

## Corporate Governance for Competitive Credibility

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**KEYWORDS** Corporate governance; competitive credibility; information technology

**ABSTRACT** Corporate governance enhances business competitiveness by integrating corporate social responsibility into every aspect of corporate management. Since corporate reputation serves as a useful and powerful asset / resource for companies to develop its competencies, and outperform competitors, companies that accommodate the needs of a wider range of stakeholders are more likely to yield good reputation and credibility than those which do not. This paper attempts to investigate the validity of the statement that corporate governance is a competitive necessity for companies in a local context. The objective of this study is to test the perceived connection between competitive credibility and corporate governance from two different perspectives: companies and consumers', using consumer survey and company questionnaire. Another objective is to identify the aspects of corporate governance that consumers and companies perceive as significant. The analysis were done not only of the outcomes of the consumer survey and company questionnaire, but a comparative analysis was also carried out to determine the link between consumer and company perception concerning corporate governance. The study concludes that corporate governance is not yet a necessity for successful competition in Indian IT sector but if local and regional companies wish to enter the global market, they will need to employ good corporate governance strategies. Finally, recommendations were made based on the outcome of this study.

### INTRODUCTION

The need for the implementation of good corporate governance strategy is not only social. but there are good economic reasons also. The Companies possessing corporate governance are more likely to gain a competitive advantage over their counterparts.

The benefits that the corporation receives from society implies certain responsibilities, including key elements of corporate governance, such as "transparency, honoring of contracts, and respect for the institutions of the larger society." (Schwartz and Gibb, 1997, 1999). The broadening of the perception of social needs by companies, in terms of extending their liabilities beyond the needs of stakeholders, can become an important asset for the company. It can build new unique competencies distinctive from its competitors and can yield good reputation and credibility. The following example can clarify this point. There are three types of firms (A, B and C), as seen in figure1. Firm A, disregards the existence of corporate governance and therefore is not effectively competing in their market. Firm B, addresses the needs of shareholders by establishing a form of corporate governance structure characterized by ownership and control. Therefore they are relatively more competitive than Firm A. Firm C, is the most competitive amongst the three firms because it takes into account the needs of their shareholders

at large, which helps them to build on useful and important resources such as good reputation. This in turn creates new business opportunities for the firm. (Lam et al., 2002)

### Objective

The objective of this study is to test the perceived connection between competitive credibility and corporate governance from the perspectives of both company's and consumers' and to identify the aspects of corporate governance that consumers and companies perceive as significant.

Propositions tested by this study are:

- Integrating corporate governance into business strategy is a necessity and will be so in future.
- Both consumers and corporations within the Information Technology sector believe that corporate governance is a "must" in gaining a competitive credibility.
- Growing features of modern corporate governance such as social/ethical responsibility are valued equally by both consumers and companies.

### LITERATURE SURVEY

#### Definition of Corporate Governance

Corporate governance was loosely defined

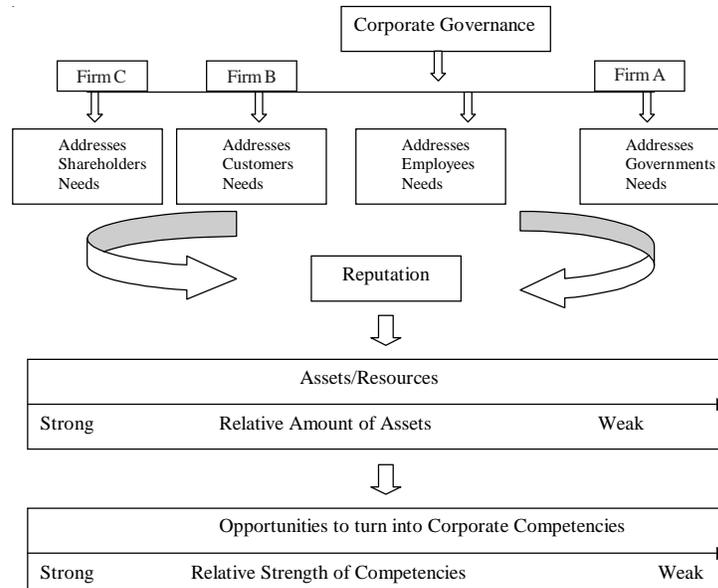


Fig. 1. Corporate governance, social responsibility and firm competitiveness the link

as “the system by which companies are directed and controlled and concerns issues such as the composition and structure of boards and directors and accountability of boards to shareholders.” (Ong, 2001)

