

Decreasing divide between Corporate Governance and Corporate Social Disclosure

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Little neglects add up to mischief's and mischief's ultimately lead to bigger frauds and scars and corporate enterprises are no exception. Little care enables to avoid little neglects; more care helps to avoid mischief's and greater care adds up to establish good governance which ultimately leads to excellences (Benjamin Franklin).

The basic rationale for high standards of corporate governance stems from the inherent character of the corporate form of organization. As the size of the organization expands so does the equity requirements. Joint stock companies are obliged to raise required capital from a large number of shareholders. Other than those in control of the operations of the company shareholders cannot have any active participatory role in the management of the organization. In these joint stock companies with vastly dispersed shareholdings, the executive is all powerful in matters relating to the management of the affairs of the company. While, there is general agreement that the principal objective of corporations is to maximize shareholders wealth, there is always a nagging suspicion that the executive may siphon off some part of the created wealth through excessive rewards to themselves and thus denying transmission of all created wealth to its rightful owners i.e. shareholders. The Board of directors in a company is vested with the responsibility of stewardship and surveillance over the affairs of the corporation, no doubt acting through the executive but ensuring that the executive does not appropriate to themselves a larger than due share of the shareholders wealth. Thus, the shareholders interest need to be safeguarded from possible induce diversion of created wealth. It is in this context that the need to have an independent board of directors becomes highly imperative.

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Good corporate governance (CG) requires that the board must govern the companies with integrity and ethicality. Good CG demands that the decision making processes should be transparent and consistent with the need to protect the competitive interest of the company as otherwise shareholders and other stockholders would lose out. Hence, corporate governance is the system of structural, procedural and cultural safeguards to ensure that a company is run in the best long-term interests of its shareholders as well as other stakeholders.

In India, company legislation has until recently been the main instrument for improving corporate governance. The first such step was by the CII (Confederation of Indian Industry) which came up with its first voluntary code of CG in 1998. The second was by SEBI, now enshrined as Clause 49 (Based on the recommendations of Kumar Mangalam Birla Committee Report in 2000).

The third was the Naresh Chandra committee report which submitted its recommending guidelines in 2002. The 4th was again in 2002 by SEBI –The Narayana Murthy Committee Based on the recommendations of this committee. SEBI revised clause 49 of the listing agreement in August 2003 which was once again revised in October 2004. As per this circular dated 29th October 2004, revised clause 49 was to be made applicable from 1st April 2005. After issuance however, corporate world raised their concern and the date applicable was extended to 31st Dec 05.

Today however, CG as practiced by some companies, unfortunately has turned out to be annual ritual involving check box provision of board composition in terms of executive and non-executive directors, setting up independent audit and CG committees, CEO/CFO certification of financial statements, legal compliance monitoring internal controls etc. Such compliance approach will not yield the due results. Infact, CG norms should be initiated through a judicious mix of the three available routes: Legislation, Regulation and Self discipline. In most of the developed countries, legislative interventions are minimal and not the preferred option. Regulatory agencies such as capital market regulators, professional bodies and the Control Bank plays an important role in bringing about an orderly and disciplined regime among their constituents. Self regulation through persuasion comes about through initiatives taken by industry, chambers and

business associations and also aided by globalization initiatives that dictate adoption of best international practices. Yet another variable i.e. societal pressure also affect corporate social responsiveness and often manifest in corporate responses well beyond legislative demands concerning ecology, environment, community development and so on. In today's context, in India, what is required is a new model of CG which recognizes and respects the trusteeship concept as advocated by Mahatma Gandhi, acknowledging corporate personality, allowing the executive entrepreneurial scope to achieve organizational objectives and yet holding it accountable and responsible for its performance. The shift from the "traditional compliance approach to the conscience one" requires vast changes. Such changes include legislative, regulatory and mindset changes. And with growing maturity and competitive compulsions, it would definitely be possible to gradually reduce legislative interventions and increase regulatory compliance with and self induced adherence to the best-practices in this filed. Till such shift comes, legislation to ensure at least minimum standard is inevitable.

Corporate Citizenship and Social Responsiveness

To be globally competitive and acceptable companies have to ensure that they establish a reputation base that would support their efforts. Corporate reputation is the external manifestation of corporate excellence and is built upon a company's product or service reputation, its business reputation and credibility in financial markets and its social reputation.

