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CORPORATE GOVERNANCE AND RECENT CORPORATE GOVERNANCE FAILURE

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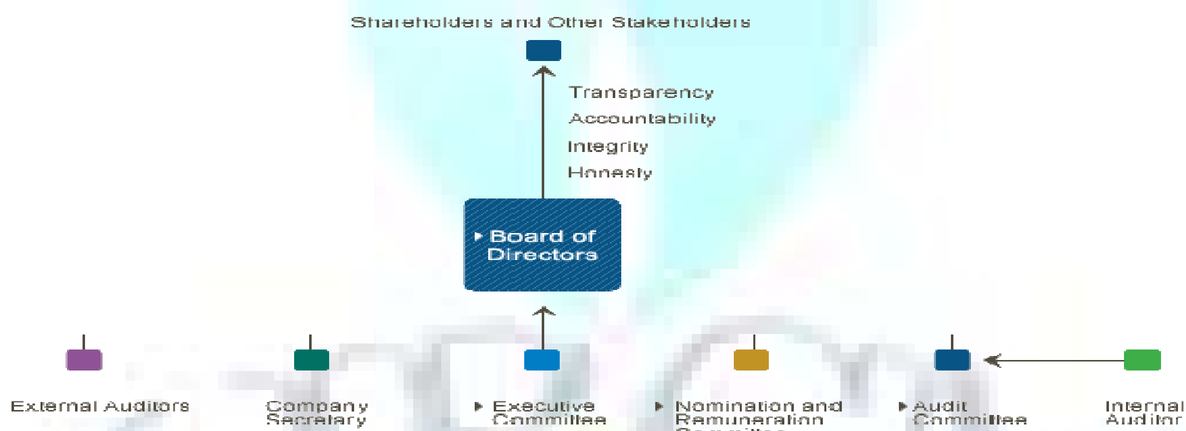
ABSTRACT
We consider corporate governance to be a key element when we talk about the success of a company but in the same time if this system fails due to different reasons, the financial, social, political consequences can be very serious. In order to understand the importance of this system we tried to explain and define the notion of corporate governance being inspired by the studies already made in this field. In the second part of the paper we pointed out the structure of a company when good corporate governance practices are embraced. In the Third part of the paper we focused out attention on some resounding financial scandals from all over the world and then analyzed the causes that led to failures. Least but not last we took a close look to the failure or corporate governance and the reasons that this happens. The conclusions express our point of view regarding failure and we agree that in most of the cases, no matter the system of corporate governance, the country in which the company activates or the stakeholders involved in the business, human nature, the power of money and control are too hard to overcome.

KEYWORDS
Benefits, control, corporate governance, ethics, failure.

INTRODUCTION
Corporate governance is a multi-faceted subject. An important theme of corporate governance is to ensure the accountability of certain individuals in an organization through mechanisms that try to reduce or eliminate the principal-agent problem. A related but separate thread of discussions focuses on the impact of a yet other aspects to the corporate governance system in economic efficiency, such as the stakeholder view and the corporate governance models around the world.

DEFINITION OF CORPORATE GOVERNANCE
The system of rules, practices and processes by which a company is directed and controlled. Corporate governance essentially involves balancing the interests of the many stakeholders in a company - these include its shareholders, management, customers, suppliers, financiers, government and the community. Since corporate governance also provides the framework for attaining a company's objectives, it encompasses practically every sphere of management, from action plans and internal controls to performance measurement and corporate disclosure.
"Corporate Governance can be defined as a set of system and processes which ensure that a company managed to the best interests of all the stakeholders, the set systems that help the task of corporate include certain structural and organizational aspects, the process that helps corporate governance embrace how things are done with in such structure and systems" By L V Iyer.

CORPORATE GOVERNANCE STRUCTURE



Corporate governance is the overall control of activities in a corporation. It is concerned with the formation of long term objectives and plans and the formal structure (organization, system and people) to achieve them. At the same time, it entails making sure the structure functions to maintain the corporation's integrity and responsibility to its various constituencies. The structure includes the board of directors, top management, shareholders, creditors and others. Role of these stakeholders is crucial in guaranteeing responsible corporate performance.

RECENT CORPORATE GOVERNANCE FAILURE IN COMPANIES
Reported to the current business environment, in which when we are pronouncing word success, the first ideas that come to mind, although sometimes unintentionally, are those relating to force, most of all, financial strength, even if it is achieved at the cost of breaking the rules. Derivatives of these rules, words such as "standards", "principles" or "control" creates disorder, worries, superficial or deep, those who were committed to "transact" holding or acquiring the image of dizzying profits because such an objective requires often ignoring or even violating their game, with any risk, regardless of consequences, making it extremely difficult governance of an entity on any scale, from medium to enterprise giants. Thus, seemingly inexplicably, star companies cannot made payments, in a capitalist world where management errors in terms of decision, administrator's indifference and complicity of auditors have created "cocktails" with devastating effects, difficult or sometimes impossible to annihilate. To support the statements made above are considered necessary to illustrate a few resounding cases in field of corporate governance and their interpretation in terms of the factors that influence corporate governance, mechanisms and tools that establish its principles.

