THE FAILURE OF CORPORATE GOVERNANCE

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ABSTRACT

This paper starts by explaining what exactly corporate governance is and how the importance has grown with increase in the number of scams. Even though, there exist strong laws for corporate governance in India, there is lack of implementation. The aim of this paper is to list the reasons for the failure of corporate governance and to understand the unique reasons of failure of Kingfisher Airlines. This paper will help the existing corporates to recognize the red flags and a possibility of failure of corporate governance. This papers objective is aiding the corporates with certain mechanisms which can be adopted for a successful governance, like, practice of performance assessors to establish a yardstick for appointment of directors or the removal of independent directors to be done by majority shareholders.

INTRODUCTION

We all have read the number of growing scams in the newspapers. Therefore, there has been a need for a vigorous corporate governance since these scams have led to damage of public capital in esteemed companies in India. Although, there are very good laws for corporate governance in India, the implementation is poor.

Corporate Governance is a multi-disciplinary study and encompasses various disciplines which includes, ethics, accounting, finance, law, management. It is a arrangement of rules, procedures and practices through which the company is controlled and guided. It supervises how the ambitions of the business are to be accomplished, supervises and evaluates risk. It is essential for protecting the interest of the stakeholders, which incorporate, suppliers, government, customers, financer. Corporate governance has to be independent, answerable and transparent for efficacious functioning.

With the constant change in situation, the corporations should be unbiased and transparent to the stakeholders. This is of utmost importance in the globalized world that we live in. Companies are in need to collaborate with international vendors and acquire funds, hence, there has to ethical conduct by the company in order to succeed. It is through corporate governance, there is relationship established between the management and stakeholder.

The aim of this paper is to enlist the reasons that lead to failure of governance so that the existing company can be mindful of the signals. Kingfisher Airlines has been analysed in detail to understand the signals and also to help developing better safeguards.

LITERATURE REVIEW

'Corporate Governance – Indian Perspective'[1] is a paper which analysis corporate governance from a viewpoint of India, it deals with the importance and need of corporate governance and the participation of internal governance, ethics and audit. However, this paper analysis the reason/factors for failure of corporate governance with respect to the composition and size of board of directors leaving all other reasons aside, which is not useful for current corporates to avoid failure.

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[1] Ruchi Kulkarni and Balasundram Maniam, *Corporate Governance- Indian Perspective*, Volume 5, International Journal of Trade. Economics and Finance, (2014), http://www.ijtef.org/papers/399-A10004.pdf

'Corporate Purpose and Governance Failure-A tale of two Corporates in India'[2], this paper has made efforts to analyse the purpose and failure of corporate governance in a unique manner, however, it is not well structured and it does not clearly explain the reasons for the failure.

In 'Case Study on the Downfall of Kingfisher Airlines'[3], there has been an analysis of what exactly happened and the factors which led to the crisis. However, they have focused more on the external factors without shedding much light on the internal facts that is corporate governance.

'Corporate Governance Failure of Five-Star Accredited Kingfisher Airlines'[4], this paper has done an in-depth analysis of the what happened and explained both the internal and external factors that led to the failure, however, certain points from the internal factors are not covered.

Therefore, this paper aims at analysing most of the reasons which can lead to failure of corporate governance along with analysing reasons for Kingfisher's failure to develop recommendations which can be adopted by existing corporates.

RESEARCH HYPOTHESIS

The research hypothesis of the paper is to answer two main questions:

1. To analysis the reasons for failure of corporate governance.
2. To analysis the unique reasons for failure of Corporate Governance in Kingfisher Airlines.

The aim of this paper is analysing the above to determine the recommendations which can be adopted by the companies to reduce the risk of corporate governance failure.

ANALYSIS

'Failure', the term, is used interchangeably with illiquidity, bankruptcy, insolvency or persistent loss. Failure basically means the incapability of the corporation to attain the goal

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[2] Dr. Ramasubramanian, *Corporate Purpose and Governance Failure-A tale of two Corporate in India*, (2017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3065586

[3] Ashok Panigrehi, Antra Sinha, Ashul Garg and Astha Mehta, '*Case Study on the Downfall of Kingfisher Airlines'*, Journal of Management Research and Analysis, (2019), https://www.researchgate.net/publication/334319115_A_Case_Study_on_the_Downfall_of_Kingfisher_Airlines

[4] J.P. Sharma and Ruchi Goyal, *'Corporate Governance Failure of Five-Star Accredited Kingfisher Airlines',* Vol 14, Journal of IMS Group, (2017), http://www.publishingindia.com/GetBrochure.aspx?query=UERGQnJvY2h1cmVzfC80NTk2LnBkZnwvNDU5Ni5wZGY=

which is producing profit in the future. Corporate failure is defined as the detrimental condition or weakness in the corporate body to avert itself in accomplishing the goals and objectives. Corporate failure is because of internal and external factors, internal factors include weak corporate governance which is focused on in this paper.

