CEO LOUNGE

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The Anatomy of Rebuilding & Recovery

A CEO LOUNGE INITIATIVE

The Good Governance Gain

Why and how it actually pays

In conversation with

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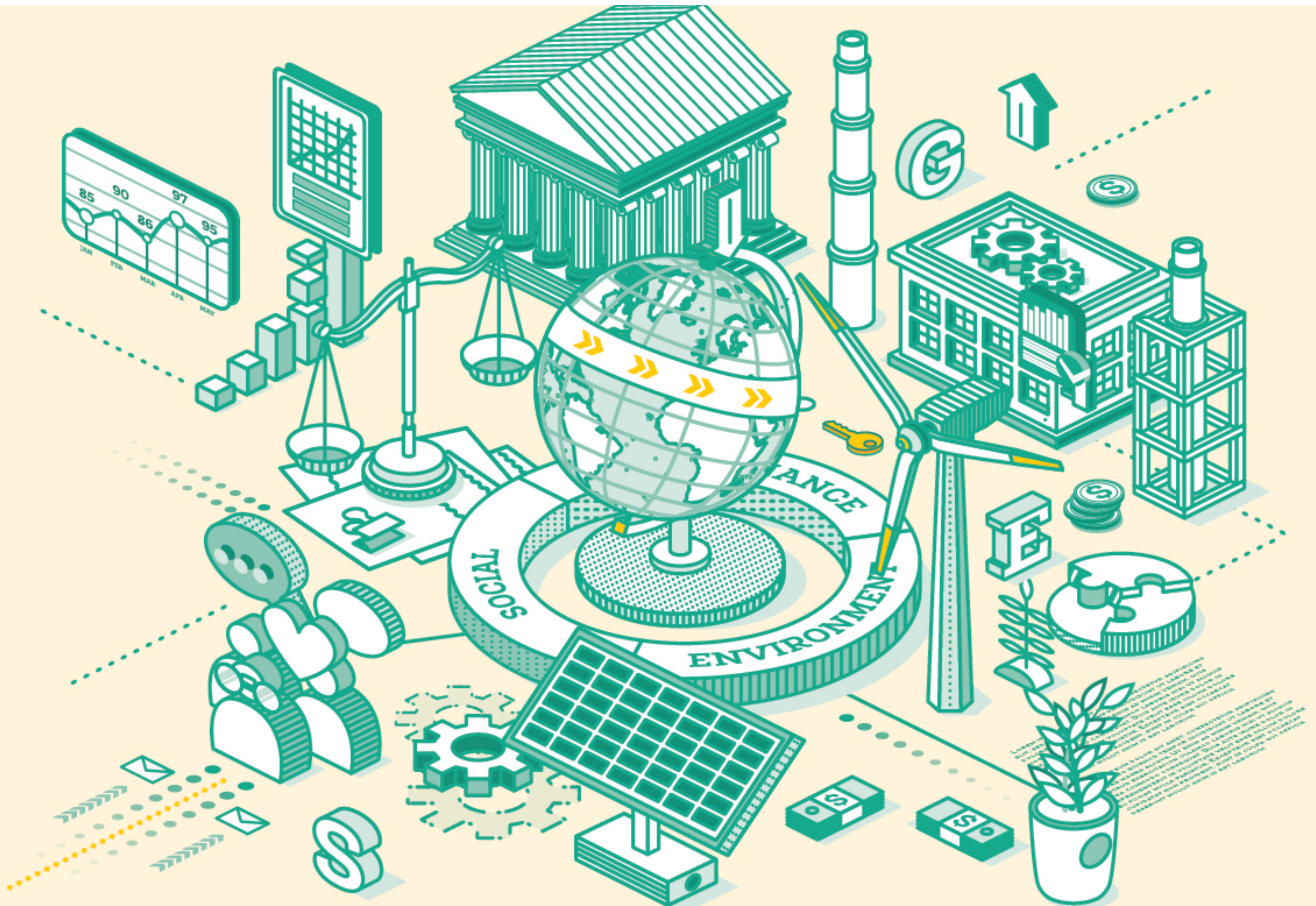
The Good Governance Gain



Corporate governance has been in the churn over the last decade due to increased shareholder activism, stricter regulatory compliances and the rise of governance scorecards. Business invariably follows money and investing in good governance has been consistently promising long-term returns. From board diversity to transparent disclosures, social responsibility to environmental responsiveness, the drivers for governance are on an evolutionary path. Some of the biggest boardroom fallouts, financial crises, diversion of funds, inadequate adherence to governance norms, executive remuneration amongst other factors have led to a heightened interest in corporate governance. CEO Lounge delves into what it truly means for the board to govern good.

