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CORPORATE GOVERNANCE IN INDIA – AN OVERVIEW

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ABSTRACT

This paper attempts to highlight the Corporate Governance in India*- An Overview. Corporate Governance is essentially all about how corporations are directed, managed, controlled and held accountable to their shareholders. In India, the concept of corporate governance has come up mainly in the wake of economic liberalization and de-regularization of industry and business.. The objective of any corporate governance system is to simultaneously improve corporate performance and accountability as a means of attracting financial and human resources on the best possible terms and of preventing corporate failure. Corporate Governance is about promoting corporate fairness, transparency and accountability. It is a multi-level and multi tired process that is distilled from an organization's culture, its policies, values and ethics especially of the people running the business and the way it deals with various stakeholders. Thus Corporate Governance is a set of laws, rules, regulations, systems, principles, process by which a company is governed.*

KEY WORDS: ***Corporation, Governance, Accountability, Disclosures, Pillars.***

INTRODCTION:

Corporate Governance entails conducting the affairs of the companies in such a manner that the corporate entity is accountable and fairness would be assured to all the stakeholders. It may be defined as a set of systems, processes and principles which ensure that a company is governed in the best interest of all stakeholders. The elements of good corporate governance include maintenance of transparency, accountability, disclosures, compliance with the legal framework, shareholder's value etc. Corporate Governance is essentially all about how corporations are directed, managed, controlled and held accountable to their shareholders. In India, the concept of corporate governance has come up mainly in the wake of economic liberalization and de-regularization of industry and business. The objective of any corporate governance system is to simultaneously improve corporate performance and accountability as a means of attracting financial and human resources on the best possible terms

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and of preventing corporate failure. With the rapid pace of globalization many companies have been forced to tap international financial markets and consequently to face greater competition than before. Both policy makers and business managers have become increasingly aware of the importance of improved standards of corporate governance. The focus on corporate governance arises out of long dependencies of companies on financial markets as the pre-eminent source of capital. The quality of corporate governance shapes the future and the growth of the capital market. Strong corporate governance is indispensable to rely and vibrant capital market.

CORPORATE GOVERNANCE:

The term "Corporate Governance" is not easy to define. The term 'Corporate Governance' denotes Corporate and Governance. A 'corporation' is an organization incorporated by a group of shareholders who have ownership of the corporation and 'governance' is the act, manner, fact or function of governing the corporate sector. Corporate Governance is about promoting corporate fairness, transparency and accountability.[1] It relates a process of decision making and implementing the decisions in the interest of all stakeholders. It basically relates to enhancement of corporate performance and ensures proper accountability for management in the interest of all stakeholders. It is a system through which an organization is guided and directed. Corporate Governance can also be defined "as the formal system of accountability and control for ethical and socially responsible organizational decisions and use of resources."[2] Corporate Governance is also defined by Business Author[3] as "an internal system encompassing policies, processes and people, which serve the needs of shareholders and other shareholders, by directing and controlling management activities with good business objectivity, accountability and integrity." Hence, Corporate Governance is the set of processes, customs, policies, laws and institutions affecting's the way of a corporation is directed, administered or controlled. Corporate Governance also includes the relationships among many stakeholder involved and the goals for which the corporation is governed. In simpler terms it means the extent to which companies are run in an open and honest manner.

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[1] J. Wolfensohn, President of the World bank- Financial Times, June 21, 1999
[2] The Cadbury Report, 1992
[3] Gabrielle O' Donovan

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Companies around the world are realizing that better corporate governance adds considerable value to their operational performance. Its objectives are as follows-

1. It improves strategic thinking at the top by inducting independent directors who bring a wealth of experience and new ideas.
2. It rationalizes the management and monitoring of risk that a firm faces globally.
3. It limits the liability of top management and directors by carefully articulating the decision making process.
4. It ensures the integrity of financial reports.
5. It has long term reputational effect among key stakeholders, both internally and externally.
6. Reduced risk of corporate crisis and scandals.
7. Higher firm valuation and share performance.
8. Improved company performance and its sustainability.
9. Recognition and preservation of needs of shareholders.
10. Safeguard the integrity of company reporting.
11. Disclosure of all relevant and material matters.

FUNDAMENTAL PILLARS/ ELEMENTS OF CORPORATE GOVERNANCE:

Corporate Governance refers to the manner in which the power of a corporation is exercised in the stewardship of the corporation's total portfolio of assets and resources with the objective of maintaining and increasing shareholder value and satisfaction of other stakeholders in the context of its corporate mission. It is concerned with creating a balance between economic and social goals and between individual and communal goals while encouraging efficient use of resources, accountability in the use of power and stewardship and as far as possible to align the interest of individuals, corporations and society. "Good Governance is not simply about corporate excellence. It is the key to economic and social information. The corporations of today are no longer sheer economic entities. These are the engines of economic and social transformation."

