CORPORATE GOVERNANCE AND RISK MANAGEMENT

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ABSTRACT

Business management and direction are governed by corporate governance. The board of directors is responsible for overseeing their companies' governance. Effective risk management is essential to accomplishing the strategic and operational goals of the business as well as strong corporate governance. It enhances decision-making, clarifies opportunities, and minimises significant occurrences that could have an impact on shareholder value. Defining the risk, locating it, and determining its impact and likelihood that it will materialise are all steps in an organization's risk management process. Finally, selecting how to effectively manage the biggest risks is the final step. Risk management is now more than just a management concern for business and operations. Additionally, it has developed into a governance issue that directly falls under the purview of the board's supervision duties. The framework for internal control and corporate governance used by all firms includes the Risk Management Policy as a core component. The Company's risk management policy offers the foundation for managing the risks connected to its operations. It is intended to recognise, evaluate, track, and manage risk. Risk management is crucial to corporate governance in each and every institution since it is uncertain what kind of dangers exist to the firm's goals and the environment within which it operates. In order to actively foster a corporate culture and environment that comprehends and employs enterprise-wide risk management, the board and pertinent committees should collaborate with management. Instead of being seen as a specialist corporate activity, comprehensive risk management should be regarded as a crucial, corporate-wide factor that influences how the business determines and rewards success. Since the Board is ultimately in charge of the Company's success, it is its duty to recognise and manage any risks. Even though a business can thrive without risk management, it cannot do so without sound corporate governance. Therefore, effective corporate governance is a must for the effectiveness of risk management. With the aid of doctrinal study on the subject, this paper attempts to highlight the fact that there is a major connection between corporate governance and management of risk.

KEYWORD: - Corporate governance; The Board of Directors; Risk Management; Risk Management Committee; Risk mitigation.

INTRODUCTION

Every public entity must systematically examine the risks related to the conduct of its activities at least once a year, create suitable plans to mitigate their potential effects, and assign accountable parties to carry out those plans. Corporate governance mandates risk management for all businesses since there are uncertainties regarding the risks to goal achievement or the nature of possibilities in the organisation and the sector it serves. Any manager must consider how to confront challenges since, if they have no impact on their objectives, they will either debunk themselves or act proactively to the company's advantage, proving their success. If uncertainty it is a daily reality, then the reaction to uncertainty must become a permanent concern. The process of identifying, evaluating, and prioritising risks is known as risk management. Risk is described in ISO 31000 as "the (positive or negative) impact of uncertainty on objectives, followed by the coordinated and efficient application of resources to reduce, monitor, and control the likelihood of unfavourable events, or to maximise the realisation of opportunities"[1]. The key issues with risk management are indeed the techniques, which typically entail assigning responsibility for the risk to another party, lowering the risk's detrimental effect or possibility, or even accepting some or all of the real or possible repercussions of a particular risk. Companies have long understood that strong governance builds trust and goodwill among investors. They now have even more motivation to enhance their corporate governance procedures. Recent academic research demonstrate that effective corporate governance raises valuations and improves profitability. With improved legal protection, a larger portion of company's profits would be returned to investors in the form of interest or dividends, and the entrepreneur who owns the company would have no possibility to expropriate the gains. Second, effective corporate governance may lower anticipated return on equity insofar as it lowers owners' costs for oversight and auditing. This should ultimately result in a greater corporate valuation. The fact that corporate governance impacts an organization's financial health and has a significant impact on investors' perceptions of risk makes clear that corporate governance is an important part of business[2]. When it comes to the cost of capital and shareholder value, good corporate governance reduces risk whereas bad corporate governance increases it. For effective corporate governance and management, risk management is a key component. Business risk management and corporate governance have

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[1] OECD (2014), Risk Management and Corporate Governance, Corporate Governance, OECD Publishing (Jan 9, 2020, 12:48 AM), http://dx.doi.org/10.1787/9789264208636-en

[2] Ibid

an increasingly apparent relationship. Numerous major enterprises and financial institutions around the world are anymore in business or have been taken over as a result of their disrespect for the fundamental concepts of risk reduction and control. Along with inadequate corporate governance & ineffective risk management, the current financial crisis has these problems as well. Poor risk management can lead to business failure, which can have serious consequences such as loss of shareholder wealth, potential liability, job losses, and business failure[3].