This definition is felt no longer sufficient now. OECD (Organization For Economic Co-operation And Development) extended the meaning of corporate governance as follows: “system by which corporations are directed and controlled. This includes specific distribution of rights and responsibilities among the board, managers, shareholders, and other stake holders” (OECD, 1999)

Direct and indirect benefits through adopting good corporate governance are:

1. Enhanced image and brand value: good corporate governance measures can positively affect “brand equity” i.e. “the consumers perception of the brand and its impact on purchasing behaviour” (Bixner et al., 1999)
2. Many private investors are now seeking guidance through organizations such as the Association for Sustainable & Responsible Investment in Asia (ASrIA), and its international counterparts, in order to make informed decisions about socially responsible investment (SRI) (Loh, 2001). Within the SRI framework companies are measured according to their adherence to the triple bottom line

principal i.e. taking into account social and environmental considerations in addition to the standard financial issues (Bowden et al., 2001).

- Reduction of Potential Liabilities.
- Improved Resource Management.
- Increased Market Reach: this can be achieved through differentiation of products/ services from competitors using good corporate governance practices as a tool.
- Effective stakeholder Relations Management: Corporate governance is a community issue. It is the responsibility of everyone to conduct himself or herself in an ethical and responsible manner (Fan, 2002)
- Increased Profitability: as a direct result of the aforementioned benefits good corporate governance will result in direct bottom line improvements.

In a microeconomic sense competitiveness is defined as sustainable growth in productivity driven by the quality of business strategy and operations, the quality of business environment and the prevalent macroeconomic environment (Yerner, 2002). From a macroeconomic perspective “competitiveness is the degree to which a country can under free and fair market conditions, produce goods and services which meet the tests of international markets, while simultaneously

maintaining and expanding the real incomes of its people over a long term.” (Garelli, 2002).

A wide range of stakeholders has recognized the notion that corporate governance is positively related to competitiveness. In Philips Corporation, the revitalization of the company’s corporate governance strategy has contributed to an overall improvement in the business despite the recession. (Freedman, 1999). The IT industry in India successfully demonstrated that good corporate governance has a role to play for industries, in terms of productivity improvement. (Arora and Athretye, 2002). Many views, including that of respected business groups, as well as research and academic community agree that improved corporate governance can positively impact overall corporate performance. (OECD, 1999).

However, not every type of corporate governance mechanism can effectively promote competitiveness. The traditional mechanism is characterized by an internal governance system, which consists of a board of directors. (Claessens et al., 2000). This type of corporate governance instrument has been widely questioned specifically in terms of the issues of ownership and control. (Berle and Means, 1932) argue that in practice the board would pursue their own interest rather than interests of its shareholders, resulting in inefficiency and diminished competitiveness. In fact, the effectiveness of traditional corporate governance mechanisms in ensuring sound corporate performance in many companies such as Japan, Germany and France has turned out to be limited. (Allen and Gale, 2000).

A more effective mechanism is the external corporate governance instrument, which relies on the market for corporate control. This type of governance relies on competition in the product markets for maintaining good corporate performance. (Allen and Gale, 2000) argue that the reliance on market, product competition has the advantage over internal corporate governance mechanisms in the way that it overcomes the problem of managerial inefficiency and selects the strongest form of management. In addition companies with strongest management force the weaker one’s out of business and develop best product, produce the highest earnings and growth. Market product competition differentiates the more competitive firms from the less competitive ones in terms of their ability to

profit maximize within a competitive environment. For this reason, companies who utilize the external corporate governance mechanism place themselves in a highly competitive position as compared with their traditional counterparts. Market driven competition can result in two potential outcomes. Firstly it can imply that stakeholders such as customers are critical for company’s competitiveness as their preferences and tastes about country and products have influential roles to play in the market movement. As such it becomes critical for companies to take into account the interest of stakeholders for gaining competitiveness. This is in line with the concept of stakeholders of the society (Kay, 1996). The welfare of stakeholders in the firm must be internalized during the design of institutions, or the corporate governance structure. (Vives, 2000). *Indian Information Technology Industry*: For this purpose of study, Indian Information Technology sector is the focus of analysis. The Indian IT sector has proved to be the country’s fastest growing segment. The performance of the Indian IT sector was determined by its growth in the following areas:

- IT software and services exports

- IT-enabled services

- The domestic IT market

- Telecom infrastructure

- Venture capital

- IT software and services exports

Software and services exports continued to remain on top of the IT industry’s revenue table. Some of the key service lines for Indian players continued to be:

- Custom Application development and maintenance

- Applications outsourcing

- IT enabled services

- R&D services

Indian companies also made modest headway in segments such as packaged software support and installation, product development and design services and embedded software solutions.

