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Corporate Governance in India: Implementation Challenges

Abstract

This paper aims at reviewing the development of Corporate Governance in India. The advent of new technologies in the era of globalisation and liberalisation has thoroughly changed the nature of all the business activities. With the concept of business life cycles, the business transactions have become relatively complex and managing risk too has become a challenging task for the businesses. The need of corporate governance in India was first felt after Harshad Mehta's stock market scam in 1992 followed by many other incidents of companies giving preferential shares to their promoters at unreasonably discounted prices and the infamous scam of Sathyam and latest PNB Scam in 2018. Good corporate governance has become a buzzword to handle accounting scandals and to address the growing concern about the quality of financial reports and statements. Hence, in short, Corporate Governance is all about ensuring corporate fairness, transparency and accountability. It is a practice to prevent corporate failure and to enhance corporate performance and accountability as a means of attracting financial as well as human resources on the best possible terms.

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Keywords: Corporate Governance, Globalization, Liberalization, Corporate Responsibility, Transparency, Accountability, Corporate Fairness, Corporate Governance.

Introduction

Governance means the process of making decisions and process of implementing these decisions. Governance can be used in diverse scenarios such as corporate governance, international governance, national governance and local governance. This is participatory, consensus oriented, accountable, transparent, responsive, effective and efficient, equitable and inclusive in nature and follows the rule of law. It assures minimized corruption while taking into account the views of minorities and that the voices of the most vulnerable in society are heard in decision-making. It takes care of the present and future needs of society.

Corporate Governance is essentially all about regulating the way corporations are directed, managed, controlled and held accountable to their shareholders. In India, the concept of Corporate Governance has come up mainly as an outcome of economic liberalization. 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 got increasingly aware of the importance of improved standards of Corporate Governance. India has best in class corporate governance policies but poor implementation together with socialistic policies of the pre-reform era; this has adversely affected corporate governance. Concentrated ownership of shares, pyramiding and tunnelling of funds among group companies are hallmark of the Indian corporate landscape.

Corporate governance refers to the set of policies, principles and processes by which a company is directed and controlled in such a way that it must achieve the company's objectives and further add to the value of the company to benefit all the stakeholders in the long term. The stakeholders, in this case, would include everyone ranging from the board of directors, management, shareholders to customers, employees and society. The management of the company hence assumes the role of a trustee for all the others. The main theme of corporate governance is a multi faceted subject and one of the important aims is to ensure the accountability of certain individuals in an organization through the elimination of principal-agent problem. The other important theme is strong emphasis on shareholders welfare.

Objectives of the Study

1. To know the evolution of corporate governance.
2. To review the Issues and Challenges for Corporate Governance in India.
3. To analyse regulatory deficiencies in corporate governance.

Research Methodology

Considering the requirements of the objectives of the study, the research design employed for the study is of descriptive type. Keeping in view the set objectives, this research design was adopted to have greater accuracy and in depth analysis of the research study. The available secondary data, referred from different News Articles, Books and Websites, has been extensively used for the study.

Review of Literature

K. M. (2017), The purpose of the paper was to analyze the legal provisions relating to the protection extended to the private employees who blows the whistle. The research has been done from primary and secondary data where researcher has read the whistle blowers Protection act, 2011, official secrets act 1923, Right to information act 2005 etc. He has found that this Acts provides a mechanism to receive complaints and inquire into allegations of corruptions or misuse of power by the public servant only. The need of exhaustive and complete law is also necessary so that the evils like corruption can curbed completely and effectively.

Qazi. M. (2017), Researcher has found that the transparent and effective corporate governance has played by SEBI. It to improve the transparency and integrity of the Market it has constituted several committees. Major amendments are made under the listing Agreement clause 49 that includes Shareholder right, provisions regarding independent Directors, related party transactions, Disclosure and transparency. He found that India has a really best law but the problem is that how the corporate is going to monitor and implement these new laws to improve the Corporate Governance.

