

# **“Social Reporting in Corporate Governance and the role of Media in Corporate Governance”**

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I would like to start my paper by talking about a very great man, the Father of our nation Mahatma Gandhi. Mahatma Gandhi was no bleeding heart socialist. He was a hard nosed realist who brought the world's greatest empire to its knees with the sheer force of moral authority. Today as Indian Corporations scampers to incorporate "inclusiveness" in its agenda, it is worth noting the Father of the Nation 's prescient observation on Corporate Governance, decades before the concept itself was born. "The rich are the trustees of the Nation's wealth", he had said. Sir Adrian Cadbury was probably the first to enshrine the "Code of Best Practices for Corporate Governance" in 1992 at the behest of the London Stock Exchange.

Why have people all of a sudden started talking about it. Because the Lopsided distribution of the wealth created by India's steroid charged growth has increased inequalities, which , if not addressed immediately to the satisfaction of those left out of the system can lead to serious political, economic and financial dislocation.

The KumarManglam Birla Report on Corporate Governance can be a good starting point. There is a solid financial rationale for companies to put in place transparent and practical corporate governance structures in place.

Birla's report points out that companies with good Corporate governance structures are rewarded with higher market valuations. At a time when India Incorporations is aggressively expanding its footprint across the globe, it will do well to ensure that corporate boards become truly independent this will need the induction of more independent directors, of unimpeachable public standing and social conscience who can nudge managements into initiatives that will make India's growth rates more "inclusive" without in any way impacting the bottom line. The Mahatma's observation can be the bedrock on which to build such an economic edifice.

The Indian business environment is a trillion dollar economy. The average rate of economic growth has been over 8.5% in the last 3 yrs. We have very impressive savings and investment rates. India has been rated as the second most favored destination for FDI in the world. Forex reserves are very comfortable. We are witnessing booming capital market and surge in exports. Our corporate are not only contributing to this high economic growth but are also spreading their wings beyond the Indian borders by acquiring stakes in business overseas. In short our economy is growing.

At the same time there is a shift in the environment within which the corporate world functions . This shift is driven by expectations of the Stakeholders who not only demand higher performance and returns but also increased transparency , accountability and responsiveness on the part of the Corporate mgmt. An appropriate enabling environment is required to growing aspirations and expectations of the stakeholders. The good CG not confine itself only to the compliance with the law but it would involve inculcation of values,

morals, and ethics s part of the Corporate culture. The growth story should not remain a fairy tale for the last man sitting at the fence. He must feel part of the whole process.

Corporate Governance is one of the critical issues in Business today. For companies Good Governance means securing access to broader based, cheaper capital. For Investors commitment to Good Governance means enhanced shareholder value. For both Good governance equals to good Business.

## **Introduction to Corporate Governance**

Corporate Governance has emerged as a response to many of corporate failures and widespread dissatisfaction about the functioning of the corporate sector. They are powerful system by which corporate bodies are directed and controlled. Primarily concerned with Power and Accountability of Corporate. The Corporate Governance refers to relationship between Owners, Directors and Managers. BODs are the Centre of Corporate Governance. Serves not only the company's interest but also the society at large. Distribution of Rights And Responsibilities among different participants-Board, Manager, Shareholders, Stakeholder

It covers issues like- The legal issues of investors, The system of Electing the BODs, The Composition of Board and its various Committees, System of Checks and balances, Ethics, Maximization of Owners wealth by Managers, The ability of the board to maintain Surveillance.

## **Need for Corporate Governance in India**

Post liberalization period (1993-1995) was a boom period, Capital through Public issues, Many Fake companies came in, which are now nowhere, Indian companies getting Global thus more transparency demanded by Foreign investors, Collaborators, buyers. Stories of Accounting Juggleries, Family owned business (family leaders appointed directors which are toothless), Growing awareness towards Good Corporate Governance, Improving Ethical climate, Shadow Directors

## **Social Reporting in Corporate Governance**

As a result of pressure from public interest groups , mandatory social disclosure requirements and management's motivation to improve the firm's image more and more corporations of developed countries are disclosing social information in some form or another. This trend has also started in developing countries like India. Will social information be disclosed regularly by all firms? An answer to this question will either depend upon the mandatory requirements or upon the demand for social information by investors and other financial statement users . Until disclosure of social information becomes mandatory , firms would be encouraged to disclose this information only if the users of annual statements demand this information and management is convinced that such a disclosure would be in their best interest .

