CEO LOUNGE

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The Anatomy of Rebuilding & Recovery

A CEO LOUNGE INITIATIVE

A Framework for Good Governance

In conversation with

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A Framework for Good Governance

Corporate governance just got tougher than it already was. Digital transformation, change management, day-to-day business challenges and navigating finances make the boardroom no less than a battlefield. Increasing focus on rising environmental concerns and social responsibility have thrown the spotlight on corporate governance. As boards accelerate their efforts to go transparent and inclusive, there is an urgent need to balance them with reality and financials. Corporate majors are looking at textbook values and going back to first principles with renewed interest. Two industry pioneers share insights on how corporate governance is evolving and what it means to navigate this maze in today's uber vitreous world.

Words by **Divya Sista**

The largest corporations of the world today have come to believe and understand that shareholders' interests are not 'primary at any cost'; especially when the cost involves a trade-off with other stakeholder interests. The shift towards sustainability and taking into account a holistic interest-based matrix involving employees, suppliers and consumers has made governance more complex than ever. It has been proven time and again that quantifiable assets like market capitalisation, size, volume and great numbers are not the only factors to set a company's value. This charter of good intentions and pledges of inclusivity seem illusionary and difficult — especially when corporations have targets to achieve and investor interests to satiate. Should good governance matter more than what is mandated?

BEING GOOD IS NOT GOOD ENOUGH

The rule book for a good company is simple. The investors put in money, the CEO works hard, generates profit and returns value to them. This was when value was restricted to financial numbers. Being good is no longer good enough. The best companies today consider the interests of customers, employees, suppliers and everyone involved in their ecosystem and believe that this is the way to build long-term sustained value. Is this the new standard for good governance in today's world? For a field that has no prescribed or accepted standards, and is constantly evolving, subscribing to an idea is complex.

"The idea of good governance coupled with shareholder value is both easy and difficult to comprehend," says JN Gupta, Founder and Managing Director, Stakeholders Empowerment Services.

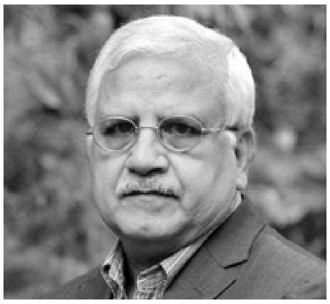
"It is like saying exercising and eating healthy is good for your body. There will always be people who eat anything they want to, do not exercise and still stay healthy. These are exceptions that can never become rules. It is a belief-based system backed by empirical evidence. Companies and corporations who believe in good governance and shareholder value, have been working on that front and reaping benefits from it," Gupta points out.

Multinational companies are investing in the well-being of their employees and giving back to the community not just because it is a mandated corporate social responsibility initiative. It is an announcement to the world showcasing their commitment to best practices, a gesture that everyone has a seat at the power table.

"Irrespective of the medium, what does not, will not and should not change is the message. While we can have mixed models of interaction with shareholders and stakeholders, the core message of engagement should never change. In difficult times like the pandemic, this is what companies big and small are being tested for. Huge corporations are being judged by not just their shareholders, but their stakeholders, and in turn the larger investing community, the government,

"Corporations are being judged by not just their shareholders but their stakeholders, and in turn, the investing community, the government and other members… It's important to define what constitutes stakeholders' expectations"

Suresh Narayanan
Chairman & MD, Nestlé India



"Good governance is like good manners — you must do things that you expect others to do"

JN Gupta
Founder and MD, Stakeholders Empowerment Services

and other members of the environment. So, it's very important to define what constitutes stakeholders' expectations," says Suresh Narayanan, Chairman and Managing Director, Nestlé India.

"Good governance is like good manners — you must do things that you expect others to do. For instance, if you've invested in a company, how would you want it to behave with you, your money and resources, and with all the stakeholders? That's what good governance is all about," says Gupta.

COMPLIANCE VS GOOD GOVERNANCE

Corporate governance as we know it today can be touted as a new phenomenon, finding its roots as late as in the 1970s, despite company law being around since the 1850s. It has therefore been a mixed bag of regulations, guidelines, internal policies and tailored consultations. The lack of standardisation has been a roadblock of sorts for successful corporate governance. In India, this is further complicated by the fact that publicly listed companies constitute a sliver of the total companies incorporated. The resultant corporate governance model is seen more as haphazard compliance, sticking by the rulebook enforcement, rather than a tool that can add value.

"Compliance to law is non-negotiable. Laws are rules that have been formulated after deliberations and taking into account innumerable facets over time. Every law is a result of and an attempt to correct some failure that has occurred. You follow the law when you are doing things because if you don't it will have legal implications. But governance is beyond just following the law. Constantly upping the ante and improvising practices for betterment is what constitutes good governance," explains Gupta.

There is a constant struggle between sticking to good governance practices and performance. Understandably, management and leadership are consumed by an unforgiving pressure to meet financial targets, business expansions, maintain investor relations and build shareholder value. Taking a stance, and importantly, maintaining the same, often leaves the management questioning its governance practices, becoming the bone of contention between the company's wants and needs.

