

Analysis of Corporate Governance Practices in Capital Goods Industry

Prachi Arora

Assistant Professor in Economics, Markanda National College
Shahabad Markanda, Kurukshetra.

Received: May 28, 2018

Accepted: July 02, 2018

ABSTRACT

The concept of corporate governance has gained extraordinary prominence in the recent years. The vast amount of literature available on the subject ensures that there exist innumerable definitions of corporate governance. The concept of corporate governance has gained importance in the recent past. In a narrow sense, corporate governance involves a set of relationships amongst the company's management, its board of directors, its shareholders, its auditors and other stakeholders. Empirical studies have been conducted in various countries on whether there is any link between the corporate governance / board composition and corporate performance. Much of the previous literature has shown a positive relationship between governance and firm performance. The broader objective of this research paper is to understand the Corporate Governance processes in capital goods industry.

Keywords: Corporate governance, auditors, stakeholders, corporate performance

Introduction to Corporate Governance

The concept of corporate governance has gained extraordinary prominence in the recent years. The vast amount of literature available on the subject ensures that there exist innumerable definitions of corporate governance. To get a fair view on the subject it would be prudent to define the concept of corporate governance both in a narrow as well as broader sense.

The Narrow Concept

In a narrow sense, corporate governance involves a set of relationships amongst the company's management, its board of directors, its shareholders, its auditors and other stakeholders. These relationships, which involve various rules and incentives, provide the structure through which the objectives of the company are set, and the means of attaining these objectives as well as monitoring performance are determined. So, the key aspects of good corporate governance include transparency of corporate structures and operations; the accountability of managers and the boards to shareholders; and corporate responsibility towards stakeholders. It gives an impression that corporate governance essentially lays down the framework for creating longterm trust between companies and the providers of capital, however it would be mistaken to consider that the significance of corporate governance lies solely in better access of finance. Companies around the world are realizing that better corporate governance adds substantial value to their operational performance:

- It improves strategic philosophy at the top by inducting independent directors who bring a wealth of experience, and a host of new ideas
- It rationalizes the management and monitoring of risk that a firm faces globally
- It confines the liability of top management and directors, by cautiously articulating the decision making process
- It assures the veracity of financial reports
- It has long term reputational effects among key stakeholders, both internally and externally

The Broader Concept

In a broader sense, however, good corporate governance- the extents to which companies are run in an open and honest mode- is important for overall market confidence, the efficiency of capital allocation, the growth and development of countries' industrial bases, and eventually the nations' overall wealth and welfare. It is important to note that in both the narrow as well as in the broad definitions, the concepts of disclosure and transparency inhabit centre-stage. In the first instance, they generate trust at the firm level among the suppliers of finance. In the second instance, they create overall confidence at the comprehensive economy level. In both cases, they result in efficient allocation of capital.

Having dedicated to the above definitions, it is imperative to note that ever since the first writings on the subject appeared in the academic domain, there have been many debates on the factual scope and nature of corporate governance mechanisms around the world.

More particularly on the question ‘Who should corporate governance really represent?’ This issue of whether a company should be run exclusively in the interest of the shareholders or whether it should take account the interest of all constituents has been extensively discussed and debated for a long time now.

Analysis of Corporate Governance in Capital Goods Industry

My research has covered these companies in order to study the corporate governance trends in the Capital goods industry.

Table : 4.1: Sample Companies in Capital Goods Sector

Sr. No.	Company
1	ABB Ltd.
2	Bharat Electronics Ltd.
3	Bharat Heavy Electricals Ltd.
4	Crompton Greaves Ltd.
5	Larsen & Toubro Limited
6	Punj LLOYD Ltd
7	Siemens Ltd.

Capital Goods Industry - Analysis of Corporate Governance Score

1. Statement of Company's philosophy on code of governance:

In the Capital Goods industry there are 8 sample units, while looking to the Corporate Governance, the first score point was statement of Company's philosophy on Corporate Governance and thus the point was assigned a weightage of 2 on a scale of 100. All 8 companies get the expected score of 2. On other hand all companies have sufficient disclosure of the statement of Company's philosophy on code of governance However, ABB have better described Company's philosophy on code of governance.

2. Structure and Strength of board

In the Corporate Governance score, the second score point was about the Structure and Strength of the board. The point was assigned a weightage of 2 on a scale of 100. All 8 companies get the expected score of 2. All companies have sufficiently disclosed the composition of the Board of Directors.

3. Chairman & CEO Duality

The appointment of Chairman of the board carries of critical importance. The third point describes about the duality of Chairman and CEO. The point assigned a weightage of total 5 points, which are assigned on the following basis.

