

# Addressing Market Opportunities and Constraints

Following are excerpts from the paper presented by Prof. Poonam Kumar, Chairperson, Mega Ace Consultancy at the 6<sup>th</sup> International Conference on Corporate Governance on May 13, 2005 organized by the International Centre for Corporate Governance, London held at the London Business School, London UK.

**A**lliances and Collaborations can create economic value in corporations and enhance value of Stakeholders provided there is strategic transformation in the firms within the framework set by corporate governance norms.

**INTRODUCTION:** It is indeed a great privilege to be here amongst all of you to share my thoughts on a subject which is of concern to any individual dealing with business. I would share my views keeping in mind the theme of the seminar 'Making Corporate Governance Decisions That Work'.

When you talk of market opportunities one cannot help reflecting on world economy as globalization has thrown open challenges and growth opportunities not seen before. As the new millennium dawns on us, we welcome it with mixed feelings. Even as an emotion of hope holds us together, a sense of suspicion is enough to keep us apart. We see the world united on one hand and divided on the other. Endeavors in science and technology have brought about radical changes in the way the world interacts and travels. They have made the world a smaller place where by even the remote corner is reachable. However the irony remains. People still find it difficult to connect and arrive at solutions to solve common problems. As the world moves towards globalization, people and policy makers alike continue to seek and identify opportunities available from this global phenomenon to find growth and prosperity.

**WORLD ECONOMY:** There is also however a great concern on the world economy. There is a general belief that unless politicians stop talking and start acting, the world economy is heading for trouble. However, the world as a whole is growing quite robustly, but the aggregate growth rates mask a growing divergence between places that are booming and those that are lagging behind. America and China lead the boomers with India running close. Continental Europe and Japan in contrast are falling even further back.

**GROWTH OPPORTUNITIES:** Having put across some



Prof. Poonam Kumar, with Dr. Ola Ullsten, Former Prime Minister Sweden at the 6th International Conference on Corporate Governance in London

economic trends I would now dwell on factors that would make world economy tick and move forward. It is widely believed that the Asian region, around the beginning of the next decade would become an area of extreme focus. India, China Russia and Brazil would move the world economy by the mid 21<sup>st</sup> century. China and India often referred as Asia's giants account for 38% of world population.

After decades of operating in a closed economy, Indian businesses are starting to spread their wings. Enthusiasm for wealth creation is replacing the long held attitude of suspicions regarding capitalism and free markets post colonial liberalisation. According to Think London, U.K.'s capital inward investment agency, Indian owned businesses now account for 5% of the London economy, employing 49,000 people with an annual turnover of US \$ 14.5b. Last year India was the 7<sup>th</sup> largest inward investor in U.K. In the past 12 months Indian manufacturing and software companies have made acquisitions in South Korea, Singapore, the U.S, Australia, Germany and the U.K. Trade flows are surging and an increasingly confident private sector is earning more money from abroad-India has found its way to play a wider role in the world.

**GLOBAL MARKET PLACE:** It is interesting to note that a high growth rate does not necessarily translate into high returns on investments for investors at large. Economists working with leading investment banks are constantly researching and trying to predict how fast output will grow in the world's leading countries in the hope of estimating future investment returns. Research conducted by Profs Dimson, Marsh and Srauton of the London Business School have found that there is no positive link between a country's gross domestic product growth and future investment returns. The professors looked at 53 different stock markets over periods reaching 105 years. The result of the research showed there was no statistically a link between previous GDP growth and future investment returns that in any of the markets. In a second test, they ranked countries by their GDP growth over 5 years and then studied subsequent returns. Investors would have earned 12% a year by investing in the countries in the lowest growth quintile (bottom 20%) but just 6% in countries with the highest growth. This may explain why the investors are disappointed in emerging economies. The markets have shown attractiveness due to growth forecasts but the investments made in these economies have not resulted in investor profits. The investors have experienced high volatility and low returns. For example, in 2004 China's GDP grew 9.5% but its stock market returned minus 21%. This would give you an idea of the irony that exists in the global markets in terms of opportunities and constraints thereof.