Gupta has a different view to offer. "Now, I have a very strong objection to the idea of shareholder value, I always say it should be a stakeholder value, because an organisation can never operate in a vacuum. If you observe how shareholder value plummeted during the lockdown due to the labour migration crisis, this is an indication of the value shift towards the stakeholder. Unless all the stakeholders are involved actively, we will not be creating true value in a holistic sense," he remarks.

The emerging idea is that at the core, in the organisation Venn diagram, shareholders are a part of the larger stakeholders.

"As a company's management we don't just address the shareholders — we engage with all stakeholders. If we picture the organisation as a concentric circular model, at its core are its employees, followed by the board and shareholders, surrounded by vendors, suppliers and consumers. On the periphery are the government, media and all other interfaces the corporation deals with. We have to constantly look inward and outwards to keep shareholder confidence while treating them as a part of the larger stakeholder community. Trust is probably the most valuable, expensive yet the most fragile commodity. This has been demonstrated across geographies, time and industries," asserts Narayanan.

ESG BEYOND THE BUZZWORD

Environmental, social and corporate governance (ESG) has quickly turned into a focus area across the globe, fuelled by consistent activism, investor demands and regulatory changes. Environmental impact, sustainability and social development have turned into metrics that have been integrated into investment processes. ESG has evolved into a

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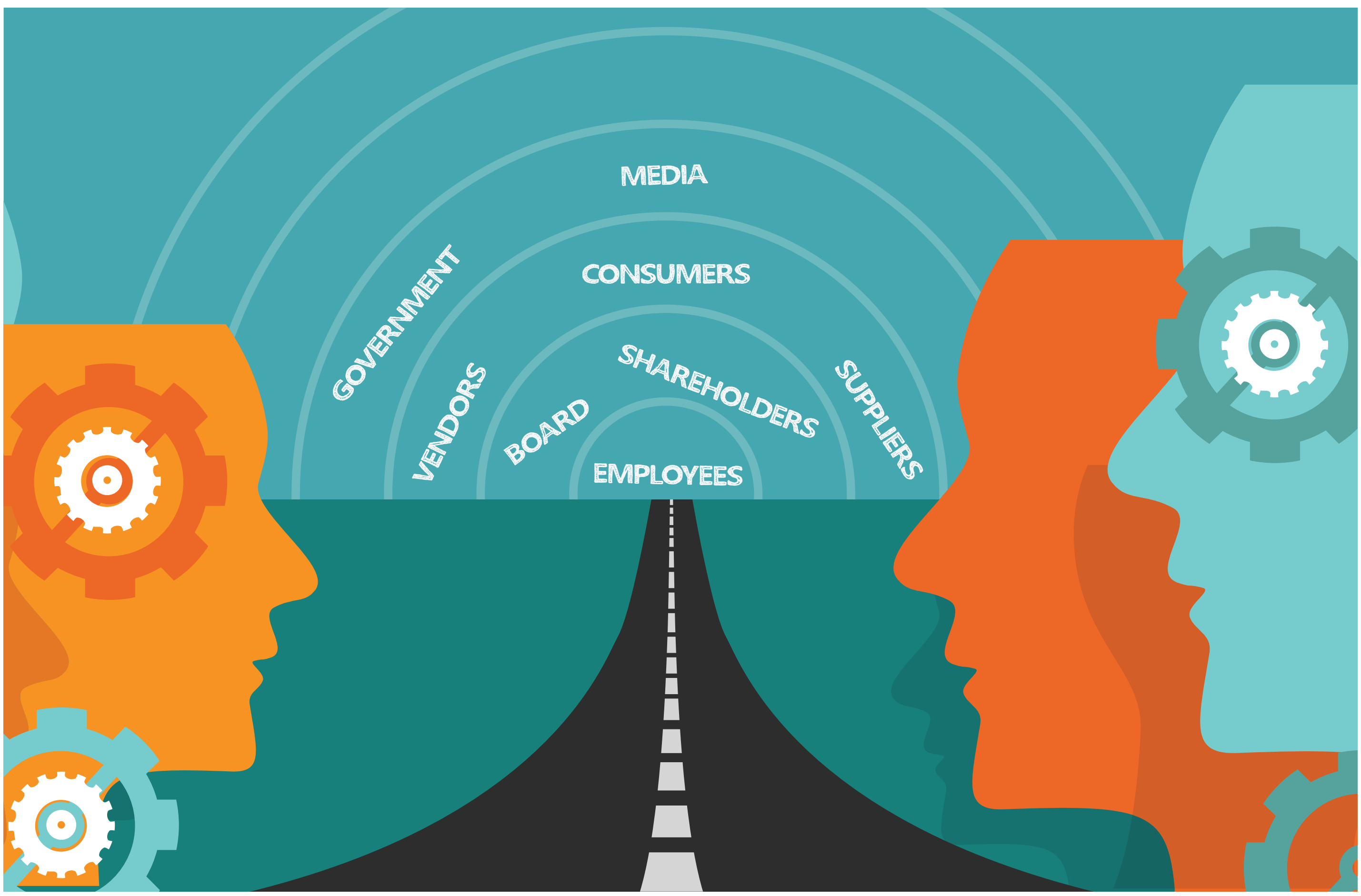

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sophisticated non-financial evaluation factor of value and a demand to execute responsible actions.