RELEVANCE

Corporate governance affects how investors perceive risk and impacts how financially sound a firm is. The cost of capital & shareholder value is directly impacted by the level of risk. Good corporate governance reduces risk, whereas poor corporate governance increases it. Corporate governance in the financial sector is one of the primary determinants of the system's health and resilience to economic uncertainty. The inherent soundness of each of the financial system's parts and the relationships between them have a significant impact on its overall health. Their ability to recognise, quantify, track, and manage risks, in turn, is a key component of their soundness. This problem was also underlined by the SEBI-appointed Kumar Mangalam Birla Committee on Corporate Governance when it was noted in the report that, “strong corporate governance is thus indispensable to resilient and vibrant capital markets and is an important instrument of investor protection. It is the blood that fills the veins of transparent corporate disclosure and high-quality accounting practices. It is the muscle that moves a viable and accessible financial reporting structure. Without financial reporting premised on sound, honest numbers, capital markets will collapse upon themselves.” The argument put up by Kumar Mangalam Birla, a member of the Committee on Corporate Governance, to adopt corporate governance in India, provides persuasive evidence of the relevance of corporate governance in risk management. So, corporate governance and effective management include risk management as a key element. It is becoming increasingly clear that corporate governance affects enterprise risk management. Because they disregarded the fundamental principles of risk mitigation and control, a number of significant businesses and financial institutions all over the world have either been acquired or are no longer in operation.

OBJECTIVE

The purpose of this study is to develop a novel index that incorporates the most significant

[3] Ngozi Vivian Okoye,’ Behavioural Risks in Corporate Governance’, pg no: 67, Tylor & Francis.

qualitative aspects of risk management for the corporations, to comprehend and analyse the relationship between corporate governance & risk management and to comprehend the purpose of risk management committees and how they work.

METHODOLOGY

The doctrinal research approach has been used to better understand the concept of risk management committees and critically examine the connection between good corporate governance & risk management. The exploration and analysis of pertinent or related judicial precedents, norms, and principles are aided by the doctrinal method of inquiry. Theological study is thought to be the most suitable type. Therefore, no non-doctrinal or empirical research techniques have been used. The study's methodology will make it easier to evaluate the current laws and regulations and the applicability of risk management committees to corporate governance. Additionally, a small quantity of empirical research data on the subject has been included in a few of the secondary sources that were used in the study. Primary data sources have been cited, including the Companies Act of 2013 and its revisions, as well as the SEBI rules and regulations. The advantages and disadvantages of the existing laws have also been examined using the appropriate Law Committee Reports. Secondary sources of information, such working research papers and research articles by lawyers, have been utilised to help people understand the value of risk management committees. These publications provide some data from empirical studies.

REVIEW OF LITERATURE

- Risk Management and Corporate Governance[4]: This article was published in 2014 by the OECD. The purpose of this study is to present the findings of the peer review conducted by the OECD in accordance with the “Principles of Corporate Governance”. In relation to business risk management, this research examines the corporate governance framework & procedures of 27 distinct jurisdictions. It goes into great detail and focuses on Norway, Singapore, and Switzerland's methods and policies.

- Corporate Governance and Risk Management[5]:This paper describes and examines the

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[4] OECD (2014), Risk Management and Corporate Governance, Corporate Governance, OECD Publishing (Jan 9, 2020, 12:48 AM), http://dx.doi.org/10.1787/9789264208636-en

[5] Corporate Governance and Risk Management: An Indian Perspective, International Journal of Management Science and Business Administration

necessity of corporate governance practises from an Indian perspective. The relationship between risk management and sound corporate governance is further established. It performs all of this while considering the Indian situation, and to further emphasise its thesis, it has completed two case studies.

• Report of the Committee on Corporate Governance[6]: This analysis on corporate governance is sometimes referred to as the Kotak Committee Report. In this paper, suggestions for improved corporate governance are provided. Additionally, the relevance and function of risk management committees have been questioned. Numerous ideas have been made to change the current Acts, rules, and regulations in order to force the corporations to follow strong corporate governance principles.

