Business Law for Managers
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Module-2: Corporate Governance

Lecture – 7
Effect of Corporate Governance

Good evening. We are starting now, model 2, lecture 7, effect of corporate governance.

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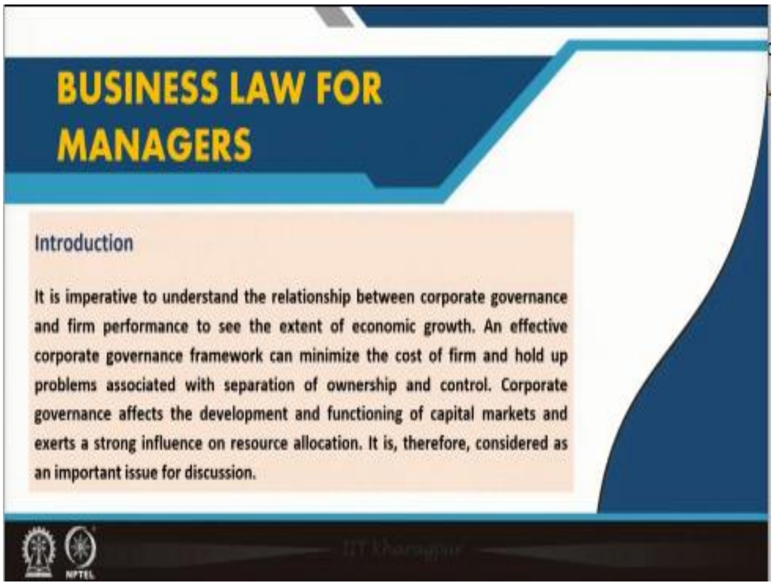

Corporate governance effect: if I have to put in a nutshell as far reaching, we can think of as a corporate, which adds value to the GDP of our country. Right? We have 7000 listed companies, I am talking of listed companies, because these are the big companies. These big companies actually shapes up the economy, their performance or the parameters of our economic performance includes BSE as well, of course. So, these BSEs are listed today.

So, all these companies adapt to the GDP, if you see the financial results of the corporate, which comes out every quarter now that will determine the performance of the economy. So, if these companies governed well and they Utilise the resources well, they take into consideration the interests of the stakeholders, the balance the interest and they are not guided by greed.

They are not guided by interest of only one particular stakeholder, the majority shareholder. And the disciplined, they are looking into the parameters of E, S and G, environment, societal and governance. They are following triple bottom line concept. The effect is for everyone to be felt; for every citizen to be felt; every citizen of every country will feel the impact of the effect of corporate governance such as its strength.

It is almost like the governance of the government. If a corporate governance is successful, then I think the government is also largely successful. And what can be the other effect, the negative? A negative effect of a big corporate, there is a failure of corporate governance of a big corporate, listed corporate having exposure in the books to the financial institutional holders. All of them have large exposures holding 10%, 15%, 20%.

Is the failure of a large corporate? In India, that will have a ripple effect, far reaching effect, on the entire investor community or the FDI inflows of the investment opportunities in India. And of course, finally, it will impact the government and the GDP as well. So, both sides are there, the positive and the negative; the magnitude one can make out that is corporate governance.

I mean, anything that is done in a corporate has to be aligned to that. Any decision has to be aligned to that. The question has to be asked; is it for the wider good? Is it for the good of all? Is it inclusive in nature? Are we being partial towards the majority shareholder? Every decision that we take; every action that we take at the highest level at the level of the board, corporate governance is always top driven.

If you see corruption at the highest level, it will percolate down to the lowest level for sure. An employee senior employee sees his boss meeting vendors separately, not meeting him outside the office. Obviously, the corporate governance of the company is questionable. Corporate governance speaks in an organisation as you enter the organization. It is something which is very much visible in the culture. It is the culture.

It is the corporate culture. If one has to stop speak of corporate governance, one has to see how the board is functioning. One is to see how the top management is functioning. Many times, big corporates ask corporate governance experts to do a random study of the corporate culture, corporate governance culture in the organisation and they come out with brilliant suggestions which the corporate has never thought of.

