Corporate Governance and India

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Abstract

To gain competitive advantage, performance of the employees are to be increased. While recent high-profile corporate governance failures in developed countries have brought the subject to media attention, the issue has always been central to finance and economics. The issue is particularly important for developing countries since it is central to financial and economic development. Recent research has established that financial development is largely dependent on investor protection in a country – de jure and defacto. With the legacy of the English legal system, India has one of the best corporate governance laws but poor implementation together with socialistic policies of the prereform era has affected corporate governance. Concentrated ownership of shares, pyramiding and tunneling of funds among group companies mark the Indian corporate landscape. Boards of directors have frequently been silent spectators with the DFI nominee directors unable or unwilling to carry out their monitoring functions. Since liberalization, however, serious efforts have been directed at overhauling the system with the SEBI instituting the Clause 49 of the Listing Agreements dealing with corporate governance.

Keywords: *Governance, Accountability, Stakeholders, incongruence, hostile takeovers, insider trading, Board committees, SEBI, TRAI, RBI.*

Introduction

This paper focuses the conceptual framework of corporate governance. It also analysis the important rules, principles and board performance of corporate governance in a keen competitive phase of economy due to globalization. It discuss the true meaning of corporate governance in the context of present economic meltdown which needs proper governance of companies to safeguard the interest of all stakeholders. Explaining the clear view of corporate governance best practices and accountability and performance of board is the prime motto of this article.

India

India is a vast, vibrant economy. It has a wide array of corporate structure including independent firms and those owned by business groups, families and multinationals. Given this special mix of corporate entities, how can "Corporate governance best practices" possibly apply to such a diverse universe of corporate structure, with such a wide range of ownership patterns? Since 1991, instances of hostile takeovers, insider trading, issue of duplicate shares (Reliance), Harshad Mehta scam (rigging of prices), and KP scams have emaciated the credibility of the stock market in India. Every disaster was a good learning experience followed by new regulations. Despite having rules and regulations, a doubt arises as to the reliability of the regulations. Undoubtedly corporate governance is more a matter of heart (commitment) than that of the mind (Compliance). Private interests however digress from the social good and continue to produce, using polluting technology, unfair means and ignoring the cost to society.

The liberalization of India capital markets enabled Indian companies to invest abroad and opened up the country to foreign investment. During the 1990's corporate governance in India grew by leaps and bounds. While India suffered a spate of stock market "Scams" in 2001 which shook investor confidence, the United States had no shortage of its own variety of frauds and mismanagement cases. Companies like Enron, Arthur Anderson and WorldCom have fallen under the weight of poor corporate governance. This should open our eyes to the fact that Indian companies, however big, need to follow good corporate governance practices to stay afloat.

Corporate governance: Its meaning and Concepts

In the 19th century, state corporation laws enhanced the rights of corporate boards to govern without unanimous consent of share holders in exchange for statutory benefits like appraisal rights, to make corporate governance more efficient. Since that time, and because most large publicity traded corporations in the US are incorporated under corporate administration friendly Delaware law and because the US's wealth has been increasingly securitized into various corporate entities and institutions, the rights of individual owners and shareholders have become increasingly derivative and dissipated. The concern of shareholders over administration pay and stock losses periodically has led to more frequent calls for corporate governance reforms.

Corporate governance is the set of processes, customs, policies, laws and institutions affecting the way a corporation is directed, administrated or controlled. Corporate governance also includes the relationships among the many stakeholders involved and the goals for which the corporation is governed. An important theme of corporate governance is to ensure the accountability of certain individuals in an organization through mechanisms that try to reduce or eliminate the principal-agent problems. The company's philosophy on corporate governance is to attain the highest level of transparency, accountability and integrity. In order to protect and safeguard the interest of all stakeholders, corporate governance should compass full systems and processes. System companies structure of board of directors, their optimum size, compositions' qualifications, role & competencies, frequency of change of board members and nominee directors. The formulation of different committees by board members such as management committee, share transfer committee, audit committee etc... Forms an integral part of the system for sound corporate governance. Different types of internal audit and audit checks are the crucial part of corporate governance. Thus success of corporate governance depends upon these sound systems of operation of company's affairs.