Words by **Divya Sista**

Corporate institutions are critical to every nation. They contribute to the growth stories of nations, put countries on global maps of importance and contribute significantly to the economy. The checks and balances corporate institutions need are put together by regulatory authorities to set standards and ensure businesses are conducted responsibly. The C-suite is bogged down by the number of compliances they have, while regulatory authorities add some more for good measure. Whether there is enough regulation, or India as a country is far behind, may be a discussion for academic roundtables, but everyone can unequivocally agree that corporate governance has emerged as a necessity rather than a fad. India's uptick on seven out of 11

parameters on the World Bank's Doing Business report, 2020[1] is a welcome position, underscoring the importance of corporate governance.

THE HEART OF BUSINESS — BEING GOOD, DOING GREAT

Often described as the heart of the way businesses are operated, corporate governance is the ways and means by which the board carries itself as an organic body. There is an increasing acknowledgment that creating a business environment that stands on the twin pillars of trust and transparency is healthy for business, healthy for industry as a whole. It is sustainable, protects shareholder capital, addresses stakeholder concerns, and opens up uninterrupted access to institutional credit. Creating something of intangible value like trust is, however, not an easy task. Especially when the board is walking on the tight rope of balancing shareholder and stakeholder interests.

"It is the responsibility of the corporate to look at shareholders as part of the larger stakeholder community that we engage with, something that forms the crux of good corporate leadership. Further, considering the fundamental question of what a stakeholder seeks in a company, any aspect you point out to ultimately boils down to trust. Trust is the most valuable and most fragile of stakeholders' asks simultaneously. Trust in the company's transparency, leadership and business model translates to trust in seeking financial returns. This is beyond a robust financial model and risk assessment, beyond the fiduciary responsibility of extending a dividend. Shareholders are objective in terms of capital appreciation, considering the long-term future. There is a convergence of a tangible financial model, and an intangible corporate governance framework, which is the essence of the ESG (environmental, social and governance) phenomenon. A confluence of investor expectations and stakeholder concerns is giving rise to an exciting space which is pushing corporate governance models to reinvent themselves," says Suresh Narayanan, Chairman & Managing Director, Nestlé India.

Collective stakeholder demand coupled with the directives of regulatory

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compliances while not losing sight of investors' capital seem to constitute good corporate governance.

"Governance in its most elemental form is nothing but a set of codes of conduct that you have for yourself. And good governance is that what you expect others to do for you. So, when you are in an organisation, running a company, governance would mean how you'd want a company you have invested in to behave with you, your money and the others who form parts of that company. So, is it compliances and ticks in all boxes on a checklist? No. That is simply following the law. Good governance is a practice that goes a step beyond. It is also about doing things which are good without being asked," asserts JN Gupta, former Executive Director, SEBI.

NUDGING COMPASSIONATE CAPITALISM

While it may seem an abstract concept with big business bashing becoming a norm around the world, there is more than meets the eye. For instance, for startups to adhere to GAAP (generally accepted accounting principles) would mean portraying themselves as sinkholes, which may not attract the capital they need during the next round of funding. Publicly listed companies, which are on the market have an entirely different set of challenges altogether. Does it, therefore, make sense to keep it simple — maximise investor capital through legitimate means, and engage in the mandated CSR (corporate social responsibility) activity?

Narayanan disagrees. "This goes back to the Milton Friedman hypothesis of the 70s, that the only job of corporate management is to maximise shareholder value. Now, shareholder value is not going to be unimportant. I think corporates which show putrid financial results, or declining results over time, while focusing on other aspects of managing the environment or society, may not be able to succeed in holding the interest of shareholders. Yet, if they do not pursue a strategy of looking beyond growth and stability with governance and sustainability as key aspects driving their business decisions, they might not win in the long term," he voices.

The idea of responsible, compassionate capitalism is simple. It is centred around doing good beyond the law.

"The law is objective — it is black and white. If I have two sons, the law simply tells me I must take good care of them, feed them and provide them with necessities. If I agreed to send one to Harvard, and restricted the other to a local college, I would not be violating any law. But would it be fair?" questions Gupta.

No business could survive without making money by being good alone. However, there is a shift from perceiving profit as monetary benefits alone towards value addition — value that may be hard to perceive immediately but promises potential. Can good governance create value in the short-term, though? In moments that capture public attention, the 'short term' is vital to institutional survival.

"If planned strategically, it can create both short-term and long-term value," Gupta answers. "While our goal is to realise the full potential of long-term value addition, corporate governance is not a one-act show but a continuous backdrop. Consistency to it will create short-term value in terms of reliability and minority stakeholder trust or brownie points on the ESG front," he informs.

THE FORMULA FOR GOOD GOVERNANCE

Good governance increases goodwill that shows in both cash inflows and investor capital on the balance sheet.