LEHMAN BROTHERS

The collapse of Lehman Brothers [9] seen by a lot of people, a corporate governance failure, not a failure of financial markets, in September 2008, was the biggest bankruptcy in the corporative history of the USA, and the event that conduced to the largest and worst financial crises of the last decades. It become true as a consequence of a fatal errors like combination of intricate accounting rules, complex derivatives, greed, excessive leverage and the complacency of rating agencies. Although it happened at a distance of seven years, it can be discovered amazing similarities between Enron and Lehman, the misbehavior of top management. Lehman's equivalent of the Enron's pre-pay transactions is the Repo 105, a fascinating term that is going to become the new example of how to fool analysts and investors. Originally, repos serve a very desirable objective of making money (they would be otherwise inactive) by circulating, lending and investing it. Repo 105 transactions doubled between late 2006 and May 2008, were known inside the company, exceeded the firm's self-imposed limits and typically happened at the end of each quarter, when financial information had to be released.

Through these transactions, Lehman Brothers managed to reduce leverage on the right-hand side of the balance sheet and, at the same time, reduce assets on the left-hand side. They used repos reportedly for financing reasons, but accounted for them as asset disposals. These Repo proceeds amounted to about $50 billion by September 2008 – which is more than the amount of General Motors outstanding bonds when it went bankrupt in 2009.

And the most resonant similarity with Enron is appearance of the name of a large audit firm, Ernst & Young, "they didn't approve the Accounting Policy", it rather "became comfortable with the Policy for purpose of auditing financial statements". Two of the Lehman's financial directors were in the past engaged in collaboration with Ernst & Young. And in the last year of complete financial reporting, Lehman Brothers was the 8th largest customer for E&Y, and the fee paid by LB was about $185 millions.

Worrying is that we are not trying to learn from history and not to repeat the same mistakes and those from Lehman Brothers walked the same steps of collapse as Enron did. They were not taken down by ill-intentioned short sellers and market manipulators; the company was bankrupt well before September 2008.

SATYAM

Satyam is another case of a resounding failure in corporate governance, this time in India [17]. It is a failure that occurred with the fourth largest software company from the country. This is not the first time that companies promoted by family groups defraud the investors. But Satyam has a different face because the Chairman himself admitted the fraud and wrote to the Board of Directors and the Capital Market Regulator about the manipulations, which have made all regulatory frameworks a mockery. Accounting manipulations, to which they appeal, consisted of understatement of liabilities and inflated cash balance. Satyam reported a net profit of Rs. 649 cores whereas the real profit was only Rs.61 cores. Although financial statements were prepared in accordance with Indian GAAP, IFRS and U.S. GAP, in 2008, the year that we reference, have been audited by the PWC only those drawn in concordance with Indian GAP. Another important fact to note is that in the Board of Satyam were present two teachers from two major schools of business, Mr. Rammohan Rao was from the Hyderabad Indian Business School, which is the leading business school in India, Mr. Krishna Paleppu was from the famous Harvard Business School, that with all their skill and competence, allowed the commit of such errors. The company's corporate governance statement for 2007 shows that an audit committee was functioning overseeing the financial reporting and disclosure process as also the ensuring the sufficiency, correctness and credibility of the financial statements. But more seriously, like in Enron and Lehman Brothers cases, PWC has slowed to hide the fraud, not all the audit tests that were required in those cases were applied, or had been partially applied. Satyam episode pulled down the stock market indices heavily.

Satyam lost over 70 per cent in the market. The fate of over 50,000 employees of Satyam is in doldrums. The investors who had great faith in Satyam lost heavily in this game. The clients have already expressed their reactions by blacklisting the company and Ramalinga Raju's was resigned from the Board.

The table below is a summary of the most resonant cases of failure of corporate governance in recent years, in addition to the causes that led to these failures, another interesting thing to note is that most cases have occurred in the USA .

