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Corporate Governance: Transparency, Stakeholders and Red Flags

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Introduction

Why is Good corporate governance important? It is important because of the following:

- It helps prevent corporate scandals,
- It helps prevents fraud and loss of finances
- It helps identify potential civil and criminal liability of the organization
- It enhances the reputation of the organization and makes it more attractive to customers, investors, suppliers.

Is Good Corporate Governance expensive? No. The answer to this question is provided hereinafter. Good corporate governance can be performed in a cost-efficient manner by focusing efforts on the significant risks facing the organization rather than attempting to cover any possible theoretical risk, and by installing the best cost-efficient practices within the organization. The benefits of good corporate governance, by avoiding governmental investigations, lawsuits, and damage to the reputation to the organization, significantly outweigh the cost of good corporate governance. The benefits of good corporate governance are longer term, whereas the costs of good corporate

Good Corporate Governance is dependent on several factors such as Transparency, Strength of Independent Directors, and Strength of the Regulators, the Stakeholder and the Management. It is often found that if the Regulators do not perform their work, there are rampant violations resulting in bad corporate governance. Therefore, Regulators should not be just paper tigers. Instead they must

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be willing to act appropriately as the situation demands. Let us see the importance of transparency in Corporate Governance. Transparency used in Corporate Governance means that all material facts and issues are revealed in real-time by Companies. This will help stakeholders to have more confidence in them. This will mean more investments more wealth to Shareholders, lesser noncompliance and lesser Corporate Compliance risks. So, Transparency helps those in charge to avoid fraud and put measures in place against it. All these factors put together enable the firm's productive capacity and productivity to improve.

What are the Red Flags that Help Detect Bad Corporate Governance

Unpaid Dividends

When dividends are declared and payment of dividends has not happened, it indicates that such a company is fudging the accounts. The company has no cash to pay dividends, taxes and statutory payments. Sooner, the company will default on many more and end up in a very bad state.

Key Managerial Persons Compensation

Despite inadequate profit or no profits, senior managerial personnel are paid huge bonus in cash. So this can mean that these senior managerial personnel are busy cooking up facts to please the promoters or someone else, but not the stake holders. Large scale credit sales and subsequently over the period of next couple of months these sales are written back or are unrealized.

- **Fake Invoicing, Off Balance Sheet Entries, SPV:** Several off shore companies to facilitate fake sales. So in this case, such companies, with the help of the parent company, will resort to discounting of their sales invoices with Banks. These debtors never pay up the parent company and the bank finances run bad, leading to several issues, including financial fraud.
- **Stuffing the Channel:** where dealers or channel partners are appointed. To boost sales, these partners are stuffed with sales from the company, even when there is no order placed by the partners or dealers. Ultimately, either these sales are returned immediately or returned as unsold stock after a period of time.

Directors – Their Capability & Independence

Another important aspect is the capability of the directors which are entrusted with the oversight of the management. It is important to analyze whether the new director, or the director whose term is being extended, has the relevant experience. Director performance appraisal helps in rating a Director. However, sometimes, Directors get away with poor rating because of their proximity to the Promoters.

- **Board – Attendance & Agenda:** Many a times, a Director seldom attends Board Meetings and again due to their proximity to the top management or promoters, they get away from being removed from the Board. Fake entries of their attendance are made in Meetings, even when such director is not present.

- **Auditors – Under Influence:** Where there in Auditor who has conflict of interest, this could be a reason for fraud going unreported.

Culture & Past History

In addition to above, it is also important to keep a tab on the news flow about the organization. One should be confident that the board culture fosters innovation and openness. Closed minds or overpowering CEOs, lead to increased friction amongst board members and also between directors and the management Funds for long term are diverted to short term use. This is a Red flag that Governance is failing. This situation will lead to non-payment of loans, defaults and the loan becoming bad.