According to Keith Devis , “social responsibility begins where the law ends. Social responsibility refers to businessmen’s decisions and action taken for reasons at least particularly beyond the firms direct economic or technical interest. Thus social responsibility has two rather different faces. On the one hand, businessmen recognize that since they are managing an economic unit in society, they have a broad obligation to the community with regard to economic development affecting public welfare (such as full employment , inflation and maintenance of competition). On the other hand, a businessman’s obligation to nature and developing human values(such as moral cooperation , motivation , and self reliance in work ). Accordingly the term ‘social responsibility’ refers to both socio- economic and socio human obligation to others.

## **Objectives of Corporate social Reporting**

The objectives for Corporate social reporting can be derived from the rationale for Corporate social responsibility , which is supported by the following two arguments :Social contract argument and quality of life argument.

### **Objectives based on the Social Contract Argument**

The socially desirable performance of the firm is evaluated in terms of a social performance criteria applicable to a specific firm and then design and operate internal accounting systems which will enable management to report social information routinely to financial statement users and regulatory agencies.

The following three objectives for social accounting are to be considered

To identify and measure the periodic net social contribution of an individual firm

To help in determining whether a firm’s activities are consistent with the widely shared social priorities and

To make available relevant information on a firm’s goals , policies, programs, performance and contribution to social goals

As is apparent, the implementation will depend upon the development of social goals , which are termed as social indicators. Once these social indicators are developed , they are expected to perform the functions which will be parallel to the economic indicators which report on the economic health of the nation. Furthermore constant changes in the social environment have made the development of such indicators q difficult task . In the absence of reliable macro level social performance indicators , social accounting objectives cannot be brought to the realm of operationality.

The social contract concept is considered to be too narrow to capture the true nature of the relationship between social institutions and society. The corporation as a social institution exists as a matter of privilege given by the society and not as a matter of right. Furthermore, the concept of right is ambiguous and it does not explain the true nature of relationship between society and corporation. In view of the criticism of the social contract concept, the objective for social reporting discussed above are considered inadequate and un realistic.

## **Objective based on the Quality of Life Argument**

Another argument which brought awareness of corporate social responsibility relates to the 'Quality of life'. The social costs of economic development, which have been increasing at staggering proportions, started affecting different aspects of the Quality of life. The increase in social costs and realization of Quality of life issues in a shift of the society's attitude towards industrialization. Society started perceiving business as a Villian, responsible for several social ills.

Business was perceived to maximize profit by exploiting environmental and social systems. These perceptions and attitude forced society to revalue their expectations from business. It was realized that increased economic development at all costs would not be desirable. Only industrial development which does not reduce the Quality of life should be encouraged. Thus if businesses do not have in a socially responsible manner, their activities will have a negative impact on the society and the society will have a negative impact. As a result of change in society's attitude towards business, relations between society and business firms first became strained, and this change triggered a sense of frustration for Corporate management in the early stage of this awareness. It created an uncertainty with regard to the role of business in the society. Later, management recognized the reality and fearing extreme reactions from society if they did not address itself to the Quality of life issues, decided to avoid confrontation by realizing the need for a fresh start of corporation with society. This realization encouraged firms to develop social goals and provide relevant information to outsiders with regard to the discharge of their social responsibility. Some of the goals which firms use for reporting social information are as follows.

### ***Positive Image Motive***

Several firms report on social information on so that they can create a positive image for the firm. The management would not like to be perceived as a destroyer of the social environments, non-contributor to social causes, primarily a user of social services, etc. Instead, the management would like the consumers and society to perceive the firm as a 'responsible citizen' for the preservation of environments. In order to accomplish this goal, firms disclose social information on all of their society and preservation of environment and resources.

### ***To meet Information Needs of Consumers and Society***

Another important objective for Social reporting would be to meet the information needs of society and particularly of consumers. With the Social awareness, several public interests groups are closely watching the activities of corporations. Furthermore, consumers are connected about the safety product. Firms, expecting reaction from consumers as well as public interest groups with regard to their activities, are willing to provide social information to the users so that they can evaluate the corporate activities in a proper perspective. The main objective in providing such social reports would be to show that the social benefits from the firm's existence are greater than the social costs, and that the firm's products are Safe.

