

Evolution of Governance and Ethical Leadership



The interrelationship between governance, leadership and ethics has assumed greater significance as never before primarily due to the cross-border movement of capital and the numerous instances of frauds that are getting reported. Instead of having isolated perspectives on governance and ethical leadership, we require a blend of the two to inspire confidence among the stakeholders so as to attract investment and to sustain progressive growth. Listing relevant experiences, the author through his article argues how the economic prosperity and sustainability of an organisation depends upon the efficiency, innovation and quality of the management as well as upon the organisation's adherence to the principles of good corporate governance backed by an ethical leadership. Read on...



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Introduction

The interrelationship between governance, leadership and ethics has assumed greater significance as never before primarily due to the cross-border movement of capital and the numerous instances of frauds that are getting reported. Instead of looking at governance in an isolated manner, one needs to integrate it with

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ethical leadership in a holistic approach. Without a blend of good governance and ethical leadership, it would be impossible to inspire confidence in the minds of the stakeholders so as to attract investment and to sustain progressive growth. The economic prosperity and sustainability of an organisation depends not merely upon efficiency, innovation, quality of the management but also upon adherence to the principles of good corporate governance backed by ethical leadership.

Governance and Intangibles

Governance is the function of Management. Good governance is about using the scarce economic resources at the disposal of the organisation in an efficient and ethical manner so as to enhance the stakeholders value of holdings. Accountability and transparency are integral part of the governance norms. Corporate Leadership has a fiduciary relationship to the stakeholders and are ultimately responsible for the actions and results of the entity. Unless the leadership ensures that governance is administered with conscious adherence to ethical values, the faith reposed would be eroded in the minds of the stakeholders and flow of investments would dry down. Focus should be on nurturing and securing intangibles such as goodwill, brand image, quality in deliverables, customer satisfaction, human resource development, so on and so forth. Then the tangibles like asset base, top line, earnings per share and market capitalisation would all follow. It is not only the end that should be good but even the means by which it is achieved should be ethical and good. Further, Vision and competence may take anyone to the top but it requires integrity to stay there.

Tracing the Origin

Indian corporate governance norms have evolved over the last two decades based on the recommendations of several committees constituted from time to time. Some of the reforms like establishing the Securities and Exchange Board of India and the National Stock Exchange have significantly improved the governance standards prevalent in India. The Confederation of Indian Industry (CII) came up with the first voluntary code of corporate governance in 1998. Subsequently, SEBI set up a committee under Kumar Mangalam Birla in 1999 to promote and raise the standards of good corporate governance. In 2000, SEBI adopted the key recommendations of the Birla committee which

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became part of clause 49 of the listing agreement of the stock exchanges. Later, in 2002 the Naresh Chandra Committee set up by the Department of Company Affairs made recommendations in terms of financial and non-financial disclosures and independent oversight mechanism. In 2003, SEBI constituted a committee under the chairmanship of Mr. N. R. Narayana Murthy with a view to review the clause 49 and suggest measures to improve the Corporate Governance standards. Subsequently under the chairmanship of Dr. J. J. Irani, the Ministry of Corporate Affairs (MCA) constituted an expert committee on Company Law to offer recommendations.

Post the Satyam scam, lot of initiatives have been taken by the regulators, MCA, ICAI with a view to study and improve the existing norms of governance and ethics within the domain of their respective jurisdiction. CII set up a task force to make recommendations to strike a balance between over regulation and promotion of strong corporate governance norms through voluntary reforms. NASSCOM (National Association of Software and Services Companies), under the chairmanship of Mr. N. R. Narayana Murthy, constituted corporate governance and ethics committee which issued its recommendations during 2010. In pursuance of recommendation by such bodies, the Ministry of Corporate Affairs released a set of voluntary guidelines addressing myriad Corporate Governance matters.

Subsequently, the Companies Act, 2013, had introduced many significant provisions for improving Governance in Indian Companies. These provisions relate to the attributes of and conduct of Independent Director; measures for securing the independence of the Board; enhanced role and responsibility of audit committee; self-declaration of interest by the Directors; closer regulation and monitoring of related party transactions; formalising whistle blower policy mechanism and above all empowering group of shareholders to file class action suits under certain circumstances.