**STOCK MARKETS AND REGULATION:** The attitude of entrepreneurs has changed with them focusing more on

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short-term gains at the expense of long term stability of the company. Entrepreneurs work around building businesses to grow them to a certain level but always seek to have an exit option planned. The well developed capital markets facilitate this. Stock markets are well developed in most of the matured economies with sophisticated instruments used for trading. Even in an emerging economy like India the stock markets are fairly well developed. Screen-based trading is the order of the day which puts all investors irrespective of their locations right across the country, on an equal platform.

Stock exchanges all over are adapting to the changed business environment. There are clauses being adopted in the listing Agreement to comply with provisions to protect interest of minority shareholders. The provisions contained in listing agreement relating to corporate governance are vast and sweeping. There are provisions of executive and non executive directors, composition, constitution and function of audit committees. All provisions aimed at providing transparency and fair business practices. As the governance of corporations is guided by the laws relating to listings, the enforcement of listing requirements by the stock exchanges and the Regulatory Authority in India, SEC in USA, FSA in U.K., ASX in Australia has to be highly effective in the sense that the corporations must not only file report in complying with the laws and regulations, but must also submit the mandatory information required by the regulators.

Corporate governance experts are still trying to determine whether governance reforms, such as increased board independence the Chairman-CEO split, and greater executive accountability have any measurable effect on performance.

According to some investors, companies with good corporate governance practices are already worth more. It is cited that most global investors would pay a premium for companies with good corporate governance practices — an average of 11% more. The reforms that directors and institutional investors believe are most needed are splitting the Chairman and CEO roles, increasing the accountability of directors, and reducing executive compensation.

**COST VERSUS BENEFIT:** One of the controversies in corporate governance is whether the additional cost of complying with stricter reforms provides a benefit to shareholders. For example, some companies are spending thousands of dollars with executive search firms to find qualified independent directors. Many companies are also investing in new technology to meet reporting requirements.

Partly because it is difficult to measure the effect that reforms have on earnings or stock prices, some companies claim that governance regulations harm shareholders by diverting money that could be spent more profitably. But regulators argue that the improvements that will result from good corporate governance outweigh the initial costs of compliance.

The essence of good corporate governance includes safeguarding the interests of stakeholders through transparency, accountability, trustworthiness and responsibility. It is incumbent upon the board of directors of companies to disclose how the principles subscribed to have been applied in practice.

The board must ensure that a sound strategy is in place with adequate instruments to control hazards and to maximize opportunities, in addition to upholding integrity and high ethical values, and monitoring and measuring company performance.

Setting performance targets and crafting effective mechanisms to translate targets into accomplishments are also an integral part of corporate governance. Good corporate governance also calls for good communications for the transmission of reliable, relevant and timely information to investors. Last but not least, corporate governance is also about culture, values and style.

Experience has shown that the impact of corporate failures tends to be extensive affecting the management, shareholders, investing public and the employees with considerable negative externalities or knock-on effects.

**CORPORATE FAILURES:** One of the biggest collapses in corporate history has been that of Enron which has forced a refocused attention on a plethora of core issues such as accountability and corporate governance.

Do issues of corporate failures relate to down turn of the economy, poor quality of management staff, or are there issues of greed by top management, ethical business conduct and lack of corporate governance practices?

**CONCLUSION:** In conclusion globalization has thrown open market opportunities and business can be driven and skills leveraged on scales and levels which would have been hard to imagine till recent past. Size was always regarded as important and crucial for success of any enterprise. Large business entities were envied and related to profitability. Economists argued it was to do with economies of scale. However we have seen huge empires collapse overnight.

Economists and strategists today talk of return on resources deployed as being the most important issue for success of any enterprise. We now talk of co-operations and alliances which can add value to each partner /associate and help give returns to stake holders which could be far more than what each partner could have managed to achieve individually. There is 'Strategic Corporate Transformation' which is taking place with the changing scenario of world economies. Change has been the essence of human evolution. Companies like human being are not isolated from this dynamic process and have undergone transformation. Such transformation tends to be induced and driven by various externalities with corporations facing extinction otherwise. Corporate transformation is directly linked to the complexity that firms of the present and future are going to face in their efforts to create value both for stake holders and for the nation. The corporations of today are no longer sheer economic entities. These are the engines of national transformation. In an age, where capital flows world-wide, a culture of corporate governance has become the need for the future growth and stability of the company as well as the economy. The process of capital allocation has not only increased the long term earnings growth potential of the economy as a whole, but has also widened the degree of uncertainty for individual firms and increasingly growing risks associated with the same.

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