Chapter Four

An Overview of Corporate Governance

4.1. Definition

Corporate governance is defined as an act of controlling, directing and evaluating the activities of an organization. The structure of corporate governance specifies that the others taking part in the organization, such as the board managers, board of directors, shareholders and other stakeholders must be provided with some rights and responsibilities. Corporate governance helps the organization achieve the goals and objectives in a desired manner.

Corporate governance has achieved a great deal of success in attracting public interest because corporate governance gives importance to the economic health of the corporation and the society as a whole. However, corporate governance covers a wide variety of the distinct economic phenomenon. Therefore, many people have given different definitions of corporate governance. A few definitions of corporate governance are as follows:

According to Shleifer and Vishny, 'C*orporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment.*'
An article from *Financial Times* has defined corporate governance as '*the relationship of a company to its shareholders or, more broadly, as its relationship to society*'.
According to the J. Wolfensohn, '*Corporate governance is about promoting corporate fairness, transparency and accountability*.'

4.2. **The Need for Corporate Governance**

There are various reasons for the need for corporate governance in an organization. These are:

- A corporation, which is a union of many stakeholders, such as employees, customers, investors, vendors, and so on, must be fair and transparent to its stakeholders in all its dealings. It is very important in today's globalized business world, where corporations require to have access to global pools of capital attract and retain the best human resource from all parts of the globe. If a corporation does not take up and show ethical conduct, it is not considered to be successful.
- Corporate governance covers ethical conduct in business, the code of values and principles that helps an individual to choose between right and wrong or make the right selection from the options or alternatives provided. Managers decide on certain actions on the basis of an principles that are governed by the culture, context and values of an organization. An organization that follows ethical values feel that it is better for the business, as it helps in the long run and the stakeholders observe that the management is running the organization in the desired way.
- It is beyond the sphere of law, i.e., it stems from the background and outlook of the management and cannot be regulated by legislation alone. It deals with running the affairs of a company in such a way that it is fair to all the stakeholders and that its dealings benefit the greatest number of stakeholders. It is about honesty, integrity and responsibility. Laws should set up a common framework to maintain standards. Since substance is very much linked with the mindset and ethical standards of management, it shall in the end lay down the creditability and integrity of the process.
- Corporations should realize that it is necessary for all the stakeholders to cooperate in order to facilitate development. Such cooperation and support can only be possible by adhering to the best practices of corporate governance. In this context, management has

to take the responsibility of the shareholders at large and stop any unbalanced benefits of the varied sections of the shareholders.

- The economic competence of a company can be improved through corporate governance. Corporate governance also ensures that corporations consider the interests of a wide range of constituencies and also of the communities within which they function. Corporate governance also makes sure that the boards of directors are responsible to the shareholders. This even helps to ensure that corporations work for the benefit of the society at large, including the society's concerns about labour and environment
- If the execution of good governance fails, heavy losses can result in terms of cost other than regulatory problems. Many organizations that do not give due importance to corporate governance end up paying a large risk premium while contending for scarce capital in the public markets. Of late, stock market analysts have started realizing, accepting and appreciating the relationship between returns and corporate governance.
- The confidence of both foreign and domestic investors is maintained and upheld due to the trustworthiness that comes from good measures of corporate governance. The cost of capital should be brought down so that more long-term investment is attracted.
- Often, importance and attention is given to corporate governance in times of financial crisis. In the US, when scandals disturbed the otherwise calm and contented corporate environment, new initiatives thrown up by them led to fresh debates in Asia and the European Union. With many instances of corporate misdemeanour coming into limelight, the emphasis now is on compliance with substance, rather than on form. It has also brought to the fore the need of intellectual honesty and integrity. The financial and other disclosures made by firms are only as good as the people who make it.

- Corporate governance is aimed at increasing the long-term value of an organization for not only its shareholders, but also partners.

