Corporate Governance - Developments and Stumbling Blocks in India

[1]Jyotsna Ghildiyal Bijalwan, [2]Dr Pankaj Shah

[1]Research Scholar Uttarakhand Technical University,Dehradun,India,
Mail-jyotsnaghildiyal@yahoo.com
[2]Prof.Amrapali Institute,Uttarakhand

Abstract- Corporate governance in India can be evident from the Koutaliya's Arthshastra, which maintain that for good governance all administrators including king were considered as servants of the subjects. Good governance and stability goes hand in hand.

The primary objective of this paper is to study the corporate governance policies, practices and system in India. Goodness of corporate governance is checked on the basis of five basic parameters i.e. transparency, ownership structure, board procedure, investor rights and governance strategies.

During the study it was observed that, in India the legislative and regulatory framework for the corporate governance is sound but the implementation part is poor. There is a huge gap between what is de-jure and de-facto.The state is still lagging behind when it comes to particularly private sector small and medium size industries. Major part of industrial set up is just their production units. The government has also set up various committees, passed various regulations for the development of the industries in the country. There is a further need to strengthen the existing governance policies.

Index Terms- Corporate governance, Regulatory frame work, Transparency, Ownership Structure, Board Procedures

I. Introduction

The root of the word corporate governance is from 'gubernate' which means to steer. Corporate governance would mean to steer an organization in the desired direction. Corporate governance is a system by which organization are directed and controlled, it is a process by which company objectives are established, achieved and monitored. So, it is concerned with relationship and responsibilities between the boards, management and stake holders within a legal and regulatory frame work. Corporate governance in India can be evident from the koutaliya's arthshastra, which maintain that for good governance all administrators including king were considered as servants of the subjects. Good governance and stability goes hand in hand.

The primary objective of this paper is to study the corporate governance policies, practices and system in India .Goodness of corporate governance can be checked on the basis of five basic parameters i.e. transparency, ownership structure, board procedure, investor rights and governance strategies. The paper further provides an insight to the concept of corporate governance, gives a brief historical development of corporate governance in India, studies the role of corporate governance in National Development, focuses on the problem areas of corporate governance and suggests the solution to the corporate governance problems of India.

II. CONCEPT OF CORPORATE GOVERNANCE

Many researchers have defined the corporate governance in their different ways as Monks and Minow have defined corporate governance as "Relationships among various participants in determining the direction and performance of a corporation".[1]
The primary participants in a corporation are the tripod of shareholders; management-led by the CEO and the Board of Directors .There are other participants as well such as the employees, customers, suppliers, creditors and the community. Keeping in view the interests of various stakeholders in a company, corporate governance is concerned with effective management of relationships. It requires the formulation of the value framework, the ethical framework and the moral framework which will guide the decision-making process.
According to James D.Wolfensohn, President of World Bank, "Corporate Governance is about promoting corporate fairness, transparency and accountability".

According to Tricker "Corporate Governance is concerned with the way corporate entities are governed, as distinct from the way business within those companies are managed. Corporate Governance addresses the issues facing Board of Directors, such as the interaction with top management and relationships with the owners and others interested in the affairs of the company".
OECD has defined corporate governance as "A system by which business corporations are directed and controlled". Corporate Governance structure specifies the distribution of rights and responsibilities among different participants in the company such as board, management, shareholders and other stakeholders, and spells out the rules and procedures for corporate decision making. By doing this, it provides the structure through which the company's objectives are set along with the means of attaining these objectives as well as for monitoring performance.
Confederation of Indian Industry (CII) – Desirable Corporate Governance Code defined Corporate Governance as follows:

"Corporate Governance deals with laws, procedures, practices and implicit rules that determine a company's ability to take informed managerial decisions vis-a-vis its claimants-in particular, its shareholders, creditors, customers, the State and employees. There is a global consensus about the objective of 'good' corporate governance: maximizing long-term shareholder value."

III. EVIDENCE OF CORPORATE GOVERNANCE FROM THE INDIAN HISTORY

Kautilya's Arthashastra maintains that for good governance, all administrators, including the king were considered servants of the people. Good governance and stability were completely linked. There is stability if leaders arcan e responsive, accountable and removable. These tenets hold good even today.
Kautilya elaborates on the fourfold duty of a king as

- raksha,
- vridhi,
- palana,
- yogakshema.

