CORPORATE GOVERNANCE IN INDIA: EVOLUTION, CONCERNS AND THE SUBSEQUENT CHALLENGES

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ABSTRACT

Corporate Governance is one of the most enthralling and at the same time perilous areas of study. Every juncture in the blossoming of corporate governance in India came in with its own set of hassles. These stumbling blocks entailed the conceptual and procedural amendments in the corporate governance structure in India. It has been globally recognized that the best rampart against the weak corporate governance practices is the strong board of directors. Therefore it is not sufficient to tackle corporate governance from the perspective of theories, regulations and policies. The perspective of the shareholders, managers, employees, board of directors and all the other stakeholders and the impact they have on the governance practices also needs to be dealt with. Hence the mindful equilibrium between all the concerns, along with the availability of requisite data to the directors, accountability, proficiency and active involvement of the promoters may be of great help in achieving the objective of effective corporate governance implementation in India. The present study gives a rundown of the evolution of Corporate Governance in India. Also it highlights some of the major issues and opportunities in the corporate governance framework in India. The need for an intensive research before framing the corporate governance policies in India is suggested so as to lead to effective framing and enforcement of corporate governance in India.

Keywords: - Corporate Governance, India, evolution, issues, challenges.

I. INTRODUCTION

Corporate governance has beguiled substantial amount of inquisitiveness, dialogue and research globally in the past few decades. Mostly without exception these endeavours gain impetus as an aftermath of some major financial failures and corporate scams as they reveal the infirmity of the corporate governance systems of the country. Corporate governance has capacious consequences apart from the good corporate governance practices leading to financial rectitude. In India also corporate governance has been an issue that has procured considerable heed and has been under perusal ever since.

There hasn’t been any agreement amongst the researchers, policymakers and other active parties to corporate governance on the ways of its incorporation into the policies and procedures of companies. There are different definitions of corporate governance as defined by different people. As stated by Adrian Cadbury (2004) “Corporate governance is concerned with holding the balance between economic and social goals. The governance frame work is there to encourage the efficient use of resources. The aim is to align as nearly as possible the interests of individuals, corporations and society”. Corporate governance is a set of processes and procedures by which a company is governed in order to achieve its long term objective of maximising shareholder value and satisfaction of all the stakeholders- employees, shareholders, customers, government, creditors, suppliers and community at large.

Corporate governance pivots around transparency, accountability and ethical behaviour of the management of the company prioritising the protection of investors. Good corporate governance practices project transparency by maintaining equilibrium between all the active participants namely the board of directors, shareholders and management. In the contradicting dialogue on the effect of corporate governance on the financial performance of the company there are two models namely the shareholder model and the stakeholder model.
Shareholder Model: It is the narrow-gauged approach wherein corporate governance refers to system and structure making the senior management accountable to the shareholders. This approach describes the shareholder’s wealth maximization as the goal of any firm and thereby making it implicit for the directors, executives and the managers to govern and manage the company in a way to achieve the aforesaid objective. This model uses market value of the firm as a performance indicator.

Stakeholder Model: This is a broader approach which considers the important role all the stakeholders play in improving the shareholder value and performance of a company in long term, thereby making firms responsible and accountable to a broader group i.e. the stakeholders along with the shareholders. The firms are to be responsible to all the stakeholders like customers, employees, shareholders, auditors, government, community at large and its environment. This approach work towards making companies “socially responsible” but this requires that the performance of the firms is measures in a much wider perspective involving the market value, employment along with the financial performance. This approach though theoretically ideal it does have a big problem with the application of this framework and ensuring it is inculcated fully by companies in their governance framework.

Therefore the corporate governance practices of majority of the countries focus on the structure of management surmising that it will spontaneously lead to the fulfillment of objectives. Also the environmental reporting and responsibility to other stakeholders haven’t received adequate attention in the recommendations and the suggested regulations.

II. EVOLUTION AND PROGRESSION OF CORPORATE GOVERNANCE IN INDIA

The corporate governance standards have undergone a major metamorphism since independence in 1947. After independence India had an operating stock markets, manufacturing firms, a reasonably functioning banking sector, and a corporate governance framework derived from British practices. However, the period from 1947 through 1991 saw the growth of socialist policies wherein the banks were nationalised and they provided the capital to the non government firms. The performance measure was the capital invested rather than return on investment for these government organisations. Even the equity was issues to public at prices decided by the government.

Since Indian firms had government as the only source of capital. The government went through a fiscal crisis in the year 1991 which led to some of the major financial reforms like liberalisation, privatisation of banks and opening ways to other sources of finance. The Securities and Exchange Board of India (SEBI) was formed in 1992 and the Indian economy was seeing the positive effects by the middle of 1990s.

However the term corporate governance in India was brought to limelight in the wake of numerous scams like Securities scam of 1992, companies fraudulently collecting money from stock market and vanishing in 1993-1994, preferential allotments by the firms to its promoters at highly discounted prices, the East Asian crisis of 1997. They all highlighted the need of corporate governance and better disclosure practices in India.

