

CORPORATE GOVERNANCE PRACTICES: ISSUES AND CHALLENGES IN THE 21ST CENTURY

Dr. Joshua. O. Miluwi

Associate Professor, Commerce & Management, Career College,
and Visiting faculty Career institute of international management
Barkatullah University Bhopal, M.P.

Ms. Hina Rashid

Department of Social Sciences, Saifia College, Barkatullah University Bhopal

Abstract:

In this paper, we have reported the issues of governance; accountability and transparency in the affairs of the company, as well as about the rights of shareholders and role of Board of Directors have never been so prominent as it is today. "Good corporate governance practices instill in companies the essential vision, processes, and structures to make decisions that ensure longer-term sustainability. More than ever, we need companies that can be profitable as well as achieving environmental, social, and economic value for society." The corporate governance has come to assume a centre stage in the Board room discussions. India has become one of the fastest emerging nations to have aligned itself with the international trends in Corporate Governance. As a result, Indian companies have increasingly been able to access to newer and larger markets around the world; as well as able to acquire more businesses. The responses of the Government and regulators have also been admirably quick to meet the challenges of corporate delinquency. But, as the global environment changing continuously, there is a greater need of adopting and sustaining good corporate governance practices for value creation and building corporations of the future.

Keywords: Corporate Governance, Company, markets, law, Accountability, Transparency.

INTRODUCTION

The subject of corporate governance leapt to global business limelight from relative obscurity after a string of collapses of high profile companies. "a well-governed company takes a longer-term view that integrates environmental and social responsibilities in analyzing risks, discovering opportunities and allocating capital in the best interests of shareowners. There can be no better way to restore public confidence in both businesses and markets and build a prosperous future. Enron, the Houston, Texas based

energy giant, and WorldCom, the telecom behemoth, shocked the business world with both the scale and age of their unethical and illegal operations. Worse, they seemed to indicate only the tip of a dangerous iceberg. While corporate practices in the US companies came under attack, it appeared that the problem was far more widespread. Large and trusted companies from Parmalat in Italy to the multinational newspaper group Hollinger Inc., revealed significant and deep-rooted problems in their corporate governance. Even the prestigious New York Stock Exchange had to remove its director, Dick Grasso, amidst public outcry over excessive compensation. It was clear that something was amiss in the area of corporate governance all over the world.

Corporate governance has, of course, been an important field of query within the finance discipline for decades. Researchers in finance have actively investigated the topic for at least a quarter century¹ and the father of modern economics, Adam Smith¹; he had recognized the problem over two centuries ago. There have been debates about whether the Anglo-Saxon market- model of corporate governance is better than the bank based models of Germany and Japan [1-3]. However, the differences in the quality of corporate governance in these developed countries fade in comparison to the chasm that exists between corporate governance standards and practices in these countries as a group and those in the developing world. Corporate governance has been a central issue in developing countries long before the recent spate of corporate scandals in advanced economies made headlines. Indeed corporate governance and economic development are intrinsically linked. Effective corporate governance systems promote the development of strong financial systems - irrespective of whether they are largely bank-based or market-based - which, in turn, have an unmistakably positive effect on economic growth

and poverty reduction. There are several channels through which the causality works. Effective corporate governance enhances access to external financing by firms, leading to greater investment, as well as higher growth and employment. The proportion of private credit to GDP in countries in the highest quartile of creditor right enactment and enforcement is more than double that in the countries in the lowest quartile. As for equity financing, the ratio of stock market capitalization to GDP in the countries in the highest quartile of shareholder right enactment and enforcement is about four times as large as that for countries in the lowest quartile. Poor corporate governance also hinders the creation and development of new firms.

