

Corporate Governance: What's The Hype?

Corporate governance has clearly become the buzz word in India Inc., in more ways than one. But what is corporate governance and why is there so much fuss around it? The concept broadly refers to the set of principles and practices by which an organisation is controlled and managed, ensuring accountability and trust towards all stakeholders.

The OECD (2015) defines corporate governance as the process, structure and systems by which an organisation is governed and operated and often involves a set of relationships between a company's executive management personnel (popularly called the c-suite), the board of directors, shareholders and other stakeholders. The key objective of corporate governance in an organisation is to enhance shareholder value and at the same time ensure long-term ethical management.

This article delves into the founding blocks of corporate governance as a concept, its significance and the interplay of different stakeholders.

Origin and Development

Corporate governance began with the rise of corporations, especially with the increase in joint venture companies, where ownership was separated from management. Significant and rampant growth in organisations required the management to call the shots and expected shareholders to follow suit, leading to problems of agency in the said organisations.

One of the earliest examples of corporations adopting corporate governance principles is by the East India Company (incorporated in the year 1600), by separating ownership from management, maintaining a board of directors, subsequently issuing shares to the public, and following annual reporting to its shareholders.

However, it was in the early 1970s that, academic and regulatory discourse on corporate governance gained traction in the United States, following the bankruptcy of the Penn Central Transportation Company (one of the causes was attributed to poor board control) and revelations that several corporations had been making illegal political contributions, which prompted the American securities and exchange commission (SEC) and the New York Stock Exchange (NYSE) to consider regulatory reforms such as requiring listed corporations to have audit committees and inclusion of independent directors on the board.

The 1980s to the 2000s was a rebuilding and recovery phase, with organisations struggling to recover from the excessive risks undertaken by banks resulting in a collapse of financial ecosystems across the globe. Board of Directors were handed heavier responsibilities to implement measures such as transparency and accountability, making boards responsible to shareholders (especially public shareholders) for the acts and performance of the company.

Multiple instances of corporate fraud, both in India (Satyam and Sahara being leading examples) and globally (Enron, Lehman, Theranos, FTX etc.), have brought the attention of the industry and regulators to devising and enforcing principles for sound corporate governance (*as referenced in the Supreme court case of Sahara India Real Estate Corporation Ltd. and Ors*), at the industry as well as the statutory level. In India, one of the reasons for reformulating company law included improved corporate governance. Notably, in the case of *Snowcem India Ltd. Vs. Union of India (UOI), 2005 (Bom)*, concerning the amendment of the provisions relating to disqualifications for directors in the Companies Act, 1956 (which provisions are also continued in the Companies Act, 2013), the Bombay High Court took note of the legislative intent of corporate governance and investor protection as an interpretative aid.

Fast forward to 2024-25, corporate governance in its modern form involves a focus on protecting stakeholders' interests alongside developing the environmental impact, social and governance aspects of an organisation. The intent is not only to protect the interests of the existing stakeholders but to enable sustainable business practices for future generations, in an ethical manner. It is becoming imperative for organisations to determine their future, keeping in mind their environmental and social responsibilities, besides maintaining the bedrock of principles of accountability and trust.

Why do we need corporate governance?

Companies require corporate governance to be able to balance stakeholders' interests while ensuring performance and growth of the company, in a sustainable manner.

Considering India's startup ecosystem has grown multi-fold, it has also witnessed its fair share of corporate outrage. From reports ranging from financial statements manipulation to misuse / excessive use of loans in companies, poor governance practices can lead to organizational failure, red-tapism, depletion of funds (in the form of penalties imposed by regulators and other penal consequences, such as suspension of licenses) and fall in valuations. The reputational damage for key stakeholders is often difficult to control and may continue to last for a lifetime.

In current times, where companies attract significant attention from the general public, corporate governance has acquired renewed importance. A successful company would often follow a fund-raising journey from a proof-of-concept stage, to raising multiple rounds of equity investments at various stages from varied classes of investors that could include angel investors, venture capital funds, late-stage private equity funds and perhaps also retail and institutional public investors, if the company is able to access capital markets. Naturally, each of these investors have different exit horizons and would be keen to maximize value for themselves. In such situations, having strong governance norms is even more important – to prevent organizational failure, expectation mismatch and ultimately, value destruction. By adhering to robust governance standards, organizations can help build shareholder trust, mitigate risks and foster long-term sustainability.

Good governance necessitates practical measures and systems for transparency, accountability, checks and balances and risk management. This can be implemented by having a competent and responsible board of directors, who continually oversee the functioning and management of the company. Risk management can be achieved by putting in place to check necessary processes and policies for each department to prevent abuse and mismanagement and regular checks for compliance and critically, implementing whistleblower policies to enable shareholders to voice their grievances where required. Companies should believe in consistently evolving by improving their governance frameworks to international standards and establish a commitment to their stakeholders towards building an ethical, transparent and sustainable system. That said, while rule making and having SOPs is critical, it is equally important to ensure the right environment and culture that motives professionals to be honest, ethical and vigilant.

Thus, in today's dynamic environment, effective corporate governance is not just a regulatory necessity but has also become a strategic imperative for companies which seek long term profitability and sustainability. In the next part, we explain India's statutory framework for governance of companies.

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