Role and importance of corporate governance

Corporate governance is a never ending process and is a way to achieve an organization’s objectives and strategies. It helps managing the conflicts of interest between shareholders and management and holds consequential national importance. Furthermore, it is the good corporate governance that makes sure that the business environment is fair and transparent and the companies can be held liable for all their actions. In contrast, bad corporate governance results in mismanagement and corruption. It is essential to keep in mind that although corporate governance has developed as a way to administer modern joint stock corporations but it is fairly significant in state-owned enterprises, cooperatives, and family businesses. Disregarding the kind of enterprise, it is only good governance that can deliver sustainable good business performance (Berghe & Ridder 1999, pp. 15-18).

Background of the Reliance Group

The Reliance Group was constituted by Dhirubhai H. Ambani (1932-2002). It deals in the businesses of energy and materials value chain. Reliance Industries Limited is the largest private sector company in India and has been listed in the Fortune Global 500 Company. The most essential element of the evolvement and development of Reliance has been the ‘ backward vertical integration’. In the late seventies, Reliance with regard to textile followed the approach of backward vertical integration – in fibre intermediates, petroleum refining and oil, polyester, plastics, petrochemicals, and gas exploration and production – to be fully merged along the materials and energy value chain (ICMRINDIA 2010). After the demise of Dhiru bhai Ambani in the year 2002 nobody anticipated that the heirs of India’s largest business organization would get separated. On June 18th, 2005 both the borthers, Mukesh Ambani and Anil Ambani started their own individual realm (Reliance Industries Limited 2010).

Family Business

In Asia, Family owned business groups dominate the private sector. They are considered as a valuable and distinctive organization in the world's economy. They consist of parents and children, husband and wife, board members, employees, working partners etc. or a combination of any or all of them. Due to the complexity of the family businesses, different models were discovered to understand the nature or operation in family businesses. The three circle model of family business portrays the relationship of three dimensions – ownership, business and family. (Refer Appendix 1). Development in terms of ownership, family, and business in every dimension is then expressed with the help of separate models (Gersick 1997, pp. 2-24). (Refer Appendix2, 3, 4)

Strengths & Weaknesses of Family Businesses

It can prove as a powerful means to improvise the communication and understanding among members of family. The family values and business history can be used a tool to develop a positive image of the company. But at the same time, Family owned businesses confront an array of challenges which they must handle properly to make the company sustainable in the long run. During the initial, start-up phase of the family business, the company and family relationships are vaguely distinguished. This accounts to various complications in distinguishing company-owned assets, and how company owned assets can be utilized by the family as a shareholder. This can result in confidence on certain key people instead of structures and processes. Such “ common” understandings may not be as universally-held or understood when situations change. This could lead to ambiguity on the part of external investors and non-family employees. Weaknesses in governance systems of family businesses are apparent in internal controls, internal audit and risk management (Smerdon 2004). Since majority of the Business are managed by the founders or their children, the control environment is largely tailored to their needs. The problem is that the controls do not evolve along with the company, so the business becomes more complex. Clashes among the siblings who manage the business, misconception between family branches may upset the company’s realm and create problems for shareholders. The Family governance organizations or institutions can play a vital role as an area where delicate issues and problems can be reviewed (Kaye 2005, pp. 17-20).

Corporate Governance Principles in India

The basic principles of corporate governance includes

1) Integrity and fairness

2) Transparency and disclosure

3) Accountability and responsibility

Integrity holds a significant place in corporate governance. Ethics and value system are the key elements of integrity. The high management should infuse ethics in the organization which consequently leads to integrity par excellence and fair practices. For this the senior management and the Board of Directors requires a code of conduct, which must be drafted in such a manner that it casts the purpose of the significant and highest principles of integrity. The base of an organization totally depends on the integrity, fair and ethical practises (Das 2008, p. 39-40).

Transparency and disclosures are fairly significant in corporate governance. The organization's Board of Directors and the all the committees are presumed to carry out all the activities in a cordial way. Though, the effectiveness relies upon progressive performance of audit committee, good management information system, suitable internal control and other process. An organisation's website, that is nicely-developed and highly interactive helping in giving all the required information related to the business and its administration, is also essential (Das 2008, p. 39-40).

Accountability and responsibility would not be an issue for any organization that practises the principles of integrity and disclosures. They will be responsible and accountable to the stakeholders for their actions. The company would have some social responsibility which would be apparent on how they work for it (Das 2008, p. 39-40).

Reliance Industries Limited

Reliance completely focuses on the proper implementation of finest Corporate Governance practices. At Reliance, Corporate Governance is derived on the following fundamental principles/standards:

Constitution of a Board of Directors of appropriate composition, size, varied expertise and commitment to discharge its responsibilities and duties.

Ensuring timely flow of information to the Board and its Committees to enable them to discharge their functions effectively.

Independent verification and safeguarding integrity of the Company's financial reporting.

A sound system of risk management and internal control.

Timely and balanced disclosure of all material information concerning the Company to all stakeholders.

Transparency and accountability.

Fair and equitable treatment of all its stakeholders including employees, customers, shareholders and investors.