The corporate governance in India needs of reforms. For example, The Satyam Scandal came into light on 16th December 2008 is really unique in many angles. The fourth largest software and BPO company in India, Satyam computer service ltd is now crippling on account of seven years continuous financial rigging by its Ex-Chairman and promoter Ramalingaraju. This scandal has generated a significiant decline in general peoples' trust in Indian corporate governance. Business trust decline was the highest which is wart this paper takes a look at explores lack of good corporate governance and therefore suggestion in this regards is forwarded.

Despite government's arguments Satyam is not a standalone case, there has been similar cases in the past, such as the Dharma Teja in India & Enron or World Com in the USA lot of our big corporate houses are exposed greatly in enterprises abroad which are facing a financial crisis's. Shares have been playing to raise further loans to put into other group companies which are bordering on the verge of sickness. Now the popular dictums "when chips are down, business crimes have a tendency to go up" have become practical in every sphere. One Satyam fiasco has proved that Indian corporate governance suffers from dubious character. In order to raise the bar for corporate governance standards, following steps must be taken into account.

The role of Auditor's recommended by Kumaramangalam committee:

Composition of Audit Committee:

The composition of audit committee is based on the fundamental premise of independence and expertise.

The audit committee should have minimum three members, all being non-executive directors with the majority being independent and with at least one director having financial and accounting knowledge.

i. The chairman of the committee should be an independent director.

ii. The chairman should be present at annual general meeting to answer shareholders queries.

iii. The audit committee should invite such of the executives, as it considers appropriate (& particularly the head of the finance function) to be present at the meetings of the committee but on occasions it may also meet without the presence of any executives of the company. Finance director and head of internal audit and when required, a representative of the external auditor should be present as invitees for the meetings of the audit committee.

iv. The company secretary should act as the secretary to the committee.

Auditors are required to check the books of accounts honestly, yet they fail to do so. In the Satyam case itself, the global firm PWC had to haul up and its partners who were signing the fabricated balance sheets have been put in jail. PWC has long been Sat yam's auditors and thus would have developed cozy relationship with the management. Companies are also required to appoint internal auditor's but that too seen to have failed in this other similar cases. Therefore, rotation of auditors should be mandatory after every three years.

Challenges and opportunities for Corporate Governance in India

I am honestly delighted, privilege and honored to be with you today to discuss corporate governance, which has become so vital not only for our corporate success, but also for our national success. What really is corporate governance? Of course, I do not have to tell you, you have had brilliant lectures from some outstanding people on the challenges and opportunities of corporate governance. But I will try to bring in a slightly different point of view. I might like to provoke you because most of you belong to the most representative class in this country, aged around 25 or less, that represents 54% of the population and which is why I say 'provoke you'. I think that this is the time. We are living in a defining moment of history in India. We will only succeed if we are able to bring a wholesale, 180-degrees shift in the concept of living, so we are not talking about one single thing. We are talking about complete change. I would like to bring in a new context.

Changes in value system

You are aware that the Enron Chief Executive was given a prison sentence of a quarter of a century, which was never given to a murderer. That is where we need to think why it has happened. There was another event where the question was 'How is it that this kind of sentence was given, he is 63, by the time he comes out of prison, he would be 98?' There is a change in the value system in the society; judges five years ago would not have given such prison sentences. In fact, there is a classic case in the UK, where, in a very similar situation, the people were completely let off. It was in Guinness where there was complete insider trading. No such case in the UK has ever come to the level of prosecution where it was successfully prosecuted. But if it happens today, the situation could be different. You remember a person who was the backbone of the Korean transformation, Kim Woo-Choong who wrote a book Every Street Is Paved with Gold. He was the Daewoo chairman. As Daewoo chairman, he was sentenced to 10 years in prison. Note that he has done tremendous good to the country.