There is a huge rift at the top level; top management below the managing director, they are not even in talking terms. No one is aware of business goals as usual. Profits are recorded quarter on quarter. But that is not healthy corporate governance. Any time, it can fall like a pack of cards that is also a kind of culture in an organization.

Various HRs admins, I mean, stalwarts are doing a lot of, you know, practices they are bringing out, consultants are being able to practice a lot of methods, how to ascertain the corporate governance that is driving the organisation how to calculate the corporate governance in a scale of 1 to 10? What will be the benchmarks? What will be the calculations done parameters to be taken into consideration?

The independent directors' interviews are being taken separately. They are asked about the organisation, their induction, their ability that not only whether they are given the scope to speak in the board meetings, whether they are being heard in the board meetings, whether they are contributing in the board meeting. Statutory audits are questioned. What kind of support they get from the finance and the other members of the top management while going for audit.

Are they given any enough time to audit the books? Internal Audit if it is done by the internal people or outside people, they are also met to find out the parameters of corporate governance, employs random. Vendors, they are interviewed; customers they are interviewed. A 360-degree survey is done to find out that impact of corporate governance in an organization.

Case studies have shown that these are extremely good parameters to find out early signals of damages which may come in in course of time. It does not happen overnight. But signals are given and the signals are to be read. It is definitely a culture of an organization.

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There is a framework financial institution to play a role. We will see to it; board of directors are the champions of corporate governance. market mechanism has a role. Institutional investments have some role and inside or outside the system of corporate governance is prevalent. Internal stakeholders, the employees, they also are randomly asked questions on practices.

There is an organisation which used to promote people based on letters of resignation. The employees came out with those suggestions; the whistle blowers are not encouraged in other organisation whoever used to blow his whistle was worried that he might get a notice. All these came out to the interviews of the random interviews of the employees of the organization.

Exit interviews are extremely good mechanism to find out these are all inside, outside a system of corporate governance measurement. Exit interviews give fantastic insights into the early signals of corporate governance failure. So, if the mindset is there, the drive is there, then corporate governance can be determined. It is not something which cannot be determined.

We have no idea that corporate governance how failed. There must be; there is so many ways out to ascertain it. Exports are there in this and it has to be done continuously. It is not that I do it corporate governance study once and then do it after 5 years. 5 years is enough for damage. Every 2 years, 3 years, it is to be done if not on an annual basis. Banks financial institutions are good informers of corporate governance.

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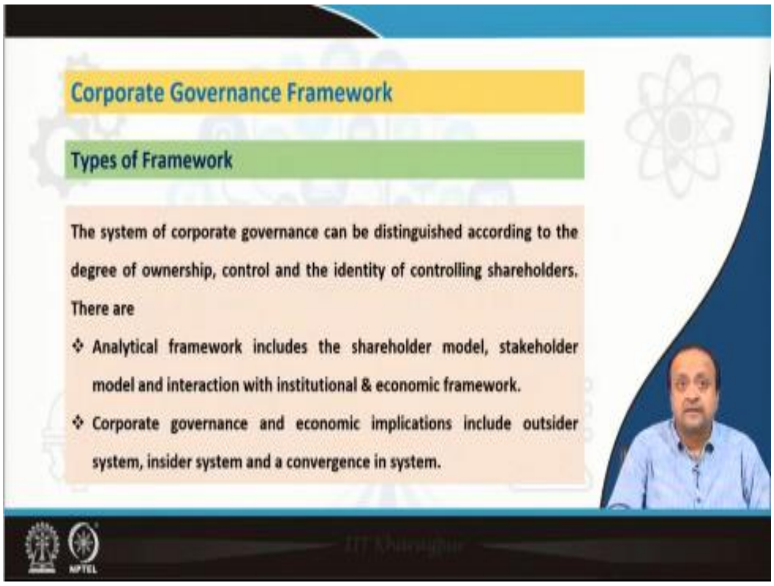

Analytical framework, shareholder model: all types of shareholders, institutional shareholders, majority shareholders, multi shareholders, large retail investors, they are extremely good source of information. Not large majority shareholders, I am talking of, large retail shareholders. Retail means, small shareholders holding large chunk of shares, maybe one single shareholder.