The substitution of the state with the corporation ,the king with the CEO or the board corporation , and the subjects with the shareholders, bring out the quintessence of corporate governance, because central to the concept of corporate governance is the belief that public should ahead of private good and that the corporation's resources cannot be used for personal benefit.

(i) Raksha - literally means protection, in the corporate scenario it can be equated with the risk management aspect.
(ii) Vriddhi - literally means growth in the present day context can be equated to stakeholder value enhancement.
(iii) Palana - literally means maintenance/ compliance, in the present day context it can be equated to compliance to the law in letter and spirit.
(iv) Yogakshema - literally means well being and in kautilya's Arthashastra it is used in context of a social security system. In the present day context it can be equated to corporate social responsibility.

Arthashastra talks self –discipline for a king and the six enemies which a king should overcome---lust, anger, greed, conceit, arrogance and foolhardiness. In the present day context, this addresses the ethics aspects of businesses and the personal ethics of the corporate leaders.

IV. REVIEW OF THE LITERATURE

Zattoni et,al,(2009) in their study on the group affiliated firms found that the Corporate governance reforms in India has resulted into the diminishing role of the business groups.[2]
Li and Filer (2007) and Li and Nair (2007)in their study found that the Corporate governance environment in India is set in rule based democratic system.[3]

In the India the pre-liberalization era is remarked by the various studies focusing on the Corporate governance problems, but post-liberalization period had witnessed an advent of the new economic reforms and new governance philosophy. In this post-liberalization era corporate governance related issues in India gained momentum. Chhibber and Mazumdar(1999)[4], Sarkar and Sarkar (1999 and 2000) and patibandla (2006)etc have done remarkable study on the corporate governance issues of the India. Gupta (2006) in his study traced the difference in the corporate governance practices of three automobile companies in India named Hero-Honda Ltd, Maruti Udhyog Ltd. and Escorts Ltd . The companies were randomly selected on the basis of their size and goodwill in the market. The study was focused on observing the compliance of the selected sample companies' corporate governance practices with the Clause-49.The results of the study revealed that the Hero-Honda with 90%, Marurti with 80% and Escorts with 70% were in line with the Corporate governance norms as per Clause-49.[5]

The old classical socialistic Indian ideology has reflected in the closed economy of the India during the Pre-Liberalization era, where the government played a dominant role. Huang and Khanna, (2003).[6]

Khanna and Palepu(2000) further propounded that only the large size business houses which were owned by the families performed better as compare to the unaffiliated firms, where as the small and medium size firms which were owned by the families performed worse as compare to the non-affiliated firms.[7]

Further in 1999, the Chhibber and mazumdar in their study based on the finding the relationship between the foreign shareholding and firms performance in the pre and post liberalization era found that in the post liberalization period the foreign ownership had a significant impact over the firms profitability .[8]

In another study conducted by Mazumdar in 1999, he compared the financial performance of the state owned, private owned and mixed state-private ownership firms. He found that the privately owned firms perform better as compare to the state owned firms followed by the mixed state-private ownership firms. The study further reveals that the state owned firms performed the worst.[9]

Similar were the conclusions drawn by some other researchers in their empirical study in the India (Ramaswamy, 2001; Shleifer and Vishny 1997; Shlefer, 1998).

Other studies of the similar time and type have reinforced these findings. (Chibber and mazumdar,1999;douma et.al,2003;Ramaswamy et al.2002).

Kumar (1994) has examined the differences between the domestic and foreign firms in India. He observed that the foreign subsidiaries operating in India were more profitable as compare to the domestic companies. He further observed that foreign firms spent less on the research and development and more on the marketing and sales promotion campaigns as compare to the domestic firms.[10]

V. COMMENTS SIGNIFICANCE OF GOOD CORPORATE GOVERNANCE

Although instituting corporate governance is clearly beneficial for firms and countries, the rapid pace of globalization has made the need urgent. Doing so requires that firms and national governments make some fundamental changes. Companies must change the way they operate, while national governments must establish and maintain the appropriate institutional framework..

Under such conditions business becomes nothing but casino capitalism where investments are simply bets: bets that people will keep their word, bets that the firms are telling the truth, bets that employees will be paid, and bets that debts will be honored. What corporate governance is all about in larger terms is how a structure can be set up that allows for a considerable amount of freedom within the rule of law. Some of the key changes involve adopting international standards of transparency, clarity, and accuracy in financial statements so that investors and creditors can easily compare potential investments.

Good corporate governance reduces the risk, stimulates performance, Improves access to capital market,
Enhances the marketability of goods and services, improves leadership efficacy, and demonstrates transparency and social accountability.

