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Corporate Governance: A Risk Mitigation Tool

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Corporate governance and economic development are intrinsically linked. Corporate governance is "the system by which companies are directed and controlled". It involves regulatory and market mechanisms, and the roles and relationships between a company‘s management, its board, its shareholders and other stakeholders, and the goals for which the corporation is governed. In contemporary business corporations, the main external stakeholder groups are shareholders, debt-holders, trade creditors, suppliers, customers and communities affected by the corporation's activities. Internal stakeholders are the board of directors, executives, and other employees. Effective corporate governance systems promote the development of strong financial systems- irrespective of whether they are largely bank-based or market-based which, in turn, have an unmistakably positive effect on economic growth and poverty reduction. This paper is an attempt to identify various types of corporate frauds in business. This study also observes the possible remedies and suggests preventive mechanisms to minimize corporate frauds.

Key words: Economic development, regulatory framework, frauds, risks, mechanism.

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Corporate governance is a system of law and sound approaches by which corporations are directed and controlled. These are the policies, procedures and rules governing the relationships between the shareholders, directors and managers in a company, as defined by the applicable laws, the corporate charter, the company’s bylaws, and formal policies. Management board of directors, customers, shareholders, eemployees, regulators and suppliers are the key players in corporate governance. Corporate Governance deals with determining ways to take effective strategic decisions. It gives ultimate authority and complete responsibility to the Board of Directors. In today’s market- oriented economy, the need for corporate governance arises. Also, efficiency as well as globalization are significant factors urging corporate governance. Corporate Governance is essential to develop added value to the stakeholders. Corporate Governance ensures transparency which ensures strong and balanced economic development. This also ensures that the interests of all shareholders (majority as well as minority shareholders) are safeguarded.

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Growing Importance of Corporate Governance in Today's Era

- **Changing Ownership Structure**: In recent years, the ownership structure of companies has changed a lot. Public financial institutions, mutual funds, etc. are the single largest shareholder in most of the large companies. So, they have effective control on the management of the companies. They force the management to use corporate governance. That is, they put pressure on the management to become more efficient, transparent, accountable, etc.
- **Importance of Social Responsibility**: Today, social responsibility is given a lot of importance. The Board of Directors has to protect the rights of the customers, employees, shareholders, suppliers, local communities, etc. This is possible only if they use corporate governance.
- **Growing Number of Scams**: In recent years, many scams, frauds and corrupt practices have taken place. Misuse and misappropriation of public money are happening everyday in India and worldwide. It is happening in the stock market, banks, financial institutions, companies and government offices. In order to avoid these scams and financial irregularities, many companies have started corporate governance.
- **Indifference on the part of Shareholders**: In general, shareholders are inactive in the management of their companies. They only attend the Annual general meeting. Therefore, directors misuse their power for their own benefits. So, there is a need for corporate governance to protect all the stakeholders of the company.
- **Globalization**: Today most big companies are selling their goods in the global market. So, they have to attract foreign investor and foreign customers. They also have to follow foreign rules and regulations. All this requires corporate governance.
- **Takeovers and Mergers**: Today, there are many takeovers and mergers in the business world. Corporate governance is required to protect the interest of all the parties during takeovers and mergers.
- **SEBI**: SEBI has made corporate governance compulsory for certain companies. This is done to protect the interest of the investors and other stakeholders.

Objectives of the study

- To identify various types of corporate frauds in business.
- To find the role of corporate governance in preventing frauds.
- To observe the possible remedies and suggest preventive mechanisms.

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Literature Review

Kraakman (1986) defines gatekeepers as 'parties who are in a position to prevent misconduct by others by withholding their co-operation'.

Chhaochharia and Laeven (2007) have evaluated the impact of firm-level corporate governance provisions on the valuation of firms in a large cross-section of countries. They have distinguished between governance provisions that are set at the country-level and those that are adopted at the firm-level and conclude that governance provisions adopted by firms beyond those imposed by regulations and common practices among firms in the country have a strong, positive effect on firm valuation.

Gupta and Parua (2006) attempted to find out the degree of compliance of the Corporate Governance codes by private sector Indian companies listed in the Bombay Stock Exchange. Data regarding 1245 companies for the year 2004-2005 was taken for the study from the CG reports (which are included in the Annual Reports) of these companies and 21 codes (of which 19 are mandatory and 2 non-mandatory) were selected for study.

Dr.YKM Naidu and Mr.Ponduri Suresh Babu (2009) in Corporate Governance: Vision vs.Illusion 21st March 2009 wrote that corporate governance is all about promoting corporate fairness, transparency, accountability and responsibility towards stake holders of the companycorporate social responsibility.

Scenario of corporate governance in India

The Indian corporate scenario was more or less stagnant till the early 90s.The position and goals of the Indian corporate sector has changed a lot after the liberalization of 90s.India with its 20 million shareholders is one of the largest emerging markets in terms of the market capitalization. On April 12, 1988, SEBI was established with objective of protecting the rights of small investors and regulating and developing the stock markets in India. In 1992, the Bombay Stock Exchange (BSE), the leading stock exchange in India, witnessed the first major scam masterminded by Harshad Mehta. Analysts unanimously felt that if more powers had been given to SEBI, the scam would not have happened.As a result the Government of India brought in a separate legislation by the name of 'SEBI Act 1992'and conferred statutory powers to it. Since then, SEBI had introduced several stock market reforms. These reforms significantly transformed the face of Indian Stock Markets

2G Spectrum Scam

The 2G spectrum scam involved politicians and government officials in India illegally undercharging mobile telephony companies for frequency allocation licenses, which

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they would then use to create 2G subscriptions for cell phones. The shortfall between the money collected and the money which the law mandated to be collected is estimated to be Rs.1,76,645 crore, as valued by the Comptroller and Auditor General of India based on 3G and BWA spectrum auction prices in 2010. India is divided into 22 telecom zones, with 281 zonal licenses in the market. According to the telecom policy of India, when a licence is allotted to an operator, some start-up spectrum is bundled along with it. In 2008, 122 new second-generation (2G) Unified Access Service (UAS) licences were given to telecom companies at a price arrived at in 2001 and on a first-come-first-serve basis.

