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Enhancing Corporate Governance through Ethics: In Indian Scenario

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Abstract*: The word 'Corporate Governance' (CG) has become a buzzword these days due to various corporate failures world over in recent past. The Corporate Governance emphasis on the Value framework, the ethical framework and the moral framework under which business decisions are taken corporate governance is a broad term is today's business environment. The legal outfits of corporate governance can be customized to fit the meticulous choice of each wearer. The goal of this paper is to determine the influence of these characteristics of the Board in terms of promoting and hindering the creation of a code of ethics. All over the world, especially in Indian Companies trying to instill the sense of governance into their corporate structure. One of the reasons is due to the very essence of social consciences that is minimal and profit making took center stage. Hence, this article is a review of literature on improving corporate governance through ethics in Indian Scenario. History has revealed that there is a never-ending evolution of theories or models of corporate governance. Ethics related theories such as business ethics theory, virtue ethics theory, feminist's ethics theory, discourse theory. However, through code of ethics which effect the situations, such as the configuration of board members, audit committee, independent directors and the role of top management and their social relationships rather than its regulatory frameworks. Hence, it is suggested that a combination of ethics with corporate governance is best to describe an effective and good governance practice rather than based on simple corporate governance in India. This paper gives a summary of how corporate governance is influencing the present economic condition of India and also analyses the relationship between corporate governance and ethics.

***Keywords*: Corporate governance, Enhancing, Ethics, Indian Scenario.**

1. Introduction

Over the last two decades, corporate governance has attracted a great deal of public. Interest because of its apparent importance for the economic health of corporations and society in general there are a number of factors that have brought ethical issues into sharper focus, including technology and rising competition. Legal mechanisms involve "doing the right thing", while ethical mechanisms entail "doing things right. The term "corporate governance" has a clear origin from a Greek word, "kyberman" meaning to steer, guide or govern. The objective of this paper is to explain corporate governance from the point of view of India. Being an emerging economy, it has its own sets of challenges and weaknesses. The paper will look at how following good corporate governance practices is not only necessary for any firm but is essential for the benefit of the countries‟ economy too and also in an ethical way. In recent years, with much corporate failures, the countenance of corporate has been scared. They have reached to every corner of the globe in various sizes, capabilities and influences. Their governance has influenced economies and various aspects of social landscape. Shareholders are seen to be losing trust and market value has been tremendously affected. As a result, there was a wave of regulations and code of ethics on corporate governance to aid in preventing similar problems occurring in the future. Those regulations focused on improving the corporate governance environment, calling for strict application of principles of corporate governance, implementing guidelines on the independence of the board of directors and other committees of firms. In other words, when investment takes place across national borders, the investors want to be sure that not only their capital handled effectively and adds to the creation of wealth, but the business decisions are also taken in a manner which is not illegal or does not involve moral hazards (S.k verma & Suman gupta, 2004). The present paper is organized as follows: Literature Review, Objective of the Study, India and Corporate Governance, Ethics, Ethics and Corporate Governance, Need for Corporate Governance, New Foundations for Directors and Shareholders, Limitations and Implications for the Future.

A. *Objective of the study*

This study is an effort to explore and examine the current corporate governance and Ethics in India.

2. Literature review

Good corporate governance practices help corporations and its stakeholders; to do so various audit committee mechanisms and theories are required. Research on corporate governance with respect to the emerging market in much needed. Various benefits of following better corporate governance practices are noticed. A corporate governance framework needs to be developed by providing a broad overview of recent corporate governance research. All aspects of corporate governance are important from board structure to ownership structure. In about 28 developed and developing countries major corporate governance reforms took place. These reforms affected investor protection as well as impacted corporate investments. Corporate governance has become an important issue for China and India as they regularly interact with investors from developed countries. Different aspects of business ethics and its relation to corporate governance can be discussed in detail by understanding various issues related to corporate board of directors and the basis on which they should be analyzed. Ethics in corporate governance also plays an important role; operational dynamics of corporate governance are a necessary part of modern industrialization and Globalization.