If I want to get the top 10, top 1000 shareholders or top 500 shareholders of a company, the registrar will give me in just 5 minutes who are my top 500 shareholders, then I tell him give me the top 10 shareholders for holding more than 10,000 shares individually. One can find out a particular group of shareholders or maybe 2 or 5 of them are holding almost 25, 50, 30,000 shares which is a huge share for a single shareholder.

And he has been picking up or he has been holding or he has been disposing what was his transaction in the last 3 years. Then you can speak to him directly and find out what is his views on the company. Why is he selling or why is he buying? Or why is he holding off either of the 3 would happen? Either he is selling or is buying or is holding on, what is the reason for that? They are extremely good sources of information.

Stakeholders definitely all stakeholders, government comes out openly. Banks comes out openly; vendors, extremely good sources of information. Customers also very, so, as to be seen that the customers are all not interviewed by a person whom they know, otherwise will not open up. They have to interview, the policy, because they also know that are we meeting the gentleman?

How can I say bad about him? To know bad, no good in general, then very interesting models and methods of ascertaining corporate governance, the framework of corporate governance in an organisation.

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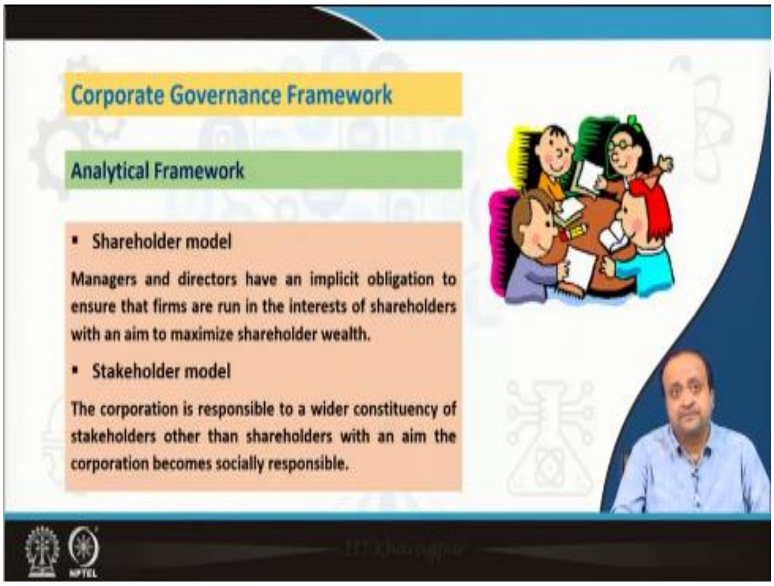

We have discussed about shareholder modelling, stakeholder modelling.

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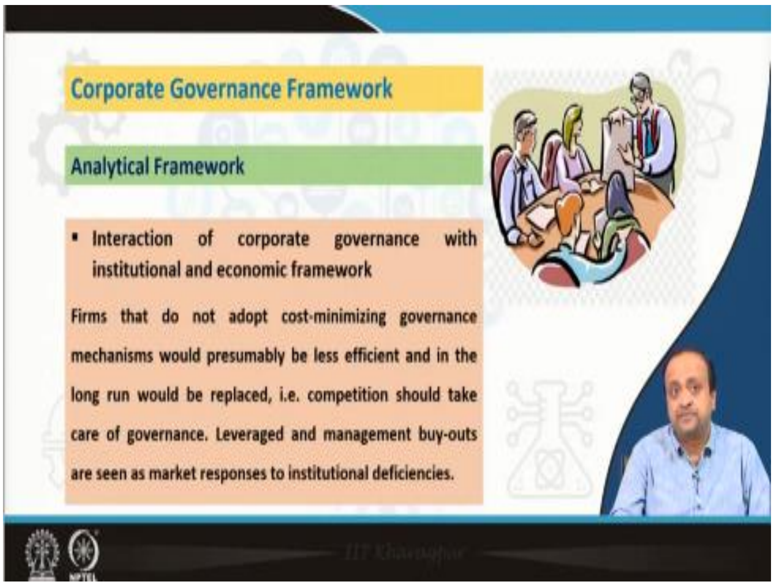

Institutional framework: interaction, there is a strong body which is called IAAS, institutional advisory institutional advisory services, institutional investor advisory services IIAS. They are actually voicing the interest of the minority shareholders. Every time, a resolution is proposed by a listed entity invariably.

