Vol II Issue XII Jan 2013
Impact Factor : 0.2105
ISSN No : 2230-7850

Monthly Multidisciplinary
Research Journal

Indian Streams Research Journal

IMPACT FACTOR : 0.2105

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RNI MAHMUL/2011/38595 **ISSN No.2230-7850**

Indian Streams Research Journal is a multidisciplinary research journal, published monthly in English, Hindi & Marathi Language. All research papers submitted to the journal will be double - blind peer reviewed referred by members of the editorial Board readers will include investigator in universities, research institutes government and industry with research interest in the general subjects.

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Indian Streams Research Journal
Volume 2, Issue.12,Jan. 2013
ISSN:-2230-7850
Available online at www.isrj.net

ORIGINAL ARTICLE

ETHICS, CORPORATE GOVERNANCE AND INVESTMENT

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Abstract:

The efficiency, integrity and capability of Board of Directors, Chief Executive Officers and Top Management of Cooperates in Directing, Controlling Corporates to accomplish their goals and objectives come under scanner when giant corporations around the globe (particularly in emerging economies like India) fail suddenly due to poor ethical practices. The Satyam Corporation may be cited as classic example.

INTRODUCTION:

Stock exchanges suffered huge losses. These shocks affected the economy and image of respective nations globally. It caused road block to national economic development and enormous suffering to humanity besides the winding/insolvency of the respective companies. These results in huge amount job loss .Such failures do not happen overnight. They develop gradually overtime and suddenly burst out one day. Everyone began to cry and rush here and there as to what will happen, how we can survive, and who will suffer the losses.

Background: - We have a very high standard capital markets (exceptions apart) in many emerging economies like India. The standards of regulations in countries like India are globally comparable, but, focus is required to fulfill the gaps that are still persisting. At present nearly ten percent of the total savings by India's small investors are being invested in capital markets and remaining are being invested in banks .There is a strong need to develop ethical standards so that maximum investment opportunities could be extended to retail (small) investors and so that they could also be benefited in growing economies like India.

Purpose of the Study:-It should be kept in mind that investor relations begin and end with ethical governance practices. The present study attempts to measure the corporate governance in a template and find out how investors can derive the right signals from the ratings. Below given are some themes through which an investor should look for while rating companies. The study also tries to define the functioning of corporate governance in a broader and practical manner. The study focuses on the functioning of financial administration, legal system, and governance practices in emerging economies with special reference to India.

1. Ethical corporate governance practice: - Corporate governance focuses on establishing the relationship of shareholders, stakeholders with board and management so as to meet the demand to make board and management more accountable. It should be aimed to reestablish the faith in ability and capability of the company and its management by replacing mis-governance by good governance so that companies should do justice to all. All the corporate today need to comply with structure and procedures relating to corporate governance. Compliance with regulatory prescription is a minimum requirement of good corporate governance. Companies need to do much more to attain efficiency, economy and effectiveness then just fulfilling legal requirements. Internal pressure, peer pressure and market pressure play a much greater role to attain higher standards in governance than legal requirements. Corporate governance focuses on the

composition of management structure at various levels, such as formation of Board of Directors, audit committee, remuneration committee and shareholders committee, selection of Independent directors. All these activities provide a structural solution to Governance practices but Governance is a judgmental and evaluation process and not merely a question of objective measurement. The point to be emphasized is corporate governance in letter versus corporate governance in spirit. This is, whether corporate boards are focusing on ensuring that all the created committees do no wrong and comply with regulations.

2. Shareholder's & Stakeholders rights and equitable treatments:- We have strong evaluation of law, listing agreements ,Sebi regulations, shareholders rights provided in our legal system which provides the best rights to our shareholders . When we compare Rights of our shareholders with those of Russian (another growing economy like India) shareholders our shareholders are better placed. A company's management in Russia can reject a shareholder if he/she troubles the managers of the company. Company can also reject his membership. However, in emerging economies like India, the full force of corporate democracy is not yet at acceptable stage .This is because shareholders are not aware about their rights. The shareholders have right to information about the working of a company as frequently as possible. In turn the corporate are accountable or producing good performance in ethical manner.This information is to be shared with shareholders as well as stake holders. This sharing and interaction will act as a self-regulatory mechanism on corporate to tune their operations ethically in line with the requirements.