Corporate Governance of an organization is "Internal Governance + External Governance= Appropriate accountability and responsibility to stakeholders."Internal Governance governs the internal control of organization whereas External Governance governs the monitoring system of

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international agencies, national regulatory agencies, professional institutes, industry associations & NGO's.

Fundamental Pillars of Corporate Governance are – Accountability, Transparency, Responsibility, Fairness and Independency. ***Accountability*** – Clarifying governance roles and responsibilities, supporting voluntary efforts to ensure the alignment of managerial and shareholder's interests and monitoring by the board of directors capable of objectivity and sound judgment. ***Transparency*** – Requiring timely disclosure of adequate information concerning corporate financial performance. ***Responsibility*** – Ensuring that corporations comply with relevant laws and regulations that reflect the society's values. ***Fairness*** – Ensuring the protection of shareholders' rights and enforceability of contracts with service/ resource providers. ***Independency*** – Procedures and structures are in place so as to minimize conflicts of interest.

CORPORATE GOVERNANCE IN INDIA:[4]- As mentioned earlier, the term 'Corporate Governance' is related to the extent to which the Companies are transparent and accountable about their business. Corporate Governance today has become a major issue of interest in the most of the Corporate Boardrooms, academic circles and even government around the globe. In the 19th Century, the State Corporation Laws enhanced the rights of Corporate Boards to govern without unanimous consent of shareholders in exchange for statutory like rights, to make Corporate Governance more efficient. In the 20th Century, many scholars such as Adolf Augustus Berle, Edwin Dodd and various others pondered on the changing roles of Modern Corporation in the society.

Liberalization and its associated developments i.e. deregulation, privatization and extensive financial liberalization have made effective Corporate Governance very crucial. Independent and effective Corporate Governance Reforms are necessary in order to restore the credibility of capital market and to facilitate the flow of the investment finance of firms. There are various committees formed with a view to reforming the Corporate Governance in India since 1990. In India however, only when the Securities Exchange Board of India[5], introduced Clause 49 in the listing agreement, for

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[4] Paveen B. Malla, (2010), Corporate Governance: History, Evolution and India Story. New Delhi: Routledge Publication Ltd.
[5] SEBI

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the first time in the financial year 2000-2001, that the listed companies started to embrace to concept of Corporate Governance. This Clause was based on the ***"Kumar Mangalam Birla Committee"***constituted by SEBI.

"Kumar Mangalam Birla Committee" – The main role of the Committee were-

1. To suggest suitable amendments to the listing agreement executed by the stock exchange with the companies and any other measures to improve the standards of Corporate Governance in the listed companies, in areas such as continuous disclosure of material information, both financial and nonfinancial, manner and frequency of such disclosures, responsibilities of independent and outside directors, also to draft a Code of Corporate best practices.
2. To suggest safeguards to be instituted within the companies to deal with insider information and insider trading.

After these recommendations were in place for about four years, SEBI, in order to evaluate and improve the existing practices, set up a Committee under the Chairmanship of Mr. N. R. Narayan Murthy during 2002-2003.

"Narayan Murthy Committee, 2003"– Purpose of the Committee was review of Corporate Governance Code to improve Corporate Governance in India, to evaluate the adequacy of the existing practices, to further improve the existing practices.

The two committees have been instrumental in bringing about far reaching changes in Corporate Governance in India through the formulation of Clause 49 of the listing agreements. At the same time, the Ministry of Corporate Affairs set up Committee under the chairmanship of Shri Naresh Chandra to examine the various Corporate Governance issues. The recommendations of the committee however, faced widespread protests and representations from the industry, forcing SEBI to revise them. Finally, on 29th Oct., 2004, SEBI announced the revised Clause 49, which was implemented by the end of the financial year 2004-2005. Apart from Clause 49 of the listing agreement, Corporate Governance is also regulated through the provisions of the Companies Act by Companies Amendment Act, 2000. Later on in 2004, an expert Committee on Corporate Law was introduced. Basically all these efforts were aimed at reforming the existing Companies Act, 1956 that still forms the backbone of Corporate Law in India.

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Kautilya Arthashastra: History of Corporate Governance cannot be completed without acknowledging the contribution of Kautilya, the most celebrated Scholar of India. Kautilya's discussion on administration and management are strikingly modern and scientific covering almost all the facets of governance. In Arthashastra, Kautilya has provided guidelines for governing the monarchy of Mauryan Empire with special emphasis on maintaining strict public governance. According to him, attainment of Good Governance ensures that the objectives of the state are fulfilled and realizes. It is evident that the state had exercised a strong control over the governance and every activity was monitored and controlled by the administration. Kautilya's view regarding governing a monarchy is equally applicable in successfully running a corporate sector in modern business context. A company following strict governance system in an ethical manner can easily win the confidence of the government, customers, employees and other stakeholders. Basically the lessons' from Kautilya's Arthashastra are relevant even today and can help in achieving the ultimate aim of Corporate Governance.