*IT Enabled services (ITES)/BPO*: NASSCOM estimates indicate that during 2002-03, the IT-enabled services segment grew by a phenomenal 65 percent.

*Telecom Infrastructure*: India’s telecom infrastructure has become a priority area for the country, with the Government focusing on making it world class. The turnover of the sector is estimated to have crossed US\$ 9 billion in 2002.

## METHODOLOGY

This study utilizes the consumer survey and company's questionnaire to obtain the relevant data.

*Consumer Survey:* Surveys were conducted with 200 consumers of both genders across a variety of employment sectors using Information technology. A short questionnaire was used in the survey comprising 6 questions. (see Appendix 1)

Questions were asked about companies' obligation and responsibility to disclose corporate information and towards society in general and to clarify the degree of understanding of corporate governance amongst consumers.

*Company Questionnaire:* An in-depth questionnaire comprising 21 questions (see Appendix 2) were administered to the headquarters of the 5-selected Indian IT companies. The questionnaire was designed to investigate companies' perception of corporate governance and the role of corporate governance in enhancing their companies' competitiveness. Following topics were covered:

- Knowledge of Corporate Governance
- Competition within the Information Technology Sector
- Consumer Demands
- Knowledge of Corporate Social Responsibility

## FINDINGS AND OBSERVATIONS

*Consumer Survey:* Factors such as gender, employment details etc. were not taken into account but they were sampled to ensure an even distribution of such variables. Out of 200 consumers 176 responses were obtained. (88% response rate) The Background of respondent's is mentioned in table 1.

## EVALUATION OF THE RESULTS

*Consumer Survey Analysis:* Responses were

**Table 1: Respondent's background**

Personal Information	%	Actual Number
Female	43.2	76
Male	56.8	100
Unemployed	07.4	13
<i>Employed at (Sector):</i>		
Banking and Finance	33.5	59
Manufacturing	21	37
IT/Telecom	14.8	26
Government/Energy	10.8	19
Education	12.5	22

obtained from 176 Consumers across the country out of 200 questionnaires sent. Participants were asked to rank factors that affect their purchasing decisions regarding products and services of the concerned companies. They were given 4 options in order of importance from most important to least important.

Overall the survey results indicate that price and quality are the more important factors followed by the brand name

To assess the importance of corporate behavior and ethical standards, the consumer survey included the factor- Social responsibility, such as observing human rights of workers, protecting workers' health and safety, engaging in fair trade etc.

The results of the consumer survey are given in table 2. Social issues were ranked as number one by 10.2% of the respondents, in top two by 14.8% and in the top three by 44.3%. Social issues were not ranked in the top three purchasing factors by 55.7% of the respondents.

Most of the respondents agreed that Companies should make their Internal Corporate Information available to the public (77.8%).

Majority of the respondents (84.1%) agreed that the Companies have the responsibility to

**Table 2: Summary of the consumer survey results**

<i>Question 1.</i>		
Total ranking Social issues as no. 1	10.2%	(18)
Total ranking Social issues in top 2	14.8%	(26)
Total ranking Social issues in top 3	44.3%	(78)
Total not ranking Social issues in top 3	55.7%	(98)
<i>Question 2.</i>		
Yes	77.8%	(137)
No	22.20%	(39)
Agree on both Q 2. And Q. 3	74.40%	(131)
<i>Question 3.</i>		
Yes	84.10%	(148)
No	15.9%	(28)
Disagree on both Q 2. And Q. 3	6.80%	(12)
<i>Question 4.</i>		
72.6% (127) have availed the services of foreign IT companies.		
<i>Question 5.</i>		
19.9 % (35) of customers displayed an understanding of the concept 'corporate Governance'		
<i>Question 6.</i>		
88.5 % (31 out of 35) of these respondents agreed that corporate governance was a must in gaining a competitive advantage.		

*Note:* Figures in parenthesis are in actual numbers

actively participate in activities beneficial to the welfare of the community whereas 15.9% were against this thinking. This shows how strongly the customers feel about these issues.

Most of the respondents (74.4%) agreed on both making the internal information publicly available and participating actively in activities beneficial to the community. Only few (6.8%) disagreed to both these propositions.

Many respondents (72.6%) had availed the Services of the foreign IT companies. About 20% of the customers displayed an understanding of the concept "Corporate Governance". Our survey shows the need to promote the awareness of corporate Governance.