Table : 4.2: Criteria for determination of Points for Chairman & CEO

SR. NO.	PARTICULARS	POINTS
I	Promoter Executive Chairman - Cum - MD / CEO	1
II	Non promoter Executive Chairman cum MD / CEO	2
III	Promoter Non Executive Chairman	3
IV	Non Promoter Non Executive Chairman	4
V	Non Executive Independent Chairman	5

No company among this sample is assigned a score of 5 as no company is having Non Executive Independent Chairman. However, Siemens and ABB have Non Promoter Non Executive Chairman hence are assigned a score of 4. While, Punj Lloyd and Suzlon are assigned a score of 1 as they have Promoter Executive Chairman - Cum - Managing Director.

4. Disclosure of Tenure and Age limit of directors

In the Corporate Governance score, the fourth point was about Disclosure of Tenure and Age limit of directors. The point was assigned a weightage of 2 on a scale of 100. All 8 companies get the expected score of 2. All companies have sufficiently disclosed the tenure and age limit of Directors.

5. Disclosure of Definition and selection criteria for (Independent) Directors

In the Corporate Governance score, the fifth point was about the definition of 'Independent Director' and 'Financial Expert' and selection criteria for board members (including independent director). The point was

assigned a weightage of 3 on a scale of 100. None of the companies have disclosed definition of 'Financial Expert' and selection criteria for board members (including independent director).

However, the definition of 'Independent Director' is available in the annual report of Bharat Heavy Electricals Ltd. (BHEL) hence it is assigned a score of 1 point. All companies (except BHEL) did not get any point.

6. Post Board meeting follow up system and compliance of the board procedures

In the Corporate Governance score, the sixth point was about disclosure of Post Board meeting follow up system and compliance of the board procedures. The point was assigned a weightage of 2 on a scale of 100. The systematic disclosures about the Post Board meeting follow up system are not sufficiently available in the annual report of the sample companies. Hence, All 8 companies did not get any point in this section.

7. Appointment of lead independent director

In the Corporate Governance score, the seventh point was about the appointment of lead independent director. The point was assigned a weightage of 2 on a scale of 100. Among the sample, none of the companies have formally appointed lead independent director.

Hence, All 8 companies did not get any point in this section.

8. Disclosure of other provision as to the boards and committees

In the Corporate Governance score, the eighth point was about the disclosure of other provision as to the boards and committees. The point was assigned a weightage of 1 on a scale of 100. It is observed that all the companies have sufficiently disclosed about the various committees and sub-committees of the board.

Hence, All 8 companies get expected score of 1.

9. Disclosure of Remuneration Policy & Remuneration of Directors

In the Corporate Governance score, the ninth point was about the disclosure of Remuneration Policy & Remuneration of Directors. The point was assigned a weightage of 2 on a scale of 100. The point was further equally divided into two points, (i) Disclosure of remuneration policy and (ii) Disclosure of remuneration to directors.

All companies have sufficiently disclosed about remuneration to directors. The remuneration policy of ABB is sufficiently disclosed in the annual report. Hence, all companies (except ABB) did not get any point in this section. However, ABB gets the score of 1.

10. Code of Conduct

In the Corporate Governance score, the tenth point was about the code of conduct. The point was assigned a weightage of 2 on a scale of 100. The point was further equally divided into two points,

- (i) Information on Code of Conduct and
- (ii) Affirmation regarding compliance for code of conduct.

It is observed that all the companies have sufficiently disclosed about both the above points.

Hence, All 8 companies get expected score of 2.

11. Board Committees

In the Corporate Governance score, the eleventh point is about the various committees of the board. The point is assigned a weightage of 25 on a scale of 100. The classification of the point is as under

Table : 4.3 Criteria for Determination of points for Board Committees

SR. NO.	PARTICULARS	POINTS
I	Audit Committee	8
II	Remuneration Committee	6
III	Shareholders' / Investors Grievance Committee	5
IV	Nomination Committee	2
V	Other Committees	4
	TOTAL	25

a. Audit Committee

The Audit Committee is assigned a weightage of 8. It is further classified as under.

Table : 4.4 Criteria for Determination of points for Audit Committees

SR. NO.	PARTICULARS	POINTS
I	Transparency in composition of audit committee	1
II	Compliance of minimum requirement of the number of independent	1

	directors in the committee	
III	Compliance of minimum requirement of the number of meetings of the Committee	1
IV	Information about literacy & expertise of committee members	1
V	Information about participation of head of finance, statutory auditor and chief internal auditor in the committee meeting	2
VI	Disclosure of audit committee charter and terms of referenc	1
VII	Publishing of audit committee report	1
	TOTAL	8

It is observed that all companies have made sufficient disclosure about the audit committee. However, none of among the sample companies, has published Audit Committee Report in the annual report.

Hence, All 8 companies get expected score of 7.

b. Remuneration / Compensation Committee

The Remuneration/Compensation Committee is assigned a weightage of 6. It is further classified as under.