4.3. Roles and Responsibilities of Corporate Governance Actors

4.3.1 Role of the Board of Directors in Corporate Governance

Board of directors is made up of individuals elected by a corporation's shareholders to oversee the management of the corporation. An organization allows different individuals or parties to add to the capital, expertise and their knowledge so that the organization can function efficiently without facing any difficulties. There are various participants in the organization such as investors and shareholders. They do not participate in the operations of the organization. Their main interest is to have a proportion of the share in the income of the organization. The shareholders and investors have the right to elect the board of directors of an organization in order to represent and protect their interests. The board of directors has the power and duty to form the corporate policies of an organization. Therefore, the board of directors has the powers to take certain decisions, which can in turn affect the long-run performance of the corporation. It means that the board of directors has a very significant function in the working of the business as it also oversees the top management of the organization.

The duties and rules that the board of directors has to follow are plainly laid down by the organization. It includes monitoring the performance of the company and its management and approving important business policies. The board of directors receives regular reports on the financial position of the organization, key areas of the organizations' operations and other issues.

Responsibilities of the board of directors

The various responsibilities of the board of directors are as follows:

- Providing continuity to the organization by setting up the organization as per the legal requirements and effectively advertising its products and services to the customers.
- Selecting and appointing a chief executive whose basic duty is to review and evaluate the performance of the organization and offering administrative guidance to the organization.
- Governing the organization by setting up broad policies and objectives and monitoring whether the organization follows the policies.
- Acquiring the resources and finance for effectively running the day-to-day operations of the organization.
- The board of directors must be accountable to the public for the products and services of the organization, which include approving the budget and formulating the policies related to the contracts for producing a product.

4.3.2. Role of top management in corporate governance

The board of directors occupies the top management whose prime concern is strategic management of the organization. The top management is supervised by the president in coordination with the vice-president of the organization

Responsibilities of Top Management

The responsibility of the top management is to get the objectives of an organization accomplished within the organization and in the industry. Thus, the role and responsibility of the top management is multifaceted and is directed towards the welfare of the organization. The duties of the top management are distinct as they may vary from organization to organization. The development of the tasks of the top management are developed by the analysis of objectives, strategies and fundamental activities of the organization The top management should primarily support two critical responsibilities, crucial for strategic management to be effective. The two responsibilities are as follows:

Provision of executive leadership and strategic vision: Executive leadership means directing the activities of the organization to accomplish its objectives. Strategic vision refers to the description of the capabilities of the organization, which is generally described in the mission statement. The top management defines the strategic vision of the organization to the employees. The enthusiasm and passion for the organization comes from the top management. Top management must have clear strategic vision, enthusiasm and dynamism. They possess three important characteristics that enable them to command respect and alter the process of strategy formulation and its implementation:

- Articulation of strategic vision with strategy: The top management visualizes the organization as what it is expected to become and not to what it already is. He adds a new aspect to the strategic activities that enables the employees to refresh their working habits to attain new heights.
- Makes guidelines for others to identify and follow: The behavior of the top management towards the values concerning the objectives of the organization should be clear and must be communicated constantly through his work and activities. If the top management behaves responsibly then the employees trust in him and get inspired to work with the same enthusiasm
- Communicate high performance level and confidence to the followers: Leadership of the managers of an organization involves setting up of goals for the employees accompanied with challenges and training his people for the same. He should provide his workforce with power and resources before setting targets.

Manage strategic planning process: In an organization, the characteristics of strategic planning are same as that in learning organizations where ideas can come from any division of the organization. Top management should encourage the planning process so that strategic management can work effectively in the organization. In multidivisional organizations, the top management should ask its units to prepare a strategy for themselves, which should be considered before planning and formulating the final strategic plan. Such practices make the work atmosphere dynamic and encourage the workforce to work according to their potential. The other method is to provide the workforce units with the mission statement and objectives and allow them to formulate strategies accordingly. Regardless of the approach taken to formulate a strategy, the board of directors expects the top management to prepare such a strategic plan that works well with the organizational objectives. Therefore, the top management's responsibilities include evaluating each unit's proposed objective, planning strategies to seek how effectively it satiates the organizational goals with respect to available resources and providing feedback.

4.3.3. **Role of the CEO in Corporate Governance**

Any action that is taken by any individual in the organization can affect the firm's operations to a great extent. For example, if any individual is appointed as a team leader, then he has the responsibility to take certain decisions that would help in the progress of his entire team. If an individual is provided with any sort of power, then it is up to him to use it for the benefit of the organization or he can use the powers to fulfil his own requirements. It is the same for CEOs in an organization. Organizations achieve great success in business because of their chief executive officer (CEO). The CEO oversees the company's finances and strategic planning.