Lisma L et al (2017), Researchers have examined that the basic concepts of transparency were an attitude or action of the company to disclose entire business and information material about the effects that can affect the decisions of investors or other stakeholders. They proved that information disclosure is determined by 3 (three) factors: clear, accurate, and timely. In applying the principles of transparency, the board of directors is responsible for providing information to stakeholders both internal and external. The application of the principle of transparency in the limited company shows that the level of transparency tends to be higher in term of nonfinancial information, but instead tend to be closed when it comes to financial information, particularly on the closed company or not a public company.

Ravi S. P. (2016), It is a case of collective failure of the system in India. Ruling party and opposition parties played a blame game. Appointments of CEOs were done through political involvement. Bank has not made the official complaint. The author has provided the solution of this problem in India by providing teeth to the watch dog organizations like SEBI, grant more powers to investigating agencies like CBI, ensuring more accountability from public banks, strengthen the other supervisor institutions and decongest courts and bringing culprit to swift justice. The corporation must be made to follow the corporate governance practices both in letter and spirit is suggested by him.

Rupali, M (2015), The Public Sector Undertakings counted very poorly on Corporate Governance and compulsory by the government. The state-owned Companies has violated rules related to boards Independence, nominations, Corporate Social Responsibility Committees, appointment of Auditor and Women Director on the board. According to Stakeholders Empowerment Services (SES) studied the top 27 Public Sector Undertakings the research says that 25 do not meet the criteria for Independence of the board, while nearly 25% do not have a women Director, almost 50% failed to create a compliant CSR Committee, 80% do not have compliant committee and Nomination and remuneration Committee.

Gopal, K (2013), Researchers have investigated that good corporate governance depends upon the effective board, the independent auditors, role of professionals and the effective legislation. According to them to improve corporate governance certain issues need to solve. These issues are effectiveness of board, the auditor, role of professionals and the legislation.

Meenu, (2012), The researcher has investigated Corporate governance is proving a very efficient and effective system for Indian economy and it saves the interest of shareholders but he has observed that some more efficient monitoring and transparent internal audit system, efficient board and management can lead it to effective corporate governance.

Rujitha T R (2012), Researcher has found that the objective of the audit committee has to be continued to include mistake of risk management control systems to create an environment for the obedience to the practices of good corporate governance. Since audit committee plays very important role in the corporate governance so continuous monitoring is required. The role of audit committee gains more prominence as there is a growing concern about the quality of financial statements for the protection of stake holders interest. To ensure the effective implementation and compliance of standards of corporate governance by SEBI rules and regulations is a need of an hour at the ground level.

Dharmapala and Khanna (2011), carried out an important empirical study of over 4000 firms for the period 1998-2006 and recognized the importance of enforcement in corporate governance reforms and studied the effect of introduction of section 23E to the securities contracts (regulation) Act,1956 in 2004, which imposed large penalties of Rs 25 Crore for non-compliance with the listing Agreement (that also includes clause 49) containing the corporate governance norms, this study revealed a “large and

statistically significant positive effect of the clause 49 reforms in combination with the 2004 sanctions.

(Singh. 2010), The researcher has found out that there are sufficient rules and regulations in the law but there is a problem of implementation of those rules and regulations, Researcher has also suggested that there should be a continuous review of an independent regulator, He has also noticed that the auditor and audit committee should work hand on hand to enhance the consistency factor of accounting documents. He has also examined that the Satyam was just a loophole rather than the rule.