Majority of the respondents (88.5%) agreed that Corporate Governance is a must in gaining a Competitive Advantage.

### Company Questionnaire

The table 3 summarizes the results of the company questionnaire.

**Table 3: Summary of the results of the company questionnaire**

<i>Questions</i>	<i>Results</i>
On Corporate Governance	3 out of 5 companies demonstrated a detailed understanding of the concept. They mentioned transparency, responsibility, disclosure and interest of stakeholders. 2 companies defined CG as a system by which the corporation is governed.
Do you understand the meaning of CG? Please define	
Do you employ CG practices? What are the key benefits of CG? Please rank.	5 out of 5 companies answered yes. 2 companies ranked FDI at top. 2 companies ranked improved stakeholder relations at top and 1 company ranked enhanced image and brand at top.
Is it your responsibility to disclose your corporate information?	All the five companies answered in positive (yes)
What are the key incentives for your company to disclose? Please rank	3 companies ranked international best practices at top. One company ranked Legal Requirements and one company ranked shareholders demands at top
On Competition within IT sector	All the five companies answered yes
Has globalization affected competition within the IT industry	
What features make you a successful competitor? Please rank	Two companies ranked Brand Name at top. Two ranked Good Customer Services and one ranked Price at top.
Is CG a must for successful competition?	All the five companies answered yes.
On Consumer Demands	
What factors you think customers take into account when making their purchasing decisions? Please rank	Two companies ranked price at top. Two ranked Quality at top and one ranked Brand Name at top

### Company Questionnaire Analysis

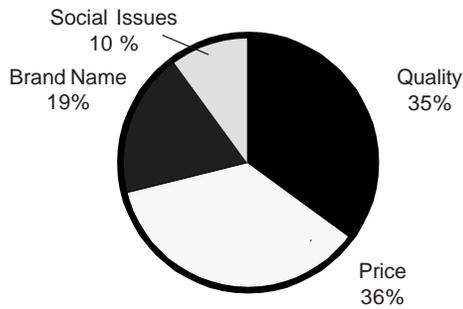
Five companies participated in the study, but their names will not be revealed as we promised not to reveal their identity.

### Observation and Evaluation of the Company Questionnaire Results

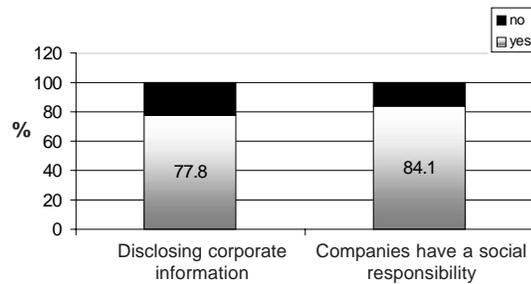
- 3 out of 5 companies demonstrated a detailed understanding of the concept. They mentioned transparency, responsibility, disclosure and interest of stakeholders. 2 companies defined CG as a system by which the corporation is governed. All the five companies are currently employing corporate governance practices.
- It is interesting to note that none of the five

**Table 3: Contd.....**

Questions	Results
Do you think that your customers would be interested in seeing your corporate information?	All five companies answered yes.
On Quality Issues	
Do you a Quality Management System (egg. SEI-CMM) in place?	Out of five only two companies have QMS in place.
On Corporate Social Responsibility	
As a local brand, do you think you have a duty of care towards the community?	All the five companies answered yes.
Please rank the social issues confronting businesses today in order of importance?	The companies ranked Health and safety, Human rights, Labor issues, and Charity work at top.
Who do you think your stakeholders are? Please tick (given 8 options see Appendix 3)	The common ticks were at shareholders, customers and employees. Two companies ticked at Local community also.



**Fig. 2. Factors affecting purchasing decisions (Opting for rank 1)**



**Fig. 3. Disclosure of information and social responsibility**

**Table 4: Company questionnaire analysis**

Companies Features	A	B	C	D	E
No. of employees	15326	8748	15230	18000	300
Annual Turnover (\$m)	753.8	33.284	423.78	932	63
No. of Board of directors	16	8	6	8	5
No. of executive directors	8	3	2	3	3
No. of non executive directors	1	5	1	6	1
No. of independent non executive directors	8	4	3	6	3
Audit Committee	6	2	3	3	2

- companies ranked profitability as the top benefit gained by employing Corporate Governance. 2 companies ranked FDI at top. 2 companies ranked improved stakeholder relations at top and 1 company ranked enhanced image and brand at top.
- All the five companies agreed that they have a responsibility to disclose the Corporate Information to all stakeholders.
- In terms of the key incentives for the company to disclose their corporate information - 3 companies ranked international best practices at top. One company ranked Legal Requirements and one company ranked shareholders demands at top
- All the five companies agree that globalization has affected the competition within the IT industry in India.