The powers of a CEO can greatly influence the working of an organization. Therefore, it is very important to know about the powers of the CEO and how his powers can ultimately influence the results of an organization. The CEO of an organization has a very important role to play in certain areas, which are:

- Personal action
- Handling of organizational politics
- Role as a negotiator
- Role as a communicator
- Role as a role model

Personnel action

The CEO of a firm has the power to take personnel actions in a manner that is beneficial for an organization in the following ways:

Ordering the employees: A CEO of an organization uses his authority to order the employees. The employees of an organization are directed by a CEO to perform certain tasks at a defined period of time. If any of the employees are disobedient or their actions are not very good, then the CEO has an authority to throw him out of the organization. The ordering of employees is done to achieve the goals and objectives of an organization.

The ordering method, which is employed by the CEO, provides certain benefits to the organization. When there is a need of any structural changes to be made in the organization, then the ordering method is very helpful. For example, if an organization decides to implement a new and improved structure for managing the performance of the employees in the organization, then the CEO has to just give instructions and train employees in operating the new system.

Making cultural changes: It is very difficult for a CEO to change the culture of an organization. Cultural changes are those changes that are deeply rooted among the employees such as collective thinking, and mindsets, which have become a part of the organizational's working environment. For bringing about cultural change in the organization, just ordering the employees will not help the CEO. A CEO has to use the right approach for bringing about a change in the cultural mindset of the employees. For bringing about a change, a CEO must look after certain agendas and the communication network of an organization. If he finds any defects in the agendas or the communication network, then he must rectify those defects in order to make cultural changes among the employees and achieve the goals and objectives of the organization.

Persuading the employees: A CEO of an organization persuades the employees to perform certain tasks in an efficient manner. If the employees find it difficult to perform certain tasks, then the CEO looks after the problems that the employees face. After looking at all the difficulties, a CEO must persuade the employees to work better and direct their efforts towards the achievement of the goals. A CEO also negotiates with the employees if there is a situation of dispute between the employees and the management.

Inducing the employees: A CEO also induces the employees to work towards the attainment of the goals and objectives of an organization. There may be certain employees in an organization that may not be performing well in accordance with the expectations of the organization. A CEO can induce the employees by asking them to change their ways of working and thinking, so that organizational goals can be achieved in a desired manner.

Handling of organizational politics

The CEO must accept the fact that politics is certain in every organization. Pfeffer has defined politics as ‘those activities taken within organizations to acquire, develop and use power and other resources to obtain one's preferred outcomes in a situation in which there is uncertainty or dissension about choices’.

An individual, subunit or department may have power within an organizational context at some period of time; politics involves the exercise of power to get something accomplished, as well as those activities, which are undertaken to expand the power already possessed, or the scope over which it can be exercised.

Therefore, it is clear that political behaviour is designed and started to surmount opposition or resistance. If there is no opposition, there is no need for politics. Opposition and resistance are bound to occur in all organizations because of severe competition for scarce resources. Five major reasons that have strong influence on the political orientation of organizations are:

Scarcity of resources: Any person or subunit having control over the allocation of scarce resources; their power and political influence play an important part in how these resources will be distributed to various departments, rather than fulfilling their own needs.

Non-programmed decisions: Non-programmed decisions involve unique problems that cannot be solved by structured methods and procedures. These unique problems involve many factors and variables that are ambiguous in nature leaving room for political planning by those who have the knowledge and techniques to successfully confront and solve such complex problems. Such non-programmed decisions are likely to be made in the areas of strategic planning, mergers and acquisitions and policy changes.

Ambiguous goals: When the goals of an organization are clearly defined and each member of the organization is aware of these goals and is also aware of his role in contributing towards the achievement of such goals, then there are limited grounds for political influences. However, when the goals of a department or the entire organization are ambiguous then there is more room available for playing politics.

Technology and environment: An organization must have the ability to appropriately respond to an external environment that is highly dynamic and generally unpredictable. The organization must adequately adapt to complex technological developments that are changing day by day. Therefore, the political behaviour in organizations is increased when the internal technology is complex and when the external environment is highly unstable.