## **Measurement Problems for Social Reporting**

Measurement of Social Costs and Benefits is a crucial problem for reporting of Social information to outsiders. If proper measurement tools and techniques are not available, the usefulness of social reports will be limited. In the absence of relevant information's technology, it would be a difficult task to capture social costs or benefits in a way that would reflect net social benefits to society. Despite several efforts, the development of measurement techniques has not advanced very much. The various problems involved in developing the measurement techniques are discussed briefly as under.

## **Quantification of Social Information**

Social information expressed in monetary terms is no doubt the most appropriate for evaluating the firm's social performance. "Social Income Statement" and "Social Balance Sheet" are used. Though not well accepted. The reason for their rejection of such report could be lack of accuracy of these figures and monetary figures contained in these reports would be arbitrary and thus may lead to confusion and consequently they may lead to confusion and consequently they may become vulnerable to misinterpretation.

## **Valuation Dilemma**

After quantifiable becomes feasible, the next problem relates to valuation of these activities. For example the management will have to decide whether the social report should reflect true economic value or the cost of resources should be used as a surrogate for the value.

## **Social Performance of Business in India**

Many business organizations in India have also contributed greatly in the area of social responsibility. Associated cement companies (ACC) has been rendering social service for over four decades. The company has set up the schools, health centers, bunds, local countryside and agro- based industries, and cooperative societies in village with the sole objective of providing employment and improving the quality of rural life. Following help from ACC, farmers in Andhra Pradesh have doubled their per acre yield of rice, whereas those in Bihar began to raise a crop of protein- rich soyabeans as a matter of routine. ACC is spending approximately Rs. 6 lakh annually on its staff which works for rural development programmes with direct investment.

The Mafatlal Group follows a slightly different line in social performance. It spends a huge fund on rural welfare programmes for helping the poor. It constructs homes for the homeless, provides drinking water, and distribute book, stationery and scholarships in rural areas.

The Tata Iron and Steel Company is the first industrial organization in the country to have carried out a social audit of its performance in the year 1979.

In the public sector, Bharat Heavy Electrical Ltd.(BHEL) is endeavoring to play a prominent role in the area of social responsibility. All division of BHEL, are aware of their social role and have drawn comprehensive scheme for the welfare of their employees in

social role and have drawn comprehensive scheme for the welfare of their employees in township and for those living in nearby areas. The company is engaged in identifying specific problems of communities and in coordinating the efforts with the local bodies, authorities and voluntary agencies in providing speedy relief to them. The active involvement of BHEL and its employees in the welfare of the surrounding communities is helping the organization to earn the goodwill of the local population and to have a better understanding of their problems. Jobs done by BHEL units in this respect include provision of drinking water facilities, construction of external sewers, roads and culverts, providing health facilities, improving the quality of life by redesigning jobs, improving educational facilities and so-on.

Many Indian companies have given 'Value Added Statement' in their annual reports in place of a social reporting . This statement exhibit the contribution and surplus made by them through their business activities and also disclosure as to how the same has been distributed to different segment of the society such as employees, government and shareholders, etc. Beside, Social Income Statement and Social Balance Sheet given by some Indian companies in their annual reports would prove very useful to the users and other interested persons.

The government should make it obligatory on the part of the companies to report their 'Social Performance' during the year through statements and/or other means of disclosure.

## **Role of Media**

Media role can be seen as key to creating awareness of Corporate Governance in business houses. Communication between Media and Corporate bodies directly and through efficient public relations or mass communications can be vital to ensure good governance and human rights. Media must be on the front line in disseminating impartial news for ensuring transparency in the Corporate sector. Media have a watchdog role to ensure accountability and transparency of corporate sector. Media also need to improve their capacity to play the watchdog role.

Role of Media in pressuring corporate managers and directors to behave in ways that are socially acceptable. Sometimes this coincides with Shareholder's value maximization. Media affects companies policy toward the environment and the amount of Corporate resources that are diverted to the sole advantage of controlling shareholders. Here I have quoted two examples though not Indian but will very well explain the effect of Media on corporate governance.