Ethical behavior is an important aspect for the success of a company, as it influences its Relations with various stakeholders (employees, investors, clients, suppliers, etc.), thus assuring the success of a business. The ethical reputation of a company doesn't necessarily lead to new performances, but non-ethical reputation may seriously affect future performance or the enhancement of new businesses. Large majority of phrases and terms, defining ethical Behavior, lead to the term of corporate social responsibility (CSR).

3. India and corporate governance

Corporate governance has played a very important role in the present economic condition of India. India successfully started its move towards open and welcoming economy in 1991. From then onwards it has seen an amazing upward trend in the size of its stock market, that is, number of listed firms was increasing proportionately. If India wants to attract more countries for foreign direct investments, Indian companies have to be more focused on transparency and Shareholders value and wealth maximization. Even though corporate governance practices can be backdated to as early as 1961 around the world, India was lagging behind. It was not until 1991 when liberalization took place and corporate governance established an international context. The most important initiative of 1992 was the reform of Securities and Exchange Board of India (SEBI). The main objective of SEBI was to supervise and standardize stock trading, but it gradually formed many corporate governance rules and regulations. The next major change was formation of Confederation of Indian Industry (CII) in 1996, which developed the set of laws for Indian companies as to initiate the act towards corporate governance. Then two committees Kumar Mangalam Birla and Narayan Murthy under SEBI started laying the standard framework for formalizing the best practices on corporate governance. Based on suggestions from these committees, Clause 49 was introduced as part of the listing contract for the companies listed on the Indian stock exchange. However, due to scandals like Enron, Satyam, WorldCom etc. forced the clause 49 to be reformed to incorporate and overcome the problems that caused these companies to collapse and shatter the economies of the respective countries. It contained all the regulations, policies and requirement of minimum number of independent directors, board members, different necessary Committees, code of conduct, rules and limits, etc. Firms that were not following these principles were removed from the listing and were given financial penalties

As far as the responsibilities of management and number of directors were concerned, they are both the same. They also have same rules regarding insider trading, refusal of loans to directors and so on. Corporate governance affects corporations as well as countries in different ways such as firm’s access to outside financing increases, which leads to more investment, better growth opportunities and that causes the job market to flourish. Firms can be attracted by this, which directs it to growth and again to reduced unemployment. Wealth is generated by better distribution of resources and good management practices, which is because of better operational performance. Better corporate governance can be associated to reduce financial crises. As these crises, have devastating effects of any countries economy. If corporate governance practices are followed properly this creates better rapport with the stakeholders. We can further see what significant role does corporate governance plays in the investment process. As corporate governance provides property protection and safe modes of ownership registration, it automatically affects the firm’s capital mobilization.

Fraudulent behavior of companies has caused countries to go through financial crisis. Corporate governance hence became a critical issue for all the countries around the world. From Satyam Computer Limited of India to Enron of the U.S., pattern is more or less same. Failure of companies of these massive sizes created havoc in the industry and had caused the economic meltdown. The immediate action that the Indian authority took in response to the scandals reveal how government in emerging economies also feel the need to promote good corporate governance practices. Furthermore, understanding corporate governance standards and issues is also important to executives of foreign multinationals planning to do business with India In this paper, the study showed how in India corporate governance has become an inseparable entity.

4. Ethics

Business ethics is based on the vast topics of reliability and justice. Business ethics means applying the general ethical principles to business problems and finding the solution that will be “right” in all aspect. Business problems arise when the decision made by the board is going to affect either profitability or its shareholders in the end. Fig. 1 gives us a brief overview of elements of corporate governance relating to ethical behavior are defining the role of board of directors and finalizing the executive compensation. Some basic functions that come under business ethics umbrella are enumerating proper behavior, set up firm’s values, defining responsibilities, present leadership and guidance; relate conclusions to stakeholders as well as shareholders.

