Strategic Management for Competitive Advantage
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Lecture-44
Corporate Governance Code

Welcome to the course Strategic Management for Competitive Advantage.

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In this lecture, we will be talking about Corporate Governance Code.

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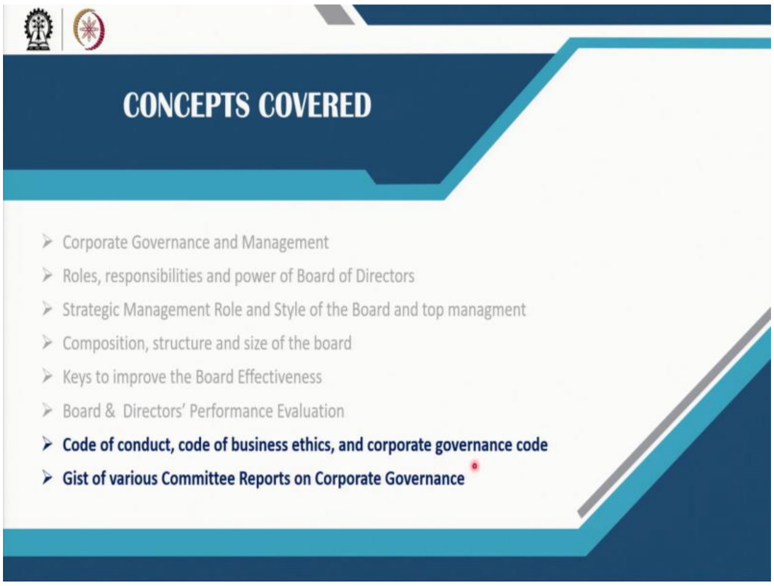

Corporate Governance Code, in this module, we have covered all these light-coloured topics. Now we will discuss the Code of Conduct, business ethics and corporate governance code.

Also, we will discuss the gist of various committee reports on corporate governance. This will be very helpful to you. Let us start.

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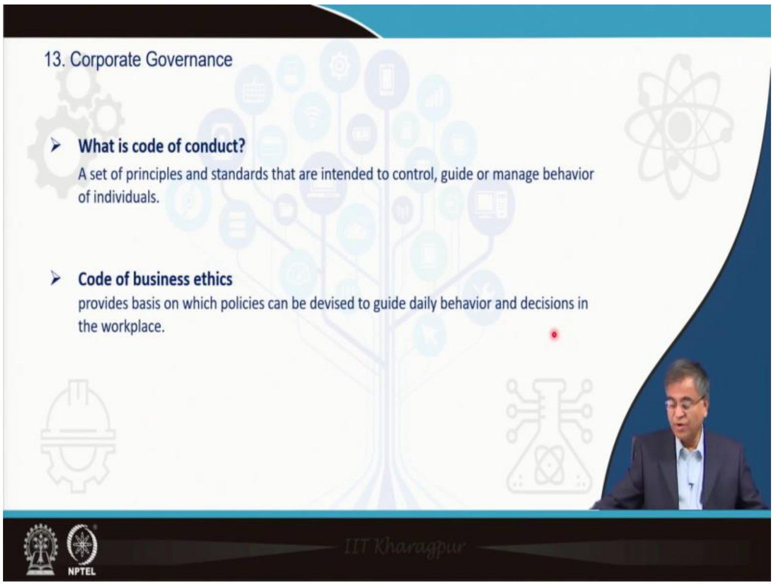

Now, first, you answer, what is the code of conduct? What do you mean by code of conduct? A code of conduct is a set of principles and standards intended to control, guide or manage the behaviour of individuals. So, all of us are familiar with it. So next, we will be talking about the code of business ethics. What is meant by a code of business ethics? It provides a basis for policies to guide daily behaviour and decisions in the workplace. This is a code of business ethics.

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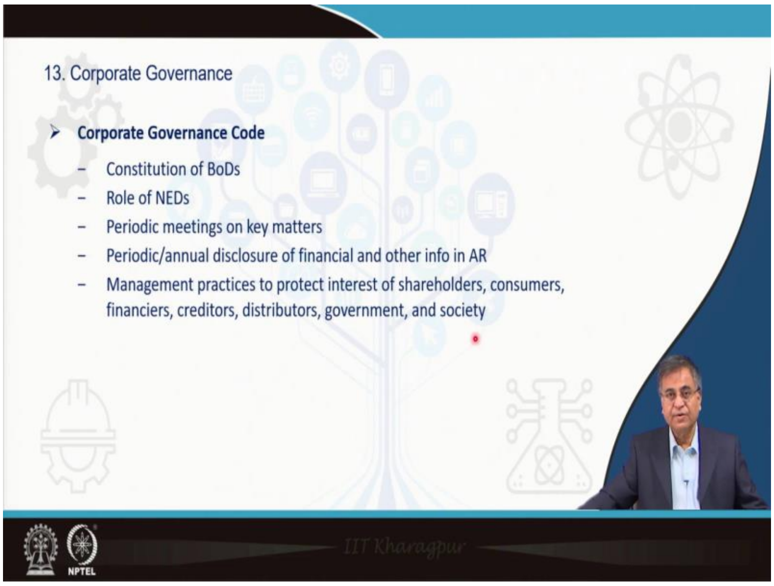