TABLE 1: RESONANT CASES OF CORPORATIVE GOVERNANCE FAILURE

No.	*Company Name*	*Country*	*Observable Causes of Failure*
1	Enron	USA	Inflated earnings
2	WorldCom	USA	Expenses booked as capital expenditure
3	Tyco	USA	Looting by CEO, improper share deals
4	Global Crossing	USA	Inflated corporate profits to defraud investors
5	Royal Ahold	Netherlands	Earnings overstated
6	Parmalat	Italy	False transaction recorded
7	Wal-Mart	USA	Weaknesses in internal controls have led to government investigations and class action lawsuits by employees.
8	Xerox	USA	Accelerated revenue recognition

(Source: "Reason for Corporate Governance failures", by Shruti Mehta & Rachana Srivastvaare*)*

APPROACHES AND DISCUSSIONS ON THE CASES OF CORPORATIVE GOVERNANCE FAILURE

A presentation of only a few cases shows an important number of similarities in the company's actions, or negligence allowed by the persons responsible for management, which inevitably led to failure, which brings together a complex financial failures, image failures or ethical failures for the company, as individual cases, but certainly for the sector in which it operates. Behind those scandals are a number of common factors, including:

- Management incompetence
- Non-observance of the procedures stipulated in internal regulations
- Insufficient attention paid to risk management
- Inconsistent distribution of duties and responsibilities
- Inefficiency of internal audit
- Ignorance showed to the signals provided by external audit
- Influencing the external auditors to express an audit opinion inconsistent with reality.

Trying to carry out a more detailed analysis could be said that the boundaries within which all this factors could be grouped, is organizational culture, motivational element that differentiates the business entities, the principles and values which they lead. Analysis of the influence of culture on corporate governance has led to the identification of three groups of individuals, distributed as for Anglo-Saxon countries, with major U.S. and United Kingdom exponents, continental European countries, like Netherlands and Italy, and the third group represented by Asian countries, having as an exponent mainly Japan. In the U.S. and UK a significant number of large national companies are listed on stock exchanges, financial markets shows a high degree of liquidity, and ownership and control rights are frequently exchanged. In Japan and Germany, instead, major banks, insurance companies and Government held the prevalent system of management, and many companies have reference shareholders and private law, which has the effect of limiting in the number of hostile takeovers.

Starting from the notion of corporate governance, following and analyzing the two types of governance, given the strong poles of this sphere, the U.S. and Great Britain, as well as Japan, have defined some mechanisms through which big companies follow the basic principles. Although, most likely in developing these mechanisms, those who have kept it in mind conceived the signals received from the practice, and the classification they tried to do was based on those habits that would be the basis of strong economy, we kept the probability that after folding the resounding failure analysis on the cases presented above, classification according to the importance of these principles could become a little surprise.

Introducing the first factor "Discipline of the capital market", is not accidental, taking into consideration the fact that most failures occurred precisely in areas where capital markets have an important influence. But there may appear the question: "This refers to the order on financial markets or the rules imposed by them?" For a delimitation of these two spheres, should be provide the role played by minority shareholders. They can refuse new equity subscriptions, or even

to sell the shares they hold, which may lead to deteriorating market share price. A low stock price will turn the company into an attractive takeover target. Although the direct connection between the failures and the discipline imposed is not directly observable, we could make an analogy with an octopus that spreads its tentacles for protection, and to conquer at the same time.

This accounting fireworks in most cases, *temporary transfer of money out of balance sheet* also called practice Repo 105 (Lehman Brothers) [9], *costs masking and the production of higher income than in reality* (Adelphia Communications) , *reporting operating expenses as capital costs* (WorldCom, Enron) , are only the hidden or masked peaks of the relationships between key players, investors, managers and representatives of the entities, audit and consultation offices, which manifest temptation to play a dual role. Thus, developed banks keep an important number of shares that allows them to exercise significant control sometimes even global. As owners of capital, they automatically are receiving rights to have persons appointed by them in the management bodies of companies, which can block the will of strategic decisions or to share them in the interest concerned by the banks, remembering here about the system called "Insider". Therefore, some other involuntary conscious management board members are simple pawns, taking upon themselves the responsibility, but making games of others.

To present a more credible situations in the past two decades in particular, so before the notion of corporate governance to be used widely, the entities have used the services of audit, internal and external alike, but mainly to second one, following through this, consolidation, repositioning, image growing and brands consecration, just in terms of ideas that these opinions expressed independently by competent and integral specialists, are independent, uninfluenced and equidistant from the partners. Cases of Enron or Lehman Brothers seem to be in opposition to the principles stated above, while statutory audit would have to represent a mechanism aimed at ensuring the enforcement and strengthening corporate governance principles, the purpose was opposition expectations. All these weak links, the imposition by lenders of certain people in management boards to influence decisions, appearance on key management positions of persons employed in the past at the largest audit companies, the deformation of reality by presenting false audit reports, can lead to two ways of explaining the phenomenon, incompetent persons involved in the process of government, or their involvement in the betrayal of ethical principles, in our opinion is the thread that binds together all other ingredients, ethical principles once regarded should strengthen, to weld components for achieving positive results.