SCOPE & IMPORTANCE of CORPORATE GOVERNANCE:

The word 'Corporate' is associated by legal enactment for the transaction of a business. Similarly, the word 'Governance' means exercise of Authority, Direction or Control. Thus, the "Concept of Corporate Governance" is the system by which the management of a business entity directs and controls the activities in the best interest of the stakeholder. Corporate Governance refers to the way a corporation is governed. It is a technique by which companies are directed and maintained. It is all about balancing individual and societal goals, as well as, economic and social goals. It includes both social and institutional aspects. Corporate Governance encourages a trustworthy, moral as well as ethical environment. Corporate Governance has competing definitions, but in Margret Blair's estimation encompasses the "Whole set of legal, cultural and institutional arrangement that determine what publicity traded corporations can do, who controls them, how that control is exercised, and how the risks and returns from the activities they undertake are allocated."

As per N.R. Narayana Murthy "Corporate Governance is the acceptance by management of the inalienable rights of the shareholders as the true owners of the corporation and their own role as trustee on behalf of the shareholders. It is about commitment of values, about ethical business

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conduct and about making a distinction between personal and corporate funds in the management of a company."

OECD originally defined Corporate Governance as the system by which business corporations are directed and controlled. The Corporate Governance Structure, the distribution of rights and responsibilities among different participants in the corporation, such as Board, Managers, Shareholders and other Stakeholders and spells out the rules and procedures for making decisions on Corporate Affairs. By doing this, it also provides the structure through which the company objectives are set and the means of attaining those objectives and monitoring performance. The OECD also offer a broader definition as Corporate Governance refers to the private and public institutions, including laws, regulations and accepted business practices, which together govern the relationship in market economy between Corporate Managers and Entrepreneurs (Corporate insiders) on one hand and those who invest resources in Corporations, on the other hand.

Corporate Governance is all about ethics in business. It is about transparency, openness and fair play in aspects of business operations. The Key aspects[6] to Corporate Governance includes –

. ***Accountability*** of Board of Directors and their constituent responsibilities to the ultimate owners – the

Shareholders.

.***Transparency*** i.e. right to information, timeliness and integrity of information produced.

. ***Clarity in responsibilities*** to enhance accountability.

. ***Quality and Competence*** of Directors and their track records.

. ***Checks and balances*** in the process of governance.

. ***Adherences to the rules***, laws and Spirit of Codes.

Good Corporate Governance is integral to the very existence of a company. Good Corporate Governance is important for the following reasons:

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[6] Nerru Vasishth & Namrata Rajput, (2010), Corporate Governance: Values and Ethics with Case Studies. New Delhi: Taxman Allied Services Pvt. Ltd.

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1. Corporate Governance ensures that a properly structured is of the company. Board, capable of taking independent and objective decisions is at the helm of affairs of the company. This lays down the framework for creating long term trust between the company and external providers of Capital.
2. It improves Strategic thinking at the top by inducting independent directors who bring a wealth of experience and a host of new ideas.
3. It rationalizes the management and monitoring of risk that faces globally.
4. Corporate Governance emphasizes the adoption of transparent procedures and practices by the Board, thereby ensuring integrity in financial reports.
5. It limits the liability of top management and directors, by carefully articulating the decision making process.
6. It inspires and strengthens investors' confidence by ensuring that there are adequate number of non-executive and independent directors on the Board, to look after the interests and well being of all the Stakeholders.
7. Corporate Governance helps provide a degree of confidence that is necessary for the proper functioning of a market economy, as it contemplates adherence to ethical business standards.
8. Finally, globalization of the market place has ushered in an Era wherein the quality of Corporate Governance has become a crucial determinant of survival of corporate. Compatibility of Corporate Governance practices with global standards has also become an important Constituent of corporate success.

Thus, good Corporate Governance is a necessary pre-requisite for the success of Indian corporate.

CLAUSE 49 - LISTING AGREEMENT:

After liberalization, serious efforts have been made towards overhauling the system with SEBI formulating Clause 49 of the Listing Agreement. SEBI revised Clause 49 of the listing agreement pertaining to Corporate Governance vide Circular dated October 29th, 2004, which superseded all other earlier circulars issued by SEBI on this subject. The Major Provisions included in Clause 49 are as follows-

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- The Board will lay down a Code Conduct for all Board members and senior management of the company to compulsory follow.
- The CEO will certify the financial statements and cash flow statements of the company.
- While preparing financial statements, if the company follows a treatment that is different from that prescribed in the accounting standards, it must disclose this in the financial statements, and the management should also provide an explanation for doing so in the Corporate Governance Report of the Annual Report.
- The company will have to lay down procedures for informing the board members about the risk management and minimization procedures.
- When money raised through public issue etc. the company will have to disclose the uses/ application of funds according to major categories (Working Capitals, Marketing Costs etc.) as a part of quarterly disclosure of financial statements.
- Further, on an annual basis the company will prepare a statement of funds utilized for purposes other than those specified in the offer document/prospectus and place it before the audit committee. The company will have to publish its criteria for making its non-executive directors in its annual report.