EXAMPLE 1. In April 1992 the Wall Street Journal published a strange advertisement. It was a full page picture of a silhouette of the board of directors of Sears Roebuck with the title "*The nonperforming assets of Sears*" This advertisement was paid for by shareholders activist Robert Monks . He exposed all the directors , identified them by name who were responsible for the poor performance of Sears Stock

The Directors greatly embarrassed by the advertisement chose to adopt many of the proposals which were given by Robert Monks even though he had received only 12% of the votes in the previous election for board members and had failed to get a seat on the board

EXAMPLE 2. On March 8 1988, All the major US networks broadcast a tape of a Panamanian tunaboat – the Maria Luisa, killing hundreds of dolphins while fishing for tuna. Building on Public outrage , the Earth Island Institute , GREENPEACE and the Humane Society launched a boycott of Tuna. Restaurant chains took tuna off the menu and many stopped using tuna until it was “dolphin safe” i.e fished with nets that were not killing dolphins

On April 12, 1990 , Heinz announced that it will sell dolphin safe tuna .Within hours the two other largest tuna producers made a similar commitment

*These episodes suggest that the Media may play a role in shaping corporate policy*

Are these isolated incidents or are they are representative of the Media’s influence. If the Media do have such an influence why do they have it.

There are various questions which can be answered

As the Media do not vote and do not set managers compensation , what mechanisms force directors to pay attention to what the Media say

How does the Media’s power relate to and interact with other corporate governance mechanisms such as the legal and Competitive environment

In what direction does Media influence lead Corporate policy

In both examples the Media plays the role of a lever but a lever used by two different groups. Disenfranchised shareholders in the first case. Environmentalists in the second case.

In the first case it was used by Shareholder activist who communicated the shortcomings of managers and directors. In the second case it was used by a Environmental group thru a Tape

The OUTCOMES were also different . In first case the public pressure generated by the advertisement resulted into the Directors of Sears to increase Shareholders value an objective that they would not have done. In the second case the corporates had to bow down to a group of Environmentalists.

Here one would argue that Media were simply instrumental in bringing crucial facts to the attention of Customers . Here it is not even clear that the Media Forced the Directors to behave in Society’s interest.

**The Media can play a role in Corporate Governance by affecting reputation at least 3 ways**

Media attention can drive politicians to introduce Corporate Law reforms in the belief that inaction would hurt their future political careers or shame them in the eyes of Public opinion

In the Traditional understanding of Reputation , Managers wages in the future depend on Shareholders' and Employer's belief that how much advantage they are going to take of the situation that they are not monitored. Thos concern about Monetary Penalty that they may have to face they always behave like good managers

Image in the eyes of the Public. As given in the first example, Robert Monk said bout the Advertisement,

*Anyone seeing the ad would read it, Anyone reading the ad would understand it, Anyone understanding it would feel free to ask questions of any board members they encountered*

Sears Directors hate Robert Monks. Because everywhere they go they are recognized through that advertisement. *No Insurance policy for Managers or Directors can protect them from such REPUTATIONAL PENALTIES.*

### **Media do affect Corporate Policy**

The extent of Diffusion of the Press also affects the role it has . Press cannot be important if it is not read. Press freedom and Independence also has some impact on the effect it has. Countries with a large newspaper circulation have better environmental responsiveness on average. Religion is major factor affecting literacy of the country and its propensity to read.

### **Corporate Governance and the Press (The Press also interacts with the Corporate Governance mechanisms )**

#### **Shareholder Activists and the Press**

Shareholder activists such as Robert Monks have found the press useful in their fight with management in US but some recent events in the Republic of Korea indicate that there Strong Shareholders take advantage of their position at the expense of small investors . National Corporate Laws give few rights to outside investors . The strength of protection for minority shareholders and expectations in relation to law enforcement is low.

The beginning of efforts to force change in Korea dates back to 1996. The formation of PSPD (People's Solidarity for Participatory Democracy ) driven by Jang Ha Sung of Korea University

As in the US the Investor Activists relied on both 1. Legal pressure, 2. On the use of Press

### **The most imp successful challenge to date has been the battle to stop insider dealings in SK Telecom**

SK Telecom has been an extremely profitable company but its financial results did not show it up because the company used transfer pricing to benefit two companies (almost 100% owned by the Chairman of SK Telecom and his relatives )

The PSPD draw attention to these Policies

After the London based Newspaper 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 Radios .