In the ownership structure of Reliance, 51% of the equity shareholding is owned by the Ambani family members, 20% is owned by FII's, 13% belong to small investors and the rest by the board controlled by the family. Furthermore, the policy of the company is to retain the optimal composition of both the Executive and Non- Executive Directors. There are 14 directors in the Board out of which 7 are Independent Directors (livemint. com 2010). (Refer Appendix 5)

Reliance Communications Limited

The Reliance Communications Limited always strives to uphold the fundamental standards of corporate governance. The basic principles of corporate governance at Reliance Communications Limited are as follows.

To maintain the highest standards of transparency in all aspects of our interactions and dealings.

To ensure timely dissemination of all price sensitive information and matters of interest to our stakeholders.

To demonstrate the highest level of personal accountability and to ensure that employees consistently pursue excellence in everything they do.

To comply with all the laws, rules and regulations applicable to the Company.

To promote the interests of all stakeholders including customers, shareholders, employees, lenders, vendors and the community (livemint. com 2010).

(Refer Appendix 6 for Structure)

Reliance and Corporate Governance Observations (Compliance)

The high standards of corporate governance makes the Reliance globally acknowledged. This particular practice leads to the sustainable growth of the company along with the fulfilment of all the goals and objectives. The intent to meet the aspirations and requirements of the stakeholders is supported by work environment that focuses on performance, all the processes related to governance, high credit ratings and shareholder returns. Corporate social responsibility is also taken care of. Apart from the traditional governance practices it also attempts to adopt and evolve the best practices of corporate governance. Several efforts are taken to maintain its best corporate governance standards. They are as follows:

Proper guidelines have been issued for the board and committee meetings for the effective and efficient process of decision making.

Corporate social responsibility holds an important place. Contributions are made for the social development to the society as a whole.

Strong system is employed for the checks and balances of financial instruments.

A legal compliance unit has been set up so that the company adheres to the legal, statutory and regulatory requirements and standards (livemint. com 2010).

(Refer Appendix 7)

Succession

Mukesh Ambani and Anil Ambani were managing the reliance group after the demise of Dhirubhai Ambani in the year 2002. It was in November 2004, when Mukesh openly accepted in an interview that there are some ownership problems between Anil and him. Anil began to disapprove the practices of corporate governance adopted by Reliance industries, owned by Mukesh. Due to poor succession planning, the competitive position of family owned businesses like Reliance had significantly weakened over the years. The failed and unsuccessful succession plans that lead to the alienation of Reliance Industries Limited is an important and widely known case in the world of corporate sector. Proper planning of succession is an important aspect of developing marketing where in the corporate bodies and the corporate governance practises are still cultivating. Reliance being a well established and successful organisation, the chances demolition of shareholder’s wealth and corporate value erosion are extremely high. With the death of Dhirubhai the stock performance of the company started going down. More over, the separation’s revelation plan of the two brothers was not the correct way to apart the business organisations from a big empire. The various reasons for the deterioration of values can be low cooperation, interconnectedness and low economy of scale and scope (Social Science Research Network 2010).

Conclusion

The family owned business houses outdo the non family owned business houses in several aspects. In comparison to the non family owned companies, the exclusive selection that gives importance to the risk, growth and control of ownership are the driving power at the rear of distinguishing financial logic. Family firms are an important source of economic development and growth. These firms create value through product, process, and service innovations that fuel growth and lead to prosperity. The long-term nature of family firms’ ownership allows them to dedicate the resources required for innovation and risk taking, thereby fostering entrepreneurship. Furthermore, the kinship-ties that are unique to family firms are believed to have a positive effect upon entrepreneurial opportunity recognition (Barney, Clark, & Alvarez, 2003).

Corporate governance plays a significant role in family owned business with globalisation and ever increasing growth. It is the corporate governance practises that makes can lead to either success or failure. The complexities can be handled by establishing and implementing the appropriate policies.

By making the corporate governance an internal part of the family business culture, succession issue will not interrupt the working of the organisation and good corporate governance will contribute to higher standards of responsilblity, accountability and business performance.

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Appendix

Appendix: 1

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3

The Three Circle Model of Family Business

Source: (Gersick 1997)

Appendix: 2Controlling Owner

Cousin Consortium

Sibling Partnership

The Ownership Axis

Source: (Gersick 1997)

Passing the Baton

Working Together

Entering the Business

Young Business Family

Appendix: 3

The Family Axis

Source: (Gersick 1997)

Maturity

Expansion/

Formalization

Start – up

Appendix: 4

The Business Axis

Source: (Gersick 1997)

Appendix: 5

Mukesh D. Ambani

Chairman/Managing Director

Non-Executive/Non- Independent Director

Executive Directors

P. M. S. Prasad

Hardev Singh

Hital R. Meswani

Nikhil R. Meswani

R. Ravimohan

Ramniklal Ambani

Yogendra Trivedi

Dr. Dharam Kapur

Mansingh Bhakta

Prof. Dipak C. Jain

Prof. Ashok Misra

S. Venkitaramanan

Mahesh P. Modi

Raghunath Mashelkar

Shri Anil D. Ambani

Chairman

Appendix: 6

Directors

Prof. Ramachandran

A. K. Purwar

Deepak Shourie

S. P. Talwar