THE REASONS FOR FAILURE OF CORPORATE GOVERNANCE ARE DELIBERATED BELOW

Structure of ownership

This determines how the company is administered. This structure can be administered by limited members or distributed among all members.[5] When in the hands of limited members, it can lead to mismanagement.

Board of Directors not competent

It is a well-known fact that decisions taken by the board does not only influence the company but also the economy. The board of directors should comprise of individuals who have adequate knowledge in the area. The decisions which are taken by them, be it of good or bad nature, have a direct effect on the corporate governance of the company.

Weak communication

Deficiency of communication between the board of directors and the companies employees leads to a fruitless corporate governance.

No adequate risk management

The companies at times are ignorant about the likelihood of risk and turn a blind eye to the risk. It is believed by them that the risk would go away over time however, that is not true.

Inadequacy and ignorance of internal audit & external auditors

Internal audit examines the accounting route, corporate governance and the internal control of the company. The role of the audit is to make sure the laws have been complied with and

[5] Dr. Navita Mahajan, *Strategies that Led to Failure- Case Study of Corporate Governance*, Volume 16 Issue 1, Global Journal of Management and Business Research: Interdisciplinary, (2016).

maintaining financial reporting.[6] When the internal audit fails to perform these functions, it leads to the failure of corporate governance. The external auditors, give true picture of the financials of the company but when the management disregards their signals it leads to corporate governance failure.

Financial Structure

Corporate governance is affected by the financial structure of the company. The most imperative is the ratio between debt and equity which has an impact on the value of governance.

Culture of the Company

This plays a vital role in terms of functioning or operating corporate governance practices. If the solitary culture of the company is to make profit, this has a consequence on the decision making of the company. When there is no protection given to the rights and interest of other parties the corporate governance is said to be not good enough.

Deleterious Environment

A very toxic environment for the employees where they have either not been paid on time or over a long period of time because of which they leave the job or they have been fired because of the financial issues being faced.

No transparency

When the company is understating their liabilities and not disclosing how much they truly owe.[7] They are not transparent within the organization. The Independent directors of the company curtailed from exercising the independence and the investors in the company limited to access basic information. This leads to failure in corporate governance.

OVERVIEW OF CRISES OF KINGFISHERS AIRLINES

Kingfisher Airlines was established by Vijay Mallya in 2003, possessed by United Breweries Group based in Bengaluru. It was the first Indian private full-service luxury airline. This

[6] Shaun George Joe and Swarnith S. Prasad, *Failure of Corporate Governance in Kingfisher Airline and Jet Airways*, Volume 1 Issue 9, White Black Legal, (2020), https://www.whiteblacklegal.co.in/wp-content/uploads/2020/05/Vol-1-Issue-9-Shaun-George-Joe-Swarnith.-S-Prasad-.pdf

[7] Kumar Sumit, *Fall of the Giants- Corporate Governance Failure*, (2020), https://taxguru.in/company-law/fall-giants-corporate-governance-failures.html

company was making losses since 2006, however the main issue occurred in 2007, when the merger with Air Deccan happened, retitled it Kingfisher Red in 2008. In 2008, the average price of aviation turbine fuel increased by 60%. The creditors and the government took note of the state in which the company was and were determined to salvage the outstanding and investments made by them. The company took more loans and there was interruption in source of fuel leading to cancelation of flights and accumulation of losses above Rs. 7000 Crore.[8] There was non-payment of remunerations which lead to employees going on strike. There was also evasion of service tax. The accounts of the company were frozen by the income tax department and warrant for arrest of Mallya and four directors was released. Kingfisher owes different government departments and banks above Rs. 9000 crore of loans and interest.

Reasons for Failure of Corporate Governance in Kingfisher Airlines

Haphazard decision and ill-timed merger with Air Deccan

Kingfisher was launched as a luxurious airline where the passenger was treated like a king, it was a lifestyle carrier. By merging with Air Deccan (low cost carrier), within a year of commencing, the company transferred its branding and run two distinctive business models, thus making a haphazard decision. No adequate time was given to soothe the business. The customers transferred to low cost carriers. Pre-merger, Kingfisher was prevalent domestic airline, however, post-merger there was accumulation of losses above Rs. 1000 crore. They brought Air Deccan (i.e. Kingfisher Red) at par with Kingfisher by hiking the fare, however it did not work, hence airline was closed in 2012. When the airline commenced international operations, other factors like fuel prices increased. They had failed to exploit their own strengths and exclusive selling point.

Absence of delegation and professional management

Vijay Mallya had blind faith in his son, who was not right for running the airline as he was not mature enough or possessed the right knowledge or expertise along with insignificant management skills. There was no delegation of operations or decision making to the people who possessed right knowledge and skill, who were qualified of taking better decisions.