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Kotak Committee Recommendations

The Kotak Committee on Corporate Governance which was constituted during June, 2017 under the chairmanship of Mr. Uday Kotak submitted its report detailing several recommendations on 5th October, 2017. After inviting and considering comments on such recommendations from the public and stakeholders, SEBI accepted many of the recommendations (some of them with certain modifications) of the committee at a meeting held on 28th March, 2018. Some of the recommendations accepted relate to:

- (i) enhancing the role of the Audit committee, Nomination and Remuneration committee and Risk Management committee;
- (ii) Expanding the eligibility criteria for independent directors, disclosure of expertise & skills of directors and reduction in the maximum number of listed entity directorships from 10 to 7 by 2020;
- (iii) Disclosure of auditor credentials, audit fee, reasons for resignation of auditors;
- (iv) Enhanced obligations with reference to subsidiaries and mandatory disclosure of consolidated quarterly results from 2019-20;
- (v) Disclosure of utilisation of funds from QIP/preferential share capital issued; and
- (vi) More disclosures of related party transactions and related parties to be permitted to vote against such transactions.

These new measures are expected to transform corporate governance to meet with the evolving global scenario and enable the listed companies in India more transparent, accountable and sustainable.

Ethics and Leadership

Ethics is the value system or consciousness that should evolve and become intrinsic to one's nature or inner self. When ethics becomes part of the character of every individual in the organisation then it takes shape of the culture of the entity. It is best imbibed at the top level of the management and its impact is expected to percolate down the line in the hierarchy to the grass root level. Apart from the Management (including the Key Management Personnel), the other critical limbs of corporate governance are the Audit Committee; independent directors and the internal & external auditors. A strong and unencumbered audit committee can review the work of internal auditors and satisfy that there are robust systems, procedures and

controls giving no room for manipulations or frauds. Statutory auditors can follow the assurance standards in executing their mandate and report on the true and fair view of the financial statements upholding the values of independence and integrity. They can qualify their report where found necessary; make disclaimer or express adverse opinion or confine to drawing emphasis of certain matters, as the case may be. The role of independent directors and Audit committee in ensuring that the financials disclosed are credible and reliable and that appropriate disclosures are made to the stakeholders for providing a comprehensive and correct view about the performance of the company can't be undermined.

Ethical Leadership is the need of the hour as it would facilitate that the governance norms are actually internalised and practised in absolute terms than following a mere 'check the box exercise' to be observed more in letter than in spirit. Moving from a regime of voluntary guidelines to mandatory law certainly helps in a democratic set up to infuse the required degree of discipline. Although morality cannot be legislated, conduct can be regulated. Indian corporate culture has moved from no disclosure to plethora of disclosures. When SOX was introduced in US in 2002, the cost of compliance shot up phenomenally and many companies opted for delisting. Subsequently, there have been relaxation measures adopted to strike a balance between enforcing compliance and to minimise the cost of such compliance. Similarly, the reforms introduced through Companies Act, 2013 and SEBI's regulatory norms have ensured that good governance is achieved with no phenomenal escalation in the cost of compliance.

Enforcement and Legal Scenario

The glaring deficiency in the Indian regulatory framework is the inefficient enforcement mechanism. Undue delays in investigation coupled with inordinate delays in the judicial process before a judgement is delivered have put the image of India in poor light to the external world. First Prime

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Minister of the country Pandit Nehru had remarked that a law is not as good as it is enacted, but it is only as good as it is implemented. A good law badly implemented can be disastrous. The effort that goes into the policy making or bringing out reforms, unfortunately, is never channelised to revamp the executive functioning for effective implementation thereof and prune judicial mechanism in the country to ensure expeditious disposal of cases. Such an endeavour, if successfully undertaken, can do a lot of good for the country and auger well for the global investment community eyeing India as one of the attractive destinations for the investment.

Mr. Madoff, the promotor of Madoff company in US was caught in the financial fraud of the magnitude of \$ 65 billion. The fraud came to light during the later part of 2008 due to which he was prosecuted, trial conducted and punishment pronounced in June 2009 imposing 150 years of imprisonment. Considering the fact that Mr. Madoff is an aged person, one might wonder on the purpose of such a severe punishment which cannot be fully served by any convict. But the point is that it sends the following two important messages to the Society at large:

1. The investigation and judicial process shall be expeditiously carried out and verdict pronounced within a short time so that no one can think that they can do any such malpractice and get away without being indicted for decades; and
2. All those with fraudulent intentions are forewarned as to what is in store for them if they defraud the stakeholders/public and erode the trust and confidence reposed on them.

If only the Indian system gears up to absorb these two principles and effectively get them practiced, there would be absolute trust and faith on the legal system in the country which is essential to escalate investment flow into India.