Then we will be talking about the corporate governance code. What does this corporate governance code include? So, we have discussed many things about corporate governance in the last four sessions. So, corporate governance code, and you have a glimpse of it. So, to put it in one space, the corporate governance code deals with the constitution of BoDs, which is the compositions and structures and all.

Then what should be the role of non-executive directors? We have talked about it. This also comes under the corporate governance code. Then periodic meetings on key matters. The meeting should be held in what frequencies and all we have to that it also deals with that, then periodic or annual disclosure of financial and other information in the annual report or the periodic report, say quarterly reports and all.

So, annual disclosures, like, you know, remuneration to the directors and all those are nowadays part of it. So, these are the corporate governance code. Then management practices to protect the interest of shareholders, consumers, financiers, creditors, distributors, government, and society. These are what are the practices followed by the management? So, these corporate governance codes are important from an organization's point of view.

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Now there are, coming to the, for this, you know, previously said 30, 40 years back, it was not that, you know, corporate governance code and all were not very, was it used to be the voluntarily, the organizations follow it or not. Still, nowadays, it is mandatory because many, you know, corporate governance say that the government said, like, corporate governance issues came up, as you have, must have heard about the Enron case, it was a corporate governance failure. The company went bust along with that, even the Anderson consulting and all that burst.

So, there are in the home also, and you must have seen Satyam computers and all those corporate governance issues. Those have defaulted. So, there are many other examples that the world was aware of and became very vigilant about. And the corporate governance committees were formed to have the reports and all, and there are some reports we will be discussing now. What are those reports about, and what does it deal with that corporate governance will discuss?

One is the Cadbury committee report. It is one of the earliest reports. This Cadbury committee was in Britain. This committee was formed by London's stock exchange, financial wing, and financial reporting. They formed this in May 1991. This committee was formed. The committee gave their report in December 1992. And this was implemented in July 1993.

And what is this report? This report deals with what should be, and there are many aspects. So four main elements should be the role and remunerations and all of the non-executive directors, the financial reporting systems of the organizations and many other things.

So, why the Cadbury committee was formed in the 1990s and early 1990s, though in London that stock exchange and non-financial institutes believed that London is a major centre for trade businesses and stock exchanges, keep their activities transparent and prevent any likely damage that might occur?

So, there should be some discipline in the financial reporting, those financial reporting disciplining, and all they have given the scope. And all this committee will look for and the committee will present their report. And when this was implemented in 1993, July, that says London, companies which are listed on the London stock exchange and are registered in Britain or UK, had to comply with all those obligations which been entrusted, which has been given in those reports and which has been enacted by the London stock exchange.

They have to comply with those. And if there is no noncompliance, they have to give the reasons for that noncompliance within a stipulated timeframe, and after that, they have to comply. So that is the Cadbury committee report for corporate governance that we will be talking more about close to it. Then CII committee report this is the Confederation of Indian Industry. This committee was formed voluntarily by the CII to look at the corporate governance issues in Indian organizations.

And this committee formed that the head as chairman of this committee was Mr Raul Bajaj, the then CEO and CMD of Bajaj Auto. And he was also the past president of the CII. And they gave there it was formed in 1996, and it submitted its report. And those reports we will be talking about. Then there are other reports: the Kumar Mangalam Birla Committee report, the Narayan Murthy Committee report, the Naresh Chandra Committee report, and many others. We will be going through the gist or the takeaways from this report. We will be discussing this now. So, you got the background of this report.

