Dharma in Corporate Governance

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< EXECUTIVE SUMMARY >

◆Governance means to rule or steer. The term Governance when gets attached with the corporates, the term that evolves makes the corporates necessarily to be committed to the people. People meaning thereby specially the stakeholders.

Corporate Governance has caught the imagination of all segments of the corporate world. Governance has assumed even greater limelight with the series of corporate failings, both in public and private sectors following which the markets, the investors and the society at large, have begun to loose faith in the infallibility of these large systems. At this point of time the conduct of those who take care of public money is being questioned. They are being tested on minimum ethical standards.

MEANING AND IMPORTANCE

Governance, derived from the word Gubernare, means to rule or steer. Though originally meant to be a normative framework for exercise of power and acceptance of accountability thereof in the running of kingdoms, regions and towns, over the years, it has found significant relevance in the corporate world.

This is particularly so in the context of the growing size of the corporates the widening base of their shareholders, their increasing linkages with the physical environment and their overall impact on the society's well-being. Corporate governance has caught the imagination of all segments of the corporate world. Governance has assumed even greater limelight with the series of corporate failings, both in the public and private sectors following which the markets, the investors and the society at large, have begun to lose faith in the infallibility of these large systems[1]. At this point of time the conduct of those who take care of the public money is being questioned. They are being tested on minimum ethical standards. And why not they should be questioned as they are the agents of the stakeholders who have invested their money in such Corporations.

HISTORY OF CORPORATE GOVERNANCE

The seeds of modern Corporate Governance were probably sown by the Watergate scandal in the United States. As a result of subsequent investigations, US regulatory and legislative bodies were able to highlight the control failures that had allowed several major Corporations to make illegal political contributions and to bribe government officials. This led to the development of the Foreign and Corrupt Practices Act of 1977 in USA that contained

The author is member of the Institute. The views expressed herein are the personal views of the author and do not necessarily represent the views of the Institute.

[1] *Reddy. Dr.Y.R.K. Report On Corporate Governance and PSUs, Administrative Staff College Of India,1997 ,p.4*

specific provisions regarding the establishment, maintenance and review of systems of internal control.

This was followed in 1979 by the Securities and Exchange Commission of USA's proposals for mandatory reporting on internal financial controls. In 1985, following a series of high profile business failures in the USA. the most notable one of which being the Savings and Loan collapse, the Treadway Commission was formed. Its primary role was to identify the main causes of misrepresentation in Financial Reports and to recommend ways of reducing incidence thereof. The Treadway Report published in 1987 highlighted the need for a proper control environment, independent Audit Committees and an objective Internal Audit function. It called for published reports on the effectiveness of internal control. It also requested the sponsoring organizations to develop an integrated set of internal control criteria to enable companies to improve their controls. Accordingly COSO (Committee of Sponsoring Organizations) was born. The report produced by it in 1992 stipulated a control framework, which has been endorsed and refined in the four subsequent UK reports: Cadbury, Rutteman, Hampel and Turnbull. While developments in the United States stimulated a debate in the UK, a spate of scandals and collapses in that country in the late 1980s and early 1990's led the Shareholders and Banks to worry about their investments. These also led the Government in UK to recognize that the then existing legislation and self-regulation were not working.

The issue of corporate governance became particularly significant in the context of globalisation because one special feature of the late 20th' century / 21 st century globalisation is that in addition to the traditional three elements of the economy, namely physical capital in terms of plant and machinery, technology and labour, the volatile element of financial capital invested in the emerging markets and in the third world countries is an important element of modern globalisation and has become particularly powerful. Thanks to the ubiquitous application of information technology, at the touch of a computer mouse, it is possible now to transfer billions of dollars across borders. The significance and the impact of the volatility of the financial capital was realised when in June 1997 the currency of South East Asian countries started melting down in countries like Thailand, Indonesia, South Korea and Malaysia. It was realised by the World Bank and all investors that it is not enough to have good corporate management but one should have also good corporate governance because the investors want to be sure that the decisions taken are ultimately in the interest of all stake holders. Honesty is the best policy is a fact that is now being re-discovered.

