10th CII Corporate Governance Summit

Mr. UK Sinha, Chairman- December 8, 2015- Mumbai,

I am honored at being invited for the keynote address at this 10th CII Summit. I thank you for giving me this opportunity. In my address I intend to speak about the role of media in corporate governance, role of board of directors, stakeholders' response to news media coverage of corporate governance and the challenges of managing information risk in the digital era.

Role of Media in Corporate Governance

Media plays a major role in shaping the creation of an image of a company and its directors. By doing so, they pressure them to behave according to societal norms. Depending on the situation this pressure can lead to shareholders' value maximization or to deviations from it. The media also intersects with various corporate governance mechanisms. In case of shareholders activities, I would like to share an example of Korea, cited by a research paper.

Korea has long been known as a place where controlling shareholders in the largest Korean firms (chaebol) take advantage of their position at the expense of small investors. National corporate laws convey few rights to outside investors—they score only 2 out of 5 in La Porta and others' (1998) index that measures the strength of protection for minority shareholders—and expectations in relation to law enforcement are low. According to an index designed to assess countries' law and order tradition, Korea has a level half of the average in the industrial countries. The beginning of efforts to force change in Korea dates to 1996 and the formation of the People's Solidarity for Participatory Democracy (PSPD) driven by Jang Ha-Sung of Korea University. As in the United States, this investor activist has focused his attention on changing corporate policies in the largest Korean firms, and has relied both on legal pressures- including proxy battles, criminal suits, and derivative suits, and on the use of the press to shame corporate leaders into changing their policies. Perhaps to an even greater extent than in the United States, the success stories have resulted more from the creation of public opinion pressure than from legal sanctions.

Shareholder activists have found media useful in their fights with management in the United States.Another successful example of media influencing the corporate governance is in the case of SKTelecom, a South Korean company. SK Telecom was an extremely profitable company, but its financial results did not show this because the company used transfer pricing to benefit two companies almost 100 percent owned by the chairman of SK Telecom and his relatives. The PSPD drew attention to these policies. After the London-based Financial Times picked up the story, a media campaign ensued to attract proxy votes. This campaign involved publishing advertisements in newspapers and using television and radio. In March 1998 SK Telecom's directors capitulated and agreed to the PSPD's requests.

The effect of shareholder and public opinion pressure in many such cases was an increase in transparency. Similarly, in case of Institutional investors, while institutional investors have many legal mechanisms to encourage change in corporate policies, the presence of an active press increases their influence. It provides a relatively cheap way to impose penalties on companies and to coordinate the response of other investors in availing themselves of potential legal protection.

Public opinion pressure generated by an active press is also essential to efforts by private sector organizations to use self-regulation to improve corporate governance.

The role of Board of Directors in the wake of coverage by media

Now, I would like to highlight the role of board of directors.As a monitor of shareholders' interests, board of directors have a responsibility to take appropriate action so as to discipline the underperforming or opportunistic management in the wake of negative publicity about the company. This may require dismissal or amending compensation. Directors would also be expected to ensure that future performance of the company will not be jeopardized by inappropriate managerial behavior.

Alternatively, media criticism of management may alert directors, be they executive or non-executive, to a need to encourage management to work towards organizational goals. Working

collaboratively and realizing the long-term utility of the company's reputation, directors and management may work to remedy a situation caused by management misconduct.

Sufficient press coverage on a corporate governance violation by a firm may pressurize and lead directors and management to institute reform within the business. The management and directors of companies which receive negative media coverage due to the occurrence of a corporate governance violation would therefore be expected to repair any damage done to company reputation by compensating shareholders and implementing reforms.

SEBI has provided the corporate governance framework and developed mechanisms to compel the disclosure by corporates, allowing the force of public pressure generated by disclosure and news stories to change practices. The effort is to reform by means of disclosure and public pressure and use fines and legal sanctions as a secondary measure. We hope that reliance on disclosure supported by widespread communication by the press on performance relative to standards will lead to changes in corporates practices.

