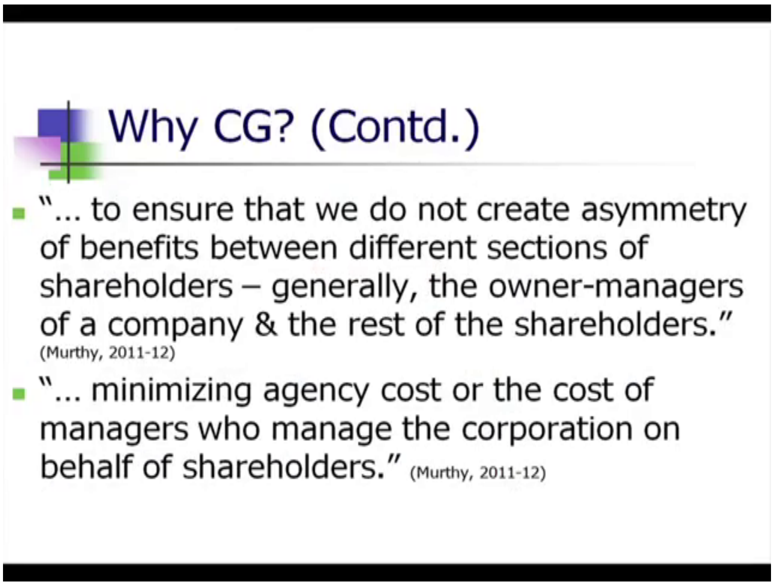

Then, to ensure that we do not create asymmetry of benefits between different sections of shareholders generally the owner managers of a company and the rest of the shareholders. So, to ensure that the benefits are distributed equitable among people who have a stake in the organization or who are financially connected to the organization minimizing agency cost or the cost of managers who manage the corporation on behalf of the shareholders because the shareholders also need a profit you cannot put all the profits back into the organization to run the company.

So, everybody tries to maximize their profit, so to ensure that their management is effective and to minimize the cost of managing the organization.

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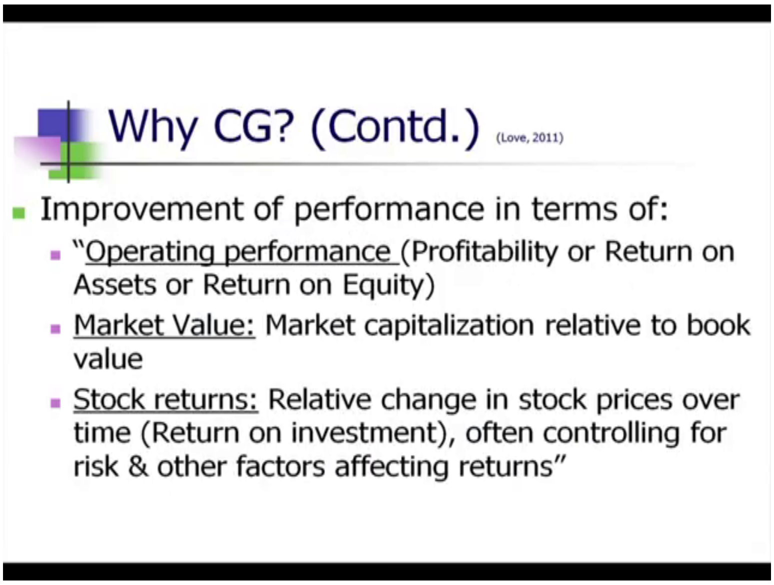

Also to improve performance in terms of operating performance which refers to the profitability or return on assets or return on equity market value, market capitalization, relative to book value, stock returns, relative change in stock prices over time, that includes return on investment, often controlling for risk and other factors affecting returns.