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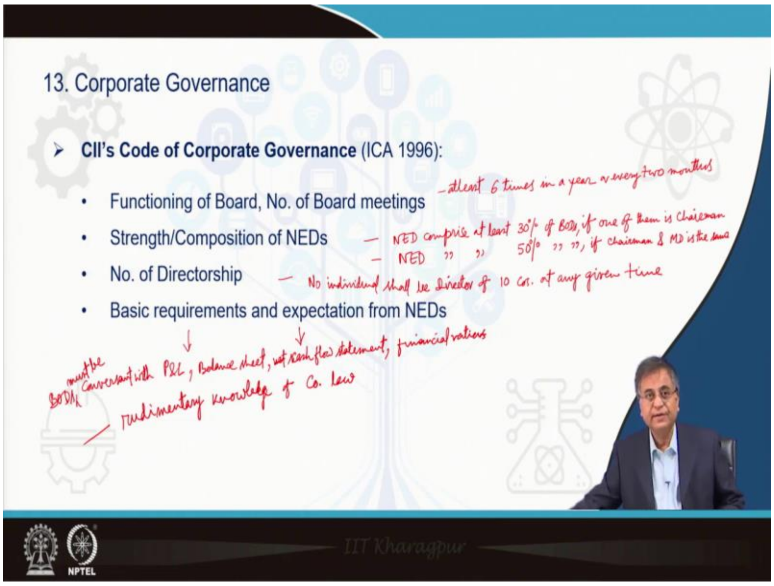

So, let us see what the Salient points of the CII's corporate governance code are; the Indian companies act, which was formed by the Indian company affairs in 1996, as I already described, the formation of the committee. So, let us see the gist of the takeaways from these reports. These reports talk about the functioning of the board and how the effective functioning of the board should take place.

And in this, they have also informed that, for the effective functioning of the board, they specify the number of board meetings; they say the number of board meetings should be at least six times a year, every two months or every two months. Then they talk about the strength and compositions of non-executive directors. That non-executive director also talks about. So, what does it say? It says non-executive directors comprise NED and at least 30 per cent of the board. 30 per cent of BODs if one of them is chairman.

And it also says that NED comprises NED comprise at least 50 per cent of BODs if the chairman and managing director of the chairman and MD are the same. So, it's NED, and it should be at least 50 per cent if the chairman and MD are the same. Then it talks about the number of directorships. So, what does it say that no individual should be a director that we already have? No individual shall be the director or the director of 10 companies at any given time.

So, these were the basic requirements and expectations. These also tell the basic requirements and the expectations from NEDs, what are the basic requirements that these board of directors should be, should be conversant or literate with profit and loss accounts, balance sheets, financial, say, net cash flow, cash flow statement, not net, cash flow statement, financial ratios, financial ratios must be conversant with BODs must be conversant with profit and loss account, balance sheet. Then cash flow statement, then financial ratios and all.

And also another thing is they must have a rudimentary knowledge of company law. So, these are the basic requirement and expectations from the non-executive directors. So, these are the major gist of the findings of these confederations of the Indian industry code of corporate governance. And most of these have been enacted in the company's next act, the CIIs code.

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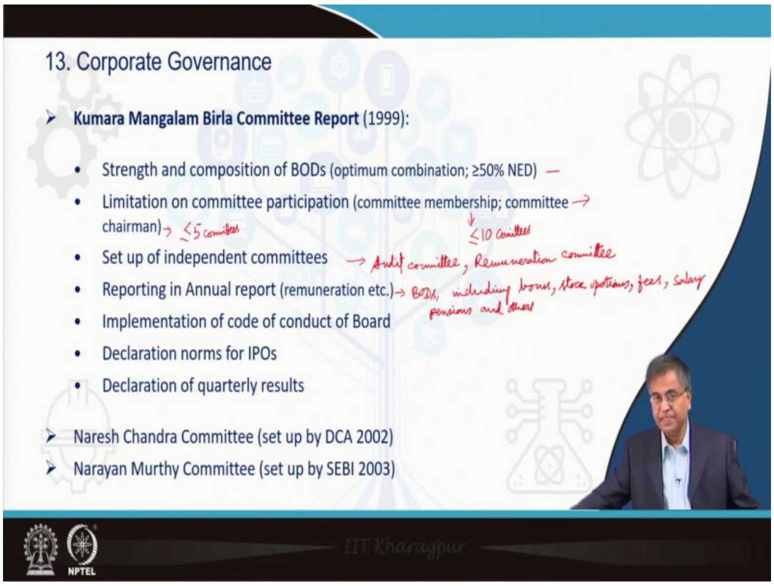

Next is the Kumar Mangalam Birla committee report. SEBI formed this Kumar Mangalam Birla committee, stock exchange board of India, in 1999, and the scope was given to have the corporate, the best practices and corporate governance. And also the IPO to curb insider trading and also the, to see transparency in corporate financial reporting.

