Special Address of Dr. M. Veerappa Moily
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International Conference on Corporate Governance & Sustainability
"Enhancing Effectiveness of Boards through
Corporate Governance Best Practices"

It is my pleasure to address the International Conference on Corporate Governance & Sustainability.
"Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The corporate governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations, and society."

Sir Adrian Cadbury

As the economy shifts and the legislature, regulators and stakeholders respond, the design and implementation of governance, sustainability, responsibility and citizenship undergoes continual change. This change, its environment, extent, impact and trends is what is being focused and discussed worldwide today.

Historically, investors tended to separate the social issues from the financial issues they pressed companies to address. This is no longer the case, as social issues, such as employment, inclusive growth, climate change, have taken on unprecedented financial implications and have been taken up not only by the social investors but also by other stakeholders. A more integrated and coordinated civic market of large investors and stakeholder groups have emerged as a new source of pressure on companies. Their goal is to deepen and make explicit corporate commitments to a range of challenging issues that arises at the intersection of business and society. Also information technology and globalization is resulting in greater interconnection between stakeholders and companies.

Globalisation has made business more complex. As the proportion of global players entering emerging markets increases, established Indian players in several sectors will be exposed to more intense competition. Cost, quality, innovation, and pricing will hold the key to future success.
A unique feature of the Indian business landscape is the large presence of promoter-led companies. Promoters manage the company's operations and take important decisions though in many cases their holding tends to be lower than that of other shareholders. According to some estimates, 95% of the listed companies and almost 100 percent of the 42 mn unlisted companies in India are family-owned businesses. These companies collectively account for over 70 percent of the market capitalization, 75 percent of the GDP and 57 percent of the employment in the country.

In highly developed markets like the US too, family owned businesses account for over one-third of the S&P 500 and Fortune 500 companies and employ over half of the American workforce.

A study of 24 family-owned businesses by Harvard Business School showed that out of the sample of 24 companies, 12 family-owned businesses frequently outperformed their non-family owned peers. The key reasons attributable to the success of family-owned businesses are: command (i.e.granting senior management decision-making independence); continuity (i.e. adhering to a farsighted mission); community (i.e. embedding a culture with deep concern for employees); and connection (establishing strong relationships with clients and suppliers).

Since the demarcation of ownership and management in owner-managed companies is not specifically drawn, corporate governance assumes greater significance in the context of sustainable value creation. As

Indian businesses globalize, it is important to approach governance challenges holistically. Achieving desired competencies requires focus on structures, processes and people.

Key Challenges

- Access to capital to finance expansion
- Implement new projects successfully
- Manage risks effectively across projects and verticals
- Achieve operating cost efficiencies
- Effective integration post acquisition
- Improve and sustain quality
- Build brand and reputation

People

- Hiring the right people
- Succession planning
- Mapping competency gaps
- Performance management systems

Structure

- Governance structures aligned to growthneeds
- Reliable assurance
- Risk Management aligned to strategic priorities

Process

- Standardised processes across operations
- Effective IT architecture to support information requirements
- Strong Finance function
- Managing compliance requirements holistically
- Robust reporting systems

The process of value creation is a complex one involving many facets. Corporate governance is a two sided coin and it depends on the ability of the board and management to work together on a common mission and strategy.

Prime Minister Dr Manmohan Singh while addressing corporates last year remarked *"Businesses, by their very definition, need to be profitable. But the manner in which they use natural resources and the extent to which they are sensitive to the needs and aspirations of the common man is also critical to their own long-term survival and growth. Sustainability of business therefore includes not merely economic sustainability in the narrow sense of the term but social and environmental sustainability as well. Indeed, financial capital needs human, social and ecological capital to be viable in the long term sense of the term. Market activity that concentrates wealth without empowering the poor and the deprived is also unacceptable ethically."*

In view of the growing global recognition of the strong linkage between competition policy and the pillars of economic development, as evidenced in several countries, the OECD stressed:
"***The building of a competition culture is the most important step to be followed by all countries that are committed to promote a more market based economy***"

Guidelines: Statement on Competition Policy:

The essential elements to assess the overall competitive environment are:

a) a stable and effective political environment;
b) a regime based on the rule of law

c) a free and open macroeconomic environment;
d) abundant market opportunities;
e) positive policy towards private enterprise and competition;
f) positive policy towards foreign investments;
g) no foreign trade and exchange controls;
h) a transparent investment and tax regime;
i) easy access to financing;
j) a sophisticated labour market;
k) transparent and fair labour and immigration policies;
l) a strong physical infrastructure; and
m) Free flow of information.