In practical terms, corporate governance has meant that there should be at the board level non-official directors who are professionals and who have no conflicting interests and who can particularly operate the two key committees, the Ethics Committee and the Finance Committee to see that there is greater transparency in the management of the enterprise. Corporate governance ultimately has to come to mean better transparency in the operations without sacrificing business strategy or business secrets which are necessary for success in the market place, and absolutely ethical behaviour where the conduct of the company will not only be legal but also ethical.

CONCEPT OF CORPORATE GOVERNANCE

To conceptualize Corporate Governance we need to understand the term governance. The term governance is not a word of business but is of political science and now days being debated under public administration.

Governance is a set of minimum framework of rules necessary to tackle problems guaranteed by a set of institutions.

The following are the characteristics of governance when applied in the context of a country[2]

1. It is the exercise of political economic and administrative authority in the management of resources.
2. The capacity of governments to design, formulate and implement policies and discharge functions.
3. It comprises mechanisms, processes and institutions through which citizens and groups articulate their interests, exercise their legal rights, meet their obligations and mediate their differences.
4. It includes formal institutions and regimes empowered to enforce compliance, as well as informal arrangements that people and institutions either have agreed to or perceive to be in their interests.

The term 'corporate' according to the Webster Dictionary means a body having the nature of, or acting by means of a corporation. A 'corporation' in turn means 'a legal entity that exists independently of the person or persons who have been granted the charter creating it and that is invested with many of the rights given to the individual.

Applying the concept of governance in the corporate world, what we get is the term, 'Corporate Governance'. The corporate world comprises of institu-

[2] *"Conceptualizing Governance" National Human Development Report 2001, 115, Planning Commission, Government of India, March 2002*

tions, like companies, firms, proprietorships, etc.

According to Maw: 'Corporate Governance is a topic recently conceived, as yet ill- defined and consequently blurred at edges'[3] Corporate Governance is defined as the distribution of rights and responsibilities among different participants in the organization, such as, the Board, managers, Shareholders and other Stakeholders, and spells out rules and procedures for making decisions on corporate affairs[4].

Corporate governance is concerned with establishing a system whereby the Directors are entrusted with responsibilities and duties in relation to the direction of a company's affairs. It is founded on the system of accountability primarily directed towards the Shareholders in addition to maximizing the shareholders welfare. An effective corporate governance system provides mechanisms for regulating the Director's duties in order to restrain them from abusing their powers and to ensure that they act in the best interest of the company in a broad sense[5].

Corporate Governance is also concerned with wider accountability and the responsibility of the Directors towards other Stakeholders on the corporation. These Stakeholders include the Company's employees, consumers, suppliers, creditors and the wider community. Sheridan and Kendall have advocated the definition of the term Corporate Governance, they believe that good corporate governance consists of a system of structuring, operating and controlling a Company in order to achieve the following objectives[6].

- To fulfill the long term strategic goals of the owners, which, may consist of building the share holder value or establishing a dominant market share or maintaining a market lead in a chosen sphere;
- To consider and care for the interest of the employees, past present and future, including planning future needs, recruitment training and working environment, severance and retirement procedures through to looking after pensioners;
- To maintain good relations with customers and suppliers, in matters such as quality of service, considerate ordering and account settlement procedures;
- To take account of needs of the environment and the local community, in terms of the physical effects of the company's operation on the surrounding area and the economic and cultural interaction with the local population;
- To maintain proper compliance with all the applicable legal and regulatory requirements under which the Company is carrying out its activities. In 1992, the Cadbury Committee on the financial aspects of Corporate Governance considered *inter alia* the concept of Corporate Governance[7]. It defined the concept as the system of which companies are directed and controlled. The Board of directors is responsible for the governance of the Companies. The Shareholders' role in governance is to appoint the directors and the Auditors to satisfy themselves that an appropriate governance structure is in place.