• Risk Management and the Board of Directors in Indian Firms[7]: In 2016, the NSE Centre for Excellence in Corporate Governance published a quarterly briefing of which it discussed risk management and the Board of Directors in Indian companies. It discusses risk management, outlines the responsibilities of the board of directors, and provides an overview of India's risk management regulatory structure. Regarding risk management, or enterprise risk management in this case, several recommendations are also provided. These are the opinions that the author, Afra Afsharipour, a professor of law at the UC Davis School of Law, presents.

DISCUSSION

"Corporate governance is the way the Board runs the Company and sets and controls the processes in the best interest of stakeholders."

For risk management to be effective, corporate governance must be strong; otherwise, risk management will have a limited impact or won't be properly implemented within the company. Risk management won't be effective without strong corporate governance. The success of risk management is dependent on a number of additional elements in addition to risk management itself. An organization's risk management entails defining the risk, identifying and evaluating the impact and possibility of its materialisation, and then establishing proper procedures for handling important risks. Risk management for the organisation is one of the recently presented

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[6] Report of the Committee on Corporate Governance, SEBI (Nov 7, 2022, 3:34 AM), https://www.sebi.gov.in/reports/reports/oct-2017/report-of-the-committee-on-corporate-governance_36177.html
[7] Afra Afsharipour, Risk Management and the Board of Directors in Indian Firms, NSE (Nov 7, 2022, 3:58 AM), https://www1.nseindia.com/research/content/res_QB14.pdf

concepts in the concept of corporate governance, which advocates a holistic vision as an intrinsic constituent of the components of all of it, namely the organisation[8]. Like how risk management ought to be an integrated element of any management approaches and shouldn't be segregated from the company's daily operations, guidelines on sound risk management state this. Developing enterprise risk management, which views risks as both exposures to be controlled and opportunities to seize, is at the heart of an organization's strategic operations. Each business must at least once a year perform a systematic analysis of the risks related to its operations, create suitable plans to mitigate those risks' possible effects, and assign accountable parties to carry out those plans. We also think it's appropriate to say that risk management is important in corporate governance, in every entity and in any kind of entity, because there are uncertainties regarding the threats to achieving objectives or the nature of prospects in the company and in the environment in which it operates. Any manager must consider how to handle threats because failing to accomplish his objectives might disqualify him or force him to miss opportunities that could benefit the company and demonstrate its performance. If dealing with uncertainty is a constant concern, then it must also be a daily reality[9]. A number of other ideas are related to corporate governance. Risk management and observance of legal requirements are both aspects of good corporate governance. By analysing the many risks and the corporation's risk profile, risk management aids businesses in making wise decisions. Knowing how much risk can be taken without having a detrimental impact on the company helps the board make wise decisions that allow the company to grow and diversify without jeopardising its existence. Effective corporate governance will eventually result in higher or better valuations for a company. Banks see the firm favourably and charge lower interest rates as a result of improved corporate governance, which encourages investors to spend more money in the company. A company with superior corporate governance is one that effectively manages risk. So, there is a direct connection between corporate governance and risk management, as better risk management results in better board decisions, which in turn lead to company growth, which in turn leads to the accessibility of much more capital and investors, which in turn leads to continued corporate growth and stability[10].

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[8] Ngoc Bich Tao & Marion Hutchinson,' Corporate Governance & Risk Management: The Role of Risk Management and Compensation Committees', Volume 9 Issue 1, JOURNAL OF CONTEMPORARY ACCOUNTING & ECONOMICS, pg 83-99. Pg no: 87, 2013.

[9] OECD (2014), Risk Management and Corporate Governance, Corporate Governance, OECD Publishing (Jan 9, 2020, 12:48 AM), http://dx.doi.org/10.1787/9789264208636-en.

[10] Jamshed Iqbal & Sascha Strobl,' Corporate Governance and the Systemic Risk of Financial Institutions', Volume 82, JOURNAL OF ECONOMICS & BUSINESS, pg 42-61, pg no: 50, 2015.