"The relationship between good governance and shareholder value is not a straight line. It is difficult to determine because it is complex. The valuation of a company depends on a million known factors and million more unknown factors. However, when you are in control of all the known factors, bracing the unknown gets easier. When you have good governance in place, you are trying to keep everything under a holistic order," remarks Gupta.

Often great businesses are a result of fantastic innovations in products, services, management practices or marketing — capitalising on their strengths while addressing the downsides. Could this be a win-win for corporates beyond trust and investors in the long term too?

"Consider capacity-building or talent management, for instance. How would you as a company add capacity along with the suppliers and stakeholders who

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work with you? Are you taking measures in that direction by building capacity amongst youth, addressing unemployment or increase their employability? These questions become important not just from a be good, do good point of view, but from a strategic standpoint as well. Investing in capacity-building today will result in quality output tomorrow. It is our responsibility to secure the future of youngsters today, who will, in turn, contribute to the entity tomorrow. The measure of culture, values, conduct, purpose are all going to become important. Maybe you cannot assign a number to it right away. But intrinsically, these would become important aspects of how corporates will get measured over a while. The next logical step is simply aligning all the measures that you have put together for each stakeholder with the purpose and values of the company as a whole. If a measure matches a company's strength and speaks to us, you automatically establish a competitive advantage for that company. Your culture, your purpose, your values are your shields, viewed by the shareholders who put money on the table for your business, ensuring that you have a sustained performance," says Narayanan.

THE EMERGING GOVERNANCE SCORECARD

This brings us to the vital aspect of a good governance framework. When there are set guidelines or best practices, even when not set in stone, good governance becomes a way of life for the corporate body. For a long time, corporate institutional decision-making has been based on the tenet that ownership and control are separate. The idea, as established above, is changing, and we are witnessing the emergence of stakeholder democracy.

"It is pertinent that we build an operating model that can sustain not just long-term value creation for shareholders, but also manage stakeholders and set financial and objective ESG targets. The world is changing dramatically and swiftly. Some forces that are upon us demand deliberation, are calls-to-action to the management. We operate loosely on what I call the five Cs of shareholder expectations. The first C is context and purpose. If you don't have context and purpose, you can be all over the place in terms of managing the shareholder expectation without actually meeting

them. The second C is calibrating performance matrices — you have to calibrate KPIs and measures that come in and maybe relevant in the future. Number three is a Culture of trust and transparency which is crucial. It is good to be clever with business but not street-smart at the corporate level. Number four, Consonance with the stakeholders — shareholders are part of the larger stakeholder community, and they are both important to the life and health of the company. And finally, the fifth C — Competitive advantage in managing shareholder expectations. These can happen in a virtual world and should happen in the real world. The medium is never more important than the message," propounds Narayanan.

The emphasis on a board in the corporate structure is because we strongly believe that a good board would mean efficient management — where the management and board operate synchronously. Good governance adds zing to the resonance, making it a symbiotic relationship, where everyone grows and thrives. It 'ups' the valuation of a company manifold.

"Good governance gives confidence to investors about stability, which reduces their risk. And when you reduce risk, you are reducing the risk premium. Good governance becomes a crucial differentiator. And we do have benchmarks for it. Benchmarks do not mean compliance to the passing grade," stresses Gupta.

"The benchmark exists because it shows you the path to excellence. As corporates, we must shed the garb of opaque disclosures, and consciously pursue transparency. With the rise of data and information people are increasingly looking for transparency along with profitability," he explains.

SEBI's recent announcement about introducing the 'Business responsibility and Sustainability report' — mandatory reporting on ESG parameters for the top 1,000 listed companies[2] — shows the increasing regulatory emphasis of global markets on governance. The number denoting the profit on the balance sheet was always crucial. However, among other trends, the world has witnessed a dramatic shift amongst investors as well as firms on the ESG front. Organisations are being evaluated not just on the basis of ratios and turnovers, but also non-financial parameters, a step in the direction of rising responsible capitalism.

"Bad governance can take the best of the balance sheets to zero, whereas good governance is a chance to repair the worst balance sheet," concludes Gupta.

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TAKEAWAYS

1. **Good governance is a global necessity — governments around the world are regulating governance along with principles of corporate ethics.**
2. **It is a win-win for both stakeholder interests as well as sustainable growth for the institution.**
3. **When managed right and made part of business strategy, good governance contributes to both, short-term and long-term gains on the balance sheet.**
4. **There is a pressing need for a standardised global corporate governance framework.**

[1] https://www.doingbusiness.org/en/data/exploreeconomies/india
[2] https://www.moneycontrol.com/news/business/markets/sebis-new-rules-on-startups-delisting-esg-and-more-explained-6697691.html

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