PHILOSOPHY

Globalization has increased the competition in which the corporate world operates, therefore it has become increasingly important for the management to make the corporate business more transparent and institutionally sound. A Company has an adopted set of practices for achieving its objectives through legal, regulatory and institutional environment. Further the Company intends to make business practices more and more transparent and accountable to the Stakeholders. It can be said that the relationship with the Stakeholders creates a social contract whereby the Company is morally obliged to take account of the interest of these groups.[8]

ETHICS

3 Maw et al, Maw on Corporate Governance (1994) as cited by Sheikh ,Dr.Salim and S.K. Chaterjee 'perspectives on corporate Governance", Corporate governance And Corporate Control, Cavendish Publishing Ltd. London 2000 p.7.

4 http //hinduonnet . com/thehindu/2001/07/12/stories/06l2000e.htm

5. Supra Fn.2 at p.5

6 Id at p.7

7 The Cadbury Committee on the Financial Aspects of Corporate Governance, The Governance of Governance' (1994)15 The Company Lawyer p.73 as cited by Sheikh ,Dr.Salim and S.K. Chaterjee "perspectives on corporate Governance", Corporate Governance And Corporate Control, Cavendish Publishing Ltd. London 2000 p 11

8 Sheikh ,Dr.Salim and S K Chaterjee "perspectives on corporate Governance", Corporate governance And Corporate Control, Cavendish Publishing Ltd. London 2000 p.6.

The recognition of issues related to Corporate Governance is at times it is appalling when we come across so many instances of well regarded Corporates looting their Share holders for the personal gains of the Managers or the Owners[9]. That brings us to the basic issue of what will be the ethical issues in Corporate Governance. Honesty is the best policy. This means that there has to be absolute integrity in all operations. Integrity is of three types:

- Financial integrity
- Moral integrity
- Intellectual integrity

Corporate Governance and ethical behaviour have a number of advantages. Firstly, they help to build good brand image for the Company. Once there is a brand image there is greater loyalty, once there is greater loyalty, there is greater commitment to the employees, and when there is a commitment to employees, the employees will become more creative. In the current competitive environment, creativity is vital to get a competitive edge.

Another area where Corporate governance and ethical issues may arise is at the time of the Annual Report and particularly preparing the Annual Balance Sheet. There may always be a tendency to do what is called, window dressing and to show that the results were better than what were projected. I think a stage has come when it is better to be transparent and not do much of financial engineering but be straight because this may prove to be better in the long run. Especially now, in the context of the liberalization, and the opening up of the Indian companies for foreign competition, an issue will also be raising about the accounting practice.

Ethics has got a major role to play in realizing the value for your efforts. But what are ethics? Not going anywhere else, if we look at the age-old Indian philosophical tradition we can derive certain values, they are also consistent with the value system of other civilizations. They are:

- **Dharma** (Righteousness): the right path, which will uphold the family, organizational, and the social fabric[10]
- **Loka Sangraha** (Public Good): work not just for private gain, but also for public good. Practice of Swartha Prartha (self plus others) seeking ones own gains and also catering to the welfare of others. [11]
- **Kausalam** (Efficacy): optimum utilization of resources efficiently and productively. Judicious use of resources and preserving the resources for future generations[12].
- **Vividhta** (Innovation): Beyond survival, Business has to be the engine of innovation constantly seeking more effective solutions to meet economic and social expectations. Such innovation is required in processes, products, materials, machines, organization, strategies, systems and people'[13]
- **Jigyasa** (learning): change and continuity will coexist. So the corporates have to keep learning from the feed back loop from society and through internal processes of question, challenges, debates and training'[14]

Dharma, the most difficult to define. Dharma has been explained to be that which helps the upliftment of living beings. Therefore that which ensures welfare is surely dharma. Its origin can be traced as solution to eternal problems confronting the human race, originating from natural human instincts.

MANU SAYS:

Akasmay Kriya Kaschdrishayate Neh Kahinchit,
Yadvati Kurute Kinchhit tattkamasse chestitam.