As the paper negotiate how important it is for a company to follow good corporate governance practices which are ultimately ethical too. Companies need to do much more than just attaining the good corporate governance practices; it should constantly strive for fulfilling the best interest of all its members. It focuses on deciding the management structure in any organization such as board of directors, audit committee, shareholders committee, and selection of independent auditors etc. The basic issue with governance is that there is no objective measure against which it can be said if it is good or bad. Here the company's ethics come into play. Corporate Governance practices should be planned in such a way that it will encourage a suitable environment for corporate social responsibility, reliability, transparency and ethics. It is one of the ten core principles of corporate board of directors that was authored by the National Association of Corporate Directors, 2008. Business ethics mostly has to deal with choice of conflict of interest and value. Corporate directors have fiduciary duty towards the stockholders. Board members are the eyes and ears for the shareholders and the firms.

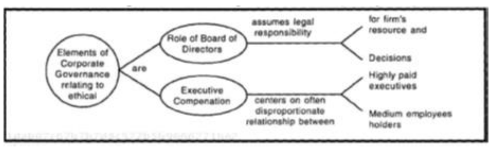

Fig. 1. Elements of corporate governance (Murthy, 2009)

5. Ethics and corporate governance

Apart from fundamental corporate governance theories of agency theory, stewardship theory, Stakeholder theory, resource dependency theory, transaction cost theory and political theory; there are other ethical theories that can be closely associated to corporate governance. These include business ethics theory, virtue ethics theory, feminist ethics theory, discourse ethics theory, postmodern ethics theory. Business ethics is a study of business activities, decisions and situations where the right and

Wrongs are addressed or analyzed. The main reasons for this are the power and influence of business in any given society is stronger than ever before. Businesses have become a major provider to the society, in terms of jobs, products and services. Business collapse has a greater impact on society than ever before and the demands placed by the firm's stakeholders are more complex and challenging. Only a handful and reputated business giants have had any formal education on business ethics but there seems to be more compromises these days. Business ethics helps us to identify benefits and problems associated with ethical issues within the firm and business ethics is important as it gives us a new light into present and traditional view of ethics (Crane and Matten, 2007). In understanding the 'right and wrongs' in business ethics, Crane & Matten,(2007) injected morality that is concerned with the norms, values and beliefs fixed in the social process which helps right and wrong for an individual or social community. Ethics is defined as the study of morality and the application of reason which sheds light on rules and principle, which is called ethical theories that ascertains the right and wrong for a situation. Whilst business ethics theory focuses on the "rights and wrongs' in business, feminist ethics theory emphasizes on empathy, healthy social relationship, loving care for each other and the avoidance of harm. In an organization, to care for one another is a social concern and not merely a profit centered motive. Ethics has also to be seen in the light of the environment in which it is exercised. This is important as an organization is a network of actions, hence influencing trans communal levels and interactions (Casey, 2006). On the other end, discourse ethics theory is concerned with peaceful settlement of conflicts. Discourse ethics, also called argumentation ethics, refers to a type of argument that tries to establish ethical truths by investigating the presuppositions of discourse (Habermas, 1996). Meisenbach (2006) contends that such kind of settlement would be beneficial to promote cultural rationality and cultivate openness. Virtue ethics theory focuses on moral excellence, goodness, chastity and good character. Virtue is a state to act in a given situation. It is not a habit as a habit can be mindless (Annas, 2003). Aristotle calls it as disposition with choice or decision. For example, if a board member decides to be honest, now that a decision which he makes and thus strengthens his virtue of honesty. Virtue involves two aspects, the affective and intellectual. The concept of affective in virtue theory suggests "doing the right thing and have positive feelings", whilst, the concept of intellectual suggests "to do virtuous act with the right reason". Virtues can be instilled with education. Aristotle mentions that knowledge on ethics is just like becoming a builder (Annas, 2003). Through the process of educating and exposure to good virtues, the development of ethical values in a child's life is evident. Hence, if a person is 94 Middle Eastern Finance and Economics - Issue 4 (2009) exposed to good or positive ethical standards, exhibiting honesty, just and fairness, than he would exercise the same and it will be embedded in his will to do the right thing at any given situation. Virtue ethics is eminent to bring about the intangibles into an organization. Virtue ethics highlights the virtuous character towards developing a morally positive behavior (Crane and Matten, 2007). Virtues are a set of traits that helps a person to lead a good life. Virtues are exhibited in a person's life. Aristotle believed that virtue ethics consists of happiness not on a hedonistic sense, but rather on a broader level. Nevertheless, postmodern ethics theory goes beyond the facial value of morality and addressed the inner feelings and 'gut feelings' of a situation. It provides a more holistic approach in which firms may make goals achievement as their priority, foregoing or having a minimal focus on values, hence having a long term detrimental effect. On the other hand, there are firms today who are so value driven that their values become their ultimate goal (Balasubramaniam, 1999).