Any resolution, any decision that you are taking, which requires shareholder approval has to go to the shareholders along with that has to be put in the company’s website as well as in the stock exchange. So, that the entire public comes to know not only the existing shareholders, the future shareholders also comes to know that I am going to invest in this company, this company is going to do this now.

Shall I invest in that company? Or shall I not? Now, the institutional investors, you do not have to ask them. They will come on their own with the recommendation that you have passed a resolution for such and such expansion or acquisition. We are not in agreement. These are the reasons for that or we are in agreement extremely good decision we support this, either way.

Now, this kind of recommendation by the institutional investor advisory services, SEBI has mandated the institution advisors to please consider these advisory services recommendations before taking a decision. So, all institutional investors when the corporates approached them for support, corporate obviously would approach them that we are coming out with this resolution kindly support us, there is no harm in asking the institutional investors, the institutional investors then say, well, we are appreciative of your efforts.

However, we are guided by IIAS. If they recommend no, then we cannot support this resolution. Therefore, the corporates now cannot go to IIAS because IIAS is guided by SEBI. SEBI has clearly stated IIAS that if we find later on that any decision that you have taken backfires and it is investigated and found out that you are partitioned towards that company. Then your entire job will be blacklisted. So, they are afraid.

Even if they have the mindset, they cannot do that. And actually, it is happening. They are not asking the corporates, they are coming out with their recommendations and saying that for, for or against, against with a line, of course at the end that if you are not in agreement with your views, they are writing the corporates, please provide evidence for that. And there are corporates which have given evidence to them, they have not accepted that.

They have clearly stated no; this is not the reason; we cannot accept it. And there are very few cases where they have modified their opinion also. So, institutional framework is very important for corporate governance and more and more such come whenever a corporate comes out with a resolution before that, they do approach the institutional investors that we are coming out with this, would you support. The question and the answer is the same.

The question is would you support; the answer is the same, we would; in fact, we are going to support. We find this extremely good proposal, but if for any reason, the institutional advisory services, investor advisory services says no in the recommendation, then we are guided by SEBI to follow that. So, you please ensure that the recommendation that comes you comply with them, because IIAS gives some recommendation like in many companies' cases.

They have given the recommendation. it was on the appointment of a managing director with their increase in remunerations, recent case of a company and it is published, everybody knows the name of the company. However, for confidentiality or not really code of conduct, I do not want to take name of any company. I am just giving the example X company. X company came out with a resolution for appointment of its managing director along with the increase in remuneration, fair enough.

The company has done reasonably well. So, there is an expectation of increasing remuneration like all employees. What was the recommendation of the institution advisory services? I follow this, vividly this is my subject. Now, when I went through it, I found very interesting. They say yes, we appreciate and approve the appointment. However, the increase in remuneration, we do not have to approve and hence, we reject the resolution.

With a recommendation, please bring out a resolution only for appointment without any increase in remuneration, we favour the resolution. I do not know what the company will do, but this is the recommendation. And the reason they are given a like this, we are not appreciating the increase in remuneration for number 1, the reason is that this remuneration is high compared to others in the industry of this nature of business, of this magnitude of business, of this turnover of business, what the CEOs or managing directors are getting, number 1.

Number 2, your remuneration that you have given is not linked to the performance. It is a fixed remuneration. So, the remuneration of the MD will be linked to the performance of the company, think the way they are thinking that is the reason we are not. So, this is the kind of control mechanism which is working now on corporate governance. Never thought of 3 years back, even 3 years back that is why my view is very clear that we are going very good on corporate governance.