Companies need to reconfirm and reiterate to themselves that they operate with in a society with its sanction and authority and ultimately for the common good of its largest part, not just for itself or its shareholders, employees and managers alone. Without this understanding there will be no social cohesion between and among government, business and society. When there is complete understanding and appreciation of these imperatives, the country and business as a sub set will thrive. Without it, there will be social chase with different constituents pulling in diverse directions.

Companies depend for its survival and long term prosperity on society providing the resources like people, raw-materials, services and infrastructure etc. These companies in turn have impact on society in three ways- they impact society in environmental, social

and economic dimensions. In the first category items such as emission and waste control, energy usage, product life cycle/ recycling and sustainable developments are included. Social impact covers areas like equal opportunities, community regeneration, human rights, education and culture and so on. Wealth generation, job creation, ethical business practices, avoiding corruption and bribery and enhancing products value could constitute the elements of economic impact. In each of these areas, the way a corporation chooses to act will determine its claim to good corporate citizenship or otherwise.

In fact, the best form of social responsiveness is adequate performance within the company's own aims and objectives. Ethical value addition and ensuring equitable distribution of value among all legitimate stakeholders is the most important aspect of social responsibility. A company serves society best if it acts ethically and efficiently.

In India, corporate social responsibility has its origin since ages. The famous, Kural, the great book of Tiru Valluvar's verses is a treatise par excellence on the art of living. It stipulates moral verses for discharge of social responsibilities. Indian Vedas say – man can live individually but can survive only collectively. Vedas further advocate application of “Samasta Janaanaam sukhino Bhavantu” (Maximum welfare of the maximum people). A large number Indian corporate houses are practicing CSR in one form or the other. Tata's have been very active in the area of town planning, education, community health, water management, supporting sports and games. The Birla group has been associated with a number of activities including temple building, running large multi-specialty hospitals. Infosys too has undertaken community projects in the area of education, rural development, promotion of art, science, culture and music. WIPRO is working for the under privileged sections of the society. Many others like Pfizer, Jubilant Organosys, Coca –Cola, Vodafone are actively participating in the fulfillment of Millennium Development Goals of UN. These goals included combat HIV/ AIDs, & other disease, ensure environmental sustainability, promote gender equality and empower woman, eradicate poverty and hunger, achieve universal primary education, reduce child mortality, improve maternal health etc.

In one analyses, the concept and definition of CSR it, infact, seems to be stakeholders theory of CG. Corporate Governance is being redefined so as to include never stakeholders. CSR is gradually getting fused into company's corporate Governance

practices. Not only government and corporations, private sector too is playing an ever increasing role in building a fair, equitable and sustainable world. There is also increasing transparency with more and more companies coming out with exhaustive sustainability reports. And, these sustainability reports are something that the investors and society definitely expects from socially responsible and efficiently governed companies.

India is one of the leading developing countries of the world. National and international social and economic pressures are compelling the modern Indian corporations to redefine their functions and disclosure practices so as to find a name in international face. The Sachar committee which was formed by Government of Indian (1978) to consider and report on the changes that are necessary in the form and structure of the legislation observed that, “the company must behave and function as a responsible member of the society just like any other individual. It cannot shun moral vales nor can it ignore actual compulsion. The real need is for some focus on the accountability on the part of management not being limited to shareholders only, proper utilization of resources for the benefit of others also, take primary objective, the company must accept its obligations to be socially responsible and to work for the larger benefit of the community. The committee further recommended the disclosure of social activities undertaken by the company on yearly basis and its future plans regarding same. An in depth examination of the observation made by Sachar committee also suggests the declining divide between CSR and CG.

Objectives of the present study The present study aims to evaluate CSR and CG practices in various Indian companies and analyzes the correlation between the two. CSR was measured by identifying significant social variables and compiling them in an index form. Similar index of CG was used to measure the extent of CG in the selected companies. The study was carried out by analyzing the Annual Reports of 50 private sector companies (Business Today Dec 2005). The data was further supplemented by primary information collected through questionnaires sent to theses selected companies. However the response rate was disappointing.

