Comments on Corporate Governance

*Shri. Kumar Manglam Birla**

It is almost a truism that the adequacy and the quality of corporate governance shape the growth and the future of any capital market and economy. The concept of corporate governance has been attracting public attention for quite some time in India. The topic is no longer confined to the halls of academia and is increasingly finding acceptance for its relevance and underlying importance in the industry and capital markets. Progressive firms in India have voluntarily put in place systems of good corporate governance. Internationally also, while this topic has been accepted for a long time, the financial crisis in emerging markets has led to renewed discussions and inevitably focused them on the lack of corporate as well as governmental oversight. The same applies to recent high-profile financial reporting failures even among firms in the developed economies. Focus on corporate governance and related issues is an inevitable outcome of a process, which leads firms to increasingly shift to financial markets as the pre-eminent source **for** capital. In the process, more and more people are recognizing that corporate governance is indispensable to effective market discipline. This growing consensus is both an enlightened and a realistic view. In an age where capital flows worldwide, just as quickly as information, a company that does not promote a culture of strong, independent oversight, risks its very stability and future health. As a result, the link between a company's

' Chairman, Committee appointed by SEBI on Corporate Governance
Adapted from the Kumar Manglam Birla Committee Report on Corporate Governance (1999)

management, directors and its financial reporting system has never been more crucial. As the boards provide stewardship of companies, they play a significant role in their efficient functioning.

Studies of firms in India and abroad have shown that markets and investors take notice of well-managed companies, respond positively to them, and reward such companies, with higher valuations. A common feature of such companies is that they have systems in place, which allow sufficient freedom to the boards and management to take decisions towards the progress of their companies and to innovate, while remaining within a framework of effective accountability. In other words they have a system of good corporate governance.

Strong corporate governance is thus indispensable to resilient and vibrant capital markets and is an important instrument of investor protection. It is the blood that fills the veins of transparent corporate disclosure and high-quality accounting practices. It is the muscle that moves a viable and accessible financial reporting structure. Without financial reporting premised on sound, honest numbers, capital markets will collapse upon themselves.

Another important aspect of corporate governance relates to issues of insider trading. It is important that insiders do not use their position of knowledge and access to inside information about the company, *and* take unfair advantage of the resulting information asymmetry. To prevent this from happening, corporates are expected to disseminate the material price sensitive information in a timely and proper manner and also ensure that till such information is made public, insiders abstain from transacting in the securities of the company. The principle should be 'disclose or desist'. This therefore calls for companies to devise an internal procedure for adequate and timely disclosures, reporting requirements, confidentiality norms, code of conduct and specific rules for the conduct of its directors and employees and other insiders. For example, in many countries, there are rules for reporting of transactions by directors and other senior executives of companies, as well as for a report on their holdings, activity in their own shares and net year to year changes to these in the annual report. The rules also cover the dealing in the securities of their companies by the insiders, especially directors and other senior executives, during sensitive reporting seasons. However, the need for such procedures, reporting requirements and rules also goes beyond corporates to other entities in the financial markets such as Stock Exchanges, Intermediaries, Financial institutions. Mutual Funds and concerned professionals who may have access to inside information.

The issue of corporate governance involves besides shareholders, all other stakeholders. Corporate governance has to be looked from the point of view of the stakeholders and in particular that of the shareholders and investors, because they are the *raison de etre* for corporate governance and also the prime constituency of SEBI. The control and reporting functions of boards, the roles of the various committees of the board, the role of management, all assume special significance when viewed from this perspective. The other way of looking at corporate governance is from the contribution that good corporate governance makes to the efficiency of a business enterprise, to the creation of wealth and to the country's economy.

There are several corporate governance structures available in the developed world but there is no. one structure, which can be singled out as being better than the others. There is no "one size fits all" structure for corporate governance.

Corporate governance extends beyond corporate law. Its fundamental objective is not mere fulfilment of the requirements of law but in ensuring commitment of the board in managing the company in a transparent manner for maximising long term shareholder value. The corporate governance has as many votaries as claimants. Effectiveness of corporate governance system cannot merely be legislated by law neither can any system of corporate governance be static. As competition increases, technology pronounces the death of distance and speeds up communication, the environment in which firms operate in India also changes. In this dynamic environment the systems of corporate governance also need to evolve.