The systematic implementation of management policies, methods, and practises for defining the context, identifying, analysing, evaluating, solving, monitoring, and communicating risk can be referred to as the risk management process. The analysis and reduction of risks are handled systematically through the risk management process. As a result, the risk management process follows a logical plan that, in our opinion, also takes corporate governance into account[11].

- Risk Identification: - Identification of all pertinent risk exposures involves doing a thorough examination of the entire company's operations. In this step, documents and records related to the entity's finances, operations, and information flow are analysed. Employees are also given risk questionnaires to complete, and the existence of risks is confirmed using check-in lists that are as thorough and as detailed as possible. Here, it should be highlighted that although the pertinent exposures are typically obvious, specialised analysis may be able to spot significant omissions as well as erroneous exposures to risk[12].
- Risk Assessment and Measurement: - Understanding how it can affect the entity's financial status is essential. The probability of realisation and the associated costs of loss should be calculated for every one of the various steps that are typically involved in the materialisation of a risk. While management frequently utilises a qualitative analysis based on categories like quasi-null probability, low, medium, and quasi-safe probability, we also believe that it would be ideal if the likelihood were statistically measured. Following assessment, risks can be further divided into categories based on their possible impact: critical risks, which pose a threat to the entity's survival, major risks, which call for securing funds, and inconsequential risks (minor losses that can be absorbed by the entity)[13].
- Selection of Risk Management Techniques: - It is primarily a managerial decision-making issue driven by the entity's goals and strategy, along with management's risk aversion; the criterion envisioned is the overarching goal of maximising the entity's value. There are four main types of risk management techniques, i.e.: avoidance (risk-generating situations are avoided, but managers have less room to manoeuvre), prevention and control (preventive behaviour, conducting investments, and conducting

[11] David Crowther & Shahla Sefi, ‘Corporate Governance and Risk Management’, pg no: 35-38, bookboon.com.
[12] Ibid
[13] Ibid

training courses to avoid eventual losses), retention (risk is assumed and damage is covered by own resources accumulated in this regard in the form of reserves), and transfer (insurance, coverage, diversification)[14].

- Implementation: - requires "technical information pertaining to the practical application of the chosen management technique, such as the creation of order to mitigate risk, specific investments, the building of reserves, the choice of an insurer or share market, the negotiation of contracts, the creation of hedging strategies, etc.
- Monitoring: - includes regular checks and reviews of previously taken risk decisions, the discovery of new exposures, changes to the likelihood and nature of risks, and the development of innovative methods for less expensive insurance. However, at this point, we also think that internal control and audit operations should be taken into account to prevent fraud that may occur when staff members in charge of implementing risk-covering tactics go above the transaction tasks and restrictions.[15]

CORPORATE GOVERNANCE IN INDIA

The efforts of many committees chosen by the Ministry of Corporate Affairs (MCA) and SEBI led to the establishment of corporate governance in India in 1998. The Board of Directors, financial and non-financial disclosures, and information that management must disclose with stakeholders and the general public are all subject to the rules and regulations established by this document. It is an honour for the Confederation of Indian Industry (CII) to have contributed to this effort. In 1995, Rahul Bajaj, the chairman of the Bajaj Group, was appointed to head a task force by the Confederation of Indian Industry (CII). On April 1, 2019, the SEBI rule was revised in accordance with the suggestions provided by the Kotak Committee, a group established with Uday Kotak as its chairman to raise corporate governance standards in India. This resulted in improvements to the corporate governance framework. The corporate governance rules are published by SEBI, RBI, and IRDA for the Indian financial institutions that fall under their separate purviews. The businesses must also abide by additional corporate governance regulations that have been imposed by several ministries and government authorities[16].

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[14] Ibid

[15] Caraiman and Mates, risk management in corporate sector, SCIENDO, 182-201, pp 191 , 2020.