As a whole, the direction is absolutely good. The speed has also picked up. Now, it is to be seen how Indian corporate response to this.

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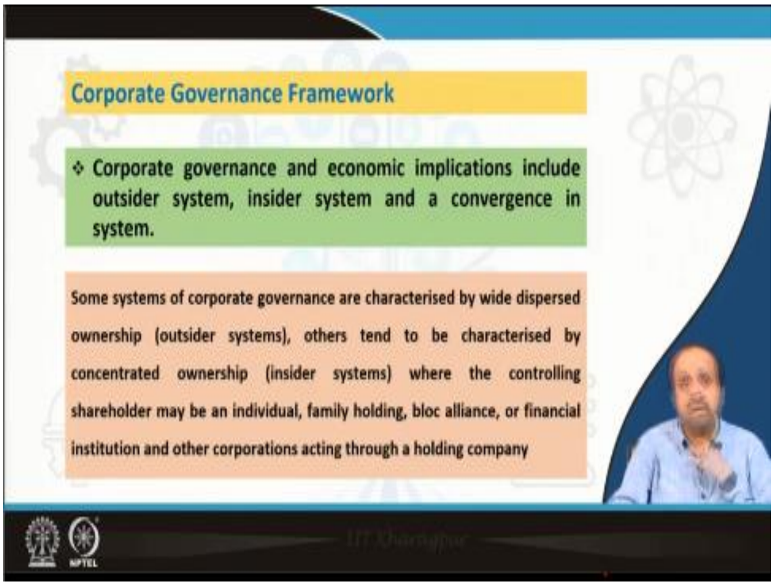

Ownership: outside the systems, inside the systems where controlling **(()) (19:01)**, maybe an individual family or financial institution, other corporation, these are all holding systems, how it holds shares, can be majority inside, can be through companies, where the majority shareholder individually is not coming out. The names are not coming out. This is a peculiar system in India.

Do not find in other companies, Indian corporates therefore when go abroad for investments, for any business transaction, they asked one question permanently, what is the beneficial holding? Who is the beneficial owner? It is very difficult for Indian corporate to find out the name of the beneficial owner. This is one thing I think which SEBI is going to dilute very surely.

SEBI has taken some steps, but it is still not the last step, the last step is still coming where the beneficiary holding name has to be disclosed in the stock exchange site. We are now having holdings of outside and inside the systems. It will not work any further, maybe in a year or had COVID not happened **(()) (20:16)** happen by that time. COVID has put everything back for 2 years.

Compliance has taken a backseat now. It is question of survival now. First to survive, then to comply I mean, compliance is definitely required, but survival is more important right now. But it is definitely going to be a something coming because already 2 or 3 steps have been taken, where SEBI has asked to disclose the beneficial owner to them, not to the stock exchange. Now, it will go to the stocking directly on a permanent basis.

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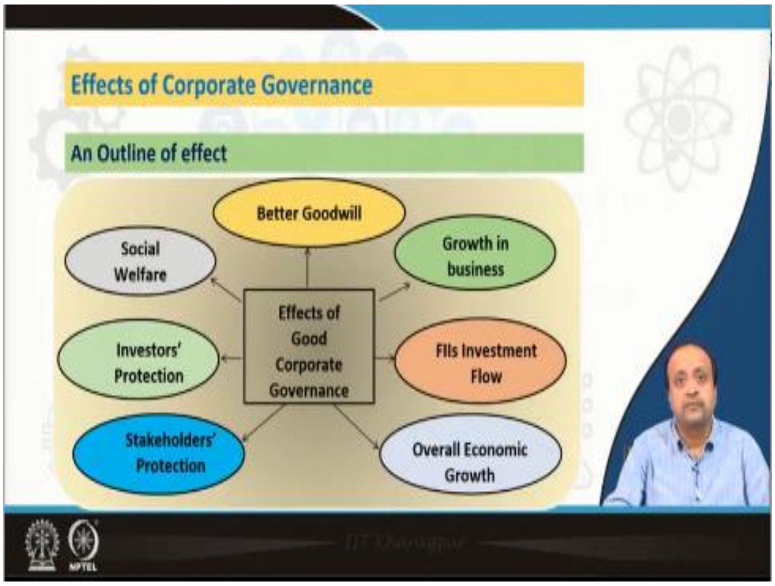

And of course, some leeway has been given where it is held by an NBFC. You do not have to give anything beyond the NBFC. All those shields are going to go away. Of course, corporate governance I have seen for myself, good corporate governance helps a lot way in retention of employees. It might look as; it might sound as a little bit myth, but it is not a myth it is a reality.