It means that there is no act of man, which is free from desire; whatever man does is the result of desire. The force behind every action of human being is his desire, which is kama. There is natural desire to have enjoyment and wealth i.e. material pleasure, which is Artha. But artha and kama are however subject to dharma. The propounders of dharma did appreciate that fulfillment of desires of human beings was an essential aspect of life but were of opinion

9 Parekh Deepak, 'Corporate Governance and Business Ethics", All India Management Association, Excel Books, New Delhi 2001 p.20

10 Dr. Athreya.M,B., "Business Values For The 21st Century", Corporate Governance and Business Ethics, All India Management Association, Excel Books, New Delhi 2001 p.4

11 Id at p.5

12 Id at p.6

13 Id at p.7

14. Id at p. 8

that unless the desires were regulated by law, it is bound to give undesirable results. Therefore all the propounders of Dharma were unanimous that for existence of an orderly society, in this case an orderly market economy, the desires (Kama) for material enjoyment, and pleasures (Artha) should always conform to Dharma.

GITA IN 16-24

Tsmachastrnm pramanam te karyakarvavyasthitao,
Gyatva shastravidhanoktam karm kurtumihahirsi.

Which means, let the shastras be your authority in deciding what you should do and what you should desist from doing. In this case the shastras are nothing else but the Codes of best practice developed by various institutions however what is needed is uniformity in those Codes.

When we say that why we should observe Dharma then it is necessary to cite Manu where he explains the necessity of scrupulous practice of Dharma

He says: Vlll- 15

Dharma aev hato hanti Dharmo rakshati rakshita
Tasmadharmo na hantavyo ma na dharmo hatovidhit.

Dharma protects those who protect it. Those who destroyed dharma get destroyed. Therefore dharma should not be destroyed so that we may not be destroyed as a consequence thereof. The concept of dharma sankata is well known in the Hindu religion. Narova Kunjarova (human or elephant) was the situation where Yudhistra in Mahabharat lied. For the sake of getting a short-term benefit, resorting to lies or straying from the straight and narrow path ultimately leads to a long-term failure. I would, therefore, suggest that even at the cost of sacrificing short-term benefits, it is better for an enterprise to adopt healthy practices.

There is an excellent example of Alacrity, an enterprise concerned with building houses as NBCC. They have adopted the policy, though in the private sector, that will deal only with cheques and there will be no cash transactions. This has brought such a reputation to Alacrity that even the public servants who normally take bribes in Chennai when they come across an employee of Alacrity, do not ask for bribes. Can we not create through, at least our public sector enterprises, an environment in which there will be no underhand dealings and no violations from the path of integrity and corporate transparency?

The pillars of the Indian philosophical tradition, which have explicitly provided for proper conduct in public and private life, need to be incorporated in our dealings with other people even though be of political or economic in nature.

Now moving on from the occidental jurisprudence towards the orientalist, we see that there is not a vast difference in the theme. Max Weber talked about the protestant ethic as being a strong work oriented culture with a high sense of commitment and responsibility,[15] but that's about work. Governance can be ethical only when it rests on the core values of Honesty, Integrity, Respect, Fairness, Purposefulness, Trust, Responsibility, Citizenship and Caring. These values are not to be lost sight of by anyone and under any circumstances irrespective of the goals that are intended to be achieved and to achieve the ends of good governance, the means are as important as the ends. There has been a length of debate over the corporate ethics and their implication over Corporate Governance, safe and fair play is always ethical, so I believe that "don't do something that you would be ashamed of, if it becomes public"

GOOD GOVERNANCE

A question arises that what is actually good Corporate Governance, is it more governance or less governance? The situation we face, what we call that of bad governance, is not actually bad governance but is that of "crisis of governability." The crisis we face now as a result of over regulation and under performance of both the public and private sectors of the economy over so long period is a crisis of Governance[16] Short-term gains had taken over the long-term vision and goal. Corporates have tried to capitalize on such grounds, which are proper from one angle but unethical from another, and finally land in a situation called Dharma Sankata. The concept of dharma sankata is well known in the Hindu religion. Narova Kunjarova (human or elephant) was the situation where Yudhistra in Mahabharata lied. For the sake of getting a short-term benefit, resorting to lies or straying from the straight and narrow path ultimately leads to a long-term failure. I would, therefore, suggest that even at the cost of sacrificing short-term benefits, it is better for an enterprise to adopt healthy