Legislating for the Exception

Yet another drawback in the Indian scenario is the tendency to make changes based on isolated events or exceptional occurrences. It makes a lot of sense, no doubt, to pick up lessons in every event so as to introspect on the scope for improvement but at the same time there should not be a knee jerk reaction to bring about drastic changes. Many a time, as

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observed by Late Shri Nani Palkhivala, the cause of concern could be a mere aberration warranting just the ironing out of the creases without any need for changing the fabric itself. On the surfacing of any fraud or scam, one may review the existing law and rules to study the scope for refinement or fine tuning to prevent recurrence but the thought process should not be swayed to take extreme positions which might bring in more complexity and make the lives of those who honestly comply with the laws miserable.

Good people do not require laws to tell them what to do and what not to do. On the other hand, there are bad people who would always find ways and means to circumvent the law irrespective of whatever changes that are brought in. If the act of changing the law or bringing in new provision by itself can prevent frauds from being committed, then Corporate financial frauds must have stopped in the US after introduction of SOX. On the contrary, frauds continued and were found to be of bigger magnitude. As Mahatma Gandhi said there is enough for everyone's need but not for everyone's greed. So long as the human desires breach sanity levels and values are compromised, frauds would continue. But effective implementation of law supported by robust investigation, speedy trial and stringent punishment would bring down offences and re-enforce faith in the minds of the stakeholders. The system should evolve zero tolerance to unethical methods in the course of building up of a credible economy.

Triple Bottomline Reporting

In the developed economies, the focus is shifting from financial reporting to "Financial, Social and Environmental reporting" which is recognised as Triple Bottom-line Reporting (TBR). The management, auditors and stakeholders need to be educated about this evolving concept and gear up to play their respective roles as and when TBR

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integrates with governance norms. This is not just about corporate social responsibility (CSR). It is far beyond CSR and CSR is a small component of TBR. Measuring financial results are comparatively easier and so is the function of reporting thereon. But, measuring contribution to social and environmental aspects of the society is challenging. The consciousness to preserve the resources of the society and preserve the environment is bound to discipline the way the businesses are carried on by the corporate citizens and that would be an important dimension of governance. The present generation cannot be allowed to exhaust or contaminate the natural resources to become prosperous at the cost of making the life of the future generation vulnerable to the hazards of non-preservation of natural resources and environment. When TBR emerges in India, the governance norms will undergo a paradigm shift. We need to gear up now to kindle the awakening and rise to the expectations then.

Ethical Governance and Economy

Corporate India plays a vital role in promoting economic growth of Nation. Efficient corporate governance administered by ethical leadership is critical for bolstering the economic growth of the nation. In a developing economy, Indian corporate leadership faces multiple challenges but if these challenges can be overcome with clear conscious and efficient governance, the fruits of the labour would be quite commensurate and rewarding. When the corporate governance norm reforms are at crossroads in India, the need to blend the governance norms with ethics and leadership cannot be undermined as it can transcend the Indian companies beyond conventional anecdotal wisdom to emerge strong in the globalised competitive environment.

In 2014, India was ranked at 142 out of 189 countries in terms of *ease of doing business*, later it moved to 130th rank, and now it has improved to 100th position. This could be accomplished mainly due to large reforms introduced in the legal field; banking sector and business environment. If this

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positive trend is continued and the ground reality is drastically altered, then there is tremendous scope for economic growth at a pace which would be befitting India's true potential. India was in the 9th position in terms of the size of the GDP in 2010 and moved to 7th position in 2015. Now it is in the 6th position and marching towards 5th position on account of significant formalisation of the economy due to demonetisation and GST coupled with substantial digitisation of transactional banking.

Conclusion

Chartered Accountancy profession can play a dominant role in the policy formulations relating to corporate governance through ICAI and in the execution thereof on account of multiplicity of roles we play in the corporate world. As we continue our glorious journey, it's time that we take stock of scams and frauds that are unfolding around us and ensure that we are neither party to such occurrences nor victims to those happenings. We must perform our duties diligently and with due adherence to the standards set by ICAI. We must be able to demonstrate to the society and regulators that if at all there is any perceived deficiency, it is on account of expectation gap and not due to performance gap. Let us make the society feel proud of our profession and thereby justify our existence. No other profession can boast of having as proximate a role and nexus as ours with the corporate governance mechanism and with the economic development of our country. Let us reinvent the significance of our role in partnering, participating and partaking in the task of building a credible economy in our incredible India. ■