Lack of corporate governance

Today, the market perception is that companies are looking for businesses that do good to the community, not necessarily make profit. So, today we begin with an assumption that corporate governance is a different concept. It is not just to make money for the shareholders. The whole reason why we brought into being the World Council of Corporate Governance is that we are here not just to look after our shareholders' values immediately, because in order to do that we must look at the stakeholder. What are we doing? If customers do not buy our products, can we really do good to our shareholders? Who are the customers? The customers now have a very different paradigm.

The world consists of two billion teenagers who are fuelling the market today. Their value system is very different. They want companies to be transparent, to be accountable. They want honesty and integrity. They want equity, and social and environmental responsibility. If companies do not provide this, companies are not sustainable. Lack of proper corporate governance practices is blocking the prosperity of a billion people in India. Today, our financial system looks after 81,000 individuals. We say growth—the rich have a growth rate of 20%. These rich are just 81,000 among a population of one billion. You see the paper today, 54 people have been killed in Chhattisgarh. There were 11 policemen. Not one of the native people came to the rescue of these people whole night. How is there so much disparity, so much incongruence between our policies and systems? Now, who is responsible? You may ask why business should do anything about it.

Globalization for all

I ask you a question: we are talking about globalization, tell me which part of the society has become the biggest winner through globalization, and name the companies whether it is Bharti, Reliance or it is Tata. Their wealth has grown at least 10 times in the last few years now. So, the big businesses are the biggest beneficiaries of globalization. What is good corporate governance? Look at our growth, it stands at 9.2%. This is India which has the largest number, 74%, of malnourished children.

Promoting equity and ethics

We want corporate governance because we say it is accountable. It promotes equity and ethics. If it does not promote equity and ethics, then it is not corporate governance. This is what we have been doing— manipulation of business of majority of people. Business has been doing this throughout history. Now things have to change. They have to change because that is what will create value. Promoting gender balance, accepting diversity are issues which will make markets worth for the poor. Markets should bring prosperity and work for the poor. If markets do not work for the poor, corporate governance is not successful. Mr Damodaran, he is great friend of mine, this is one of his agendas: how can markets work for the benefit of the poor? Not just for 2%, we are now shining in the glory of India, and we say that our stock markets have gone up to 14,000—it may have come down temporarily—we are talking of 9.2% growth, we are talking of US$190 billion worth foreign exchange reserves and a whole lot of things.

But stock market participation is just 2%. While it is 25% in the US, here it is just 2%. What about the rest of 98%? How can we bring the rest and why do we think stock markets are important? This is one instrument where it does not matter whether you are from Chennai or from Bangalore or you are from Mumbai. Stock markets do not distinguish between your castes.

Issues of corporate governance have been hotly debated in the United States and Europe over the last decade or two. In India, these issues have come to the fore only in the last couple of years. Naturally, the debate in India has drawn heavily on the British and American literature on corporate governance. There has been a tendency to focus on the same issues and proffer the same solutions. For example, the corporate governance code proposed by the Confederation of Indian Industry (Bajaj, 1997) is modelled on the lines of the Cadbury Committee (Cadbury, 1992) in the United Kingdom. This paper argues however that the crucial issues in Indian corporate governance are very different from those in the US or the UK. Consequently, the corporate governance problems in India require very different solutions at this stage of our corporate development. The corporate governance literature in the US and the UK focuses on the role of the Board as a bridge between the owners and the management (see for example; Cadbury, 1992; Salmon,1993; Ward, 1997). In an environment in which ownership and management have become widely separated, the owners are unable to exercise effective control over the management or the Board. The management becomes self perpetuating and the composition of the Board itself is largely influenced by the likes and dislikes of the Chief Executive Officer (CEO). Corporate governance reforms in the US and UK have focused on making the Board independent of the CEO. Many companies have set up a Nominations Committee of the Board to enable the Board to recruit independent and talented members. There is now increased recognition of the role that the Board could play in providing a strategic vision to the company. The Compensation Committee of the Board has been strengthened to exercise greater control over CEO compensation following widespread complaints that top management pay is disproportionate to performance. There is also a great deal of discussion in the literature on the role of the Board in firing non performing management and in managing the CEO succession. Perhaps the most powerful and well established of the Board committees is the Audit Committee. Apart from acting as a deterrent against financial improprieties and frauds, the Audit Committee also enables the Board to keep a pulse on the financial health of the company. Turning to the Indian scene, one finds increasing concern about improving the performance of the Board. This is doubtless an important issue, but a close analysis of the ground reality in India would force one to conclude that the Board is not really central to the corporate governance malaise in India. As elaborated at length in this paper, the central problem in Indian corporate governance is not a conflict between management and owners as in the US, and the UK, but a conflict between the dominant shareholders and the minority shareholders. The Board cannot even in theory resolve this conflict. One can in principle visualize an effective Board which can discipline the management. Government regulations have required most MNCs in India to operate through subsidiaries which are not 100% owned by the parent. In the 70s, the government enacted a law limiting foreign ownership in most industries to 40% while allowing 51% in a few high technology areas. This law was liberalized in the 90s and now 51% is permitted in most industries while 74% or even 100% ownership is allowed in some cases. These regulations have created severe corporate governance problems in several key areas as may be seen from the examples below.

