CHAPTER 6

CORPORATE GOVERNANCE GROWTH

6.0 ORIGIN [GLOBAL]

The outcome of modern corp.govn.is originated to the Watergate scandal in U.S.A. making illegal contribution to the politicians and corruption in govt. depts. bribes to govt. officials by the corporations .U.S .legislative authorities and U.S govt. to enacted the foreign and corrupt practices act 1977.

Prior to that U.S. govt. initiated other measures such as Treadway Philippines commniman on collapse of savings and loans in U.S.A.in 1987. Collapse of many industrial houses in U.K. during 1980 led the govt. to think that existing regulations and legislations were not enough to take care of financial irregularities. In the first half of 1990 the issue of corp. govn. received considerable attention due to series of dismissal of C.E.O.s by the boards of. I.B.M., Kodak. Honeywell.

Water gate scandal of U.S.A. was an eye opener and there after London Stock Exchange appointed High Level Committee under the chairmanship of Sir, Adrian Cadbury in1991 to draft a code of practices for corporations in U.K for defining and applying internal controls to limit the financial losses and suggest the measures to raise the standard of corp. govn. and level of confidence in financial reporting and auditing by setting out clear respective responsibilities for those involved with clear specifications on what is expected out of them.

The committee submitted its report in 1992. The committee in their report spelt out methods of governance, need to achieve the balance between the essential powers of the Board of Managing Directors and their accountability.

The Cadbury committees ‘Code of best practices in the U.K.’ the ‘Combined Code of London Stock Exchange,’ The Blue Ribbon committee appointed by United States Securities and Exchange Commission to elaborate the suggestions on the role and functions of Audit committee as a ultimate guardian of investors interest and corporate accountability.

The committee recommended statement of disclosure by audit committee to stakeholders duly certificated by statutory auditor regarding independence of corporate philosophy of the company,
OPCD Code of 1998, and jointly with World Bank developed benchmarks in corp. govn. which qualify as best practices under the standard and codes identified by, 'Financial stability Forum’. Which has consolidated all the deliberation and debate in last twenty years. The Sarba-Oxley Act in the U.S in July 2002 recognizes the importance of timely and reliable public disclosure of financial statements, audit committee obligations, changes in pattern of ownership, etc. Euro share holders corporate governance guidelines 2000 has given ten recommendations one of the important is disclosure of financial objectives as well as strategy in the Annual Report of the company. Early 2000 massive bankruptcies and criminal offences of Enron Power, and World Com, Layman Brothers and scandals in other corporate created a heat of political interest across the world. Pakistan is also not secluded to bank frauds and tainted financial performances as manifested in Bank Of Commerce and Credit International [BCCI] and Mehran Bank scandals. In Pakistan code of corp. govn. was introduced in March 2002 making it mandatory to all listed companies, financial institutions, Poor corp. govn. may lead to loss of public confidence in the ability of bank to manage its assets and liabilities in a prudent manner. Banks have ‘duties of care’ not only to their shareholders but also to other stake holders namely depositors, customers. [Muhammad Javaid Iqbal : -Impact of Corp. Govn. on operational performance of financial sector in Pakistan].

6.1 ORIGIN [INDIA]- HISTORY

The corporate governance in Indian companies assumed greater importance in recent past. As it was found that despite the companies act specifying the elements of governance such as boards authority, responsibility, accountability, penalty for violation of company act, rules, due to growth of financial market, multinational trade and business under WTO and change from companies to corporate world in India it was felt necessary to prepare comprehensive code of corp. govn.
The Confederation of Indian Industry [CII] made an attempt to bridge this space by formulating code of desirable corp. govn. in April 1988. The Indian companies were among the first in the corporate sector to take initiative for ensuring corp. govn.

The Cadbury report created a lot of interest in India. It was studied in depth and dealt by the Confederation of Indian Industry [CII] and Associated Chamber of Commerce and Industry [ASSOCHAM] and Securities Board Of India [SEBI]. By taking the points of recommendations of Cadbury committee SEBI appointed committee under the chairmanship of Kumaramangalam Birla in 1999 to prepare ‘Voluntary Code Of Corporate Governance ‘for companies listed with CII.