[16] OECD (2014), Risk Management and Corporate Governance, Corporate Governance, OECD Publishing (Nov 2, 2022, 12:48 AM), http://dx.doi.org/10.1787/9789264208636-en

KOTAK COMMITTEE: - The committee recommended,

Composition of the Board

• Minimum six directors

• At least one independent woman director

• Maximum number of directorships capped to 8

• Role of Chairperson and managing director to be separated

• Competencies/expertise of directors to be disclosed

• Independence of directors - Promoter/relatives not to be independent directors in each other's companies.

Accounting and disclosure

• Disclosure of consolidated financial results mandatory for all the listed entities every quarter

• Disclosure of cash flow statement on a half-yearly basis mandatory for all listed entities

• Limited review/audit of at least 80% of financial information of the group

• Mandatory disclosures of quantification of audit qualifications

• Disclose the list of all credit ratings obtained along with any revisions in the corporate governance section of its annual report

• Disclose specific critical financial ratios in the section of management, discussion, and analysis in the annual report.

A corporation's system of internal control mirrors its control environment and must be able to react swiftly to changing business risks brought on by internal company factors and environmental changes. Internal controls are indeed the cornerstone of a company's corporate governance strategy and the primary tool for regulating, balancing, and reducing the majority of risks, particularly those connected to hasty and dishonest financial choices. The 1992 Cadbury Report emphasises this by stating: “having a Code such as ours been in existence in the past. We believe that a number of the recent examples of unexpected company failures and cases of fraud would have received attention earlier."

Corporate governance is distinct from compliance. Corporate governance places a strong emphasis on using systematic techniques to continuously monitor a company's performance. Contrarily, compliance is seen as a continuing duty to fulfil certain goals, such as confirming the noted regulatory requirements, legal requirements, industry standards, or corporate promises. For instance, the board of directors and senior management must prioritise accountability and compliance so that management can plan for the future of the company by ensuring that daily choices and deeds are consistent with the right course, and compliance is just one component of the overall process of corporate governance[17].

The fundamental principles of corporate governance that regulate risk management are;

- Reporting: - In regard to the topics they address, the management reports to the board should offer a fair assessment of the important risks and the efficiency of the internal control system in managing those risks. Reports should cover any important control flaws or weaknesses, together with the effects they have had or might have on the business and the steps being taken to address them.
- Roles and Responsibilities: - As part of their accountability for attaining goals, all personnel have some duty for internal control. They should all have the knowledge, abilities, information, and power required to set up, run, and maintain the internal control system.[18]

A strong Corporate Governance frame work can mitigate risk if it includes the following:

Identify the risk inherent in achieving goals and objectives:

• Establish risk appetite across the entire risk spectrum;

• Establish and communicate risk management frameworks.

Assess:

• Build accurate and consistence risk assessment;

[17] David Crowther & Shahla Sefi, 'Corporate Governance and Risk Management', pg no: 35-38, bookboon.com
[18] Sharukh Tara, Corporate Governance and Risk Management : Indian perspective, Volume 1 Issue 9, International Journal of Management Science and Business Administration, pp 33-39, pp 37, 2015

• Establish and implement measurement reporting standards/methodologies;

• Build a risk profile.

Control:

• Establish key control processes, practices, and reporting requirements;

• Monitor the effectiveness of control;

• Ensure all the exposures are adequately identified, measured and managed in accordance with board approved frameworks;

• Provide early warning signals;

• Ensure risk management practices are adequate and appropriate for managing the risks.

Report:

• Report areas of stress where crystallization of risks is imminent;

• Present remedial actions to reduce and/or mitigate such risks;

• Report on sensitive and key risk indicators;

• Communicate with relevant parties.

Manage and Challenge:

• Review and challenge all aspects of the company's risk profile;

• Advice on optimizing and improving the company's risk profile;

• Reviewing and challenge risk management practices.

CONCLUSION

To sum up, corporate governance is an essential component of risk management for any business and should be strictly adhered to because it will increase shareholder wealth, increase investor confidence, lower the cost of capital, as well as other advantages like better brand equity, higher employee morale, and greater creditor confidence. The level of trust that stakeholders place in an organization's corporate governance and its capacity to accomplish its goals rises as a result of effective risk management. Furthermore, risk management must become an integral element of the organization's operations and must receive the management board's undivided attention if it is to be successful.

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