

## A Study on Corporate Governance in India

Rajnish Kumar Lohani<sup>1</sup>, Durga Prasad Rath<sup>2</sup>

<sup>1</sup>(Department Of Basic Science & Humanities, Gandhi Engineering College, India)

<sup>2</sup>(Department of Basic Science & Humanities, Gandhi Institute For Technology, India)

---

**Abstract: Background:** The foundation of the word corporate administration is from 'gubernate' which intends to direct. Corporate administration would intend to control an association in the ideal course. Corporate administration is a framework by which association are coordinated and controlled, it is a procedure by which organization targets are built up, accomplished and observed. In this way, it is worried about relationship and obligations between the sheets, the executives and partners inside a lawful and administrative casing work. The essential goal of this paper is to consider the corporate administration arrangements and practices and framework in India. Goodness of corporate administration is kept an eye based on five fundamental parameters for example straightforwardness, possession structure, board technique, financial specialist rights and administration systems. During the investigation it was seen that, in India the authoritative and administrative system for the corporate administration is sound however the usage part is poor. There is a colossal hole between what is by law and de-facto. The state is as yet falling behind with regards to especially private part little and medium size enterprises. Significant piece of modern set up is only their creation units. The legislature has likewise set up different advisory groups, passed different guidelines for the advancement of the ventures in the nation. There is a further need to reinforce the current administration approaches

**Key Word:** Corporate governance, National Productivity, National growth, Cost of capital.

---

### 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 and 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.

Secondary objectives being

- a) To study the concept of corporate governance
- b) To brief the historical development of corporate governance.
- c) To study the role of corporate governance in National Development.
- d) To study the problem areas of corporate governance.
- e) To suggest the solution to the corporate governance problems.

### Concept of Corporate Governance

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. The responsibility to steer lies with the board of directors/governing board. Governance is concerned with the intrinsic nature, purpose, integrity and identity of an organization with primary focus on the entity's relevance, continuity and fiduciary aspects.

Contrary to popular misconception about corporate governance in modern times, the roots of corporate governance are not besmirched in negative trail. That is to say, corporate governance did not have its raison d'être in the negative happenings in the corporate world. Looking at corporate governance from that perspective is to undermine its creative, positive, regenerative and prosperous aspects. Good governance has been an eternal source of inspired thinking and dedicated action.

### **Evidence of Corporate Governance From The Arthashastra**

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 are 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 of directors, 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 be 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) Vridhi - 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.

India. (10)

## **II. Literature Review**

There is no universal definition of corporate governance. In the narrowest sense, Noble laureate Milton Friedman defined corporate governance as "the conduct of business in accordance with shareholders' desires, which generally is to make as much money as possible, while conforming to the society embodied in law and local customs."

Some of the definitions of corporate governance are given below:-

Monks and Minow have defined corporate governance as "Relationships among various participants in determining the direction and performance of a corporation".

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".

Standard & Poor's has defined Corporate Governance as "the way a company is organised and managed to ensure that all financial stakeholders (shareholders and creditors) receive their fair share of a company's earnings and assets."

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. Cadbury Committee, U.K. has defined corporate governance as follows:

"(It is) the system by which companies are directed and controlled".

It may also be defined as a system of structuring, operating and controlling a company with the following specific aims: -

- (i) Fulfilling long-term strategic goals of owners;
- (ii) Taking care of the interests of employees;

- (iii) A consideration for the environment and local community;
- (iv) Maintaining excellent relations with customers and suppliers;
- (v) Proper compliance with all the applicable legal and regulatory requirements.

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. 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 risk
- stimulates performance
- improves access to capital markets
- enhances the marketability of goods and services
- improves leadership
- Demonstrates transparency and social accountability."

"Corporate Governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The corporate governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations and society" (Sir Adrian Cadbury in 'Global Corporate Governance Forum', World Bank, 2000)

### **Historical Developments**

Ever since the concept of corporate entity was recognized, corporate governance in various manifestations has been in existence. The Foreign Corrupt Practices Act, 1977 (USA) made specific provisions regarding establishment, maintenance and review of systems of internal control. In 1979, US Securities Exchange Commission prescribed mandatory reporting on internal financial controls. Due to high profile failures in the US, the Treadway Commission constituted in 1985 highlighted the need of putting in place a proper control environment, desirably of constituting independent boards and its committees and objective internal audit function. As a consequence, the committee of Sponsoring organizations took birth. It produced and stipulated in 1992, a control framework. After the Enron debacle of 2001, came other scandals involving large US Companies such as World Com, Qwest, Global Crossing and the auditing lacunae that eventually led to the collapse of Andersen. These developments triggered another phase of reforms in the area of corporate governance, accounting practices and disclosures-this time more comprehensive than ever before. In July 2002, less than a year from the date when Enron filed for bankruptcy, the Sarbanes-Oxley Act popularly called SOX was enacted. The Act made fundamental changes in virtually every aspect of corporate governance in general and auditor independence, conflict of interests, corporate responsibility, enhanced financial disclosures and severe penalties for willful default by managers and auditors, in particular.