So, these were the scopes given. So, what was the board deliberating, and the gist of their recommendations are being presented to you? This talks about the strength and composition of the board of directors. They impress on the compositions of the board of directors, which should have optimum combinations between the executive and non-executive directors.

And they say that under no circumstances should non-executive directors always be the half 50 per cent, more than 50 per cent of the strength of the board of directors. And this is the same as, if they their recommendation that has been taken in the SEBI that we, I have already in previous lectures had told, you know, if the chairman is an executive chairman, then the non-executive director should be at least 50 per cent. If the chairman is a, if the chairman is an executive director, then the non-executive directors' strength will be at least 50 per cent.

If the chairman is an executive chairman, then in that case, that it will be the non-executive directors' strength will be 30 per cent of that. These are their recommendations. Then they also talk about the limitation on committee participation, such as the committee memberships and chairman participation. This also, I have discussed in the previous lecture, which is enacted in India, the companies act, and thus SEBI regulation committee membership should be what committee membership should be limited to not less than equal to 10 committees.

And committee chairman should be less than or less than equal to five committees. This, we have already discussed it. Suppose they have a company's activities and all SEBI rules. They have, this was their recommendation, and it was accepted subsequently. Then they also talk about setting up independent companies. Like they say, independent companies, the audit committee, the audit committee, the remunerations committee.

It was so, setting up of that previously, before that it was not there. So, though recommended this. Then they also recommended reporting annual reports. And in the annual report, what is the reporting of the remuneration of the director's remuneration of the board of directors, including that remuneration includes what, including bonus, stock options, fees, salary, pensions, and others? Everything had to be presented before that, and it was not there.

So, it has been accepted now; you will find in the BODs that financial gains and all is nowadays is part of the annual report and then implementation of the code of conduct or board. It also has advocated that, and they have given details on how to do that. And all, they have also discussed the declaration norms for IPOs in those times, you know, 97, 98, there was some scam that IPO scam hit the Indian market and all that is well known if you go back and search the literature or the net and all you will find.

So, they have declared stringent norms for initial public offerings of the stock. This was one of the main scopes given to this committee. So, they have incorporated that they have recommended this and declarations of quarterly results. Nowadays, you will find the SEBIs and all that quarterly reports, and you have to every organization you have to submit; previously, it was only an annual report.

So, this has also been accepted and incorporated in the SEBI regulations and declarations of the quarterly reports. So, these are some of the salient points of the outcome of this Kumar Mangalam Birla report. Similarly, there was a department of company affairs, and they formed another Naresh Chandra committee to set up the corporate; it was set up in 2002 to look after the corporate governance code of the Indian companies and all, then there was Narayan Murthy Committee. It was set up by SEBI in 2003.

So, there are many more committees, and these committees' reports were submitted, which have been subsequently accepted and incorporated in the companies act or the SEBI regulations. So, these are some of the reports.

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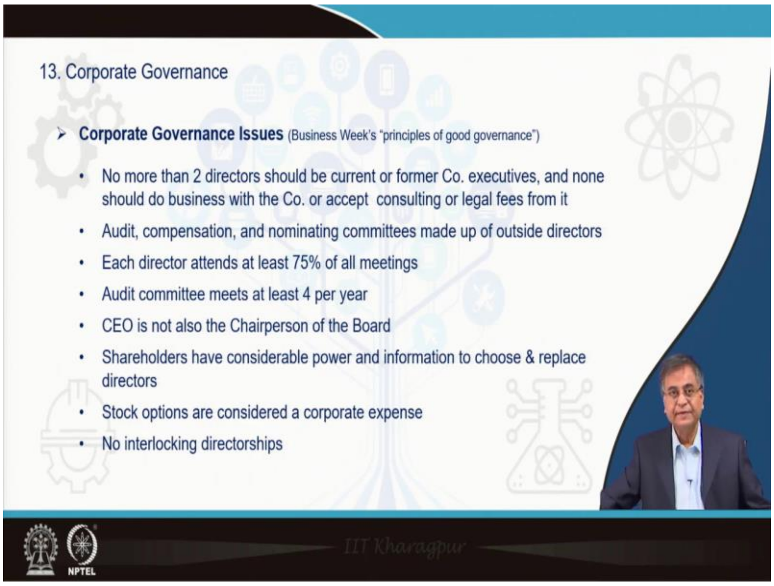

Now, I, this is the, I will show you sub corporate governance issues. The business came out in business week principles of good governance in that they had recommended a few suggestions. I am just showing you the, for your knowledge, some gist of some primary suggestions for this. What are these? Like they say, business week principles of good governance.