Sahara Case

On January 4, 2010, Roshan Lal, a resident of Indore, sent a note, written in Hindi, to the National Housing Bank, requesting it to look into housing bonds issued by two companies of the Lucknow-headquartered Sahara group, Sahara India Real Estate Corporation and Sahara Housing Investment Corporation. Being a chartered accountant, Lal wrote in the small note, he found that the bonds, bought by a large number of investors, were not issued according to the rules. The National Housing Bank did not have the wherewithal to investigate the allegation, so it forwarded the letter to the Securities and Exchange Board of India, or Sebi, the capital markets regulator. That note set in motion a chain of events that resulted in the Supreme Court ordering the two companies on August 31 to return the money they had raised through the bonds — Rs 24,029 crore — to the 29.6 million investors, along with interest (15 per cent per annum).

Corporate Governance as Risk Mitigation

Corporate governance is of paramount importance to a company and is almost as important as its primary business plan. When executed effectively, it can prevent corporate scandals, fraud and the civil and criminal liability of the company. It also enhances a company's image in the public eye as a self-policing company that is responsible and worthy of shareholder and debt holder capital. It dictates the shared philosophy, practices and culture of an organization and its employees. A corporation without a system of corporate governance is often regarded as a body without a soul or conscience. Corporate governance keeps a company honest and out of trouble. If this shared philosophy breaks down, then corners will be cut, products will be defective and management will grow complacent and corrupt. The end result is a fall that will occur when gravity – in the form of audited financial reports, criminal investigations and federal probes – finally catches up, bankrupting the company overnight. Dishonest and unethical dealings can cause shareholders to flee out of fear, distrust and disgust.

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SEBI's initiatives towards corporate governance

In India also, various initiatives have been taken in the past by the Ministry of Corporate Affairs and SEBI to ascertain that those entrusted with the responsibility of governing shareholder wealth are adequately regulated and made accountable. Over the past 15 years, there have been many reforms in the corporate governance framework - starting from constitution of the Kumar Mangalam Committee (1999), introduction of Clause 49 in the listing agreement (2000), revision in Clause 49 on recommendations of the Narayana Murthy Committee (2006), issue of voluntary guidelines on corporate governance (2009), issue of guiding principles on corporate governance (2012) based on recommendation of the Adi Godrej Committee, enactment of the revised Companies Act (2013) and finally the new corporate governance norms by SEBI (2014).Although, the Companies Act 2013 specifies the minimum requirements of governance applicable to all companies. The regulator has clearly indicated a move towards increased transparency on conducting Board matters and articulated several changes in the roles and responsibilities of the board, board committees and independent directors. This move also indicates the intent of the regulators to align with the global standards on corporate governance adopted in mature economies (such as the UK Companies Act, US MBCA, US-DGCL, UK FRC Code, Stewardship Code and SOX). The revised listing agreement is likely to be publicly available in due course.

Suggestions for Improving the Effectiveness of the Corporate Governance in India

- Expand the jurisdiction of SEBI to control unlisted companies and their activities, since they constitute a large chuck of business in India. Normally SEBI has the power to control the behavior of listed companies in India. It thus, needs to have more powers to control the nature of the business and protect the interest of share-holders, as well.
- It is the responsibility of the government and its various nodal agencies to furnish every area of business with necessary provisions to ensure that it is working, according to the interest of the nation and different share-holders, at large.
- Make necessary clarity and transparency in provisions dealing with regulating business towards the general objectives of the nation.
- Establish necessary banking institutions in the rural parts of India and make awareness among the people about various banking products. In essence, a loin

share of people in rural parts of India does not have bank accounts for want of sufficient number of "Banking" institutions".

- Pre-emptive policies should put in place to keep away corporate-houses from political interventions, which enlarge the magnitude of corporate scams. It is clear that behind every corporate scam, there is an unscrupulous political nexus with corporate institutions. For example, both 2G spectrum scam and Saradha group financial scandal believed to have political patronage to an extent.
- All the informal collective investment schemes must be brought under the jurisdiction of a centralized enforcement authority with necessary stipulations and moreover, discourage the unscrupulous investment schemes

Conclusion

Corporate governance and economic development are intrinsically linked. Effective corporate governance systems promote the development of strong financial systems which, in turn, have an unmistakably positive effect on economic growth and poverty reduction.The last few years have seen some major scams and corporate collapse across the globe. In India, the major example is Satyam which is one of the largest IT companies in India. All these events have caused the pendulum of public faith to shift away from free market to a more closely regulated one. The need to comply with the Companies Act has proved challenging for several companies and with the introduction of the revision in governance requirements by SEBI, the compliance is likely to become more onerous for listed companies with a consequent effect on the cost of compliance. Notwithstanding the implications and challenges, organizations need to leverage this development as an opportunity to strengthen the governance framework and deliver incremental gains through enhanced investor confidence.

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