- On the question of important features which make their companies successful competitor. Two companies ranked Brand Name at top. Two ranked Good Customer Services and one ranked Price at top. Social and ethical responsibility of company was ranked only after price, brand name, customer service and quality.
- All the five companies considered Corporate Governance to be a must for successful competition in the market.
- On the question of the factors which company think that customers take into account when making their purchasing decisions- two companies ranked price at top. Two ranked Quality at top and one ranked Brand Name at top. The social issues were ranked last or second last by all of the five companies.
- All the five companies agree that customers would be interested in seeing their corporate information.
- Out of five only two companies have Quality Management System in place. This is surprising because some of these companies who don't have such QMS claimed that quality is their strength in the market.
- All the five companies believe that they have a duty of care towards the community. They ranked Health and safety, Human rights, Labour issues, and Charity work at top.
- These five companies believe that shareholders, customers and employees and local community are the stakeholders of their companies.
- Out of the five companies three companies provide very wide choice for their employees in terms of the training that include Financial, Legal Compliance training, Customer Service, and Product Knowledge trainings.

#### COMPARATIVE ANALYSIS

The link between consumer and company perception concerning corporate governance can be revealed using the comparative analysis of the two surveys undertaken.

The key findings are:

- Both group consumers and companies valued price, quality and brand name as the top factors for purchasing decisions. But companies failed to perceive Social issues as an important factor that is valued at the top by a significant portion of the consumers (55.7% consumers ranked social issues in top three). This fact

suggests that companies need to improve their understanding of the consumer's expectations to gain the competitive advantages. This fact is felt in the marketing companies also: "Marketers may not feel motivated to change until more Asians demand greenness with their purchasing power. But those who wish to capture some of the North American, European or Austrian markets had better prepared to make their products meet the standards now being demanded by consumers there." (Asian Advertising & Marketing, 1991). Lam et al. (2002) in their study using Hong Kong retail industry, obtained similar results.

- All the five companies agree that consumers want to see their corporate information but they did not rank customers expectation as a key incentive to disclose. In consumer Survey 77.8% of the respondents feel that the companies have the responsibility to make their internal corporate information available to the public.
- Only 20% of the consumers have an understanding of the Corporate Governance but all five companies have quite a good understanding of the concept. All five companies agreed that Corporate Governance is an important factor of successful competition. Most of the respondents (88.5%) agreed that corporate governance was a must in gaining a competitive advantage. This fact clearly depicts the importance of corporate governance in the minds of the consumers and companies.

#### Limitations of the Study and Scope for the Future Researches

Only IT sector in India is taken for the study and a limited number of consumers and companies are included in the sample because of time and resource constraints. Moreover, many demographic factors are ignored in the study. There is a need for a more detailed study on the topic taking samples across the countries and industries and using a more scientific and effective tools like focus group discussions and more sophisticated questionnaires.

#### CONCLUSION

An apparent discrepancy is revealed existing between the consumer's expectations and

companies perceptions especially in the social aspects. More than fifty percent of the consumers rank these factors in top three criteria for purchasing decisions but the companies do not rank these aspects as top priorities.

The study results show that integrating corporate governance into the strategy is not yet a competitive necessity as companies rank profitability as the least important incentive to implement corporate governance. However companies are implementing it to meet global international standards. Thus, the study suggests that in the future corporate governance may become a competitive necessity.

### RECOMMENDATIONS

A standard definition of Corporate Governance needs to be arrived at as corporate confuse Corporate Governance with accountancy aspects. All the stakeholders need to be taken into account for success. Social and environmental aspects are also to be taken care of.

We have come up with the following recommendations to assist the Indian IT companies to gain a competitive advantage through Corporate Governance:

1. In Indian IT sector most of the companies are family owned. For more accountability and responsibility a more sustainable management model the companies should have a number of independent, non-executive directors. The board should be audited independently.
2. High quality information concerning both accounting and non-accounting matters should be produced and disclosed. Environmental, Sustainability and Social reporting should be increased to the proper level.
3. The quality of products and services should be improved.
4. Companies should form strategies based on triple bottom line concept (economic, social and environmental) for enhancing corporate performance.
5. A company must be able to remain flexible and should have the ability to adapt in an ever-changing market.