Organizational change: Whenever there are changes in the organizational structure or the rearrangement of organizational policies, individuals in powerful positions have the opportunity to play political games. These changes may include restructuring of a division or creation of a new division, personnel changes and introduction of a new product line. All these changes are invitations to political processes when various individuals and groups try to control the given situation.

Role as a negotiator

The CEO performs the role of a negotiator in which he has the full support of an organization. A CEO negotiates the problems that the employees face in performing the tasks in a specified period of time. If the CEO is busy in performing some other tasks, then the role of negotiator can be delegated between the general manager and any other departmental head. A CEO must keep some factors in mind before performing the negotiations:

If the demands of the two persons cannot be met, then the person who is shouting should not get what he wants. If the demand of a person who was shouting more is fulfilled then it will lead to the belief that the demands of the person who shouts will be fulfilled. Therefore, to mitigate these problems, a CEO must patiently hear the problems or demands of the employees and must arrive at a situation that is acceptable by all wholeheartedly.

A CEO must negotiate the problems in such a manner that the employees of an organization agree to increase the productivity and reduce the absenteeism.

Role as a communicator

A CEO plays the role of a communicator in an organization. It is an important duty of a CEO to communicate the organizational mission, vision, goals and objectives to the employees. The CEO, while playing the role of communicator, must listen to the employee's complaints and problems. A CEO must understand the problem first and then respond in a positive manner to the satisfaction of the employees who are facing the problem. Right communication given correctly at the desired time can motivate the employees and can charge them to perform the most difficult tasks with great ease.

Role as a role model

The CEO of an organization sometimes becomes a role model for the employees of the organization. The employees try to emulate the working style of the CEO. For example, if a CEO of an organization comes late, then the employees will follow him and they will also start coming late. On the other hand, if a CEO is punctual, then the employees will also be punctual. Therefore, the CEO has a great deal of influence on the employees and he must remain perfect in his actions.

4.3.4. Managerial Roles in Corporate Governance

The managers of an organization also play a very important role in the success of an organization and corporate governance. An organization must examine the roles that the managers are expected to perform. Henry Mintzberg developed these roles in the late 1960s after a careful study of executives at work. All these roles in one form or another ***deal with people and their interpersonal relationships***. These managerial roles are ***divided into three categories***. The first category of interpersonal roles arises directly from the ***manager's position*** and the formal authority bestowed upon him. The second category of ***informational roles*** is played as a direct result of interpersonal roles and these two categories lead to the third category, that of ***decisional roles***.

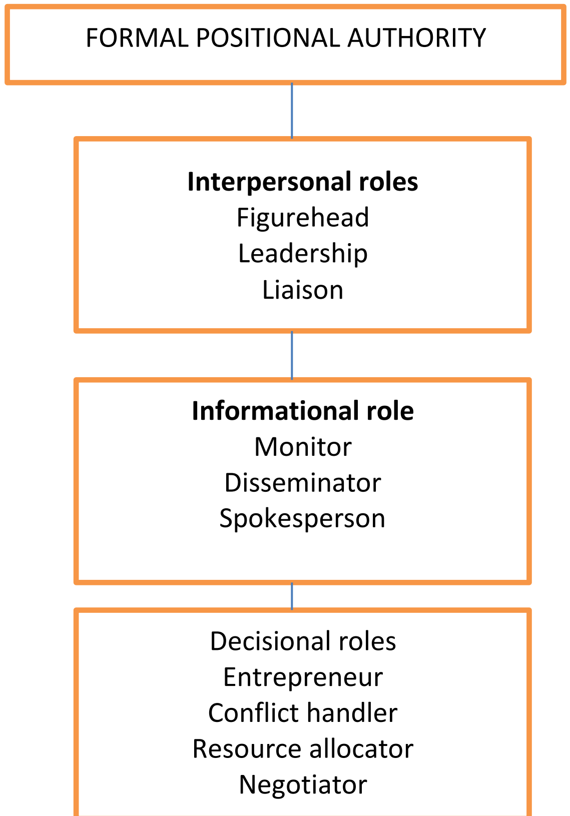

Figure 1 : various managerial roles

Interpersonal roles

Managers ***spend a considerable amount of time in interacting with other people***, both within their own organizations as well as outside. These people include ***peers, subordinates, superiors, suppliers, customers, government officials and community leaders.*** All these interactions ***require an understanding of interpersonal relations.*** Studies show that interacting with people takes up nearly 80 per cent of a manager's time. These interactions involve the following three major interpersonal roles, which are:

Figurehead: Managers act as a symbolic figurehead performing ***social or legal obligations***. These duties include greeting visitors, signing legal documents, taking important customers to lunch, attending a subordinate's wedding and speaking at functions in schools and churches. All these, primarily, ***are duties***

of a ceremonial nature but are important for the smooth functioning of an organization.

