

# HOW TO DEREGULATE CORPORATE GOVERNANCE?

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It would not be an exaggeration to say that corporate governance gained prominence after the Cadbury Committee Report. Since the committee was appointed by business associations, many business people construe their voluntary desire to evolve a 'code of conduct' as primary driver of corporate governance. Such a profile of virtuosity is superficially true.

Reality is corporate governance is associated with tackling a variety of shortcomings, if not malpractices, followed by businesses. The Cadbury Committee, for instance, notes quite a few of them. Repeated unearthing of corporate frauds suggests that things have not changed much. It is not surprising therefore that process of corporate governance is dominated by 'regulatory' overtones. This is not to suggest that all managers indulge in questionable practices. However, even if one concedes genuine desire on the part of some business(industry) managers to practice spirit of corporate governance, such urge is feeble and limited. Regulators, overwhelmed by (or taking advantage of, depending upon one's point of view), have steadily tightened regulations and reporting requirements with mounting public outcry against public exposure of unethical and questionable practices followed by several companies. Public trust in business is substantially eroded, reinforcing desire to regulator. Topdown externally imposed corporate governance standards have created an environment of a confrontation, even if not a strong clash, between regulator and businesses though awareness of benefits of corporate governance is also growing.

From an evil to be tolerated, corporate governance is perceived as valuable differentiator. However, with a view to ensure that all listed companies follow basic standards of corporate governance, regulatory authorities, all over the world, have endeavoured to tighten the standards and insisted on compliance

reporting. How to deregulate corporate governance so that instead of remaining 'catch a thief' game it becomes a tool of overall efficiency and fair distribution of rewards of corporate success is a key question. In my view, answer lies in how best the concerned stakeholders tackle four C's of corporate governance namely, Culture, Competition, Convergence and Compliance.

Two most important traits of Culture on the part of managers are varying degrees of 'arrogance' and reluctance to subject to 'accountability'. Managers of several listed companies that draw large amounts of 'risk capital' from community believe that they know all about business and shareholders, small as well as institutional, should be bothered only about return on their investments.

This appeared a fair argument till it came to light that several well-known managers, including those of 'blue chip companies' in the western world, often indulged in manipulation of financial reporting in order to maintain the façade of generating high returns and thereby make huge performance bonus! Enron is a classic example of this Managerial arrogance, combined with reluctance to subject to discipline of ongoing accountability, is the principal reason for continuing conflict between managers on the one hand and regulators, lenders and investors on the other. While it would be idle idealism to expect managers to practice the concept of 'trusteeship', unless they realize their fallibility, posture of conflict would continue.

History of business failures is replete with examples of managers, even from Ivy League Schools, going on an ego trip and expanding businesses, which, even a rudimentary analysis would suggest were highly risky decisions and had high probability of disastrous failure. Corporate governance would evolve smoothly

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if managers are willing, even if they own majority stake, to subject themselves to a rigorous discipline of analysis of risk and its mitigation as well as high standards of accountability. They should be willing to bow down, if they fail. Like mediocre politicians, most find alibis!!

What can help the process a great deal is internal discipline, transparent and open-minded deliberations at senior executive and board meetings, sharing of information, including risk involved, with shareholders, workers and other stakeholders. On their part, investors must differentiate between incompetence and negative outcome of a risk. There cannot be any business, small or big, in which negative outcome on account of factors beyond the control of business managers can be always avoided. In my view, cultural change on the part of managers and other stakeholders would go a long way in smoothening evolution of corporate governance.

Another factor is competition. More than competition in product markets, my reference is to competition in market for factors of production, particularly risk capital and knowledge workers. Since product markets have become fiercely competitive and as most businesses have to increase 'scale and size' for success, acceptance of 'modern organization' with emphasis on decentralization and innovative work culture have become inevitable. Overpowering boss & non-functional hierarchies are not the structures to get best out of people. Likewise, in tune with high risk-reward profile of competitive business environment, debt capital has yielded place to risk capital.