Figure 1:

The term 'Corporate Governance' is much in use these days; everybody and anybody who has anything to do with the corporate sector talks about Corporate Governance. As is the case with anything popular, the term 'Corporate Governance' has almost become rhetoric; like all rhetoric's it is the most spoken and the least meant. The conjunction of the two words, Corporate and Governance provokes some interesting and somewhat cynical reactions. Some say that corporate governance is eligible to be the title of a book. Corporate governance refers to the way that Boards oversee the running of a company by its managers, and how Board members are held accountable to shareowners and the company. This has implications for company behavior not only to shareowners but also to employees, customers, those financing the company, and other stakeholders, including the communities in which the business operates. Research shows that responsible management of environmental, social and governance issues creates a business ethos and environment that builds both a company's integrity within society and the trust of its shareowners. Others refer immediately to the scandals of the eighties and the nineties where governance has been clearly overlooked in favor of profits. Corporate Governance deals with laws, procedures, practices and implicit rules that determine A Company's ability to take managerial decisions vis-à-vis its claimants--in particular, the shareholders, creditors, the state and the employees. There is a global consensus on the objective of good corporate governance: maximizing long-term shareholder value. Also there is a diversity of opinion regarding beneficiaries of corporate governance. The Anglo-American system tends to focus on shareholders and various classes of creditors. Continental Europe,

Japan and South Korea believe that a company should also discharge their obligation towards employees, local committees, suppliers, ancillary units and so on.

The companies have the fundamental aim to maximize profits through good governance. The permanent search of the firms for increasing productivity and competitiveness leads to economic growth. If the companies present a good performance, based in the best practices of Corporate Governance, they assure their permanency in the market. This translates into employment for the families, as social responsibility and wealth for the country. On the contrary, if the firms do not achieve this favorable performance, they can fail and originate problems of unemployment, migration and violence. Knowing the internal variables of Corporate Governance that improve the firm's performance is important, not only for the company but also for the society in general. Though it is clear that the Corporate Governance influences the firm performance, which does not remain clear is what mechanisms of Corporate Governance they favor to this performance. Even, some policies of Corporate Governance can be favorable (or harmful) for companies of certain countries (and not of others); also, some mechanisms of Corporate Governance can give different results depending on the situation especially.

The Corporate Governance is intimately related to the firm performance, as they show it La Porta et al. (1997; 1998; 2000; 2002). Hutchinson and Gull (2004) conclude that this relation is especially relevant for the companies that present opportunities of growth. Lowenstein (1996) suggests that the good practices that should be had of Corporate Governance make the financial transactions more transparent [4-6]. This allows the capital suppliers to better calculate the risk of his investments and diminish the cost of financing. In synthesis, though it is clear that the Corporate Governance influences the firm performance, what does not remain clear is what mechanisms of Corporate Governance would help the performance. In a nutshell, Corporate Governance is about promoting corporate fairness, transparency and accountability. Let us see how corporate governance has been defined. Corporate Governance can be traced back to early nineties when due to a series of corporate mismanagement and failures were reported in UK that led to the formation of Adrian Cadbury committee who came out with first document, laying the foundation of the present day format of the corporate governance. This report was

primarily based on the frauds perpetrated by some of the unscrupulous directors usurping stakeholders' money for their personal benefits. So the terms of reference of this committee was mainly on the financial aspects of the corporations and focused on the roles of the institutional investors, auditors and remuneration of the top executives along with some measures on internal controls. The Cadbury Committee's terms of reference were mainly restricted to issues related to accountability.

There is considerable difference of opinions on what corporate governance is all about. But one thing is very clear is that corporate governance is nothing but a method of enhancing the corporate performance by monitoring and controlling the management performance at one hand ensuring the accountability of the management to all stakeholders on the other hand. Governance and accountability are two sides of the same coin and combination of these two factors should lead to both efficiency and marshalling all the resources of the organization to increase not only shareholder value but should work for the benefit of all stakeholders. One of the major issues in this period (even in the early 21st century for that matter) was misappropriation of funds of the shareholders by so called professional managers (read non-owner manager).