Companies need to realize that market growth and competitiveness are not won merely on the back of selling more products and services more profitably than anyone else. Instead, long-term sustainability of operations will matter increasingly, and will rely on intangibles such as building and maintaining a good reputation, trustworthiness, ability to innovate and responsiveness to all stakeholders including society and the environment. **In recent years, as corporations and governments have increasingly been confronted with managing the expectations of a society newly alerted to the social and environmental risks of economic development, recognition is dawning that achieving a sustainable world is dependent upon democratic management, equitable distribution of wealth and** enhancement of corporate governance standards**.**

Strong corporate governance is indispensable to resilient and vibrant capital market and an important instrument for investor protection. It is the blood that fills the veins of transparent corporate disclosure and high quality Accounting Practices and it is here that the greatest damage has taken place in terms of scandals, which we go again preventive. More than dollar amounts involved in financial scams it is the loss of confidence, which is dead, which is deadly blow. Trust is fragile in nature and by definition it is fragile, it takes years of efforts to build trust but only a few acts to completely destroy it. Once it is broken it is even harder to rekindle and rebuild. While laws can address the regulatory and legal level and the changes in the structure of the board can address the issues of their independent functioning, no act by itself can guarantee a fickle behaviour.

Good governance requires efficiency, effectiveness, ethics, equality, economy, transparency, accountability, empowerment, rationality, impartiality and participation of citizens.

Quality of corporate governance primarily depends on following factors, namely:- integrity of the management; ability of the Board; adequacy of the processes; commitment level of individual Board members; quality of corporate reporting; participation of stakeholders in the management; etc. Since this is an important element affecting the long-term financial health of companies, good governance framework also calls for effective legal and institutional environment, business ethics and awareness of the environmental and societal interests.

Research has been inconclusive on the linkage between corporate governance and a company’s financial results. However, it is true that good corporate governance improves the reputation and image of an organization which in turn can contribute to sustainable inclusive growth. Companies which have demonstrated a culture of openness, transparency and accountability in good and bad times have been able to attract growth capital and have had the benefit of winning the trust of their customers, vendors, trading partners and employees and therein lies the true value of corporate governance beyond compliance.

"It is clear that good corporate governance makes good sense. The name of the game for a company in the 21st Century will be conform while it performs."

Mervyn King, Chairman – King Report

<u>Social Responsibility, Sustainability: Role of MCA:</u>

In India, Ministry of Corporate Affairs is bringing about and being part of the change to enable industry to adapt to the evolving business environment. The Ministry has been proficiently transforming the corporate environment to encourage foreign investment and domestic corporate contribution in taking the Indian economy from a high rate of growth to a rate of more inclusive and sustainable growth.

A significant feature of the expanding growth of the Indian economy is the increasing integration of the Indian corporate economy into the global business environment. We are working towards reforming the enabling environment for easing doing business in India by offering an enlightened regulatory regime and efficient services so that the entrepreneurial energies and growing foreign interest are utilized in creating value for the stakeholders. The Ministry is also encouraging the corporate sector to take into account the concerns of stakeholders beyond their investors and to demonstrate that responsible business governance can generate value for all the stakeholders. In the long run, this collaborative effort between the government and the corporate sector will become a key multiplier in helping India's growth story.

A number of initiatives have been taken by the Ministry on legislative, regulatory, service delivery and capacity building sides.

<u>CSR initiatives:</u>

The Ministry of Corporate Affairs had released Voluntary Guidelines on CSR in 2009 as the first step towards mainstreaming the concept of Business Responsibilities. Keeping in view the feedback from stakeholders, it was decided to revise the same with a more comprehensive set of guidelines that encompasses social, environmental and economical responsibilities of business.

The Ministry thus recently formulated and released "National Voluntary Guidelines on Social, Environmental and Economic responsibilities of Business" that will mainstream the subject of business responsibilities. The Guidelines are not prescriptive in nature, but are based on practices and precepts that take into account the realities of Indian business and society as well as the global trends and good practices adapted to the Indian context. It urges businesses to embrace the "triple bottom-line" approach whereby its financial performance can be harmonized with the expectations of society, the environment and the people it interfaces with, in a sustainable manner.