Companies with good corporate governance can retain employees with lesser salary. It is a fact. Wherein employee has clear mind and eye and line of sight that good performance of his will be recognised, if he can perform, no amount of influence, no amount of you know favour is required for that. Even a lesser salary, he will work in that organisation rather go to an organisation with higher salary, where nepotism works. It is true for everyone.

Similarly, an organisation which takes care of our employees, when in need obviously, would be somebody who sought for then an organisation which says you have to survive always on your own perform or perish. Not for a moment I am saying performance is not the aesthetic, performance is the aesthetic everywhere. But is it Performance plus something or only performance? That is what is important.

So, effective corporate governance, better goodwill, better branding, better retention, better market cap better pipe inflows and of course, social values.

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Auditor has also same way. There has been a case at least, I think from December 9, from March 19 to just before COVID February 20, a little before that, if one sees the number of statutory auditors who have resigned from corporates, number of statutory auditors and all of them coming under big 4, many of the big 4 have resigned giving reasons for loads of work or something on the other from corporates. Because they have also understood that as temporary auditors, they also have a moral responsibility for corporate governance.

They cannot afford to just write the word to the best of my knowledge and belief. And only gives, this is true and fair view; they cannot wash their hands off by saying I have been provided with this information, I have restricted my audit to this information. Knowing fully well, whatever I provided, there are areas which required me to do a deep diving, I have not done. I have done a test check only that is very clear now.

You have to take responsibility. You have been given a protection by the law. Law is; you are appointed now for a number of years, not on a regular basis. Earlier, it was hired on hour basis. So, your appointment, your job was at the mercy of the shareholders again that 40, 60; 60 shareholders 60% of the shares held by one shareholder, 40% of the shares are held by 40 shareholders.

So, majority shareholders actually deciding whether the auditors will remain or not. That concept actually made the auditors appointment in the hands of the majority shareholders. So, they were in one way you know employees within the bracket of the majority shareholder, this has been detached. They have said, they have been told categorically that he will continue once appointed for a certain number of years, 5 years and then cooling off period, then again, 5 years.

Now, what the auditors have done is that they have taken this in the right space, they said nothing doing. Wherever we find we are not comfortable, the management is not providing adequate information. In spite of our repeated disclosures that this is required, the management is not disclosing, better let is resign from the corporates. So, they have to resign. So, corporate governance also depends on a large scale on the efficacy of the statutory auditors and how independent they are.

Again, that is what I feel the word independence should come again. Here, are the statutory auditors truly independent? Are the independent directors truly independent? These are the 2 questions which if or as strong as that corporate governance will always fly in high colors and it will always be a success story for that company.

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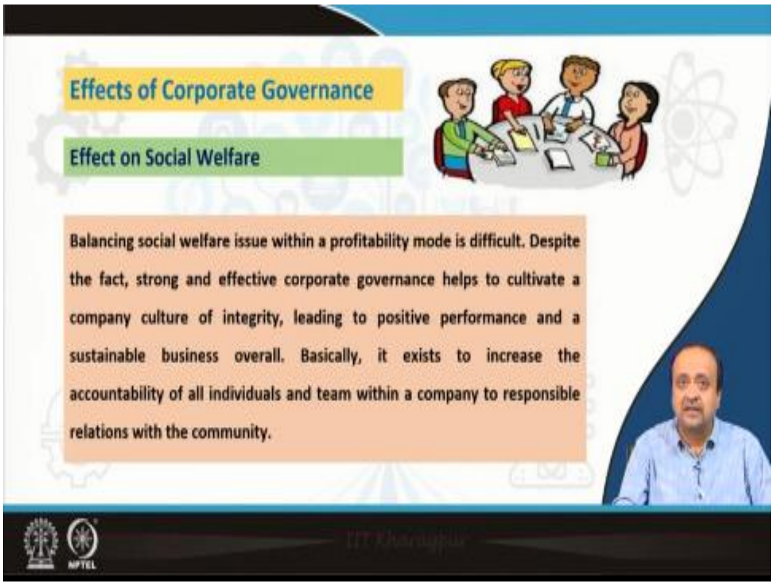