It is pertinent to mention here that the authors of the papers had conducted a related study in the year 1998 and 1999 on some selected companies in private and public sector to

analyze if there exists a significant difference in the economic performance of private vis-à-vis public sector. If yes, what variables discriminate the two? The study further went to evaluate if there exist a significant difference in the social responsibility as undertaken by public sector vis- a vis private sector. The results of the study were surprising. Within the selected sample, equal numbers of public sector units were financially sound and an equal number of private sector units were discharging their social responsibility on parallel footing as in case of public sector. Public or private character does not define the performance a company. There are other variables like ability and autonomy of the top management to take decisions, political interference, location, forward and backward linkages, training and mind set of the people working there in etc, go a long way in affecting the overall performance of a business unit.

Construction and scoring of Disclosure Index

Social Reporting Index

After going through various studies carried out on specific areas of CSR, journals related to the topic and annual reports of various companies regarding corporate social information, a comprehensive list of 20 variables was identified and prepared. These variables collectively constituted the social variables. Although these variables varied in importance, yet equal weightage was assigned to each of them to avoid subjectivity. Once the index was finalized, the annual reports of the selected companies were thoroughly searched and fitted into the social reporting index. If a variable was found disclosed in the annual report of a company in any form it was assigned a score “1” otherwise it was assigned “0”. These scores were finally summed up to represent total score of the company on social reporting index. The various variables identified were

- i. Information on energy conservation
- ii. Expenditure on social overheads
- iii. Pollution control / waste disposal
- iv. Import substitution
- v. Expenditure on research & Development.
- vi. Human resource accounting
- vii. Value added statement

- viii. Net foreign exchange inflow / outflow
- ix. Contribution welfare schemes
- x. Community welfare schemes
- xi. Training programmes for employees
- xii. Donations for national cause like Earthquakes, flood etc.
- xiii. Industrial safety
- xiv. Capital expenditure on township for the employees
- xv. Family planning and welfare
- xvi. Promotion of sports
- xvii. Development of ancillary units in nearby areas.
- xviii. Consumer grievance handling procedures
- xix. Industrial Relations
- xx. Suggestion Box schemes

All the variables identified above relate to one or the other category of stakeholders or nation as a whole. These variables are self explanatory and need no further detailing. Some of the variables are mandatory to be disclosed under various Acts (Disclosure of particulars in the report of Board of Directors Rules 1988, Consumer Protections Act, Factories Act, Industrial Disputes Act etc), while others are important though not mandatory.

Corporate Governance Index

Good corporate governance provides a competitive edge in the global marketplace, enables companies to raise capital widely, easily and economically, improves employee morale and generates higher productivity. Well governed companies last longer, stand the test of time and changing environment.

After going through the available literature, annual reports and journals regarding CG, it was found that there are two components of corporate governance- one the mandatory requirements and the other part includes non-mandatory information. Mandatory information includes (per annexure IC of clause 49)

- (i) Composition of Board of directors
- (ii) Non-executive directors compensation and disclosure
- (iii) Qualified and independent audit committee

- (iv) Information on subsidiary company
- (v) Disclosures relating to-
 - (a) Related party transactions
 - (b) Accounting treatment
 - (c) Risk management
 - (d) Proceeds from public issues, right issued, preferential issues, etc.
 - (e) Remuneration of directors
 - (f) Management discussion and analysis report
 - (g) Communication to the shareholders relating to changes in directorships, company news financial or otherwise.
- (vi) CEO/CFO certification of the financial statements and the cash flow statements
- (vii) A separate section on corporate governance has to be made in the annual report of the company.
- (viii) Certificate from auditors/practicing company secretaries regarding compliance of the condition of corporate governance as stipulated in clause 49 and attach the same to the director's report.

The list of non-mandatory requirements as per annexure ID of clause 49 of listing agreement includes-

- (i)
 - (a) Non- executive chairman to be entitled to maintain a chairman's office at the company's expense to enable him perform his duties diligently.
 - (b) Tenure of independent directors not to exceed nine years.
- (ii) Setting up of the Remuneration committee to determine the compensation payable to executive directors.
- (iii) Half yearly declaration of financial performance including summary of the significant events in last six months, to be sent to each shareholder.
- (iv) Opting for unqualified financial statements.
- (v) Training of Board members in the business model of the company, risk management, their responsibilities as directors and the best way to discharge them.

