CORPORATE GOVERNANCE AND OTHER STAKEHOLDERS

OBJECTIVES

If long-term shareholder value is the chief purpose and objective of a corporate entity, it is not the be-all and end-all of its existence. It is now ubiquitously agreed that there are other claimants as well that crave for its attention and equitable distribution of its profits.

Employees, customers, creditors, institutional investors, government and the community at large are the other stakeholders that vie with the stockholders for a pie of its time and resources.

CHAPTER OUTLINE

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Introduction

- It is fallacious to argue anymore that the immediate concern of a Company is to be exclusively directed towards the shareholders, while other stakeholders are only of a peripheral importance to it.

(1) CORPORATE GOVERNANCE & EMPLOYEES

- Employees are also one of the stakeholders of the organisation; by increasing their participation in the organisation, one could ensure corporate governance.

Wealth Creation Requires Capital and Labour

- Today, the growing recognition that human capital is a source of competitive advantage has led to the understanding that labour is more important than capital, if not, is at least as important as capital. Corporate leaders in developed countries increasingly understand that people and the knowledge they create are often the most valuable assets in a corporation.

The **interests** of employees can be protected through

- Trade Unions
- Co-determination: employee representation on boards of directors
- Profit-sharing
- Equity-sharing
- "Team production" solution

Trade Unions

- Trade Unions could represent the collective interests of the employees and fight for what is rightly due to them from the organization.

Co-determination

- It is a situation where there is employee representation on the board of directors of the organization.

Profit-sharing

- **Most profit-sharing plans are broad-based i.e. all or most employees were included in the scheme of profit sharing rather than just executives only.**

Profit sharing could be done in many ways such as

- **Cash-based sharing of annual profits where the annual cash profits of the organization are shared among the employees.**
- **Deferred profit sharing where the deferred profits of the organization are shared among the employees.**

- The objective of such profit sharing is to encourage employee involvement in the organization and improve their motivation and distribution of wealth among all the factors of production.

Equity-sharing

- Under equity-sharing, the employee is given an option to buy the shares, identify themselves with, and thus become the owners of the organization.

- There are various ways in which equity sharing could be done: (i) Employee share ownership plans (ii) Stock bonus plans (iii) Stock option plans (iv) Employee buyout, and (v) Worker cooperatives.

Team Production Solution

- Team production solution is a situation where the boards of directors must balance competing interests of the various stakeholders and then arrive at decisions that are in the best interest of the organization.

- There are some guidelines that could be used here while deciding on employee representation in the organization.

1. Voluntary Participation :

There should be voluntary participation on the part of the employees and they should not be forced to do anything out of compulsion.

2. Extend Benefits to all Employees :

The benefits should be extended to all employees, factory workers, clerical staff and the executives of the organization indiscriminately.

3. Clarity and Transparency :

The process by which the allocation of shares is done should be clear and transparent, and not too complicated.

4. Predefined Formula :

There should be a predetermined formula to work out the number of shares that could be offered, and it should not be left to the discretion of any party.

5. Regularity :

There should be some regularity when such offers are made, they cannot be made as and when the organisation feels like making such offers.

6. Avoiding Unreasonable Risk for Employees :

The organisation should take into consideration the interests of the employees when they make any decisions, and they should see to it that there is no undue risk taken.

7. Clear Distinction :

There should be a clear distinction between the participation schemes that are offered to the employees and the regular wages and the benefits that are offered by the organisation.

8. Compatibility with Worker Mobility :

The participation schemes offered should be compatible with the worker mobility. The worker should not be penalised by accepting the schemes offered to him.

Customer's Information Needs

- The Advocacy Group, dealing with customer information needs, stresses the need for corporates to disclose actions brought by customers and regulatory authorities regarding products, services and market practices.

The information needs of customers include:

- Risks of injury from normal usage;
- Noise, odours and other nuisances or problems associated with use;
- Design for recycling;
- Biodegradability of products and packaging;
- Unusual life cycle costs, including repairs, energy consumption and disposal that will be borne by parties other than the producer or seller;
- Warnings, with appropriate detail, regarding unusual contamination and adulteration exposure and risks during production, shipping, marketing and storage;

The information needs of customers include:

- Content, additives and treatments of food and medicines, sufficient to allow reasonably-informed consumers to make rational market decisions and to protect themselves and their families - appropriate descriptions may include pesticides used in fruits and vegetables, hormones and chemicals used in growing and processing meat, and substances in cosmetics and personal grooming products to which some consumers may be allergic; and
- "Well hidden characteristics" or those product qualities which, regardless of expense or purchase frequency, remain hidden even after use -- such as the amount of toxic chemicals and nicotine in cigarettes.

- **The Alliance has also pointed out that customers, in choosing from competing producers and vendors, may legitimately consider standards of social responsibility.**

- **These might include such issues as the working conditions under which products are manufactured, sustainability of production and business methods and so on. Decisions that may appear to be ‘merely' economic are, to many customers, reflections of personal -- and possibly intense -- religious, moral, political and social convictions.**

- A customer who is also a stakeholder of a company contributes towards the success of the enterprise as much as he is affected by the actions of the company.

(3) CORPORATE GOVERNANCE AND INSTITUTIONAL INVESTORS

Types of Institutional Investors In India

- The development oriented financial institutions, such as IFCI,ICICI, IDBI, the State Financial Corporations, etc form the first category.
- The second category covers all the insurance companies such as the Life Insurance Corporation of India (LIC), General Insurance Corporation (GIC), and their subsidiaries.
- The third category includes all the banks.
- Finally, in the last category, all mutual funds (MFs), including UTI, are included.

Factors Influencing Investment Decisions

- Financial results and solvency
- Financial statements and annual reports
- Investor communications
- Composition and quality of the Board
- Corporate governance practices
- Corporate image
- Share price

(4) CORPORATE GOVERNANCE AND CREDITORS

- Without dependable debt collection, no amount of supervision or competition can make banks run efficiently.

- External financing for private firms comes essentially from two sources: debt and equity. While control by equity holders is appropriate in profitable times (when entrepreneurial risk taking is needed), creditor monitoring and control become binding in times of financial distress, particularly when tight controls on spending and investment are needed.

Creditor Monitoring and Control

Adequate Information

- The first requirement is information. Lenders need information on the creditworthiness of potential borrowers, and depositors and bank supervisors need information on bank portfolios.

Creditor Incentives

- The existence of appropriate market-based incentives for creditors, in the form of higher margin of profit, high interest charges from customers and sometimes even reduction in the quantum of Non-Performing Assets (NPAs).

Debt Collection

- The third requirement for creditor monitoring and control in a market economy is an appropriate legal framework and effective procedures for debt collection.

- Around the world, legal protection of diffuse debt holders seems insufficient to protect the rights of investors and limit managerial discretion.

(5) CORPORATE GOVERNANCE AND THE COMMUNITY

- That is the role of governance. Corporate governance is the mechanism by which the values, principles, management policies and procedures of a corporation are made manifest in the real world.

- The fundamental basis of corporate governance and responsibility is the value system of the corporation:

(6) CORPORATE GOVERNANCE AND THE GOVERNMENT

- Political economy forces that produce the laws, enforcement mechanisms, bankruptcy processes, and the ability of powerful managers to influence legislation will profoundly shape corporate governance.

- Some argue that governments will tend to use regulations instead of the threat of legal sanctions when the legal system does not effectively dissuade managers from taking socially costly actions.

- Thus the government in every country exercises a certain amount of control over operations of the organisation and the government could use this to steer the organisation towards the path of good corporate governance.