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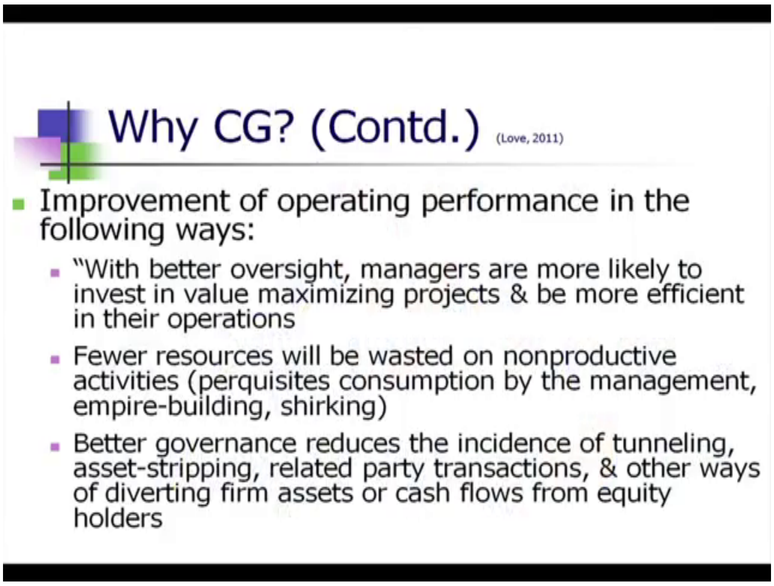

So to improve the performance of the organization then how does the operating performance improve with better oversight again this is directly from this paper and I will read out with better oversight managers are more likely to invest in value maximizing projects and be more efficient in their operations do their work better. Fewer resources will be wasted on nonproductive activities, perquisites consumption by the management empire building shirking a work etcetera. Better governance reduces the incidence of tunneling asset stripping, related party transactions and other ways of diverting firm assets or cash flows from equity holders.

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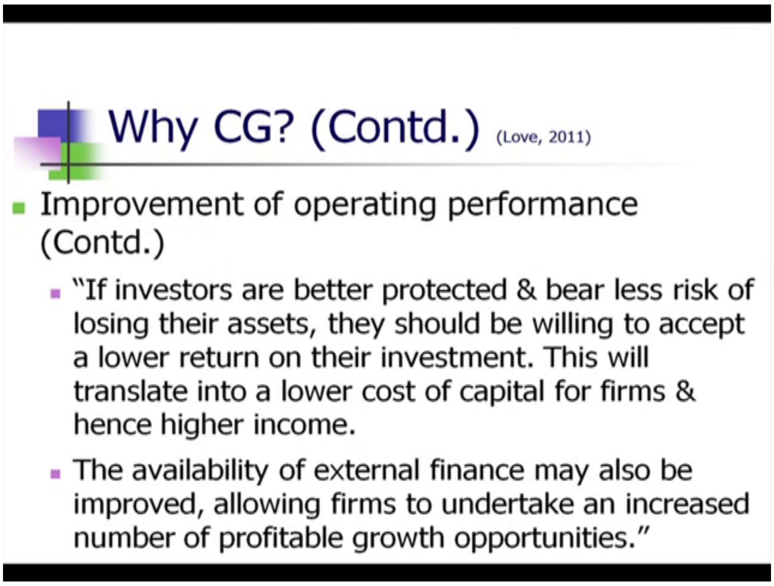

So this is the way operating performance can be improved, then if investors are better protected and bear less risk of losing their assets they should be willing to accept a lower return on their investment; that means, that they are not really. So, they do not want to take on the risk of losing their assets which means they do not want to invest in risky transactions in risky activities. So, when they do not do that its low risk low benefit high risk high benefit. So, they should be willing to accept a lower return on their investment this will translate into a lower cost of capital for firms and hence a higher income.

The availability of external finance may also be improved allowing firms to undertake an increased number of profitable growth opportunities. So, these are some of the ways in which the operating performance of the organization can be improved through corporate governance.