Evolution of Corporate Governance in India

The concept of good governance is not new in India and it dates back to third century B.C. where Chanakya (Vazir of Patliputra) elaborated fourfold duties of a king viz. Raksha, Vriddhi, Palana and Yogakshema. In today's corporate world, replacing the king of the state with Company CEOs or Board of Directors, the principles of Corporate Governance refers to protecting shareholders wealth (Raksha), enhancing the wealth by smart utilization of assets (Vriddhi), maintenance of wealth through profitable ventures (Palana) and on top of all safeguarding the interests of the shareholders (Yogakshema or safeguard). Until early 1990s, corporate governance was not a consideration for Indian Companies and no one would find much reference to this subject in book of law till then. In India, weakness in the system such as undesirable stock market practices, boards of directors without adequate fiduciary responsibilities, poor disclosure practices, lack of transparency and chronic capitalism were all crying for reforms and improved governance. The fiscal crisis of 1991 and resulting need to approach the IMF induced the Government to adopt reformative actions for economic stabilization through liberalization. The corporate governance gathered the momentum albeit slowly once the economy was pushed open and the liberalization process got initiated in early 1990s. As a part of liberalization process, in 1999 the Government amended the Companies Act, 1956. Further amendments have followed subsequently in the year 2000, 2002 and 2003.The major corporate governance initiatives have been launched in India since the mid 1990s.There are various reforms which were channelled through a number of different paths with both the Security and Exchange Board of India (SEBI) and the Ministry of Corporate Affairs, Government of India (MCA) playing important roles.

Committees on Corporate Governance Reforms

Some of the recommendations of various National Committees on corporate governance in India since 1990s are:

Confederation of Indian Industries (CII)

The Confederation of Indian Industries set up a taskforce in 1995 under the leadership of Rahul Bajaj, a reputed industrialist. In April 1998, the CII released the code called "Desirable Corporate Governance". It examined various aspects of Corporate Governance and was first to condemn nominee directors and suggested dilution of government stake in companies.

Kumar Mangalam Birla Committee Report

While the CII code was well received by corporate sector and some progressive companies also adopted it, it was felt that under Indian conditions a statutory rather than a voluntary code would be more meaningful. Consequently, the second major initiative was undertaken by the Securities and Exchange Board of India (SEBI) which set up a committee under the chairmanship of Kumar Mangalam Birla in 1999 with the objective of promoting and raising standards of good corporate governance. In early 2000, the SEBI Board approved the key recommendations of this committee and these were incorporated into Clause – 49 of the Listing Agreement of the Stock Exchanges.

Department of Corporate Affairs (DCA)

In May 2000, the Department of Corporate Affairs (DCA) constituted a broad based study group with Dr. P.L. Sanjeev Reddy, Secretary of DCA as its chairman. The job of the group was to "operationalise the concept of corporate excellence on a sustained basis" so as to "sharpen India's global competitive edge and to further develop corporate culture in the country". In November 2000, the Task Force of the group released a report of recommendations for raising governance standards in all companies of India.

Naresh Chandra Committee Report

A committee was formed by Ministry of Finance and Company Affairs in August 2002 with Naresh Chandra as its chairperson to review and recommend inter alia amendments to the law involving the auditor-client relationships and the role of independent directors. The committee, in its recommendations, covered two key disclosures of corporate governance: financial and non-financial. Also, the committee recommended independent auditing and board oversight of management.

Narayana Murthy Committee Report in 2002

The SEBI constituted a committee under the chairmanship of Narayana Murthy for reviewing implementation of the corporate governance code by listed companies and issue of revised clause 49. Some of the main proposals of the committee were about audit and audit reports, independent directors, party transactions, risk management, directorships and director compensation, codes of conduct and financial disclosures.

Clause 49 of the Listing Agreement

After liberalization, some desperate efforts were made to overhaul the system. As a result, SEBI formulated the Clause 49 of the Listing of Agreements dealing with corporate governance. The Agreement to the Indian stock exchange was implemented from 31 December 2005. It includes the following key requirements:

1. Board Independence: Boards of directors of listed companies need to have a minimum number of independent directors.
2. Audit Committees: Listed companies must have audit committees of the board with at least three directors; two-thirds of them must be independent.

3. Disclosure: Listed companies must make necessary disclosures regarding financial and other matters to ensure transparency.