What exactly is the role of codes of ethical conducts, does not the non-observance contributing to their failure, triggers all the failures in corporate governance? Ethics in business is not just the current international conventions and statements; it must be represented in the first by reasonable actions and decisions, but more importantly the professional desire to achieve these actions. We presented above cases in which companies set standards of conduct and agree to comply, but suffer failures caused by corrupt temptations that show. Of course, adherence to ethical standards will not always guarantee that societies will keep every time right thinking, but here the reverse may be available, there are companies that have experience in neglecting ethical principles, but now they have implemented sound systems of governance. The most important thing in a corporatist system, without which it would be impossible to implement and maintain ethical principles, is the leadership position. Only the leadership must establish through its actions moral skills that will govern the activity.

Presented in the Table 2, we find the most common scenarios that companies face when it comes to implementing corporate governance principles based on ethical actions.

TABLE 2: CORPORATE GOVERNANCE AND ETHICS

		CORPORATIVE GOVERNANCE FRAMEWORK	
		Weak	***Strong***
ETHICAL	***Weak***	I Goal– Focus on overcoming systemic corruption	II Goal – Focus on building an ethical organization
	Strong	III Goal – Focus on improving corporate governance framework	IV Goal – Focus on compliance, disseminating best practice experience

(Source: *The moral compass of Companies: Business ethics and Corporative Governance as Anticorruption Tools*, John D. Sullivan)

Of course the ideal situation is depicted in quadrant IV, but even if found in any of the other three cases, companies can take steps to reach the ideal position. Ethics, principles that govern companies from outside, and the solutions given by external supervisors, directs the development of corporate governance so that this does not serve only entity in particular but also for society as a unit. After determining the involvement of principles underlying corporate governance in triggering cases of failure of large companies have tried to establish a hierarchy of "guilt" of those, presented in Figure 3.

FIG. 4: CLASSIFICATION OF CORPORATE GOVERNANCE PRINCIPLES

Source: Own processing (adapted after *"Reason for Corporate Governance failures",* by Shruti Mehta & Rachana Srivastvaare)

As you can see, in our opinion, the most important principle which was broken, starting from the bottom of the pyramid, was complying with the rules of ethical conduct. We have to become concerned that very few times *ethics is seen as the pillar structure* for a healthy management system, though, especially ethics is one that most often lead to corporate behavior – both the management and the subordinates, regardless of country, sector of the economy or business size. Placing on the second level the *board's nominations* has as a foundation the structure of governance types and mechanisms to make used by shareholders to influence managers' decisions and thus to marginalize their decision-making power. Statutory audit, discipline imposed by capital markets or laws governing the system of corporate governance are factors that influence the process outside the company, but that may be as toxic as the fraudulent use of the first two principles. The most conclusive proof is the support given by consulting firms in masking errors or stimulates the production of their conscious.

CONCLUSIONS

A transparent and timely communication between those who are involved in decision making process must be the first tool that can prevent cases of failure. The link between information and fraud prevention must go beyond the particular mode of corporate governance chosen, organizational structure and control mechanisms applied. People are more important than processes, so one of the main goals is to encourage the diffusion of advanced practices, which lead not only to defend the interests of investors but also to ensure social stability, improving the quality of human capital and promoting authentic values [10]. Financial crises detached from economic crises about we heard last year can head us on two ways, namely, accounting fraud can be attributed to excessive control or lack of control, external standards provided by the company or by internal regulations [2]. Highlight the close links between fraud and corporate governance is relevant again. These items mentioned are really important, in idea that the regulations remain ineffective if there is not a tandem with organizational culture,

supported by strong ethical principles, to point out the priorities, transparency of accounting information and efficiency of exercised control. Removing conflicts of interest is the safest way to ensure the correct functioning of control systems.
As possible ways to avoid future cases of collapse may be the following:

- Separation of powers of the Chairman and CEO. Each has to activate on its own pathway, otherwise we could reach a situation of excessive concentration of power and control capabilities of the supervisory board to be diluted.
- Integrity and missing of conflict of interest between managers, that should not target capital gains from the position they occupy, rather than wage remuneration they deserve.
- The existence of a strict flow of information so that decision-makers, have to receive timely and adequate information to perform their duties.
- Drawing concrete tasks and functions, especially in management teams, where decisions require a sustained effort and a great responsibility.

Finally we have to ask a question, that has to be answered by everyone interested in this field of activity, "What is the value of corporate governance principles declared by the companies?" Although here have been treated just a few of the many cases of corporative governance failure, we attend to believe that we managed to emphasize the main ideas, which are the interpretation and point of view of the authors, and as a solution to eliminate or at least to reduce the differences between the three main types of corporate governance, we would see a set of standards and requirements that include features of all types of governance factors, namely an attempt to globalize the management techniques.

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