<u>Governance: Companies Bill</u>

They are part of the effort of the Government to create a flexible and less regulated corporate governance framework. However, regulations which are essential for protecting the interest of investors and making the Board responsible and accountable shall be the hallmark of the governance framework on the passage of the Companies Bill.

The new incorporations are based on the need for modernization of corporate regulation governing setting up and running of enterprises, structures for sharing risk and reward, governance and accountability to the investors and other stakeholders and structural changes in the law commensurate with global standards.

To highlight a few of them: The Bill sets out the duties and liabilities of the directors. It provides for independent directors on Boards of such companies along with attributes determining independence while laying the responsibility for searching, evaluating, and recommending appropriate

Independent Directors and Non-Executive and Executive Directors with the Nomination Committee.

The Bill seeks to provide class action suits for investor protection. It also seeks increased accountability of the auditors. It also proposed to provide a statutory recognition to audit committee, remuneration committee and stakeholder's relationship committee of the Board and the Chief Executive Officer, the Chief Financial Officer and the Company Secretary as Key Managerial Personnel.

Given the need of the present economic scenario, risk management has been highlighted in the Bill. It requires the Board to affirm and disclose in its report to members about critical risk management policy for the company.

Green Initiatives:

MCA has taken a lead in green initiatives in governance by allowing paperless communication and compliance by companies. Some of the important initiatives in this area include allowing service of documents including balance sheets and auditors report through e-mail; participation by Directors and shareholders in meetings through video conferencing; voting in General Meeting of Companies through electronic mode etc.

Others:

The Ministry of Corporate Affairs has simplified procedures under MCA-21 by which a company can now be registered in India within 24 to 48 hours where there is no difficulty about availability of name etc.

We intend to strengthen the checks against corporate fraud in a time-bound manner. In the field of financial reforms, given the approval of convergence with IFRS and desirable standardization globally, the XBRL taxonomy has recently been finalised.

Governance: Changing landscape

Organizations are now voluntarily accepting responsibility and focus on rebuilding a better business model that is both profitable and sustainable. In an age shaped by 'bigger, better, faster technology, it turns out that our oldest values of trust, integrity and accountability remain at the core of all successful businesses. Board members and senior management are focusing on designing sustainable business and corporate governance strategies. These strategies not only provide a return on investment, but also generate shared value for society and to promote environmental and business model sustainability.

Conclusion:

India has become one of the fastest emerging nations to have aligned itself with the international trends in Corporate Governance. As a result, Indian companies have increasingly been able to access to newer and larger markets around the world; as well as able to acquire more businesses. The response of the Government and regulators has also been admirably quick to meet the challenges of corporate delinquency. But, as the global environment changing continuously, there is a greater need of adopting and sustaining good corporate governance practices for value creation and building corporations of the future.

The companies have the fundamental aim to maximize profits through good governance. The permanent search of the firms for increasing productivity and competitiveness leads to economic growth. If the companies present a good performance, based in the best practices of Corporate Governance, they assure their permanency in the market. This translates into employment for the families and social responsibility and wealth for the country. In today's world, corporate citizenship can not be a carve-out only remotely related to the company's core business. As it enters a new decade, we are seeing an increasing integration and blurring of boundaries between the traditional definitions of social responsibility as dealing only with the moral, ethical soft issues and the hard strategic and financial frameworks for making organizations more responsive to stakeholder needs.

It is our belief that good corporate governance and corporate social responsibility are the two hallmarks of responsible corporates. As an enlightened Regulator, it has been our constant endeavor in the Ministry to build broad consensus on the issues affecting the corporate regime, phase out regulations which cause impediment for the growth of the business and introduce new regulations, if necessary, for the protection of the investors to achieve sustainability in business.

Finally, I quote the following note of our Prime Minister Dr. Manmohan Singh

"***On this occasion when you are celebrating two decades of economic reforms and liberalization, I affirm our commitment to a new wave of reforms. I am aware of the fact that much more needs to be done to make our economy more competitive… I sense a mood for renewal, as I did 20 years ago. We did not disappoint India in the summer of 1991. We will grasp the nettle once again. India stands at the threshold of new opportunities. It is my firm conviction that we can and we will grasp these opportunities for posterity's stake, we will overcome***'.

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