The committee quoted the statement ‘The pivotal role in any system of corporate governance is performed by the board of directors. It is accountable to the stakeholders and directs and controls the management. It stewards the company, sets its strategic aim and financial goals and oversees their implements, puts in place adequate internal controls and periodically reports the activities and progress of the company in a transparent manner to the stakeholders’.

The committee made 25 recommendations of which 19 are mandatory and 6 are voluntary. The most of the recommendations were implemented by SEBI in 2000. The listed companies with SEBI, including banks whose shares are listed at Bombay Stock Exchange[BSE], National Stock Exchange [NSE] are obliged to comply with these recommendations on account of their listing agreement [clause no.49] with stock exchange. One of the recommendation is disclosure of corporate governance philosophy, status of compliance, transparency in information accounting standard and financial reporting.

Ramakrishna commission report 1999 on Public Sector Undertaking [PSU] on corp. govn. emphasized amongst other the need for autonomy in professionalization of board of financial institution, bank, etc as these are directly related to monetary business of the economy.

CII and ASSOCHAM have also made separate studies focused on the role of board directors and need for it to observe a code of best practices.

The finance ministry in the govt. of India set up the committee under the chairmanship of Shri Naresh Chandra to examine the Auditor –Company relationship, the role of independent directors in ensuring corp. govn. and identity measures to ensure that the management and auditor present a true picture of the affairs of the company etc.
Similarly Narayan Murthy [Chairman of Infosys] committee was also set up for recommendation of good corp. govn.

However all these committees were having common view for strong code of ethics, including having more non executive and preferably independent directors in the board and formation of various committees like remuneration, nomination, audit, investors grievances committees etc.

In short the Indian corporate sector has to keep itself ready to face challenges and to grab the opportunities thrown open by the economic, financial reforms and do the business by following international trade practices and international accounting standards with strong corporate governance philosophy and disclosures in the reports for the knowledge of investors.

India is marching towards global economy, with multinational trade and commerce financial markets are working under different competitive forces, govt. legislation of different countries and investment by multinational is very sensitive to the issues like political stability, govt. economic policy, federal banks monetary policy, regulatory controls pattern of ownership, nature of investment etc.

In the developing countries banks are mostly owned by govts. and guided by govt. procedures. Generally working of govt. organization lacks competitive spirit, accountability, initiatives, control, lack of professional management autonomy. The need for governance arises to ensure transparency in the working for the knowledge of stake holders though govt. ownership provides strength to banks.

During the last two decades even public sector banks [Govt. owned] govt. has gradually reduced its stake and these banks are getting corporatize with the stake of other financial institution. Hence corp. govn. issues assumes greater importance. In India the process of nationalization, of banks created a tool of economic development along with social economic objectives. Corp govn. for banks has become very essential to perform and remain in competition in the era of liberalization and globalization.

Basel committee on banking supervision 2005 has not made any statement on co-operative governance as it is more focused towards the governance of companies. However in recent years the need of governance is well recognized in the cooperative sector and debate and discussion has started taking place in and around the world.
6.2 GOVERNANCE—CORPORATE TO CO-OPERATIVE

Though the recommendations of these committees were applicable to corporate stakeholders of listed banks in stock exchanges, co-operative are also member driven organization including co-operative banks. The main difference is corporate are majority investors driven firms besides individual share holders many financial firms are also stake holders where as in case of co-operatives it is ordinary members, individuals are owners users, borrowers and investors.

Co-operative work on democratic principle i.e. one share one vote’ and power of voting is not based on the size of holding. Co-operative is an autonomous association of persons united voluntarily for mutual self help and mutual aid, non discrimination and equality of members.

In other word co-operatives are organized groups of people and jointly managed and democratically controlled enterprise. They serve their members depositors, borrowers, who are also owners of the co-operatives.