A spate of scandals and financial collapses in the UK in the late 1980s and early 1990s made the shareholders and banks worry about their investments. This led the UK Government to recognize insufficiency of existing legislation and role of self-regulation as a measure of controlling scandals and financial collapses. Some of the corporate disasters took place primarily due to insufficiency of implementable governance practices. To prevent the recurrence of such business failures, the Cadbury Committee was set up by the business failures; the Cadbury Committee was set up by the London Stock Exchange in May 1991 inter alia to help raise standards of corporate governance.

### **The Cadbury Report-1992**

The Committee on Financial aspects of Corporate Governance was the first CG code developed in the UK was incorporated in the London Stock Exchange Listing Rules. It was set up under the chairmanship of Sir Adrian Cadbury. The important recommendations were-

- Separation of the role of CEO & Chairman
- Balanced composition of BOD
- Selection process for NED

### **The Greenbury Report-1995**

The report of the committee is popularly called the Greenbury Report. It included a code of Best Practices and its recommendations. The confederation of British Industry set up a group under the Chairmanship of Sir Richard Greenbury. It was set up to examine the remuneration of the directors, particularly compensation packages, large pay increases and share options. The important recommendation was the establishment of Remuneration Committee composed of Non-Executive Directors which would be responsible for deciding the remuneration of executive directors. The majority of the recommendations of the Committee were incorporated in the Listings Rules of the London Stock Exchange.

### **The Hampel Report-1998**

The Hampel Committee was set up to review the extent to which the Cadbury Committee Report and the Greenbury Committee Report had been implemented and whatever their purposes of recommendations were being achieved. The Hampel Committee's recommendations and further consolations by the London Stock Exchange became the combined Code on Corporate Governance.

### **The Turnbull Report**

The original Combined Code Required companies to include a narrative statement in their Annual Report of how internal control provisions had been applied. However, the combined code did not have guidelines of how the provisions should be applied by the companies. This led to the establishment of a Working Group under the Chairmanship of Nigel Turnbull. The resulting Internal Control Guidance for Directors on Combined Code was issued.

### **Higgs Report, Smith Report & Tyson Report**

Following the review of the Company Law, a review of the Combined Code was commenced in July 2002. The subject was Review of the role and effectiveness of non-executive directors. It was conducted by Derek Higgs.

A group under the chairmanship Sir Robert Smith was set up to develop Guidance Audit Committee in the Combined Code. The Tyson Report was commissioned on the Recruitment and Development of Non-executive Directors. All the three provided recommendation for the revised combined code which emerged in 2003.

Combined Code on Corporate Governance (2008)

The Combined Code on Corporate Governance sets out standards of good practice in relation to issues such as board composition and development, remuneration, accountability and audit and relations with shareholders.

All companies incorporated in the UK and listed on the main market of the London Stock Exchange are required under the listing Rules to report on how they have applied the Combined Code in their annual Report and accounts.

### **Developments In India**

The initiatives taken by the Government in 1991, aimed at economic liberalisation and globalisation 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 Committee, led to inclusion 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 inter alia amendments to the law involving the auditor-client relationships and the role of independent directors.

#### **N.R.N Arayana 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.

Obstacles in improving Corporate Governance:

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 these countries are:

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

The creation of corporate regulation is often linked to perceived failures of corporations and their management to behave in the way society expects them to. Corporate governance is not an exception to this trend, and, as with accounting, different countries may well experience difficulties at different times. For example, the development of British codes of best practice, which began with the Cadbury Committee, can be related to governance scandals such as Polly Peck and Colson in the late 1980s and early 1990s. However, the wave of corporate scandals, mostly in the USA, at the turn of the century has been marked not only by the number of cases but also by the effect they have had on investor confidence and market values worldwide.