In March 1998 – SK Telecom ‘s Directors capitulated and agreed to the PSPD,s request.

### **Institutional Investors**

While institutional investors have many legal mechanisms to encourage change in Corporate policies the presence of an active Press increase their influence. It provides cheap way to impose penalties on companies and to coordinate the response of other investors.

### **CalPERS (The California State Pension Fund For Public Employee )**

**Policy of CalPERS** – Identifying underperforming firms and generating widespread media attention as an imp tool in its efforts to change corporate policies to increase their returns . Under performance is judged thru various parameters. CalPERS give a threat that they will conduct a proxy contest and reveal the firm in Focus List. CalPERS found that when it removed the Publicity threat than its strategy did not work.

Thus Single most important corrective mechanism against Misgovernance is Press.Through Press Media’s attention of Management Failures. Press reporting can put institutional investors to shame and do good actions. Press reporting can also shame Politicians and Managers who care about their international reputation to act to improve policies in firms. As William Browder reported “The Press is one of the reasons why we pursue lawsuits . We have pursued 24 lawsuits so far and lost 23 . But the advantage is Publicity ”

### **Private and Govt Regulations**

Public opinion pressures generated by an active press is very important to improve CG . Two Countries are given as examples.

United Kingdom      2. China

**U.K** – Approach of U.K to the range of Financial scandals of 1980s including the collapse of *Bank of Credit and Commerce International and Maxwell group*.

U.K pursued self regulation enforced through disclosure. The Cadbury commission was the first initiative to reform by means of Disclosure and Public Pressure (The 19 key recommendations included enhanced role for independent directors, a minimum no. of independent Directors, Separation of the role of CEO )

**China** - In Hongkong (China the Stock Exchange has historically not had the legal authority to impose penalties on companies that misbehave).The Threat is usually enough. Shaming is both a Personal penalty and a Financial Penalty.

### **THEORETICAL FRAMEWORK**

We should try and understand the channels through which media effects the Corporate Policy. The first channel of influence is that media attention can drive enforcement of corporate laws. The second channel is the link between Media and Manager's and Directors reputation. An environmentally friendly mgr will find polluting more painful than somebody who does not care about the environment. Even bad managers can be induced to take the "right" action by the desire to mimic the good type. And in so doing being recognized as environmentally friendly. Reputation Model is based on the assumption that information about the managers action is revealed to the public with probability.

The broader the Media coverage the more likely that the public at large will acquire this information. Similarly the more attention the media command the more widely this information will travel. In particular, if a higher diffusion of the Press leads to a higher probability of Detection then the higher the diffusion of the Press the more likely mgrs will behave in an environmentally conscious way.

### **Where do the Media get their Information**

For the Media to collect their information about managers action is costly, thus they rely on information provided to them. An important source is Government either directly or indirectly thru Mandated disclosure, For instance required financial or environmental disclosures.

Government mandated information is the most reliable. It is easy for the Interest groups and Journalists to collect information and use it when they communicate to the Public. Third potential source of Information is Interest groups, Shareholders activists, institutional investors, environmental activists

### **Selective coverage of Media Credibility**

Financial Times is very credible and Business Week is very reliable and Widespread. The issue of credibility is particularly delicate because it opens up the question of Newspapers 's incentives to conduct further investigations to establish the Validity of the information reported to them. If wrong information's they have to pay fine for revealing damaging information. There are newspapers who take bribes. More Stringent Libel laws reduce the likelihood of a newspaper publishing information which is false.

### **Reputational Penalties and social Norms**

Media activity can hurt managers reputation. Any Media account of underperformance has a significant impact. The newspapers can make Corporate Business Heroes or Also Villains

### **Conclusion**

Media selectively reduce the cost of acquiring and verifying information. This information is crucial in shaping the reputation of the key players who determine corporate policy. The reputation that decision makers seem to care about is not just the reputation in the eyes of current and future employees but also in the eyes of Public at large. More diffuse the press in

a country is the more companies are responsive both to environmental issues and to the minority shareholders concern.

While the strength of the impact of the media depends on their credibility, the direction of their net effect depends on special norms and values, but much more research is needed before coming to a conclusion on this matter. Media are important in Shaping Corporate policy and should not be ignored in any analysis of a Country's Corporate Governance System.

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