Co-operative Corporate governance is therefore about ensuring co-operative relevance and performance by connecting members, management and the employees to the policy, strategy and decision making process. In case of co-operative banks in India there is need for restoring customers confidence in co-op sector and corp.govn.in the co-op banks assumed critically.

The corp.govn.in co-operative has come into severe focus because more and more co-op banks in India both in rural and urban areas have experienced grave problems in recent times which has in a way posed a threat to the profile and identity of the entire co-op system. These problems include mismanagement financial impropriety, poor investment decisions and lack of communication between members and the society.

However unfortunately as there is no formal system of governance in co-operatives, serious irregularities, financial scams occurred and collapse of banks in different states of country mainly in Gujarat, Maharashtra Andhra etc. There was a high degree of discomfort amongst depositors share holders who lost their hard earned money. The banks were run by violating co-operative principles, ethical values. Honesty and integrity of board members was very much doubted.

To ensure inclusive development of co-operative movement in India effective governance of co-operatives, professionalization of management are certain pre-requisites which need to be considered.
Governance is a simple concept at heart.’’ Good Governance is Good Government’. The concept relates to the quality of the relationship between government and the citizens [co-operatives and its members] for whom it exists to ‘serve’ and ‘protect’. Governance means the way those with power use that power. Governance is the reflection of the quality of management.

The context of co-operatives, governance concerns with the management of the institution, performance by the management leaders and participation by members in organizational and business affairs. Realization of ‘Governance’ in co-operatives in fact, begins with two aspects e.g.

[1] Belief in the principles of co-operation and

[2] Being aware of the rights and duties of office bearers, members, management staff and employees of the co-operatives which are clearly stated in the byelaws.

Education and training are, therefore, the two strong pillars of governance in co-operative business. Co-operatives should create confidence, trust, and goodwill among its members, general public and their clients.

Some of the elements which helps to generate such feelings leading to good governance are

[1] Good working relationship between the board and the managers and the members,

[2] Effective linkages with govt. agencies,


[4] Good reporting system, audit inspection and timely compliance of the issues raised by the auditors, inspectors,

[5] Timely sending of annual reports with notice of meeting, timely holding the annual general meeting and encouraging members to participate in the meetings. Quick and satisfactorily clarification of the queries raised by the members and general public.
[6] Circulation of notice of the meeting with agenda notes well in advance to the committee members.

[7] Preparation and display of a Citizens’ Charter to ensure that the organization is responsive, lively, and vibrant.

There was an urgent need for guidance to many state governments on the policy regarding co-operatives and the co-operative movement in view of the importance of the movement and to inculcate the elements of good governance within the co-operative institutions.

Effective implementation of good governance is not the game of singles. It requires conducive and supportive government policies and co-operatives and govt. have to join forces to bring about positive changes in favor of the members who are stakeholders, owners for strengthening the co-operative enterprise.

Therefore on the above stated background it is thought and felt necessary by regulators to incorporate good governance principles and code of ethics on the lines as suggested by Basel committee, SEBI in order to maintain identity of co-operatives in Indian banking sector.

It may be mentioned here that few co-operative banks have voluntarily taken initiative towards this approach such as

[1] Orissa Dist. Co-op bank is the first in co-op sector to adopt the corporate governance principle policy from 2003 with the clause of right of the employee for accountability of the members of the board and management.

[2] The Bhatkal Urban Co-op Bank Ltd. Karnataka has decided formation of code of conduct for the members of the board, office bearers, and employees of the bank and it was one of the agenda item for the banks Annual General Meeting of September 2012.