6. Need for corporate governance

The need for corporate governance is highlighted by the following factors:

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1) Wide spread of shareholders

Now a day's companies have a very large number of shareholders spread all over the nation and even the world; and a majority of shareholders being unorganized and having an indifferent attitude towards corporate affairs. The idea of shareholders' democracy kept confined only to the law and the Articles of Association; which requires a practical implementation through a code of conduct of corporate governance.

2) Changing ownership structure

The system of corporate ownership has changed considerably, in the present -daytimes; with institutional investors (foreign as well Indian) and mutual funds becoming largest shareholders in large corporate private sector. These investors have become the greatest challenge to corporate managements, forcing the latter to abide by some established code of corporate governance and ethical laws to build up its image in society.

3) Corporate scams or scandals

Corporate scams (or frauds) in the recent years of the past have shaken public confidence and trust in corporate management as well as in Indian market. The event of Harshad Mehta scandal, which is perhaps, one biggest scandal, is in the heart and mind of all, connected with corporate shareholding or otherwise being educated and socially conscious. The emergence for corporate governance is, then, imperative for reviving investors' confidence in the corporate sector towards the economic development of society.

4) Greater expectations of society of the corporate sector

Society of today holds greater expectations of the corporate sector in terms of reasonable price, better quality, pollution control, best utilization of resources, awareness of the accurate information etc. To meet social expectations, there is a need for a code of corporate governance, for the best management of company in economic, legal and social terms.

5) Hostile takeovers

Hostile takeovers of corporations witnessed in several countries, put a question mark on the efficiency of managements of take over companies. This factor also points out to the need for corporate governance, in the form of an efficient code of conduct for corporate managements and also better provisions for directors.

6) Huge increase in top management compensation

It has been observed in both developed and developing economies that there has been a great increase in the monetary and non-monetary incentives (compensation). Packages of top level corporate executives. There is no justification for exorbitant payments to top ranking managers, out of corporate funds, which are a property of shareholders and society.

In corporate relationships, it seems reasonable to expect that operating organizations should serve different stakeholders in an ethical manner. A corporation should engage with its internal and external stakeholders to determine its current ethical reputation amongst the stakeholders, as well as what their ethical expectations are of that organization (Rossouw, 2010). Thus, under the corporate governance requirements, a corporation should account for its ethical performance and duly report it to relevant stakeholders. According to Khomba and Vermaak (2012), the discussion of the business ethics dimensions is varied depending largely on social and economic elements surrounding the organizations concerned. The view that prevails depends on the roles that organizations are supposed to play internally and in society in general. In micro ethics, the central question is the fairness of the organizational choice of an economic system and also the ethical merit of the key elements of such a system. Essentially these key elements comprise the profit motive, private property, the Limited liability of corporations, competition, and andfree markets (Du Plessis, 2010).