What this means is that most businesses have to compete in markets for knowledge worker and risk capital. Knowledge workers, by definition, feel suffocated in a 'centralized' management structure. Large institutional investors, with huge amounts to manage, cannot manage their investments in 'hands on' style. Corollary of these changes is that any business, which is aspiring to attract either of the factors, must create an environment of 'well-managed' business.

Good work environment and high standards would increasingly drive process of corporate governance. Almost all traditional and family run businesses have generously infused outside professionals and empowered them well. However, one would like to caution that creating organizational structures and

practices that improve competitive power of a company in knowledge worker and risk capital markets is not always accompanied by high standards of corporate governance. There are innumerable examples of knowledge workers, popular synonym for 'professionals' and institutional suppliers of risk capital have colluded in shortchanging other stakeholders! All the same, competition in factor markets is a facilitating factor for corporate governance.

What can provide durable corporate governance is convergence of objectives. It is a reasonable belief that a good manager would want to run his business efficiently and profitably. Unfortunately, evidence disproves such a hypothesis. There are several large businesses in the world, whether East or West, that provide telltale examples of greed in pursuit of which professional managers resort to self-serving and collusive style of running enterprises. Many siphon off funds to become rich. Hopefully, intense competition in product and factor markets, tighter regulation, shareholder awareness, rigorous accounting standards and judicial assertiveness would create an environment for good corporate governance.

While this is not the place to divert into a discussion of managerial compensation, which, according to one view, is exorbitant and underserved, fact remains that performance-linked compensation and broad basing of the class of beneficiaries have enhanced area of convergence between personal motivation and good corporate performance. Though virtually unknown in India, ruthless sacking of underperforming management, has also played an important role in improving managerial efficiency. Injection of financial motivation and redesigning organizations to combine 'responsibility with accountability' have improved the levels of transparency and effective communication leading to overall improvement in performance of businesses. Several research studies have highlighted correlation between good corporate governance and market capitalization. Work environment that encourage innovation and reward innovation and initiatives have helped improve competitive power of businesses.

Unfortunately, worrisome trend of 'collusive convergence' between managers, whether family or professional, with outside agencies such as independent directors and auditors needs to be

tackled effectively. The best safeguard against this is value-based management and vigilant stakeholders. This would strengthen industry's argument for constructive and benevolent regulation. Alternative is obstructive regulation that invariably ends into an exercise in micromanagement. Detailed regulation tends to stress form rather than substance.

How the scenario evolves has implications for the final factor namely, compliance. Companies that perceive managerial discipline, transparency, open organizations that communicate rather than restrict information flows as highly conducive to getting best out of resources, have achieved enviable financial and other performance parameters. Large majority of managements, however, are yet to appreciate virtues of open and transparent organizations.

If true spirit of self-compliance of underlying tenets of corporate governance, which, shorn of details, emphasize efficiency and fairness, is not imbibed by businesses, corporate governance will remain regulation driven. In obsessive search for freedom, which is often based on 'arrogance' and reluctance to be accountable, business is likely to miss benefits of

standardization of certain basic practices and framework that can subserve underlying tenets of corporate governance. What has brought bad reputation, and deservedly so, as well as created friction is poor administration and mechanical execution of well-intentioned and well-designed regulation. This overshadows underlying thrust to improve degree of openness and transparency of business to a wider class of stakeholders.

The best parallel for the situation that comes to mind is ongoing controversy between 'religious ritual' and 'spirit of religion', both of which are often described as being 'religious'. If corporate governance remains essentially regulator driven then it could end up being a ritual, ticking off on check list without absorbing true underlying spirit. High compliance may not necessarily mean high standards of socially relevant management of businesses. Corporate governance debate should focus on how best create convergence between industry and regulators so as to enhance productivity and competitiveness of businesses for cooking a larger cake and ensuring its fair distribution.