The balance directors strike between monitoring and stewardship is a matter of contingency. Nevertheless, should a company receive negative coverage in the news media regarding the way its standards of corporate governance, directors and management would be expected to take actions to repair the reputation of the company. Measures may include addressing parties affected by misconduct within the company through a realignment of goals or financial reimbursement. Management accountability, financial transparency and active board oversight and/or stewardship would also be expected from the board of directors in future, that is to say that if reputation is considered an important company resource, one would envisage that the board of directors would take steps to implement corporate governance reform.

Stakeholders' response to news media coverage of corporate governance

a) Shareholders

The theory of the market for corporate control vindicates that shareholders in inefficiently managed companies may dispose of their shares whereby, the threat of takeover is a means of

disciplining management. If shareholders learn that management has failed to safeguard their interests in pursuit of their own objectives, they may choose to exit the firm and sell their shares. News media is one means through which shareholders may receive such information and there may be downward movements in share price following media pessimism regarding firm performance.

Investor behavior may not be so predictable, however, Individual investors tend to ‘overreact’ to media scrutiny of the corporate governance practices of companies, quickly disposing of shares. Share price movements in either direction may potentially impact upon the company management leading to corporate governance reform. Collectively, investors may seek to change corporate policy and campaign for improved governance through the use of ‘more sophisticated communication strategies’.

By disposing of company shares upon learning of violations of corporate governance through the news media, dissatisfied shareholders impose the threat of takeover, which may compel management to act within the interests of shareholders in future or face a situation where more diligent management would be instituted by new owners. It would be expected that under new management, better standards of corporate governance would be practiced in the firm. Using this rationale, through the market, the news media influences corporate governance practices of violating firms.

The discussion of the political model of corporate governance must take into account the actions by shareholders who chose voice over exit following media criticism of the governance of the companies in which they have interests. The activist strategies outlined provide viable means through which coordinated shareholders may discipline management and lobby for improved corporate governance practices. Moreover, engagement or intervention may lead to greater alignment of corporate strategy, improvements in board structure or enhanced managerial performance

b) Policymakers

The political model of corporate governance indicates that shareholders may require court or governmental protection. As a debating forum for political affairs, policymakers evaluate the efficacy of corporate policy in parliament as part of their professional duties. Having identified a problem in a given environment, which for the purposes of this discussion is assumed to be the corporate environment, members of government formulate policy through parliamentary debate. Following this, laws and regulations are passed, implemented and evaluated. The media may not necessarily initially alert the policymaker to a violation of corporate governance. However the level of media coverage of the issue allows legislators to gauge the extent of its effects, that is the number of shareholders or general stakeholders whose interests have been neglected. The degree of effort and attention with which the policymaker intervenes depends on a number of factors-including political objectives, political reputation with the voting public and international political reputation.

In the wake of corporate governance scandals, political parties opposing the governing party may use the issue as an opportunity to criticize the performance of the principle legislators, thereby coercing them to increase the stringency of corporate legislation or approve regulatory intervention. The stakeholder model further points toward how the media potentially influences corporate governance practices by way of corporate policymaking activity. The media has traditionally been referred to as the fourth branch or 'fourth estate' of the government. That is to say that by informing the voting public, the media facilitates the functioning of a democracy.

Corporate policymaking activity would be expected to be prevalent at times when corporate misconduct is an issue of public concern. This agenda-setting effect therefore, depends on the amount of media exposure politically sophisticated audiences receive. It is also important to consider the international dimension. Policymakers' concerns with reputation overseas further propel corporate policy and regulatory activity. When a corporate governance violation is criticized by the international press, politicians must be seen to take action it in order to preserve their international political reputation. Policymaker responses to violations of the gravity to attract international attention should be effective, involving measures to bring management to account and prevent future occurrence in other companies. In doing so the policymaker upholds their own reputation with international counterparts along with signaling that the country is one

in which companies are managed with integrity. In this sense, the media further influences the corporate governance practices of companies by pressurizing policymakers to ensure an operational legal and regulatory infrastructure is in place the jurisdiction in which they do business.