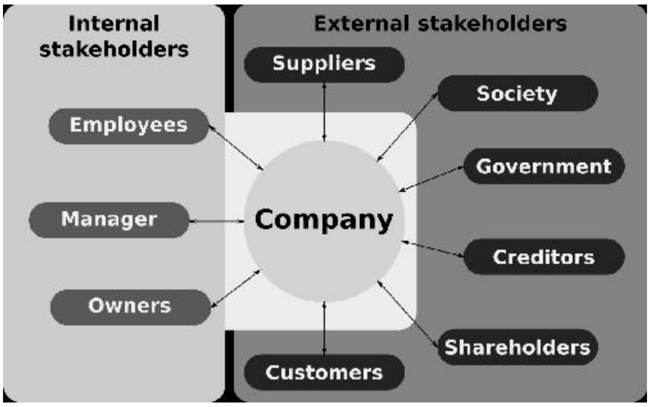
Corporate Governance and Stakeholder

Who is a stakeholder- The following four criteria determines a Stakeholder. These are:

- A Stakeholder is one who has a fundamental impact on your organization's performance
- Secondly stakeholder relation with the organization will be dynamic
- Organization can also identify what it needs from the stakeholder
- IF the stakeholder can be replaced, it is not a stakeholder

Answering the above four criteria, provides us a list of some important stakeholders:

- Customers
- Employees.
- Shareholders
- Suppliers, distributors and other business partners
- The local and international community
- National Government and regulatory authorities



Corporate Governance Check List

- **Determinants of Board and Disclosures**
  - Are the roles of Chairman/MD or CEO split?
  - Is the Chairperson an ID or Non ED?
  - Do NED comprise 2/3 of the Board strength?
  - Does the board meets at least four times in a year or just paper meetings are held?
  - Are Minutes properly recorded, dated and signed by Chairman within due dates is dissent recorded in Minutes?
  - Whether directors are clearly classified into executive, NED, and independent?
  - Is Board, its committee's performance evaluated?
  - IS CEO/MD's performance and effectiveness is appraised and disclosed?
  - Are Independent and Non ED performance evaluated?
  - Whether directors' biography, experience and responsibilities are disclosed?
  - Does a policy exist that prohibits directors, officers and employees (insider) share dealings around the release of price sensitive information is disclosed?
  - Is there a Company Secretary and other Key Management Personnel?
  - Is a nomination committee established?
  - Whether the nomination committee consists of a majority independent NEDs?
  - Whether the chairperson of the nomination committee is an independent NED?
  - Whether the membership of the nomination committee is disclosed?
  - Whether the nomination committee's members' meetings attendance record is disclosed?
  - Whether a remuneration committee has been established?
  - Whether the remuneration committee is constituted entirely by independent NEDs?
  - Whether the chairperson of the remuneration committee is an independent NED?
  - Whether the membership of the remuneration committee is disclosed?

  - Whether the remuneration committee's members' meetings attendance record is disclosed?
  - Whether directors' remuneration, interests, and share options are disclosed?
  - Whether director remuneration philosophy and procedure is disclosed?
  - Whether directors' have access to free independent professional legal advice?
- **Section 2: Comprehensive Accounting and Auditing Disclosures**
  - Is there an Audit Committee?
  - Does the Audit Committee comprise of majority NED? Are AC minutes discussed in Board Meetings, and what actions are taken on the recommendations of AC?
  - Whether a board statement on the going-concern status of the firm is disclosed?
- **Risk Mitigation, Internal Control Measures and Disclosures**
  - Is there a Corporate Risk management Committee?
  - Does this committee meet each quarter and are the minutes recorded and shared at Board Meetings?
  - Whether a narrative on both actual and potential future systematic and non-systematic risks is disclosed?
  - What is the information available on existing internal control systems (including internal audit)?
  - Is there a Corporate Compliance Committee in place? Does this committee meet quarterly and are non-compliances placed before Board?
- **Reporting and MIS**
  - Whether a narrative on the actual measures taken by a firm to address occupational health and safety of its employees is disclosed?
  - Whether a narrative on how a firm is actually complying with and implementing rules and regulations on the environment is disclosed?
  - Whether a narrative on the existence of a code of ethics is disclosed?
  - Whether a narrative on the actual community support and other corporate social investments or responsibilities is disclosed?

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