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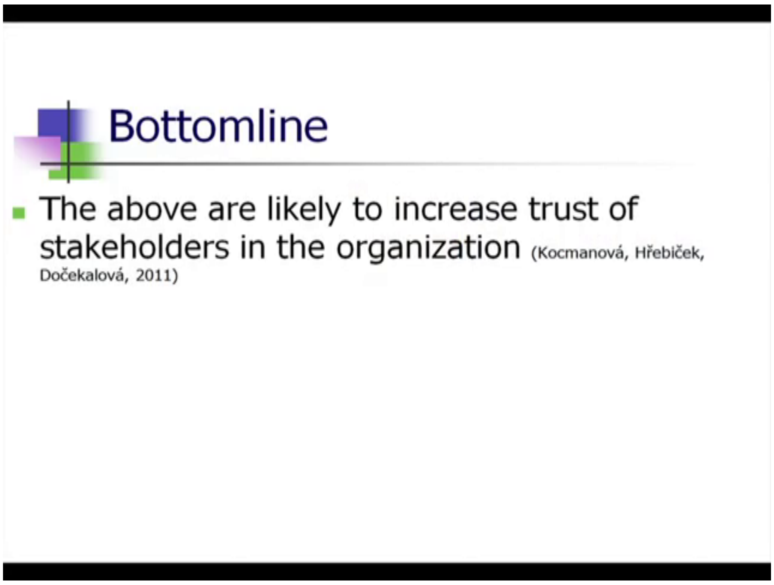

Now, the bottomline is at when we take care of all of these things the trust of the shareholders, the trust of the stakeholders, the confidence they having the running of the organization are bound to increase. When everything is transparent accountable when things are being taken care of properly you know there being managed effectively and a structure is an place a structure that can be viewed that is open to scrutiny then their confidence in the organization grows.

And we will see how different countries you know or how different systems of governance exist in another lecture variance types of governance exist and some people have or in some places you have a very strict form of governance in other places there are networks, but that is you know will save that for another discussion. So, all of what we have said or we have talked about is likely to increase in the trust that the stakeholders the shareholders have in the organization. Shareholders for legal purposes stakeholders for future investment for pr overall trust and confidence in the organization is increased.

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What does good governance do it creates sustainable value, value that sustains over a period of time. It puts in place some ways of achieving the firms goals, it helps increase the satisfaction of stakeholders, it helps efficient and effective management, it helps with increasing credibility people start trusting the organization more. It ensures efficient risk management you have a structure and place you take risk, but then the effects of that risk are again you would able to deal with them because you have a structure and place to deal with these the actions that the activities that you undertake.

Providing an early warning system against all risk, ensuring a responsive and accountable corporation describing the role of a firms units developing control and internal auditing things are opened to scrutiny, transference is their you can go back and check what you did and what it resulted in and whether things can be changed in future.

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Keeping a balance between economic and social benefit ensuring efficient use of resources controlling performance, distributing responsibility fairly you trying to ensure that peoples interest are being looked after.

So, the responsibility is shared equitable. So, producing all necessary information for stakeholders, so that they know what they are getting themselves into what their connection where do the organization holds. Keeping the board independent from management. Facilitating sustainable performance, now this, all this happens because of good governance.

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Benefits of good governance it increases the firms market value. It increases the firms rating, it increases the competitive power, it is likely to help with attracting new investors because people start believing in the organization.

So it is likely to attract new investors, share holders and more equity. Higher credibility, higher trust in the organization, it enhances flexible borrowing conditions or facilities from financial institutions, transference is there people can go back and check what was happening. So, the borrowing power increases decreasing credit interest, interest rate and cost of capital, new investment opportunities come up, attracting better personnel or better employees and reaching new markets.

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Now, good corporate governance is likely to be influenced or corporate governance in general is likely to be influenced by the following one is politics.

Politics when influence the policies of the government, the pressure the external pressures on the organization, what the company is dealing with the external in management, economics will influence the organization management both internal and external, accounting within the organization, ethics the ethical standards and values that the organization follows or holds their and the values followed by the or the value system of the employees will affect the way the organization is governed or run and the law, the legal requirements that the organization has to adhere to.

So, these you know it. So, all of these factors will influence how these systems are created and how these structures are put in place and that is all we have time for in this lecture. We will continue with some more discussion on corporate governance in the next class.

Thank you very much for listening.