The combined impact of various US corporate scandals caused the Dow Jones Index to drop from a high for 2002 of 10,632 on 19 March to 7,286 on 9 October, wiping out trillions of dollars in market value. Investor confidence in the fairness of the system and the ability of corporations to act with integrity was ebbing. According to a poll in July 2002, 73 per cent of respondents said that Chief Executive Officers (CEOs) of large corporations could not be trusted (Conference Board, 2003). Amongst the many negative effects of this was a worsening of the pension funding crisis caused by the dramatic drop in the value of pension fund assets. It also increased the cost of capital and caused a virtual cessation in new securities offerings. The International Federation of Accountants (IFAC) claims that while there has been a lot of strategic guidance for business, there has been too little said about the need for good corporate governance. These authors emphasize the fact that successful companies were visionary companies, with a long track record of making a positive impact on the world. They did more than focus on profits; they focused on continuous improvement. They took a long-term view and realised that they were members of society with rights and responsibilities.

Adelphia manipulated its earnings figures for every quarter between 1996 and 2002 to make it appear to meet analysts' expectations. Some of the better known cases of financial irregularities are summarised in following table.

In terms of corporate governance issues, A hold, Enron and WorldCom all suffered from

- Questionable ethics
- Behavior at the top
- Aggressive earnings management
- Weak internal control
- Risk management
- Shortcomings in accounting and reporting

#### **IV. Reasons of Failure of Corporate Governance**

However, the long-term view is something of a rarity in many companies. A critical factor in many corporate failures was:

- Poorly designed reward package
- Including excessive use of share options (that distorted executive behavior towards the short term)
- The use of stock options, or rewards linked to short-term share price performance (led to aggressive earnings management to achieve target share prices)
- Trading did not deliver the earnings targets, aggressive or even fraudulent accounting tended to occur. This was very apparent in the cases of Ahold, Enron, WorldCom and Xerox (IFAC, 2003).

#### **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 the 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 mobilisation 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, agribusiness and service sectors and soon.

#### **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 cost of financial resources.

### **V. Conclusion**

#### **Role of corporate governance in the development:**

Corporate Governance has a major role to play in not only the national development of the developing economies, but also development at state level as a unit of a nation.

### **Need for good governance:**

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.

### **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.

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.

### **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 fullboard.

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.

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.

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.

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.

### **References**

- [1]. D. Tobin, "The Anglo-Saxon paradox: corporate governance best-practices and the reform deficit in China's banking sector," *Journal of Chinese Economic and Business Studies*, vol. 10, pp.147-168.
- [2]. B. Ford, "In Whose Interest: An Examination of the Duties of Directors and Officers in Control Contests," *Ariz. St. LJ*, vol. 26, p. 91,1994.
- [3]. W. Rees and S. Sheikh, "Corporate governance and corporate control," London: Cavendish,1995.
- [4]. R. Monks and N. Minow, "Watching the watchers: Corporate governance for the 21st century," *Recherche*, vol. 67, p. 02,1996
- [5]. A. Chayes and A. H. Chayes, *The new sovereignty: compliance with international regulatory agreements*: Harvard Univ Pr,1998.
- [6]. M. O'Neill, "When European integration meets corporate harmonization," *Company Lawyer*. 21 (6), 2000.
- [7]. O. Goswami, "The tide rises, gradually: corporate governance in India," *Development Centre Discussion Paper*,2001.
- [8]. R. A. G. Monks, "Creating value through corporate governance," *Corporate Governance: An International Review*, vol. 10, pp. 116-123,2002.
- [9]. J. R. Deckop, K. K. Merriman, and S. Gupta, "The effects of CEO pay structure on corporate social performance," *Journal of Management*, vol. 32, pp. 329-342,2006.
- [10]. J. Solomon, "Corporate governance and accountability 2e," *Recherche*, vol. 67, p. 02,2007.
- [11]. L. H. Tan and J. Wang, "Modelling an effective corporate governance system for china €™s listed state-owned enterprises: issues and challenges in a transitional economy," *Corporate Governance*, vol. 151, pp. 154-155,2007.
- [12]. M. Pattanayak, "Strategic Ownership, Networking Effect and Firm Value: A Study of Indian Corporate Governance,"2008.
- [13]. M. N. Young, M. W. Peng, D. Ahlstrom, G. D. Bruton, and Y. Jiang, "Corporate governance in emerging economies: A review of the principalâ€"principal perspective," *Journal of Management Studies*, vol. 45, pp. 196-220,2008.