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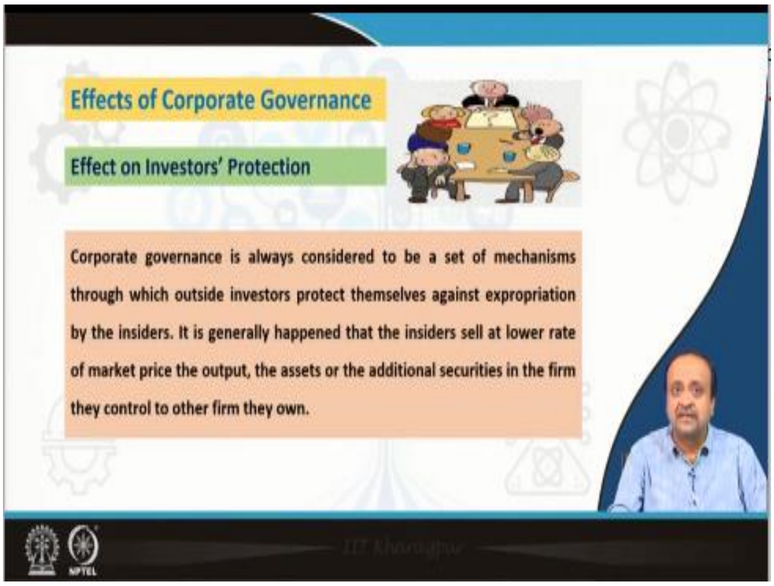

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Goodwill for sure. Branding for sure. Investor Protection, social welfare, we have discussed stakeholders' prediction, overall economic growth, it goes to the GDP.

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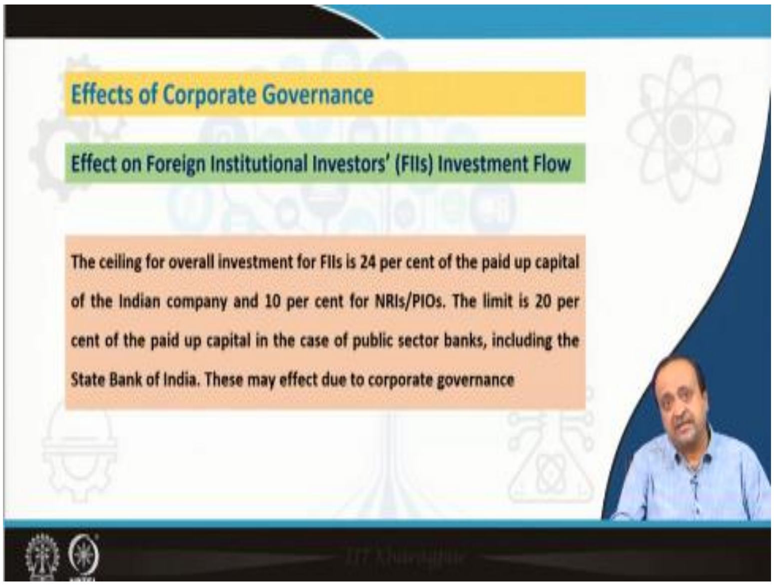

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Disclosure in annual reports, quality of corporate reporting, adequacy processes, involvement of managers in corporate governance activities, board and corporate ethics. Ethics is another thing, which is something which is beyond law. Example, many corporates have board of directors who do not even look at the shares of the companies, **(()) (27:08)** stopped buying shares of companies.