"ESG has become a buzzword and garnered immense relevance. But we have known about it all along. We have seen environment — the E factor come into play when Vedanta's copper plant shut down in Tuticorin. There are similar instances of the S (social) factor bringing corporations to a grinding halt. That said, the relationship between these factors and value is not a straight line. They have a definite and increasingly larger effect on creating shareholder value but it still a complex formula of variables. Paying attention to ESG means you are in control of most known factors. If you consider shareholder value in an institution under a good governance regime, it could be said that it functions like a system under Brownian motion — where everything moves erratically because of constant collisions between each other. What good governance essentially does is bring order to this system, so it is more systemic," Gupta says.

Does paying attention to environmental impact and social development, in addition to sound business parameters and financials, guarantee a great valuation is the million-dollar question.

Gupta emphasises the importance of governance with an example, "Consider how the governance factor reflects in the valuation of companies in the Indian private sector versus the public sector. The public sector has enviable resources, professional talent and free flow of capital as compared to the private sector. But when it comes to market valuation, the valuation metrics of public sector flails each time. The only discerning factor is governance. Good governance is efficient and this translates into value. Similarly, let us consider two private entities YES Bank and Kotak Mahindra Bank. The differential vector even in this case is governance," he says.

Good governance has the power to increase value or wipe off the relationship. It also establishes authority and injects stakeholder confidence and stability into the organisation.

"With ESG, there is a convergence between expectations of investors and other stakeholders. It is this synergy that is both exciting as well as challenging, as they undertake the journey of growth with profitability and enter a sustainable involvement with the planet. Values like trust, transparency, timeliness and transformation are the four outcomes of building a relationship with the shareholder. With the world moving at breakneck speed, inequality is on the rise, there are geopolitical fractions, you see walls being raised across countries, sex and denominations. But there's growing awareness at the same time. This changes the whole equation and the yardstick by which a corporation is going to be measured. The priority now is to strike a balance between financial health and the pursuit of good value ideas and objectives. It is not enough to be a highly profitable company. Showing robust financial health is vital, but ESG has to be considered carefully to maintain overall standing," says Narayanan.

THE CORPORATE VIRTUE OF EXCELLENCE

Transparency, accountability and security are three critical factors to build a company's integrity, which automatically rises shareholder-stakeholder value. This three-pronged approach offers multifaceted benefits. More and more companies today are shifting their agenda and strategy to line every practice and decision with the larger purpose, while not losing sight of maximised profits and shareholder value. Companies are engaging in open dialogue, some pushed by shareholder activism and some as a course of natural progression. Since this affects the integrity of the company, which in turn is central to economic stability, market confidence and financial efficiency, there is a need to maintain a robust governance model. It also serves as a means to maintain checks and balances of systems between leadership and decision-makers and stakeholders.

"When we aim at constant excellence,

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it becomes a habit, a permeable, all-encompassing trait that we can pass on to our investors as well. Transparency is key and this should not be an opaque disclosure of sorts. For instance, when Sebi mandated that arbitration give a certain ratio and furnish appropriate reasons for, say, a higher ratio, the idea behind this mandate was to facilitate higher transparency. It is childish to say the ratio is high because the numerator is higher! The idea should be a proper full disclosure in both word and spirit for a more transparent corporation in all areas and not just financials," declares Gupta.

The shareholder-centric model, based on what is popularly known as the agency theory, is making way for a more sustainable, democratised and value-based model which involves all stakeholders. Companies that have been early adopters of it, emphasising on resilience and overall health of the company seem to be the ones that have withstood not just the test of time but also crises.

"The context and purpose of calibrating are beyond performance matrices — it is a culture of trust, transparency and timeliness continuity of business model to reflect shareholder in consonance with stakeholders and competitive advantage in managing shareholder expectations. The medium is never more important than the message," Narayanan concludes.

The idea that the purpose of a company's existence is solely to please its investors and shareholders no longer holds relevance. Governing bodies, regulators and managements — are all concerned with the value the organisation creates in the long term. Whether these are steps towards a deeper change that could create a more equitable and equal world, which is also practical or a utopia of sorts, where everything is sustainable, is something only time will tell. But as stakeholders, everyone must orchestrate reform for the better and constantly develop alternatives to the status quo — that is the only way to grow.

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TAKEAWAYS

Good governance is not just good for brand image, it adds brand value.

The power dynamics are shifting and it is about involving shareholders and stakeholders.

Power-sharing is in everyone's interest — it can change corporations for the better.

ESG (environment, social and corporate governance) is not a fad — it is about involving everyone, giving back to the community and acting responsibly.

JN Gupta and Suresh Narayanan's inputs are a part of their keynote address to a recently held virtual conference by Chorus Call.

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