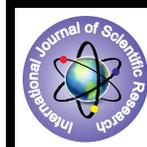


Corporate Governance: Major Issue



Management

KEYWORDS:

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ABSTRACT

Corporate governance is a term that refers broadly to the rules, processes, or laws by which businesses are operated, regulated, and controlled. The term can refer to internal factors defined by the officers, stockholders or constitution of a corporation, as well as to external forces such as consumer groups, clients, and government regulations.

The corporate governance system resembled the bank-based German model where these institutions could have played a big role in keeping their clients on the right track.

Corporate governance is a system of structuring, operating and controlling a company with a view to achieve long term strategic goals to satisfy shareholders, creditors, employees, customers and suppliers, and complying with the legal and regulatory requirements, apart from meeting environmental and local community needs.

Corporate governance is the set of processes, customs, policies, laws, and institutions affecting the way a corporation is directed, administered or controlled. Corporate governance also includes the relationships among the many stakeholders involved and the goals for which the corporation is governed. The principal stakeholders are the shareholders/members, management, and the board of directors. Other stakeholders include labour (employees), customers, creditors (e.g., banks, bond holders), suppliers, regulators, and the community at large. For Not-For-Profit Corporations or other membership Organizations the "shareholders" means "members".

In recent years, corporate governance has received increased attention because of high-profile scandals, like Satyam scandals, involving abuse of corporate power and, in some cases, alleged criminal activity by corporate officers.

Corporate Governance Norms

Corporate governance are the policies, procedures and rules governing the relationships between the shareholders, (stakeholders), directors and managers in a company, as defined by the applicable laws, the corporate charter, the company's by-laws, and formal policies.

Corporate Governance in India – A Background

The history of the development of Indian corporate laws has been marked by interesting contrasts. At independence, India inherited one of the world's poorest economies but with four functioning stock markets (predating the Tokyo Stock Exchange) with clearly defined rules- governing listing, trading and settlements; a well-developed equity culture if only among the urban rich; and a banking system replete with well-developed lending norms and recovery procedures. In terms of corporate laws and financial system, therefore, India emerged far better endowed than most other colonies. The 1956 Companies Act as well as other laws governing the functioning of joint-stock companies and protecting the investors' rights built on this foundation.

The turn towards socialism in the decades after independence marked by the 1951 Industries (Development and Regulation) Act as well as the 1956 Industrial Policy Resolution put in place a regime and culture of licensing, protection and widespread red-tape that bred corruption and stilted the growth of the corporate sector. The situation grew from bad to worse in the following decades and corruption, nepotism and inefficiency became the hallmarks of the Indian corporate sector. Exorbitant

tax rates encouraged creative accounting practices and complicated emolument structures to beat the system.

In the absence of a developed stock market, the three all-India development finance institutions (DFIs) – the Industrial Finance Corporation of India, the Industrial Development Bank of India and the Industrial Credit and Investment Corporation of India together with the state financial corporations became the main providers of long-term credit to companies. Along with the government owned mutual fund, the Unit Trust of India, they also held large blocks of shares in the companies they lent to and invariably had representations in their boards. In this respect, the corporate governance system resembled the bank-based German model where these institutions could have played a big role in keeping their clients on the right track. Unfortunately, they were themselves evaluated on the quantity rather than quality of their lending and thus had little incentive for either proper credit appraisal or effective follow-up and monitoring. This stage would come after the company has defaulted on its loan obligations for a while, but this would be the stage where India's bankruptcy reorganization system driven by the 1985 Sick Industrial Companies Act (SICA) would consider it "sick" and refer it to the Board for Industrial and Financial Reconstruction (BIFR). As soon as a company is registered with the BIFR it wins immediate protection from the creditors' claims for at least four years. Between 1987 and 1992 BIFR took well over two years on an average to reach a decision, after which period the delay has roughly doubled. Very few companies have emerged successfully from the BIFR and even for those that needed to be liquidated, the legal process takes over 10 years on average, by which time the assets of the company are practically worthless. Protection of creditors' rights has therefore existed only on paper in India. Financial disclosure norms in India have traditionally been superior to most Asian countries though fell short of those in the USA and other advanced countries. Noncompliance with disclosure norms and even the failure of auditor's reports to confirm to the law attract nominal fines with hardly any punitive action. The Institute of Chartered Accountants in India has not been known to take action against erring auditors. Sometimes non-voting preferential shares have been used by promoters to channel funds and deprive minority shareholders of their dues.

All in all therefore, minority shareholders and creditors in India remained effectively unprotected in spite of a plethora of laws in the books.

- The Indian corporate scenario was more or less stagnant till the early 90s.
- The position and goals of the Indian corporate sector has changed a lot after the liberalization of 90s.
- India's economic reform programme made a steady progress in 1994.
- India with its 20 million shareholders is one of the largest

emerging markets in terms of the market capitalization.