Any data can buy the shares of that company, when the trading window is not closed. The time when trading window is closed that means when financial results are to be disclosed, that time, you cannot buy the shares. Otherwise, you can buy the shares. But there are corporates whose ethics are so high that their board of directors never buy the shares of the company because they feel somehow the other, they are private to some information, which that information does not have in the public domain.

So, it is better to shy away to do away with those companies. I mean, shares of the companies, not only that they are also do away with the shares of the group companies means associate companies one step further. They will not buy and sell the shares of the company in which their directors though, a lot of law does not stop even not the independent directors, right.

Law does it stop them, only they need to disclose that is it. But they do not want to buy and sell the shares for better good, for wider good, not only of that company, but also the associate companies. That is what I call ethics. Ethics is beyond law. A law might require X; ethics is X plus 1, 2, 3. Whatever you think is best, so that there is not even a nudge, an iota of evidence of conflict. Independent directors, directors, ethics, whenever they come to know there is a conflict of interest, which the company will never come to know.

If for example, an employee joins an independent and knows that employee his relation of him, even a distant relation, law defines only near relationship, does not define the distant relationship. The independent director discloses that this gentleman is known to me, so anything to do with him on any information relating him should not be shared with me number 1.

Number 2, if the board feels that is for this, I need to step down, I am ready to step down, left do the decision of the board, because why the young man should join, I mean, why the young man should resign. He has done nothing wrong. He has joined about company on merits, but he has a conflict of interest and discloses. Similarly, taking a loan from a bank or taking appointing somebody a consultant, he might say that we have worked with him in the past.

Law form: a partner of a law form joining a company the moment he says that this law form, he doing business with him, he has to disclose that well, my form is doing business with you and the amount of business is quite high. So, I do not want to be a part of the board. So, these are all ethical practices, which law is not bothering you, but your own value system is stopping you from continuing in the board.

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Various references that I have taken, in fact, some of the articles I have also written in Taxman on his corporate governance a myth or reality. My article is also there on how independent other independent directors if you want to find out from Taxman publications, I think it is possible that you can get this. From there, at least 4 to 5 articles is published in Taxman on the subject of corporate governance, independent directors, which I have not mentioned here.

But it is very much there, from which I have, of course, developed my presentation, but I always say mostly it is from my understanding and it is from my experience that I have gathered that I prepare this and share with you all. Being in this profession for so many years and looking into all these aspects, I do not look into books for this kind of presentation which is more of my experience that I share. Thank you so much.Thank you.

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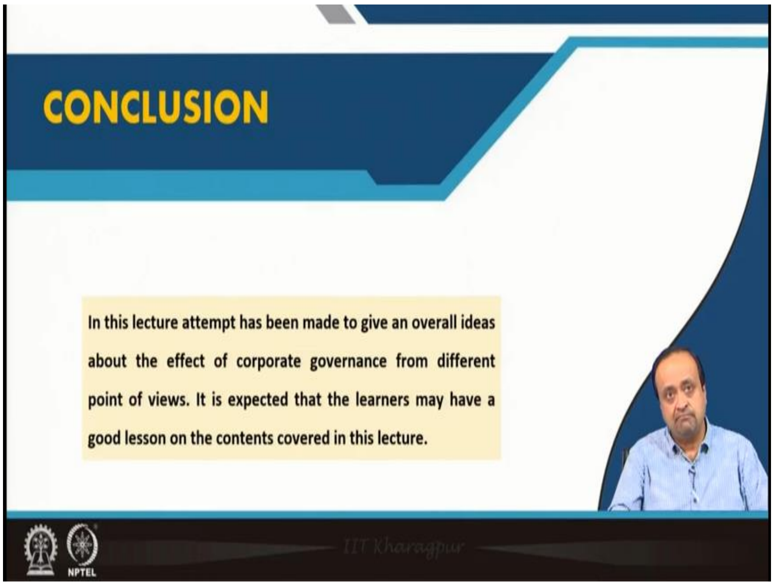
CONCLUSION
In this lecture attempt has been made to give an overall ideas about the effect of corporate governance from different point of views. It is expected that the learners may have a good lesson on the contents covered in this lecture.
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