The scams like Harshad Metha scam, Ketan Parikh scam, UTI scam, the vanishing company scam, the Bhansali scam all entailed an investigation into the establishment and improvement of corporate governance framework in India. The Confederation of Indian Industry (CII) code for Desirable Corporate Governance was amongst the first such measures taken. It was developed by a committee formed in 1996 under the chairmanship of Rahul Bajaj which submitted its code in April 1998. Two more committees were formed by SEBI. The first one was under chairmanship of KumarMangalam Birla and the second under Narayana Murthy. The first committee submitted its report in early 2000, and the second three years later. These two committees have played a very constructively influential role in the establishment of clause 49 of The Listing Agreements by SEBI. Later the Department of Company Affairs and the Ministry of Finance of the Government of India also began cogitating into the subject of Corporate Governance and the amendments needed. A study group was formed to initiate the Birla Committee recommendations in 2000, the Naresh Chandra Committee on Corporate Audit and Governance in 2002, and the expert committee on Corporate Law (The J.J.Irani Committee) in late 2004. All these endeavours were the foundation of new The Companies Act which is the backbone of corporate law in India.
III. VARIOUS COMMITTEES ON CORPORATE GOVERNANCE IN INDIA AND THEIR RECOMMENDATIONS

The major recommendation of the committees that sketched out the Indian corporate governance framework is discussed below.

CII CODE RECOMMENDATIONS (1997)

1. The German style board is not needed.
2. If a listed company has turnover more than Rs. 100 crores and chairman duality is present then fifty percent of the board should be independent else thirty percent.
3. Any person cannot be a director in more than 10 companies
4. The roles and responsibilities of the non executive directors should be clearly defined.
5. The commission paid to directors should not exceed one percent for a company with MD or three percent without MD over the sitting fees.
6. Directors with less than fifty percent attendance cannot be reappointed.
7. The details to be include in the report presented to the board is also included.
8. The listed companies with turnover exceeding Rs. 100 crores or paid-up capital of Rs. 20 crores should have an audit committee with at least three members, all non-executive and proficient. They must assist the board in corporate accounting and reporting.
9. Companies should communicate to their shareholders the monthly averages of their share prices and share performance.
10. The consolidation of group accounts by the firms should be optional taking into account IT’s assessment norms.
11. A compliance certificate from CEOs and CFOs of the companies on the company accounts must be submitted to stock exchanges.
12. The disclosure norms for domestic and foreign creditors are same.
13. The financial institutions should eliminate nominee directors from loan contracts in case of default.
14. The information on multiple credit ratings (if present) should tell about the relative position of the company.
15. No company that defaults on fixed deposits can accept more deposit or declare dividend till rectification of the default is done.

BIRLA COMMITTEE (SEBI) RECOMMENDATIONS (2000)

1. At least half of the members on the board of directors must be non-executive
2. If the chairman of a company is an executive director then fifty percent of the board should be independent otherwise one-third.
3. Any person cannot hold more than 10 directorships or more than five chairmanships.
4. An independent audit committee with minimum of three non executive members, independent chairman and at least one member with sufficient accounting expertise.
5. The chairman of audit committee must attend all meetings which should be more than three.
6. There should be a remuneration committee deciding the compensation for executive directors. It should have a minimum of three non executive directors and an independent chairman.
7. The annual report must contain details on the remuneration of directors
8. Board must meet at least four times a year with a gap of four months.
10. Disclosure of related party transactions
11. The annual report must include Management Discussion & Analysis that discusses the structure of industry and development opportunities, risks etc. along with the financial and operational performance and managerial developments in HR.
12. All potential areas of conflicts should be brought before the management.
13. The quarterly and half yearly financial results should be communicated to shareholders and investors
14. A grievance redressal committee must be formed with a nonexecutive chairman.

The Committee in its report observed that “the strong Corporate Governance is indispensable to resilient and vibrant capital markets and is an important instrument of investor protection. It is the blood that fills the veins of transparent corporate disclosure and high quality accounting practices. It is the muscle that moves a viable and accessible financial reporting structure.”

NARAYANA MURTHY COMMITTEE (SEBI) RECOMMENDATIONS (2003)

1. Board members must be provided proper training.
2. All the directors will be elected by the shareholders and thus an end to nominee directors.
3. The compensation of non executive directors is decided by the board and approved by the shareholders.
4. Quarterly report on the foreseeable risks and their mitigation strategies to be presented to board.
5. All the members of the audit committees should be non executive with at least one with accounting expertise.
6. All related party transactions to be approved by the audit committee
7. Whistle blower policy should be put in place for all employees.
8. Same board rules applicable for subsidiary companies.
9. Minutes of the subsidiary board meetings in the board report of the parent company.
10. The non executive directors should have a performance evaluation done by the fellow board members.
11. The independent and the non executive directors are leaglly responsible for company affairs.
12. The annual report must contain the code of conduct for board members and the statement affirming its compliance.
13. Any variation from the accounting standards must be explained by the management.
14. The practice of unqualified financial statements must be practiced.
15. Certificate from CFOs and CEOs of companies on the financial reports confirming appropriate disclosures.