Table:4.5 Criteria for Determination of points for Remuneration Committee

SR. NO.	PARTICULARS	POINTS
I	Formation of the committee	1
II	Information about number of committee meetings	1
III	compliance of minimum requirement of number of non executive directors in the committee	1
IV	Compliance of the provision of independent director as a chairman of the committee	1
V	Information about participation of all members in the committee meeting	1
VI	Publishing of committee report	1
	TOTAL	6

It is observed that all companies, except Bharat Electronics Ltd. have formed the committee. They have also disclosed sufficiently about point No. i to v. However, none of among the sample companies has published Remuneration Committee Report in the annual report. It is observed that Bharat Electronics Ltd (BEL) have not formed the Remuneration / Compensation Committee. Hence, All companies (except BEL) get the score of 5. However, BEL gets the ZERO score in this section.

c. Shareholders' / Investors Grievance Committee

The Shareholders' / Investors Grievance Committee is assigned a weightage of 5. It is further classified as under.

Table:4.6 Criteria for Determination of points for Shareholders / Investors Grievances Committee

SR. NO.	PARTICULARS	POINTS
I	Transparency in Composition of the committee	1
II	Information about nature of complaints & queries received and disposed.	1
III	Information about number of committee meetings	1
IV	information about action taken and investors/shareholders survey	1
V	publishing of committee report	1
	TOTAL	5

It is observed that all the sample companies have formed the committee and have sufficiently disclosed about point i to iii.

However, none of the sample companies have published information about the investors / shareholders' survey (if conducted). The Report of this committee is also not published by any of the sample companies.

Hence, all companies get the score of 3.

d. Nomination Committee

The Nomination Committee was assigned a weightage of 2. The point was further equally divided into two points,

- (i) Formation of the Committee and
- (ii) Publishing of committee charter and report.

It is observed that none of the sample companies - except Larsen & Toubro Ltd. (L&T) have formed this committee. However, none of the sample companies have published charter and report of this committee. Hence, all companies except L&T get the ZERO score. L&T gets the score of 1.

e. Other Committees

The formation of other committees is assigned a weightage of 4. It is further classified as under.

Table : 4.8 Criteria for determination of Points for Other Committees

SR. NO.	PARTICULARS	POINTS
I	Health, Safety and Environment Committee	1
II	Ethics and Compliance Committee	1
III	Investment Committee	1
IV	Share Transfer Committee	1
	TOTAL	4

It is observed that following committees are not formed by any of the sample companies.

- i) Health Safety and Environment Committee,
- ii) Ethics and Compliance committee and
- iii) Investment Committee

However, Share Transfer Committee is formed by Bharat Heavy Electricals Ltd. (BHEL) and Suzlon Energy Ltd. (Suzlon). Hence, all companies except BHEL and Suzlon gets ZERO score. The BHEL and Suzlon gets the score of 1.

12. Disclosure and Transparency

In the Corporate Governance score, the twelfth point is about the various disclosure and transparency shown by the company in the annual report. The point is assigned a weightage of 25 on a scale of 100. The classification of the point is as under.

Table : 4.9 Determination of points for Disclosure and Transparency

SR. NO.	PARTICULARS	POINTS
I	Significant related party transactions having potential conflicts with the interest of the company	2
II	Non Compliance related to capital market matters during last three years	2
III	Accounting Treatment	2
IV	Board Disclosure - Risk Management	3
V	Management Discussion and Analysis	2
VI	Shareholders' Information	4
VII	Shareholder Rights Audit	2
VIII	Qualification	2
IX	Training of Board Members	2
X	Evaluation of Non-Executive Directors	2
XI	Whistle Blower Policy	2
		25

It is observed that:

1. All sample companies have sufficiently disclosed about significant related party transactions.
2. All sample companies have adequately disclosed about Non Compliance related to capital market matters during last three years.
3. All sample companies have clearly mentioned about the accounting treatments and significant changes in their accounting policy.
4. All sample companies have given sufficient information about risk management and policies of the board. However, no sample company has published risk management report.
5. All sample companies have published the Management Discussion and Analysis as a part of the annual report.
6. All sample companies have sufficiently disclosed the shareholders' information.
7. None of the sample companies have published rights of the share holders as a part of their annual report.
8. All sample companies are clear from any audit qualification.

9. ABB Ltd and Bharat Electronics Ltd. have given information about the training to board members. However, it is not given by other sample companies.
10. None of the sample companies have given information about the system of Evaluation of Non Executive Directors.
11. ABB Ltd and Bharat Electronics Ltd. (BEL) have given information about the Whistle Blower Policy. However, it is not given by other sample companies.

Hence, all companies except ABB and BEL gets the score of 16. ABB and BEL gets the score of 20.