Clause 49 contains both mandatory and non mandatory requirements.

(I) Mandatory Requirements are compulsory which are as follows-

1. **Board of Directors** – The Board of Directors of the company shall have an optimum combination of executive and non executive directors not less than 50% of the BOD comprising of Non Executive Directors. Where the chairman of the Board is non-executive director, at least 1/3 of the Board should comprise of independent directors and in case he is an executive director, at least half of the Board should comprise of independent directors. Non Executive Directors' compensation and disclosures shall be decided by BODs and Shareholder's approval in General Meetings. The Board shall lays down a Code of Conduct for all Board Members and Senior Management of the company.
2. **Audit Committee** – Qualified and independent Audit Committee shall be set up and shall have minimum of three directors as members. Two third of the members of audit committee shall be independent directors. The Audit Committee should meet at least four

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times in a year and not more than four months shall elapse between two meetings. Powers of Audit Committee are to investigate any activity within the term of reference and also to seek information from any employee. Role of Audit Committee is to oversight of the Company's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.

3. **Subsidiary Committees** – At least one independent director on the Board of Director of the Holding Company shall be a director on the Board of Directors of a material Non Listed Indian Subsidiary Company. The Audit Committee of the Listed Holding Company shall also review the financial statements, in particulars, the investment made by the Unlisted Subsidiary Company.
4. **Disclosures** – (a) Basis of related party transactions: A statement in Summary Form of Transactions with related parties shall be placed periodically before the Audit Committee; (b) Disclosure of Accounting Treatment: The financial statements shall be prepared in a prescribed form; (c) Board Disclosure – Risk Management; (d) Proceeds from public, preferential issues; (e) Remuneration of Directors; (f) Management; (g) Shareholders.
5. **CEO/CFO Certification** – Director/Head finance shall submit a Certificate to the Board on the following things – (a) Reviewed financial statements and its contents no untrue or misleading statements; (b) Financial Statements present true and fair view; (c) They accept responsibility for establishing and maintaining internal control for financial report and rectifying deficiencies, if any.
6. **Report on Corporate Governance** – Annual Report should contain a separate section on Corporate Governance with detailed Compliance Report. Quarterly Compliance Certificate should be submitted to Stock Exchange.
7. **Compliance** – A Certificate from either the Auditor or a Practicing Company Secretary on Compliance of conditions of Corporate Governance should form the part of Directors Report.

(II) ***Non-Mandatory Requirements*** refer to those requirement which are not compulsory and can be adopted at the discretion of the company. It includes:

- Regarding the max. Tenure of independent directors.

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- Training of Board Members.
- Evaluation of Mechanism for employees to report unethical behavior to the management.

CONCLUSION:

Corporate Governance is a way of life and not a set of rules, a way of life that necessitates taking into account the Stakeholder's interest in every business decision. AS a part of the process of economic liberalization in India, and move toward further development of India's capital markets, the central government established regulatory control over the stock market through the formation of the SEBI. Originally established as an advisory body in 1988, SEBI was granted the authority to regulate the securities makers under the Securities Exchange Board of India of 1992. Public listed companies in India are governed by a multiple regulatory structure. The Companies Act is administered by the Ministry Corporate Affairs (MCA) and is currently enforced by the Company Law Board i.e. the MCA, SEBI and the stock exchange share jurisdiction over listed companies, with the MCA being the primary government body charged with administering the Companies Act, 1956, while SEBI was served as the Securities Market Regulation since 1992. SEBI service as a market oriented independent entity to regulate the security market akin to the role of the Securities and Exchange Commission in the United States. The stated purpose of the agency is to protect the interests of investors in security and to promote the development of and to regulate the security market. The voluntary guidance on Corporate Governance by MCA is a benchmark for the Corporate Governance Practices in the Indian Corporations, and hopefully the Corporate World will make the best use of it. Efforts are also made by the legislature having introduced the Companies Act, 2013 enshrined with provisions specifically related to Corporate Governance. With growing awareness, there has been shift in company packing order, with young companies managed by modern, outward oriented professionals who place a great deal of value on Corporate Governance. While Corporate Governance has been slow in making its marks in India, but with time passing Corporate Governance has become a major element of Corporate World.

Indeed, Corporate Governance reforms in India now stands at an interesting crossroads and the future development of the next generation reforms and in their implementation during the current decade, will decide how effective they are for Indian Business.