Narayana Murthy committee reviewed the state of Corporate Governance in India and determined the response of companies to price sensitive information like rumours circulating in the market in order to enhance the transparency and integrity of the market. The Committee in its Report observed that “the effectiveness of a
A system of Corporate Governance cannot be legislated by law, nor can any system of Corporate Governance be static. In a dynamic environment, system of Corporate Governance need to be continually evolved.”

The recommendations of the Committee were the building blocks of the clause 49 of The Listing Agreement by SEBI in the year 2000. The phased application of the corporate governance regulations brought all the listed companies with the paid up capital of Rs 3 crores and above or net worth of Rs 25 crores or more at any time in the history of the company under the policies by March 31, 2003. On the basis of the recommendations by committee and public the clause 49 was amended on August 26, 2003 to upgrade the corporate governance standards in India.

SUMMARY OF CLAUSE 49

1. If the chairman of a company is executive director then fifty percent else thirty three percent of the board must be independent.
2. The nominee directors of financial institutions are considered independent.
3. The board must meet four times a year.
4. Any person can have not more than ten directorships and five chairmanships of committees.
5. The code of conduct of directors must be clearly stated.
6. The audit committee must have at least three non executive members with at least one with accounting expertise. It must meet at least four times a year.
7. The audit committee must review the statutory auditors along with the internal audit procedures.
8. The annual report must contain disclosures on related party transactions, the accounting procedures and the deviations, risk management framework, remuneration of directors, foreseeable risks and their mitigation measures and the corporate governance reports.
9. The annual report must contain the certificate from CFO and CEO confirming compliance with corporate governance and the comprehensive financial statements.
10. The whistle blower policy is optional.
11. There should be training programs for the directors of the company.
12. The performance of the non executive members must be done by fellow board members.

The regulatory framework of corporate governance in India changed positively and significantly with the clause 49 coming into effect in 2005. Moreover, the increasing inflow of foreign investments entails more and more transparency and disclosures for the Indian companies to be at par with their foreign counterparts. Also there were new voluntary guidelines added to the clause 49 in the year 2007 for the state-owned firms focusing on the role of the board of directors and management, audit committee, code of conduct and business ethics etc. However the important challenge of any regulation is the implementation. Though these guidelines seem very efficient yet their effectiveness depends on the level of implementation.

REGULATORY STRUCTURE OF CORPORATE GOVERNANCE IN INDIA

To ensure the implementation of the corporate governance regulations in India, there are the following mechanisms.

1. THE COMPANIES ACT

This is the act regulating the companies in India. This act provides the rights like the voting power, power to elect and remove a director, determine remuneration of directors and be a part of the annual general meeting to the shareholders as a part of its corporate governance implementation endeavours.

2. SEBI ACT
The SEBI Act is a step further towards better disclosures in the company’s documents and annual reports. This act adds to the list of regulated disclosures of The Companies Act so as to ensure better implementation of corporate governance standards and to help achieve the objective of shareholders wealth maximization.

3. RESERVE BANK OF INDIA (RBI)

The RBI, established in 1935, is the central bank of India working towards monetary stability, management and supervision of the financial systems and currency. It functions as the banker to the state and national governments, the lender of last resort and the controller of the country’s money supply and foreign exchange. The RBI supervises the operations of all banks and NBFCs in the country. It frames the monetary policy, decides the interest rates, and manages the foreign exchange reserves.

Apart from the above three mechanisms there are other mechanisms like the impact of capital market, the nominee directors on the boards of companies, statutory auditors, code of conduct and the best corporate governance practices that act as both the monitoring and guiding structures ensuring proper and effective implementation of corporate governance regulations.

CHALLENGES FOR CORPORATE GOVERNANCE

- **Agency Gap**: The agency gap in its textual sense means the difference of interests of the management and the shareholders. In India, however the agency gap is between the majority shareholders and the other stakeholders. This is because of the hold of the controlling shareholders who tend to use the company resources as per their interests.

- **Power of the Boards**: The corporate governance norms focus mainly on the boards, board committees, succession planning and independent directors. But in India in majority of the cases the boards are not empowered enough to make all the required decisions. Rather their decisions are mostly influenced by other parties. Like in public enterprises there are many decisions taken at ministry level thereby involving the political parties and their interests. Similarly the multinational corporations also tend to operate according to the parent company guidelines.

- **Information Processing**: a small shareholder is not able to process all the available information by himself so he tends to go by the judgements of other professional investors.

- **Accounting information**: since financial accounts are generally taken to be a proxy of the performance of directors by the external finance providers. Any error in the accounts will hamper the effectiveness of corporate governance.

Hence it is quite clear that a major concern is the way the companies manage their operations in their political, economic and social environment. As the multinational corporations are setting foot into the country the regulatory bodies have to work more than ever to ensure proper implementation of corporate governance standards. Also the firms have to implement good corporate governance practices in order to create a value in the market for its long term survival. Nevertheless as all the regulatory bodies and the organizations are moving towards better corporate governance structures the corporate governance system in India can clearly be seen becoming better and better.

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