13. General Body Meetings

The Thirteenth score point was disclosure about the General Body Meetings thus the point was assigned a weightage of 3 on a scale of 100. This point is further equally divided into the disclosure regarding the following :

- i) Location and time of general meetings held in last three years Details of Special Resolution passed in last three AGMs \ EGMs
- iii) Details of resolution passed last year through postal ballot including conducting official and voting process

All 8 companies have sufficiently disclosed about the above points in the annual report.

Hence, all 8 companies get the expected score of 3.

14. Means of communication and General shareholder information

The Fourteenth score point was disclosure about the means of communication and general shareholder information. This point was assigned a weightage of 2 on a scale of 100. All 8 companies have sufficiently disclosed about the point in the annual report. Hence, all 8 companies get the expected score of 2.

15. CEO / CFO Certification

The Fifteenth score point was about the certification of CEO \ CFO for the corporate governance. This point was assigned a weightage of 2 on a scale of 100. It is observed that all 8 companies have certification from CEO \ CFO. Hence, all 8 companies get the expected score of 2.

16. Compliance of Corporate Governance and Auditors' Certificate

The Sixteenth score point was about the compliance of Corporate Governance guidelines issued by SEBI and Auditor's Certificate. This point was assigned a weightage of 10 on a scale of 100. The companies who have clean certification can are assigned 10 points, whereas companies who do not have a clean certification are assigned 5 points. It is observed that all 8 companies have clean certificate from auditor. Hence, all 8 companies get the expected score of 10.

17. Disclosure of Stakeholders' interests :

The Seventeenth score point was about the disclosure of the stakeholders' interest. This point was assigned a weightage of 10 on a scale of 100. These points are divided equally to the following.

1. Environment, Health & Safety Measures (EHS)
2. Human Resource Development Initiative (HRD)
3. Corporate Social Responsibility (CSR)
4. Industrial Relation (IR)
5. Disclosure of policies on EHS, HRD, CSR & IR

It is observed that most of the companies have provided information about above mentioned points in various forms. The disclosure about all items except Corporate Social Responsibility are not adequately provided in the report. The information regarding Corporate Social Responsibility is not adequately provided in the report of BEL, CG, L&T and PL. However, the information regarding CSR is adequately provided in the report of ABB, BHEL, Siemens and Suzlon. Hence, ABB, BHEL Siemens and Suzlon are getting a score of 2. However, BEL, CG, L&T and PL get ZERO score.

Conclusion:

Hence, ABB Ltd. gets highest score of 69 whereas Punj Lloyd gets the lowest score of 59 in the Capital Goods industry. It can be also analyzed that that the Industry Average Score of Capital Goods Industry (63) is LOWER than the Aggregate Average Score of all Industries.

References

1. Securities and Exchange Board of India (2002) Report on SEBI Committee on Corporate Governance (under the chairmanship of Shri N R Narayanamurthy)
2. Report of the CII Taskforce on Corporate Governance Chaired by Mr. Naresh Chandra (November 2009)
3. Ministry of Corporate Affairs, Government of India. Corporate Governance Voluntary Guidelines 2009

4. Securities and Exchange Board of India Clause 49 of listing agreement.
5. Demsetz, Harold, and Kenneth Lehn, 1985, The structure of corporate ownership: causes and consequences, *Journal of Political Economy*, 93, 1155- 77
6. Jensen, Michael C., 1993, The modern industrial revolution, exit, and the failure of internal control systems, *Journal of Finance*, 48, 831-880.
7. Yermack, David, 1996, Higher market valuation of companies with a small board of directors, *Journal of Financial Economics*, 40, 185-221.
8. Eisenberg, Theodore, Sundgren, Stefan, and Martin T. Wells, 1998, Larger board size and decreasing firm value in small Firms, *Journal of Financial Economics*, 48, 35-54
9. Mak, Yuen Teen, and Yuanto Kusnadi, 2002, Size really matters: further evidence on the negative relationship between board size and firm value, *Pacific-Basin Finance Journal*, 13, 301-318.
10. Baysinger, Barry D., and Henry N. Butler, 1985, Corporate governance and the board of directors: performance effects of changes in board composition, *Journal of Law, Economics and Organization*, 1, 101-124.
11. Mehran, Hamid, 1995, Executive compensation structure, ownership, and firm performance, *Journal of Financial Economics*, 38, 163-84.
12. Klein, April, 1998, Firm performance and board committee structure, *Journal of Law and Economics*, 41, 275-303
13. Vafeas, Nikos, 1999, Board meeting frequency and firm performance, *Journal of Financial Economics*, 53, 113-142.
14. Adams, Rene B. and Ferreira, 2004, The moderating effect of group decision making, Working paper, Stockholm School of Economics.