- (vi) Performance evaluation of non-executive directors by a peer group comprising the entire board of directors excluding the director being evaluated.
- (vii) Formulating whistle blower policy to encourage employees report to the management about unethical behaviors, actual or suspected fraud and violation of the company's code of conduct.

Matters provided above are of such a nature that it does not directly concern the shareholders or any other stake holders but nevertheless is an expense for the company to comply with. However, as a good corporate governance measure, it would be advisable for the companies to comply with these non-mandatory requirements as the benefits are notional and for reaching in nature.

Table-1 Scores of various parameters of the Social Reporting index

S.No.	Social Variable	No of Companies disclosing the variable (in %)	
(i)	Energy Conservation	31	62
(ii)	Expenditure on social overheads	11	22
(ii)	Pollution control	21	42
(iv)	Import substitution	36	72
(v)	R & D Exp.	35	70
(vi)	Human Resource Accounting	31	62
(vii)	Value added statement	20	40
(viii)	Net F/E inflow/outflow	24	48
(ix)	Contribution to national Exchequer.	50	100
(x)	Community welfare	20	40

	schemes		
(xi)	Training Expenses	30	60
(xii)	Donations for national cause	28	56
(xiii)	Industrial safety	20	40
(xiv)	Capital Exp. on township	11	22
(xv)	Family planning & welfare	7	14
(xvi)	Promotion of Sport	6	12
(xvii)	Promotion of Ancillary units	7	14
(xviii)	Consumer grievances	33	66
(xix)	Industrial Relations	38	76
(xx)	Suggestion Box Schemes	27	54

The above table indicates that the picture of social reporting index is not very encouraging and the areas which are most popular for disclosure are energy conservation, import substitution, R & D expenditure, payment of taxation, information on industrial relations and consumer grievance as procedures. The most neglected items are family planning welfare expense disclosure, promotion of sports, development of ancillary units and information on net foreign exchange inflow & outflow.

With regard to CG, disclosure index, 100% companies are disclosing the mandatory requirements of clause 49 Annexure IC of the listing agreement. But with regard to items covered under Annexure ID of the clause 49 the listing agreement, the results are not encouraging. Only 25% companies are disclosing information relating to non-mandatory items. Items like whistle blower policy and information on half yearly financial performance of a company are vital for the health of a company but unfortunately not many companies are disclosing this information. (40% companies do have a whistle blower policy but no case has been reported under it).

John Elkington in his book “Cannibals with Forks: The Triple Bottom line of 21st Century Business” published in 1997, talks of corporate Governance as a

phenomenon which is to satisfy all stake holders. He propounds that the three prongs of the fork constituting triple bottom line are:-

- a) Economic prosperity
- b) Environmental preservation, and
- c) Social justice

If we evaluate the companies from author John Elkington's view point, we see a complete alignment between CG and CSR. CSR results indicate that more than 50% companies report on energy conservation, improving productivity to save natural resources, contribution towards promotion of education, sports, family planning and development of ancillary units. All these activities are part of environmental preservation. Similar % age of companies were found to be reporting on issues like having a machinery to settle industrial disputes, training of employees, reporting on human resources, maintaining good industrial relations which are part of social justice. The concept of sustainability reporting increasingly used by companies to report on issues of environment and society is a step towards fulfillment of good governance.

As the stakeholders list in business increases, so is the responsibility to show better governance towards each category of stakeholders. CG will gradually cover key topics and concerns that have been raised through stakeholder engagement and how the organization has responded to it. This trickle is gradually becoming a torrent. Corporate governance is being refined so as to include newer stakeholders. CSR is gradually getting fused into companies CG practices.

Conclusion and suggestions

For any programme to be successful it must have the support of the top management and some form of implicit benefit in the near future of the business. As such, the top management can play a significant role in creating a climate of socially responsible behaviors of the business and ensuring that the same is reflected in the annual reports of the company. Professional bodies like ICAI, ICSI, CII, etc can play an important role in bringing uniformity in disclosure and encouraging companies to take more steps towards corporate social responsibility & its disclosure. Similarly, so far as CG is concerned, these professional bodies should encourage companies to (i) disclose

more and more relevant information in their annual reports, then as the environment matures these non-mandatory items should be made a part of mandatory disclosures.

(ii) Include more stakeholders in their business list and disclose activities undertaken by the company to satisfy these stakeholders.

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