Stakeholder's rights:-Companies generally fail to identify this risky area that can affect their sustainability while following some unethical practices. Most of the times, stakeholders suddenly strike and whole business model suffers. Consider the case of auto component manufacturers in pre-globalization era. Auto component manufacturers were in a position to dictate terms to the suppliers and, can even ignoring suppliers would not have made much difference then. However, in post liberalization era because of increased competition, many companies are ready to take supplies and such a situation increases risk on the part of the companies dependent on those suppliers.

Employee's rights and their representation:-When we ask most of the company heads or CEO's the most important aspect for them, the oratory answer would be 'employees'. In annual reports, when it comes to information related to fixed assets, there is no mention about employee satisfaction but only appraisal for board and management team. On one hand, employees are considered most important asset but on the other, no aspect relating to them is being shared in any report disclosed to shareholders. Is it not an unethical practice?

3. Disclosure and transparency:-At present in Indian business environment the disclosure practices, both in terms of financial information and current happenings are transmitted transparently because of timely reaction of media and regulatory requirements. The shareholder has every right to obtain information about the working of the company, so information has to be shared with them properly. The information sharing mechanism would act as self regulatory internal mechanism for corporate to tune their operations in an ethical manner, media has a vital role to maintain ethical practices as media analyze and discuss performance of companies and educate investors.

Role of Media:-Media needs to play a positive role in ensuring good corporate governance by increasing investor's knowledge through investor education and timely disclosure of information in emerging economies like India. Media help to investors to analyze what corporate are saying. Media discusses the performance of corporate in addition to educating the investors and applying pressure on organizations when needed.

4. Independent Directors: - Independent Directors are at the core of success of corporate and are responsible for operation and soundness of a company. They help the company to focus on set goals and objectives and act as guardians to the stakeholders and management. They are the advisors to guide the corporate behavior and increase value and wealth of the company in the most ethical manner. The best form of relationship between Management and Board of Directors is when Board challenges the management but also supports it when necessary. The management must look after the board and should benefit from the experience of Independent Directors. Independent Directors address Governance issues and complement what management needs in terms of skills and capabilities in the most ethical manner.

Adequate number of independent directors with adequate abilities:-It has also been noticed specially in countries like India that industrialists usually employ people like drivers, cooks as independents directors just to comply with regulations stipulated by SEBI(Recent blames on Purti group (A company managed by one of the famous Indian politician)can be sited as classical example . Such an independent director would be paid minimum amount of salary or cutoff salary stipulated by SEBI or other such regulating bodies .These directors are no way related to the company and there are no transactions between them and the company, so the persons qualify to be an independent director. The way complying with regulations in this fashion is just a structural solutions and not an evaluation process. Corporate needs to remember that Governance is not an objective measurement but a judgmental process.

5. Capital Asymmetry: - This is an effect that misguides the small investors to a large extent in addition to reducing the investment quotient of small investors and pushes them away from the market. Suppose there is company whose analysts are expecting twenty five percent rises in income and actual rise ends up to twenty eight percent. This would result in six percent rise in share price of the company, but, suddenly, if income rise is twenty two percent, then share price would fall by fifteen percent. This is capital asymmetry. The effect of good news (about company) on company's share prices is less in comparison to bad news (about company). Management need to think seriously about their performance reporting in order to manage such effect without compromising on ethics.

6. Corporate Governance Vs Community Governance: - To improve Corporate Governance, we need to focus on a broader concept, 'Community Governance'. Community Governance is not a charity, but, it comprises the way how we live and contribute to our society. No single person can improve Community Governance but community needs to work jointly for it.

Quoting Chancellor Allen, "The waters of Corporate governance have been stirred and they will not be stilled yet….the evolution of a global market and growth of institutional investors….. Are dynamic ….they will, they are now, pushing in the direction of greater efficiency and greater accountability."