15 Prof Rao.S.L, "A Work Ethic," Corporate Governance and Business Ethics, All India Management Association, Excel Books, New Delhi 2001 p 22

16 Supra Fn 8 at p. 14

practices. Governance is about not merely ownership; even an owner has to learn to govern'[17]. Corporate Governance is a way of life and not a set of rules. A way of life that necessitates taking into account the shareholders interest in every business decision[18]. A key element of good governance is transparency projected through a code of good governance, which incorporates a system of checks and balances between key players- Board, Management, Auditors and Stakeholders. Transparency in turn requires enforcement of right to information and the nature, timeliness and integrity of the information produced at each level of interface. All of which can only succeed when the responsibilities of each entity and their interface is defined by great clarity an understood by all[19]. Good governance at any level will crucially depend on greater simplicity in the process of governance combine with much stronger checks and balances, clarity of roles, the assignment of responsibilities and obligation, which will enhance accountability where it is due[20].

CONCLUSION

The word governance when it gets attached with the corporates term that evolves makes the corporates necessarily to be committed to the people. People, meaning thereby specially the stakeholders. We see on a larger platform, pluralism of values and a broad definition of stakeholding. Therefore a framework needs to be constructed out of a series of key common principals and conceptual issues regarding ethics in Corporate Governance. We need to strike a broad indication of balance between impact oriented and self-standing values and needs to be stated as per the organization's mission. A policy towards consistent and transparent corporate behavior should be adopted, including public justification of major strategic decisions. Dharma, lok sangrah, kausalm, vividhta and jigyasa, the core values of the rich Indian philosophical tradition. These should not be mere rhetoric but should become the guiding forces towards good governance. These are the various benchmarks on which an ethical best practice is based upon.

However, if one fails to observe such a practice, then he must remember what Manu had I said in the famous verse of Dharmo Rakshati Rakshita that means Dharma protects those who follow Dharma simultaneously Dharma destroys those, who try to play with it. That is why minimum ethical practices are advocated. We need to create ethically informed governance and mechanisms for consistently monitoring of organizational ethics. Maintaining transparency in their practice and accountability to people within and out. Then only we can achieve the end of Good Governance.

17 Id at p.19
18 Idatp 15 ,
19 Id at p. 15
20 Parekh Deepak, "Corporate Governance and Business Ethics",AII India Management Association, Excel Books, New Delhi 2001 p 17

Statement on Companies (Auditor's Report) Order, 2003

As the members are aware, the Department of Company Affairs, Government of India, had vide its Notification No. GSR 480(E), dated June 12, 2003, had issued the Companies (Auditor's report) Order, 2003. The said Order replaces the Manufacturing and Other Companies (Auditor's Report) Order, 1988. In view of this, it has been decided to replace the existing Statement on the Manufacturing and Other Companies (Auditor's report) Order, 1988 by the Statement on the Companies (Auditor's Report) Order, 2003. It has also been decided that the draft Statement be hosted on the website of the Institute for comments from members and others.

The draft of the Statement would be hosted on the website by 15th December 2003. Members and others are requested to send their comments on the draft Statement at the earliest to the Secretary, Auditing and Assurance Standards Board, the Institute of Chartered Accountants of India, PO Box 7100, Indraprastha Marg, New Delhi-110 002 or email at vijaykapur@icai.org.

Members are also requested to note that due to time and space constraint, the draft of the Statement would not be published in the Journal of the Institute."

The draft of the Statement would be available at www.icai.org, on the both the following links:

(i) main menu RESOURCES, sub menu EXPOSURE DRAFTS

(ii) main menu ANNOUNCEMENTS, sub menu MEMBERS