Corporate governance of India has undergone a paradigm shift

- In 1996, Confederation of Indian Industry (CII) took a special initiative on Corporate Governance.
- The objective was to develop and promote a code for corporate governance to be adopted and followed by Indian companies, be these in the Private Sector, the Public Sector, Banks or Financial Institutions, all of which are corporate entities.
- This initiative by CII regarding the protection of investor interest, especially the small investor, the promotion of transparency within business and industry.

Impact of Corporate Governance

The positive effect of corporate governance on different stakeholders ultimately strengthened the economy, and hence good corporate governance is a tool for socio-economic development.

Principles

Key elements of good corporate governance principles include honesty, trust and integrity, openness, performance orientation, responsibility and accountability, mutual respect, and commitment to the organization.

Commonly accepted principles of corporate governance include:

1. Rights and equitable treatment of shareholders
2. Interests of other stakeholders
3. Role and responsibilities of the board
4. Integrity and ethical behaviour
5. Disclosure and transparency

Issues involving corporate governance principles include:

1. Internal controls and internal auditors
2. The independence of the entity's external auditors and the quality of their audits
3. Oversight and management of risk
4. Oversight of the preparation of the entity's financial statements
5. Review of the compensation arrangements for the chief executive officer and other senior executives
6. The resources made available to directors in carrying out their duties
7. The way in which individuals are nominated for positions on the board
8. Dividend policy

Systemic problems of corporate governance

- Demand for information
- Monitoring costs
- Supply of accounting information

The National Task Force

A National Task Force was set up with the draft guidelines and the code of Corporate Governance (Desirable Corporate Governance Code) in April 1997 (at the National Conference and Annual Sessions of CII.)

Since 1974, CII has tried to chart new path in terms of the role of an Industry Association such as itself. It has gone beyond dealing with the traditional work of interacting with Government of policies and procedures, which impact on industry.

CII has taken initiative in Quality, Environment, Energy, Trade Fairs, Social Development, International Partnership Building etc. as part of its process of development and expanding contribution to issues of relevance and concern to industry.

Securities and Exchange Board of India

The Government of India's securities watchdog, the Securities and Exchange Board of India, announced strict corporate governance norms for publicly listed companies in India.

The Indian Economy was liberalized in 1991. In order to achieve the full potential of liberalization and enable the Indian Stock Market to attract huge investments from foreign institutional investors (FIIs), it was necessary to introduce a series of stock market reforms.

On April 12, 1988, the Securities and Exchange Board of India (SEBI) was established with a dual objective of protecting the rights of small investors and regulating and developing the stock markets in India. In 1992, the Bombay Stock Exchange (BSE), the leading stock exchange in India, witnessed the first major scam masterminded by Harshad Mehta. Analysts unanimously felt that if more powers had been given to SEBI, the scam would not have happened. As a result the Government of India (GoI) brought in a separate legislation by the name of 'SEBI Act 1992' and conferred statutory powers to it.

Since then, SEBI had introduced several stock market reforms. These reforms significantly transformed the face of Indian Stock Markets.

The major changes to SEBI and Clause 49

1. Independent Directors - 1/3 to 1/2, depending whether the chairman of the board is a non-executive or executive position.
2. Non-Executive Directors - The total term of office of non-executive directors is now limited to three terms of three years each.
3. Board of Directors - The board is required to frame a code of conduct for all board members and senior management and each of them have to annually affirm compliance with the code.
4. Audit Committee - Financial statements and the draft audit report /reports of management discussion and analysis of financial condition and result of operations/reports of compliance with laws and risk management/management letters and letters of weaknesses in internal controls issued by statutory and internal auditors/appointment, removal and terms of remuneration of the chief internal auditor.
5. Whistleblower Policy - This policy has to be communicated to all employees and whistleblowers should be protected from unfair treatment and termination.
6. Subsidiary Companies - 50% non-executive directors & 1/3 & 1/2, independent directors depending on whether the chairman is non-executive or executive.
7. Disclosures - Contingent liabilities/ Basis of related party transactions /Risk management, Proceeds from initial public offering/ Remuneration of directors.
8. Certifications - Certification is reviewed the necessary financial statements and directors' report; established and maintained internal controls, disclosed to the auditors and informed the auditors and audit committee of any significant changes in internal control and/or of accounting policies during the year.

Clause 49 amended

The Clause 49 of the Listing agreement of SEBI Act is the outcome of Narayana Murthy Committee, which has come into effect January 1st 2006.

Amended Clause 49 of the Listing Agreement.

Aid to Corporate Governance

- Control Environment
- Risk Assessment and Management

Conclusion

As Indian companies compete globally for access to capital markets, many are finding that the ability to benchmark against world-class organizations is essential. For a long time, India was a managed, protected economy with the corporate sector operating in an insulated fashion. But as restrictions have eased, Indian corporations are emerging on the world stage and discovering that the old ways of doing business are no longer sufficient in such a fast-paced global environment.

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