Leader: The influence of a manager is most clearly seen in his role as a leader of the unit or organization. A manager is ***responsible for the activities of his subordinates***, he must lead and coordinate their activities in meeting task-related goals and he must motivate them to perform better. He must be ***an exemplary leader*** so that his subordinates follow his directions and guidelines with respect and dedication.

Liaison: In addition to their constant contact with their own subordinates, peers and superiors, the managers must ***maintain a network of outside contacts*** in order to ***assess the external environment*** of competition, social changes or changes in governmental rules, regulations and laws. In this role, the managers ***build up their own external information*** system. In addition, they develop networks of mutual obligations with other managers in the organization. They also ***form alliances*** to win support for their proposals or decisions. The liaison with external sources of information can be developed by attending meetings and professional conferences, by personal phone calls, trade journals and by informal personal contacts within outside agencies.

Informational roles

By virtue of his interpersonal contacts, a manager emerges as a ***source of information*** on a variety of issues concerning the organization. In this capacity of information processing, a manager executes the following three roles:

 Monitor*:* Managers are constantly ***monitor and scan their environment***, both internal and external, collect and study information regarding their organization and the outside environment affecting their organization. This can be done by ***reading reports and periodicals***, by ***asking their liaison contacts*** and through ***gossip and speculation.***

 Disseminator of information*:* Managers must ***transmit the information*** regarding ***changes in policies or other matters*** to their subordinates, their peers and to other members of the organization. This can be done through ***memorandums, phone calls, individual meetings and group meetings.***

 Spokesperson*:* A manager has to be a spokesman for his unit and he represents his unit in either sending relevant information to people outside his unit or making some demands on behalf of his unit. This may be in the form of the president of the company making a speech to a lobby on behalf of an organizational cause or an engineer suggesting a product modification to a supplier.

Decisional roles

On the basis of the environmental information received, a manager must ***make decisions and solve organizational problems***. In that respect, a manager plays four important roles, which are:

 Entrepreneur*:* As entrepreneurs, managers are ***continuously involved in improving their units and facing dynamic technological challenges.*** They are constantly on the lookout for new ideas for product improvement or products addition. They initiate feasibility studies, arrange for capital for new products if necessary and ask for suggestions from the employees for ways to improve the organization. This can be achieved through suggestion boxes, holding strategy meetings with project managers and research and development personnel.

 Conflict handler*:* Managers are constantly involved as arbitrators in ***solving differences among the subordinates*** or the ***employee's conflicts with the central management***. These ***conflicts may arise*** due to demands for ***higher pay*** or other benefits or these conflicts may involve ***outside forces such as vendors*** increasing their prices, a major customer going bankrupt or unwanted visits by governmental inspectors. Managers ***must anticipate*** such problems and take ***preventive action*** if possible or take corrective action once the problems have arisen. These problems may also involve ***labour disputes, customer complaints, employee grievances, machine breakdowns, cash flow shortages and interpersonal conflicts***.

- ***Resource allocator****:* The third decisional role of a manager is that of a resource allocator. Managers must ***establish priorities*** among various projects or programs and ***make budgetary allocations*** to the different activities of the organization based upon these priorities. They assign personnel to jobs, allocate their own time to different activities and allocate funds for new equipment, advertising and pay raises.

All these roles are important in a manager's job and are interrelated even through some roles may be more influential than others, depending upon the managerial position. For example, sales managers may give more importance to interpersonal roles, while the production managers may give more importance to decisional roles. The traits of effective managers are their ability to recognize the suitable roles to play in each situation and the flexibility to change roles when required. However, managerial effectiveness is determined by how well the decisional roles are performed by the manager in the organization.