Corporate governance and the national development- The corporate governance has a very important role to play in the national development. Its significance was ignored for many decades. The East-Asian financial crises of 1997-98 drew attention to it and the problems of "crony capitalism" in the growing economies.

Corporate Governance and Productivity growth- Paul krugman predicted in 1994, by comparing East and south East Asia to soviet model that 'it is not impossible for any country to achieve and sustain high rates of output and income growth for a long period of time even for decades by massive mobilization of factors of production. It can be achieved through various kinds of forced savings, significant and sustained investments in the education of the country's population high rates of rural –urban migration, by more involvement of female population into modern manufacturing ,agri-business and service sectors and so on.

Corporate Governance and Cost of capital- Good corporate governance ensures the regular supply of funds to the investors, as the traditional resources are not enough to meet the requirements. The good governance also lowers the costs of financial resources.

VI. CORPORATE GOVERNANCE FAILURE

The dishonest practices of the corporate s resulted into the sudden collapse of the several giant corporate houses around the world such as in 2001 Enron, in 2002 WorldCom (USA) , in 2003 Ahold(Netherlands), in 2003 Parmalat (Italy),Xerox and many more. The virtual collapse of the Russian economy in 1998 resulted in large measure from the weakness of governance mechanisms. The so called managers are said to have robbed share holders, creditors, consumers, the government, workers and all possible stake holders. The consequent distrust predictably resulted in the virtual collapse of external capital to firms, reveals that the corporate bad governance can shake the foundations of a society. Likewise, the Asian financial crisis also demonstrated that even strong economies lacking transparent control, responsible corporate boards and share holder rights can collapse due to dilution of investors' confidence.

India was also not exception to the scenario Harshd Mehta Scam (1992), Ketan Parekh Scam, Stock Market Scam (1996), UTI Scam (2000), Fake Stamp Racket by Abdul Karim Telgi (2004), Satyam Fiasco and many more are in the list.

REASONS FOR CORPORATE GOVERNANCE FAILURE

In terms of corporate governance issues, all suffered from questionable ethics, behavior at the top management, aggressive earnings management, weak internal control, risk management failure, poor accounting and reporting policies and loopholes in the legislative and regulatory frame work in the country. However, the lack of long-term vision is something of a rarity in many companies which further results into such scandals and frauds.

VII. CORPORATE GOVERNANCE DEVELOPMENTS IN INDIA

The initiatives taken by the Government in 1991, aimed at economic liberalization, globalization and privatization of the domestic economy, led India to initiate reform process in order to suitably respond to the developments taking place world over. On account of the interest generated by Cadbury Committee Report, the confederation of Indian Industry (CII), the Associated Chambers of Commerce and industry (ASSOCHAM) and, the Securities and Exchange Board of India (SEBI) constituted Committees to recommend initiatives in Corporate Governance.

CII's Desirable Corporate Governance Code
Confederation of Indian Industry (CII) took a special initiative on Corporate Governance, the first institution initiative in Indian Industry. The objective was to develop and promote a code for Corporate Governance to be adopted and followed by the Indian companies, whether in the Private Sector, the Public Sector, Banks or Financial Institutions, all of which are corporate entities. The final draft of the said Code was widely circulated in 1997.In April 1998, the Code was released. It was called Desirable Corporate Governance Code.

Kumar Mangalam Birla Committee
Following CII's initiative, the Securities and Exchange Board of India (SEBI) set up a committee under the chairmanship of Kumar Mangalam Birla to promote and raise standards of corporate governance. This Report was the formal and comprehensive attempt to evolve a Code of governance in Indian companies, as well as the state of capital markets at that time.
The recommendations of the Kumar Mangalam Birla Committe, led to inculsion of clause 49 in the Listing Agreement in the year 2000.These recommendations aimed at improving the standards of Corporate Governance, are divided into mandatory and non-mandatory recommendations. The said recommendations have been made applicable to all 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. The ultimate responsibility for putting the recommendations into practice lies directly with the Board of Directors and the management of the company.

Naresh Chandra Committee

The Enron debacle of 2001 involving the hand-in-glove relationship between the auditor and the corporate client, the scams involving the fall of the corporate giants in the U.S. like the WorldCom, Qwest, Global Crossing, Xerox and the consequent enactment of the stringent Sarbanes Oxley Act in the U.S were some important factors which led the Indian Government to wake up and in the year 2002,Naresh Chandra Committee was appointed to examine and recommend interalia amendments to the law involving the auditor-client relationships and the role of independent directors.