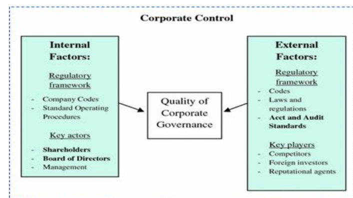

Fig. 2. Factors for corporate Governance Control

7. New foundations for board of directors and shareholders

- One or more women directors are suggested for certain classes of companies
- The Independent directors must attend at least one meeting a year
- Every company in India must have a resident directory
- The maximum permissible directors cannot exceed 15 in a public limited company. If more directors have to be appointed, it can be done only with approval of the shareholders after passing a Special Resolution in the meeting.
- The Independent Directors are a newly introduced concept under the Act. A code of conduct is prescribed and so are other functions, responsibilities and duties.
- Every company must appoint an individual or firm as an internal auditor. The responsibility of the Audit committee has increased.
- Filing and disclosures of reports with the Registrar of Companies has increased.
- Top management recognizes the rights of the shareholders and ensures strong cooperation between the company and the stakeholders.
- Every company has to make accurate disclosure of financial situations, performance, material matter, ownership and governance.

A. Additional Preparations

- *Changes in Clause 35B:* The evoking facility has to be provided to the shareholder for any resolution in the meeting is a legal binding for the company.

- *Corporate social responsibility:* The Company has the responsibility to promote social development in order to return something or produce some productivity that is beneficial for the society.
- *Related party transactions:* A Related Party Transaction (RPT) is the transfer of resources or facilities between a company and another specific party. The company devises policies which must be disclosed the facts on the website and in the annual report. All these transactions must be approved by the shareholders by passing a Special Resolution as the Companies Act of 2013. Promoters of the company cannot cast a vote on a resolution for a related party transaction.
- *Whistle blower policy:* This is a mandatory provision by SEBI which is a vigil mechanism to report the wrong or unethical conduct of any director of the company which enables the company and management affairs in systematic way.

8. Limitations and implication for the future

As the scope of this paper was limited to India, it discusses only the perspective of India's corporate governance. For future research, more developing and developed countries can be compared to see the impact of reforms of corporate governance and ethical practices and other factors that affect corporate governance can be analyzed and examined and added to this study too. The future of corporate governance is becoming a little clear now, as in the future the investors would be promoted to behave like owners rather than just traders. Independent directors will have more defined roles and responsibilities. And the incentives said to be given out to others will be distributed to the shareholders. In long run, a market-oriented and shareholder-centered system will develop into a new emerged system as stakeholder-oriented system making finance itself accountable to the public interest.

9. Conclusion

In this study, we saw how significant it is for a company to follow good corporate governance practices in an ethical way. Then we looked at the brief history of corporate governance in India and its present economic, social and financial situations. Then the paper started going deep into factors that affect corporate governance such as ethics, internal governance, and choice of auditors and other committee. India being an emerging economy needs to work more on regulating the corporate governance policies. Indian companies still have the scope to paint a brighter future for them. They need to acknowledge and continue with the corporate governance reform, and always keep in mind that this brighter future will have its own set of challenges. We can very well conclude that, "As legal rules are, to a significant degree, endogenous to the political economy context of the systems in which they operate and so are the corporate governance practices"

Corporate governance practices are playing an important role in the growth of companies. So the conclusion is that the moral practice should have to follow by all organizations for smooth running of business, for formulate good corporate image, to increase the transparency in corporate affairs and at the end to protect the interest of its stakeholders without any hurdles or issues in the firms.

With the effective corporate governance based on core values of integrity and trust, companies can gain much competitive advantage which attracts and retains best significant alternatives and generates positive reactions in the market place- if any company got reputed for ethical behavior in this competitive market place it ensures not only customer loyalty but also employee loyalty. Effective corporate governance can be derived by following a set of principles and best practices. A great deal depends upon fairness, honesty, integrity and the manner in which companies conduct their management affairs. Companies must make a profit in order to survive and grow; however, the pursuit of profits must stay within ethical boundaries. Companies should adopt policies that include environmental protection, whistle blowing, ethical training programs etc.

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