Employing Corporate Governance should be a good first step for the Indian It companies to stay ahead of competitors and to gain a market niche.

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## APPENDIX 1

**Consumer Survey**

## Background Information

What is your field of work?

\_\_\_\_\_

Please tick: Your gender M  F 

1. Please rank the factors you would take into account when making your purchasing decision in order of importance (1-most important, 4-least important)
  - a) Price
  - b) Quality
  - c) Brand Name
  - d) Social responsibility, such as observing human rights of workers, protecting workers' health and safety, engaging in fair trade etc.
2. Do you agree that the companies have the responsibility to make their internal corporate information (relating to product development, product distribution and management) available to the public?
  - a) Agree
  - b) Disagree
3. Do you agree that the companies have the responsibility to actively participate in activities beneficial to the welfare of the community?
  - a) Agree
  - b) Disagree
4. Have you availed the services of any Foreign IT company ?
 

Yes

No
5. What is your understanding of Corporate Governance? Please mention in detail.
 

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_
6. Do you think Corporate Governance is a "must" in gaining competitiveness locally and internationally?
 

Yes

No

## APPENDIX 2

**Company Questionnaire****Corporate Governance Survey: IT Sector****A. Knowledge of Corporate Governance**

1. Do you know what Corporate Governance means?
 

Yes

No
2. What does the term Corporate Governance mean to you?
 

\_\_\_\_\_

\_\_\_\_\_

3. Does your company currently employ Corporate Governance Practices?
 

Yes

No
4. What do you perceive to be the key benefits of Corporate Governance? (Please rank, 1-most important, 8-least important)
 

Improved Resource Management

Enhanced Image and Brand Value

Competitive Advantage

Attracting Foreign Direct Investment (FDI)

Improved Stakeholder relations

Limit Potential Liabilities

Strengthen the capability of the Board of Directors

Increased Profitability
5. Do you think that your company has a responsibility to disclose corporate information to both your internal and external stakeholders?
 

Yes

No
6. What would be the key incentives for your company to disclose your information? (Please rank, 1-most important, 5-least important)
 

Legal Requirements

Customer expectations

Shareholder Demands

International Best Practices Standards

Competitors Practice

Competition within the IT industry
7. Who do you perceive to be your main competitors?
8. Do you believe that globalization has affected competition within the IT industry?
 

Yes

No
9. What are the distinguishing features of your company, which in your opinion make you a successful competitor? (please rank, 1-most important, 6-least important)
 

Price

Quality

Brand Name

Social and ethical responsibility of company

Good Management Practices

Good Customer Services

Other \_\_\_\_\_
10. Do you perceive competition in the IT sector in India to differ significantly from Europe and the US?
 

Yes

No
11. Do you think that Corporate Governance is a "must" for successful competition in today's market?
 

Yes

No

**B. Consumer Demands**

12. What factors do you believe customers take into account when making their purchasing decisions? (Please rank, 1-most important, 6-least important)
 

Price

Quality

Brand Name

- Social and Ethical responsibility of Company  
 Good Management Practices  
 Good Customer Services
13. Do you think that your customers would be interested in seeing your corporate information?  
 Yes   
 No
14. Do you have a Quality Management System (egg. SEI-CMM) in place?  
 Yes   
 No
15. Do you think there are benefits from partnering with Non-governmental Organizations (NGOs)?  
 Yes   
 No

**Knowledge of Corporate Social Responsibility**

16. As a local brand, do you think you have a duty of care towards the community?  
 Yes   
 No
17. How do you rank the following social issues confronting businesses today?  
 (Please rank, 1-most important, 5-least important)
- Labor issues  
 Human Rights  
 Health and Safety  
 Fair trade  
 Charity Work
18. Who do you perceive your stakeholders to be?  
 WTO  
 Indian Government

- Shareholders  
 Customers  
 Employees  
 Local Community  
 Non-Governmental Organizations(NGOs)  
 Media  
 Others \_\_\_\_\_

**C. Additional Information**

19. Please indicate your position within the company  
 CEO  
 General Manager (Regional/Branch)  
 Administrator/Secretary  
 Public Relations Officer  
 Others \_\_\_\_\_
20. Number of employees in the company.  
 1-50  
 51-100  
 101-500  
 501-1000  
 1001+
21. What type of training do you currently provide for employees?  
 Financial (Accounting etc.)  
 Legal Compliance  
 Customer Service  
 Product Knowledge  
 Management  
 Others \_\_\_\_\_