N.R.Narayana Murthy Committee

In the year 2002, SEBI analyzed the statistics of compliance with the clause 49 by listed companies and felt that there was a need to look beyond the mere systems and procedures if corporate governance was to be made effective in protecting the interest of investors. SEBI therefore constituted a Committee under the Chairmanship of Shri N.R.Narayana Murthy, for reviewing implementation of the corporate governance code by listed companies and issue of revised clause 49 based on its recommendations.

Dr. J j irani Expert Committee on Company Law

In 2004,the Government constituted a committee under the Chairmanship of Dr.J.J.Irani, Director, Tata Sons, with the task of advising the Government on the proposed revisions to the Companies Act,1956 with the objective to have a simplified compact law that would be able to address the changes taking place in the national and international scenario, enable adoption of internationally accepted best practices as well as provide adequate flexibility for timely evolution of new arrangements in response to the requirements of ever-changing business models.

VIII. OBSTACLES IN IMPROVING CORPORATE GOVERNANCE IN INDIA

Shareholding patterns in the countries like United Kingdom and United States of America is scattered in the nature. It is in such a way that no single individual investor can hold above a specific mentioned limit of stocks of a particular company. But the conditions in the rest of world are not the same. Developing countries like India are still suffering from the problems of concentrated ownership, agency problems and expropriation problems. Some of the main reasons behind poorly defined corporate governance in India are.

a) Resistance to change.
b) Distributional Carters.
c) Principal-Agency Problems.
d) Strategic Oligopolistic Rivalry.
e) Poorly defined Corporate Governance Institutions
f) Poor political Governance

SCOPE FOR THE IMPROVEMENT IN CORPORATE GOVERNANCE FRAMEWORK OF INDIA

The whole world is facing the problem of global financial meltdown. Western and European countries are the worst hit by this economic T-sunami. The Indian economy is not that severely affected but this has slowed down the growth rate of the economy. In order to have a sustainable growth and development of the economy, India needs a quick and effective change in its corporate governance framework. Followings are some of the suggestions for improving the corporate governance system of the country.

1) Need for good governance for foreign investments.

The recent trends show a significant flow of Portfolio investment to developing nations, mainly by the financial institutions and the big pension funds ect. It further necessitates the need for improvements in the corporate governance in India.

2) Development of basic financial infrastructure:

A proper attention must be given to strengthen the banking sector and countries financial institutions. Institutions for corporate governance must be fair, transparent and effective in the country.

3) Chairman and CEO: It is considered good practice to separate the roles of the Chairman of the Board and that of the CEO. The Chairman is head of the Board and the CEO heads the management. If the same individual occupies both the positions, there is too much concentration of power, and the possibility of the board supervising the management gets diluted.

4) Internal control system and Audit Committee: Boards work through sub-committees and the audit committee is one of the most important. It not only oversees the work of the auditors but is also expected to independently inquire into the workings of the organization and bring lapse to the attention of the full board. There is a strong need for developing a sound internal control system in India.

5) Independence and conflicts of interest: Good governance requires that outside directors maintain their independence and do not benefit from their board membership other than remuneration. Otherwise, it can create conflicts of interest, by having a majority of outside directors on its Board.

6) Flow of information: A board needs to be provided with important information in a timely manner to enable it to perform its roles. A governance guideline of General Motors, for instance, specifically allows directors to contact individuals in the management if they feel the need to know more about operations than what they are being told.

7) Too many directorships: Being a director of a company takes time and effort. Although a board might meet only four or five times a year, the director needs to have the time to read and reflect over all the material provided and make informed decisions. Good governance, therefore, suggests that an individual sitting on too many boards looks upon it only as a sinecure for he or she will not have the time to do a good job.

8) Good governance parameters: In order to have good corporate governance in the organization the firm must ensure:

- Transparency in the organization
- Sound board structure
- Defined board procedure
- Investor right protection
- & Good governance strategy.

IX. CONCLUSION

In India the legislative and regulatory framework for the corporate governance are sound but the implementation part is poor. There is a huge gap between what is de-jure and de-facto. The state is still lagging behind when it comes to particularly private sector small and medium size industries. Major part of industrial set up is just their production units. The government has also set up various committees, passed various regulations for the development of the industries in the country. There is a further need to strengthen the existing governance policies.

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