J. J. Irani Committee Report

The Companies Act 1956 was enacted on the recommendations of the Bhaba Committee set up in 1950 with the objective to consolidate the existing corporate laws and to provide a new basis for corporate operation in independent India. With the enactment of this legislation in 1956 the Companies Act 1913 was repealed. The need of streamlining this Act was felt from time to time as the corporate sector developed in pace with the Indian economy and as many as 24 amendments have taken place since 1956. The major amendments to the Act were affected through Companies (Amendment) Act 1998 after referring the Sachar Committee recommendations followed by further amendments in 1999, 2000, 2002 and finally in 2003 through the Companies (Amendment) Bill 2003 pursuant R.D. Joshi Committee report. After a shaky beginning in 1980, India took up its economic reforms programme in 1990s and a need was felt for a thorough review of the Companies Act 1956. The Government therefore took a fresh initiative in this regard and constituted a committee in December 2004 under the chairmanship of Dr. J.J. Irani with the task of advising the government on the suggested revisions to the Companies Act 1956.

Central Coordination and Monitoring Committee

A Central Coordination and Monitoring Committee (CCMC) co-chaired by Secretary, Department of Corporate Affairs and Chairman, SEBI was set up by the Department of Corporate Affairs for monitoring the actions taken against the vanishing companies and dishonest promoters who misused the funds raised from the public. It was decided by this committee that seven Task Forces be set up at Mumbai, Delhi, Chennai, Kolkata, Ahmedabad, Bangalore and Hyderabad.

National Foundation of Corporate Governance

Recently the Ministry of Company Affairs has set up NFCG, The National Foundation for Corporate Governance in collaboration with Confederation of Indian Industry (CII), Institute of Company Secretaries of India (ICSI) and Institute of Chartered Accountants of India (ICAI).

Voluntary Guidelines Issued by Ministry of Corporate Affairs

Ministry of Corporate Affairs issued Voluntary Guidelines on Corporate Governance in December 2009. Some of these guidelines are worth discussing.

1. There need to be separate offices for chairman of the board and chief executive officer.
2. The companies may have a Nomination Committee comprising majority of Independent Directors, including its Chairman.
3. Independent Directors should not be paid in terms of stock options or profit-based commission.
4. The Board should arrange for the necessary training to the directors.
5. The Audit Committee should have minimum of three members, with Independent Directors in the majority and an Independent Director as the chairperson.
6. The tenure of audit partner should be rotated every three years; the firm should also be rotated after every five years.
7. The Committee may appoint an internal auditor.

Establishment of the NSE Centre for Excellence in Corporate Governance

To encourage best standards of corporate governance among the Indian corporates and to keep them abreast of the emerging and existing issues, the NSE set up in December, 2012, a Centre for Excellence in Corporate Governance (NSE CECG). This is an independent expert advisory body comprising eminent domain experts, academics and practitioners.

Corporate Governance Provisions in the Companies Act, 2013

The enactment of the companies Act 2013 was major development in corporate governance in 2013. The new Act replaces the Companies Act - 1956 and aims to improve corporate governance standards, simplify regulations and enhance the interests of minority shareholders.

1. Board of Directors (Clause 166): The new Act provides that the company can have a maximum of 15 directors on the Board;
2. Independent Director (Clause 149): The concept of independent directors (IDs) has been introduced for the first time in the Company Law in India.
3. Related Party Transactions (RPT) (Clause 188): The new Act requires that no company should enter into RPT contracts pertaining to sale, purchase or supply of any goods or materials
4. Corporate Social Responsibility (CSR) (Clause 135): The new Act has mandated the profit making companies to spend on CSR related activities
5. Auditors (Clause 139): A listed company cannot appoint or reappoint (a) an individual as auditor for more than one term of five consecutive years,
6. Disclosure and Reporting (Clause 92): In the new Act, there is significant transformation in non-financial annual disclosures and reporting by companies as compared to the earlier format in the Companies Act, 1956.
7. Class action suits (Clause 245): For the first time, a provision has been made for class action under which the order passed by the Tribunal shall be binding on all the stakeholders including the company and all its members, depositors and auditors.