Companies approach to Social Media Campaigns

Companies need to take a proactive approach toward social media, since experience shows that those companies that leverage social media to their advantage can offset potential liabilities and enhance the company's value. In sum, the board should be aware of the risks and liabilities involved in using social media but should also see the potential opportunities and advantages:

a) New level of transparency

Watchdog organizations and individuals monitor companies' actions and practices demand a response on a wider range of issues than companies are used to. These organizations disseminate their opinions via social media and engage other stakeholder groups, thus initiating a dialogue about a company, whether that company participates in the discussion or not.

Companies should be proactive in this dialogue. The constant flow of information generated by the end-users and stakeholders could serve as a guide to understanding market trends and stakeholder concerns, and it could help mitigate business risks. It also allows the board to assess how the company's vision, actions, and values are being fulfilled in the public eye—and take corrective actions when necessary.

b) Empowered stakeholders

Use of social media encourages formerly passive stakeholders to unite quickly under common objectives and to be outspoken about them to achieve their goals. More importantly, in social media, stakeholders have the same communications channels and technologies that the companies have, thus reducing the disparity of power that companies wield through traditional media.

c) Immediacy of social media

Any opinions or information (true or otherwise) related to the company or its leaders could "go viral" in a matter of hours; it would require an immediate, accurate, and equally strong response to avoid harmful effects on the company's reputation, operations, or strategy. Social media content does not necessarily distinguish between personal views of employees and official company positions, occasionally creating confusion between the two. Every second worldwide, more than 2,200 tweets are posted (of which 700 are sharing YouTube videos) and 500- plus updates are added to Facebook.

In 2009, two Domino's employees filmed a video of themselves preparing food at the restaurant while violating numerous health code standards. They then uploaded it on YouTube. Although the employees claimed they never delivered the tainted food, the video quickly received over 1 million hits and resulted in a marketing disaster for the company.

The challenges of managing information risk in the digital era

With the overwhelming amount of personal data virtually everywhere, managing information risk is no easy task. The "consumerization" of corporate technology means more devices will access this information. Implementing a comprehensive risk assessment for all enterprise information is costly, time-consuming and can strain available resources. So, it's difficult for organizations to identify the right level of detail needed to assess risk based on the business criticality of the process or capability.

In the legal world, there is an especially increasing concern that there are unknown, dangerous risks associated with the creation, storage, and use of information within an organization. In order to mitigate risk exposure, in-house lawyers are asserting their control over key information risk management activities, but many of these efforts backfire, so the need to think more critically about who manages which activities and why.

Given the growing need for effective information risk management, companies may consider the following:

a) Emphasize communications between owners:

Due to the evolving risks associated with information management, department responsibilities will overlap. So, it is essential that risk owners communicate with each other to clarify expectations. More specifically, risks associated with social media and data privacy are very concerning, given their potential impact on a company's reputation.

b) Let information workflows dictate owners:

Responsibilities are assigned according to the organizational structure, with legal overseeing the areas that have traditionally fallen under IT owning technology-heavy areas. When delegating information risk responsibilities, it is useful to consider identifying business workflows and who within the organization often handles the specific information.

Cross-functional committees work best when utilizing functional participants: While cross-functional committees often work well for information risks, these committees work best when they include employees involved in the day-to-day information management.

Conclusion

Many companies are already leveraging social media as a powerful tool for connecting with stakeholders and building a trusted, reputable brand. Yes, there are risks, but avoiding social media is no longer an option. The days of one-sided communication are long gone. Instead, we now have a continuing two-way conversation with traditional stakeholders and the community at large, including technology-savvy people who know how to shape and dominate public discourse. This means that all stakeholders can demand accountability. Ethics, working conditions, and company culture take on new importance as employees become de facto examiners and raters of the company, putting the company in the public spotlight. Under these circumstances, it is key that boards provide the necessary resources for management to address social media opportunities and challenges. For boards, the first and most important social media question is one they need to ask themselves: do they have the knowledge necessary to understand these changes and new technologies? Does the board need a change in composition to deal with the complexities of social media? Does the board need external support and training to do so? Intel cofounder Gordon Moore famously predicted that the number of transistors on a chip will double approximately every two years. His prediction—popularly known as Moore's Law—is a

way to illustrate exponential growth. And it certainly applies to the dizzying rate of advances in social media. To keep up, boards will have to change their practices, policies, and capacities. This is the new requirement for company leadership**.**

******