[3] Rajkot Nagrik Sahakari Bank Ltd. [Raj Bank] followed prudent practices, systems of corp. govn. and guidelines of supervisors and regulators and performed well compared to other UCBs of Gujarat state as reflected in RBI comparative charts. Raj bank is considered as a case of good
6.3 Corporate Governance in Urban Co-op. banks

1. Basic principles

Urban co-op banks are member driven democratically managed, owned, and controlled by an organization which provides various financial services. General body of the bank is the supreme authority of the bank. Members of the bank elect the board of directors, they even decide the constitutional changes i.e. amendment to bye laws through general body. Members of the bank are generally customers, borrowers, depositors. Therefore members, board of directors and employees are the major stakeholders of urban co-op banks.

Corporate does not mean only big companies but any organization which fulfills following criteria namely

[1] It is a legal entity established under law, act.

[2] It is established with specific objectives.

[3] It works to achieve those objectives.

[4] Its motive is to make profit.

[5] It provides service to the community, society i.e. it works with corporate social responsibility.

It may be noted that urban co-op banks [UCBs] fulfills all the above criteria and therefore co-op banks are also corporate entities and principles of governance are also applicable to them.

The issue of corporate governance has aroused mainly because of separation of ownership from management and control, the corporate governance concerns the way in which the organization
is managed by the managers and shareholders and other stakeholders could exercise their influence, with effective control over the actions of management of the organization. Governance involves a set of relationship between the board of directors, its management, members, and other stakeholders i.e. creditors, employees. It provides the structure through which the objectives of organization are set and means of attaining those objectives and monitoring performance are determined.

In other words the corporate governance in banks including urban co-op banks is related to how the corporate objectives are set by banks, day to day operation of banks business, protecting the interest of depositors, members, running the business on sound manner, by following all regulatory norms and compliance with applicable laws ,rules and regulations. The most important factor in this is managing the affairs of the bank with utmost diligence, minimizing the business risk and maintain profitability and pay reasonable dividend to shareholders.

Sapta –Sutras of corporate governance in urban co-op banks.

[1] Well designed corporate strategy along the techniques of measurement of the performance of all the employees and bank.

[2] Proper hierarchy structure ,delegation of powers to officers, managers and committee of the board.

[3] Proper mechanism for coordination of the work between board of directors ,committees executives, managers for implementation of decisions.


[5] Development of management information system and communication to members.

Good human resource development policy for the employees, promotion, career, incentives, compensation, recognitions, etc.

2. Relevance of corporate governance for urban co-op banks.

The following are the related factors.

1. Financial scams in UCBs—confidence of depositors, members has lost.
2. Stiff competition for banking sector i.e. public, private, commercial, foreign banks.
3. Risk challenges on account of technological banking services.
4. Effects of globalization, innovative product services.
5. Diversification of business activities for growth and profitability but lack of addressing system for related issues.

However this is not exhaustive but illustrative list which are responsible for the survival and growth of urban co-op banks. Therefore adoption of good governance practices can lead to success of banks.

3. Role of responsive and responsible board of directors in promoting corporate governance in urban co-op banks.

The success of implementation of corp.govn.is based on the certain rules which attribute to the commitment of board of directors i.e. top management.

1. Line of functional separation between and board and executive team, chief executive officer of the bank, clarity of delegation of powers.
2. The qualified, experienced, knowledgeable, members of the board to contribute in policy making process.

3. Formation of board Sub committees such as loan, recovery, investment, audit, risk with appointment of separate members as a chairman which will encourage collective responsibility. The committee should be delegated with rights and powers.

4. The board should frame various policies such as credit, investment, recovery, audit, I.T, with the standard set of procedure and hierarchy so that executive team can work under delegated authority as set by board.

5. Lack of professionalism, political nexus, concentration of power in one hand, absence of qualified members and monopolistic approach of chairman are some of the crows for lack of effectiveness of board of directors and practicing good governance.

Conclusion

Corporate governance focuses on self regulated, disciplined, management, rather than regulatory control, supervision i.e. R.B.I., Registrar, or Government authority. The urban co-op banks has to cultivate professionalism in the working of the organization. Corporate governance is now a ‘Market Mantra’ of corporate world. Hence co-op banks are no expectation and they have to go along with same direction.

Issues in corporate governance in co-op banks.