[8]J.P. Sharma and Ruchi Goyal, '*Corporate Governance Failure of Five-Star Accredited Kingfisher Airlines'*, Vol 14, Journal of IMS Group, (2017), http://www.publishingindia.com/GetBrochure.aspx?query=UERGQnJvY2h1cmVzfC80NTk2LnBkZnwvNDU5Ni5wZGY=

Absence of power over governance by Board of directors & immoral objectives of promotors

Companies success is dependent on the standard of the decision appropriated by the directors. Kingfishers first CEO was selected subsequent to planning of the airlines and he resigned the very same year. Till 2010 there was no other CEO selected. It was evident that it was Vijay Mallya who was formulating all the decisions. The directors did not have assurance in the airline and did not shelter the interest of stakeholders. There was nothing done by independent directors and they were resigning. The meetings with independent directors would take place on document and not in practice and the positions were givens to relatives or friends, thus they did not oppose the decisions of the promoters. It was because of lack of control by directors the company reached this state. The promoter, Mallya had no money to pay the liabilities to banks, government, employees, however, had more than enough money to spend on parties, Indian Premium League etc.

Management controlling the auditor

The auditors of the company could not give any opinion and had no input in decision making. The auditors play a vital role as they are aware of the changes in accounting policy, financial statements and give a true picture of the state of the company, however, the work of the management was to oppose the views of auditors.

Absence of transparency

The transparency in the company was very pathetic. There was absence of cash flow and the securities given by them to financial institutions were insufficient, further, the liabilities were untrue and understated.[9]

Earning of employees in jeopardy

Kingfisher delayed in making reimbursement of salaries to the employees in July- August 2011 and October 2011 to January 2012.[10] Employees went on strike in 2012 due to overdue reimbursement. The engineers went on strike on for the fourth time in 2012 due to overdue

[9] Kulbeer Kaur, *Governance and Ethical issue in Sahara and Kingfisher*, Volume 02 The IJBM, (2018).
[10] Dr. Urvashi Sharman and Ms. Nancy Rao, *Exploration of Kingfisher Airline's Fiasco,* Pramana Research Journal, https://www.pramanaresearch.org/gallery/prj-p481.pdf

reimbursement. The funds which were supposed to go to state insurance, provident funds etc., were used to fund the company.

Unethical Demeanour towards employees

The company did not pay the remunerations of the employees for several months which led to the employees going on strike and instead of assuring them about the payment, Mallya threatened them that if they went on strike, the company would not earn money. Further, one of the employees wife committed suicide as they were facing financial crises due to the non-payment of salary. This incident was not acknowledged by Mallya. He was totally ignorant to the state of the employees, there was no humanity shown towards the employees.

Kingfisher Airlines had taken loans from 17 banks which was approximately Rs. 900 crores. Vijay Mallya fled the country in 2012 without repaying any of loans taken from the banks. Further, they owed Rs. 341 crore to Hindustan Petroleum Corporation Ltd.

RECOMMENDATION & CONCLUSION

Composition of Board of Directors

Companies Act 2013 mandates a fusion of executive and non-executive directors, however the companies fulfil this only on paper. They appoint directors who are their friends or relatives and not on the foundation of merit and specialized knowledge. This was the cause for downfall of Kingfisher. The resolution to this is carrying out a rating of the board and governance practice implemented and publishing th**e** same or making use of performance assessors for a minimum yardstick for appointment of directors.

Risk Management

Adequate system for risk management should be present in the company. This risk should be evaluated on regular basis and done by experts.

Independent Directors

One of the biggest developments in law for corporate governance is selection of independent directors but they have not been able to make an effect. There have been regulations made to make a broad demarcation of independent director, however, we know that this is practiced only on paper. Since it is the promoters who appoint the independent directors it may be challenging for them to question the promoter. Further, if these independent directors go in contradiction of the promoters, the can be removed as under the law it is easy to remove the independent directors by the promoter or majority shareholders.[11] There has to be increase in transparency with the appointment and removal of these directors. This can be done by addition of checks in the method like mandating the approval of public shareholders. There has to be a limit on the powers of promoters.

Increase Accountability

One method of doing this is by mandating through law, all the board members be in attendance at general meetings in order to give the stakeholders a chance to question the board.

Separate Body for making laws for corporate governance

The rules pertaining to corporate governance are scattered in several statues like SEBI and company law, therefore, there should be one statutory authority regulating corporate governance which help in making and implementing stricter laws.

The 2013 Act has tried to finish the malice. This act has tried to reduce vicious dealings by promoters. There needs to be more protection brought about for independent directors as they can easily be dismissed, the selection process of these directors should be improved. Further, more laws need to be made to take the opinion of auditors for companies financial control to be taken into account. The gap between management and ownership needs to there for successful company, supremacy is of no assistance in progression of company. SEBI has put forth mechanisms like whistle blower policy, class action, independent audit etc. However, the effectiveness of these will be known in future. If the mentioned recommendations are taken into account by the law and companies, the scams and failures of corporate governance can curbed.

[11] Section 149, Companies Act 2013.

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