Issues and Challenges in Implementing Corporate Governance in India

Bypassing Shareholders' Interests

The bad corporate governance has resulted in problems like Non Performing Assets (NPAs) and Bad Debts, which has adversely affected the corporate sector. There has been a practice of making expensive acquisitions in the last decade by companies without a proper approval of the

shareholders. As a result, only a few of them paid off for the shareholders.

Board Composition

The Companies Act, 2013 laid several good corporate governance provisions like one-third of the company board should be Independent Directors, the board should also have at least one Woman Director, a constitution of Audit Committee for the board etc. However, many companies are still carrying on without woman directors in their boards while some of them have just named the female family members or friends of promoters as directors.

Role of Independent Directors

Independent Directors were expected to further enhance the accountability of the board to the shareholders. As part of the Audit Committees, they were supposed to ensure the financial disclosure process as per the law. However, it was observed that they could not make a mark on company boards. Many of them failed to stand up against promoters' decisions which were not in the interest of all the stakeholders. The main reason affecting their independence was the process of their removal from board - they could be easily ousted by the promoters or majority shareholders.

The Conflict between Promoters and Management

Since most of the companies are family based enterprises, the promoters as majority shareholders continue to influence business decisions disproportionately. This often leads to conflicts between the promoters and the management responsible for routine functioning of the company. Recent instances of removing of Tata group chairman by Tata Sons, and the forced exit of the Infosys's CEO, both outcome of differences between the top management and the promoters, have highlighted India's weak corporate governance norms.

Executive Compensation

According to the new Companies Act, the Nomination and Remuneration Committee of the Board (composed mainly of independent directors) is authorised to decide on the compensation to employees for key roles. This needs to be approved by the shareholders. However, the top employees are paid exorbitant remuneration in many instances where they have a significant say to the promoters as quid pro quo. On the other hand, many small companies cannot afford to offer competitive remuneration to attract talented professionals. Sometimes, unaffordable remuneration to the top employees becomes an issue of conflict between promoters and management, as happened in the case of Infosys.

Suggestions

Rights for Shareholders

The organizations should show proper respect to the rights of shareholders and support them to exercise these rights. The shareholders must be given information that is understandable and accessible to them and they should be encouraged to participate in general meetings.

Guarding Interests of Other Stakeholders

Organizations should recognize that they have legal and other obligations to all legitimate stakeholders.

Role of the Board

The board needs to be capable of understanding and dealing with various business issues and should have the ability to review and challenge management performance.

Board Composition

It is suggested that the good corporate governance provisions like one-third of the company board should be Independent Directors, the board should also have at least one Woman Director, a constitution of Audit Committee for the board etc. must be implemented effectively.

Integrity and Ethical Behaviour

Ethical and responsible decision making is not only important for dealing the outside parties that is necessary for risk management and avoiding lawsuits. The organizations that promote ethical and responsible decision making should have a code of conduct for their directors and executives.

Disclosure and Transparency

Organizations should disclose the roles and responsibilities of board and management to run the company for shareholders with a level of accountability. They should also lay down procedures to independently cross verify and safeguard the integrity of the company's financial reporting.

Conclusion

The concept of corporate governance is a medium to ensure total transparency, integrity and accountability of the management and the board of directors in a company. Corporate Governance norms are primarily needed to ensure that a company is run in the interest of all its stakeholders rather than only for the promoters and the management. Moreover, a company with good corporate governance standards enjoys increased confidence of investor, adding value to its share price in the stock markets. Foreign Institutional/Portfolio Investors (FII/FPI) prefer investing in companies having good corporate governance.

Most of the private and public sector organizations, dealing with finance, taxation, banking, legal framework, etc., are now resorting to Corporate Governance in order to achieve Corporate Excellence. Good Corporate Governance standards are essential to ensure significant value enhancement to all the stakeholders of a company, including the minority shareholders, the government and the economy. India has always stood upright protecting the interests of minority shareholders and this has been attributed to positive corporate governance norms put in place by the government and SEBI. Though, so much has been done at this front, but there is a lot of scope for further improvements in Indian Corporate System to fully implement and best utilize the Corporate Governance.

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