1. The co-op banks are democratically governed, owned and controlled by the members, shareholders. Election of board, constitutional changes in the bye laws are decided by members. All the major resolutions are discussed and adopted in the bank’s annual general meeting.

It is a part of governance that board should call the annual meeting once in a year within the specified time period for adoption of banks financial statements like balance sheet, profit and loss account budget, business plan etc. Adoption of annual report and appropriation of net
profit. The queries raised on the report, agenda items should be suitably clarified by board of directors.

2. In respect of corporate members as their share and securities are marketable, traded on stock exchanges value of holding varies with reference to performance or any policies decisions of the company by board .Therefore shareholder exercise their control from out side over the board through market information.

However the same is not the case with members of urban coop banks as they strictly depending upon the yearly annual reports and annual general meeting to get the information on the performance working of the bank.

3. As the cooperative organization is the state subject state govt. co-op dept, cooperative minister are the controlling authority for the administration of the banks. All state co-op banks, District co-op banks are controlled by political group ,leaders ,state sponsored board of directors.

This has weakened the management of the bank and accountability to the members Governance is not all practiced. This has resulted into majority state co-op ,dist.co-op. banks are in worst financial position with accumulated losses, non payment of even statutory obligations.

4. The cooperatives are governed by respective cooperative societies act and rules and provision of model bye laws .Any amendments to the act, provision ,byelaws are to be approved by state registrars The state governments are also holding part share capital in central district co-op banks. and also providing guarantees to agricultural advances ,assistance under refinance schemes of govt.

Under these circumstances general members ,depositors, has no say in the working of the banks.

5. The entire co-op structure is further divided and subdivided into number of units representing various activities ,coop banking is one of the segments. This has created ambiguity between the decision which are politically motivated by the government. Such interference makes hardly any attempt for good management and practicing governance.

6. Co-operative bank organization by nature is local with local membership. Therefore the bank has to observe good governance practices to avoid the conflict of interest of various groups of society Bank can not ignore the importance of local demands.
However the banks which are registered under multi state co-op act and working at different states corp. govn. is very vital as the members, stakeholders, are spread across the different states of the country.

**Corporate governance and board management**

1. The very basic issue in corp. govn. particularly for co-op banks is need for separation between governance and management. Board of directors is governing body whereas chief executive officer and executive team are running the bank with due reporting to board for guidance or policy framing. This requires proper coordination, cooperation, clarity and mutual support between the executives and board of directors.

   Board role is developing corporate strategy framing policies, overseeing, supervising the working of the bank. As a head of management team role of chief executive officer is expected to be effective.

2. The board should use collective wisdom while arriving at the decisions, conclusions. The Qualification experience, knowledge of the member in the key areas of banking, finance, cooperation. Information and technology is always helpful for arriving at the decisions.

   It is necessary that board of co-op banks should be well qualified and professionally trained for the growth and development. There is a provision in the bye law for cooption of expert directors. Besides R.B.I. has directed to have at least two professional directors in the field of banking, finance, accounts on the board of coop banks.

   The member who has defaulted in repayment of society’s dues is not eligible to become director of the bank.

3. Another responsibility of the board is to ensure that executive should not use their position for using preferential treatment while sanctioning loans and advances, awarding contracts, investments, recruitment, promotions etc.

   The board should frame standard policies credit, recovery investment, audit, I.T. with the standard set of procedure and hierarchy for execution of policies under delegated authority.

   Action taken report of earlier decisions should be placed for perusal in the board meeting.

4. Formulation of sub committees of the board such as loan, investment, recovery, audit, development I.T. Risk management etc. with the appointment as a separate chairman of the
committee. could enhance good governance. This will also encourage collective wisdom and collective responsibility. The scope and delegation of power of committee should be well defined.

5. Lack of professionalism, political nexus, concentration of power in one hand, absence of qualified member and monopolistic approach of chairman are some of the crocks for lack of effectiveness of board of directors and practicing good governance.