They say no more than 2 directors should be current or former company executives. And, none should do business with the company except for consulting or legal fees. Then it further says audit compensation and nominating committees should be made up of outside directors. NEDs, each director must attend at least 75 per cent of all board meetings. If it is less than 75 per cent, do not reappoint them; audit, though it should be mandatory, say there will not be reappointed.

Then it also says the audit committee meets at least four times yearly. Then it further says that the CEO is not also the board's chairperson. That means you take out the role of the positions of CEO and chairperson. These roles should be separated. Otherwise, it will have that. It is not good corporate governance. Then it also says shareholders have considerable power and information to choose and replace the director.

So, empower shareholders with information and power to change even the directors. And it further says stock options are considered a corporate expense. And it also advocates that there should not be any interlocking of directorships. These are some of the corporate governance issues brought out and suggested by the business week. This will give you a broad overview of various corporate governance issues.

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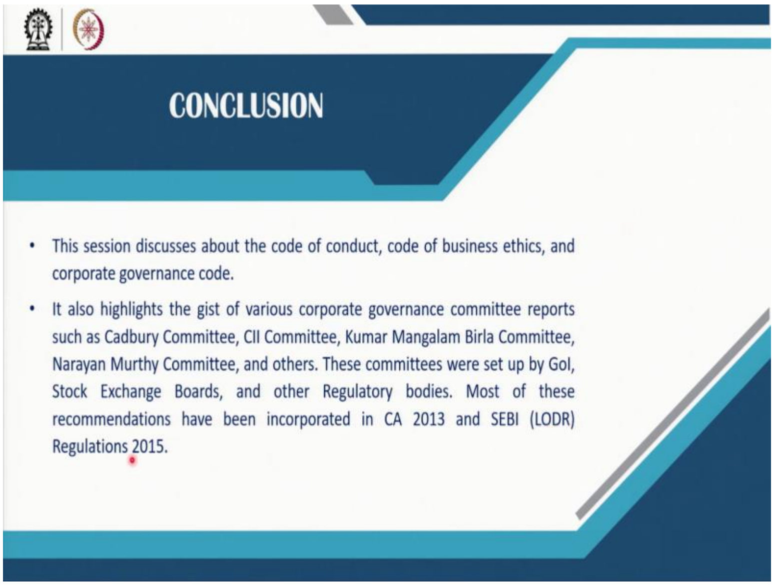

To conclude, we will summarize what we have learned in these sessions. In these sessions, we discussed the code of conduct, business ethics and corporate governance code. We have further discussed or highlighted the gist of various corporate governance committee reports such as Cadbury, CII, and Kumar Mangalam Birla committees.

Then we have seen the Narayan Murthy committee and others. The government of India set up these committees, stock exchange boards and other regulatory bodies like the Cadbury committee was set up by the London stock exchange financial reporting section. Then most of these recommendations have been incorporated in the companies act 2013 and SEBI Listing Obligations and Disclosure Requirements Regulation 2015.

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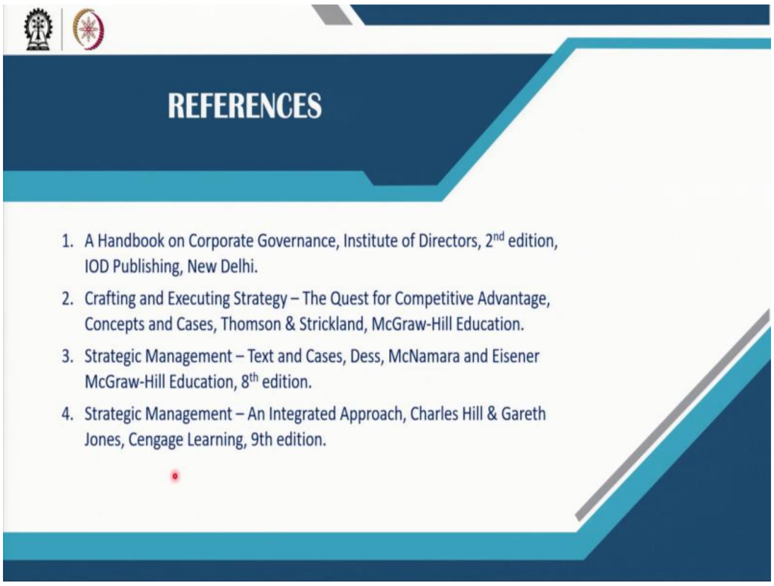

Then there are those reference books you can go through. And these are similar to the other sections in this module same books. And these are, they will be helpful for you. And here we end this, this module of corporate governance. Thank you very much for attending the lecture.