In the 70s, MNCs were forced to issue shares to the Indian public to comply with the law. The controls that then existed on pricing of public issues meant that these issues were at substantial discounts to the market price. In the 90s when the law permitted higher foreign ownership, these MNCs raised the foreign stake by issuing shares at very deep discounts to the market price. This obviously meant a large loss to the minority shareholders. One particular case where shares were issued to the parent at less than one-tenth the market price was analysed in detail by Barua and Varma (1993a and 1993b). They calculated that the net gain to the foreign parent after compensating for the loss that it suffered in the 70s (together with interest thereon at market rates of interest) amounted to over $200 million. This and other similar share issues by MNCs were made with the explicit consent of the shareholders in general meeting. The parent companies with their dominant shareholding were able to get the resolutions passed with impressive majorities. In fact when the government introduced regulations to prevent such preferential issues, the MNCs protested against what they called an assault on "shareholder democracy". Another corporate governance problem arises where the foreign parent has two subsidiaries in India in one of which it holds a higher stake (say 100%) while in the other it holds a smaller stake (say 51%). The manner in which the MNC structures its business in India between these two subsidiaries is riddled with problems as far as the minority shareholder is concerned.

Conclusion

Most of the companies in India are managed by promoters as against the ones in western economics. Hence we need home grown solutions to tackle this type of problems for vanishing companies the companies act already prescribes barriers that such promoters will be barred from raising further capital in that market and their names are enter on the governments websites etc... It is suggested that promoters should be barred from holding management positions after some times. But at least when promoter's management is caught in a crime and their punishment should be exemplary and the trial must be conducted on a day-to-day basis with a time limitation. At least on the basis of above discussion we conclude that the cooperate governance in India needs to be overwhelmed. Regulatory body like SEBI, TRAI, RBI etc... Should be more empowered and tighten to take quick and prompt action against the equity entity. The concept of corporate governance hinges on complete transparency. For this, several restructuring measures in company's regulation are to be made.

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AUTHOR'S PROFILE

Mr. P. Balasubramanian holds triple masters to his credit, PG Degree in Business Administration, Commerce and Management (M. Phil by Research) and possesses more than six years of experience to his academics and specialized in Finance. He has a blend of teaching current trends in management, both theory and practice and also by sharing his rich academic experience with practicality amongst students. He presented numerous publications in national and international conferences and couple of papers in national journals. He also serves as visiting faculty to many colleges and few universities to the department of management and teaches financial aspects of management education. He holds many professional memberships and panel member for many academic institutions and business organizations. He actively engaged in consultancy and guided projects. He holds the best academic cream award for his outstanding teaching in MBA stream. He is currently serving as Faculty in Finance under the Department of Management at Sri Ramakrishna Institute of Technology, Coimbatore District, Tamil Nadu.