Corporate governance has been defined by scholars and market practitioner's as per the perspective with which they were analyzing the subject. The practitioner's point of view that was powerfully conveyed was that of N.R. Narayana Murthy, Chairman, Committee on Corporate Governance, Securities and Exchange Board of India, 2003 and he himself a highly successful and globally acclaimed entrepreneur who built Infosys on the premise and foundations of a strong corporate governance, the term "corporate governance", is susceptible both to broad and narrow definitions. In fact, many of the codes do not even attempt to articulate what is encompassed by the term. The important point is that corporate governance is a concept, rather than an individual instrument. It includes debate on the appropriate management and control structures of a company. Further, it includes the rules relating to the power relations between owners, the Board of Directors, management and, last but not least, the stakeholders such as employees, suppliers, customers and the public at large [7].

Corporate governance is a concept, rather than an individual instrument. It includes debate on the appropriate management and control structures of a

company. It includes the rules relating to the power relations between owners, the board of directors, management and the stakeholders such as employees, suppliers, customers as well as the public at large. Corporations around the world are increasing recognizing that sustained growth of their organization requires cooperation of all stakeholders, which requires adherence to the best corporate governance practices. In this regard, the management needs to act as trustees of the shareholders at large and prevent asymmetry of benefits between various sections of shareholders, especially between the owner-managers and the rest of the shareholders.

CORPORATE GOVERNANCE IN INDIA - A HISTORICAL BACKGROUND

The system of corporate governance in India operates in an administered environment. Administrative control is seen as arbitrary and enforcement as poor, as many recent scams have demonstrated. Directors from the promoter's family have traditionally dominated the Indian boards. Professionals and other persons close to them constitute the majority on the board. Positions of chairman and managing director and executive directors are filled in from among the above persons. In most of the Indian companies there is no separation of roles of the Chairman and Managing Directors and one individual combines both the positions. Most boards of directors, inspired by having nominees of Government controlled financial institutions, have little information about illegal or unethical conduct of their executive. The boards find it difficult to monitor the compliance of the company to the various legal requirements. The monitoring of professional standards by professional association such as chartered accounts and auditors is also considered lax and discretionary.

In government corporations the boards are a mere legal formality. The elaborate system of accountability of public enterprises operates through the means of parliamentary committees, independent vigilance officers and the comptroller and auditor general of India. Accountability has remained more in form than in substance. Major decisions such as appointments, investments, purchase contract, selling arrangements, collaborations, and industrial relation agreements have moved out of the corporation ambit into the bureaucracy and the political arena, bringing into focus the widespread corruption. None of the stakeholders-boards, the stock market, the banker, the financial institutions, the trade unions, and government-exercise major monitoring role over the

inappropriate actions taken by the top management in the corporate sector [8-12]. The Indian corporate sector, largely represented by family-owned companies, has come to realize that managing company affairs demonstrably in the interest of shareholders is the only way to attract capital. There is evidence of a fundamental shift from management-dominated boards to shareholder sensitive ones and this strength is likely to be further strengthened.

The historical development of Indian corporate laws has been marked by many interesting contrasts. At independence, India inherited one of the world's poorest economies but one which had a factory sector accounting for a tenth of the national product. The country also inherited 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 procedures². In terms of corporate laws and financial system, therefore, India emerged far better endowed than most other colonies. The 1956 Companies Act built on this foundation, as did other laws governing the functioning of joint-stock companies and protection of investors' rights.

Early corporate developments in India were marked by the managing agency system. This contributed to the birth of dispersed equity ownership but also gave rise to the practice of management enjoying control rights disproportionately greater than their stock ownership. The turn towards socialism in the decades after independence, marked by the 1951 Industries (Development and Regulation) Act and the 1956 Industrial Policy Resolution, put in place a regime and a culture of licensing, protection, and widespread red-tape that bred corruption and stilted the growth of the corporate sector. The situation worsened in subsequent decades and corruption, nepotism, and inefficiency became the hallmarks of the Indian corporate sector. Exorbitant tax rates encouraged creative accounting practices and gave firms incentives to develop complicated emolument structures with large "under-the-table" compensation at senior levels [13-15]. In the absence of a stock market capable of raising equity capital efficiently, three central (federal) government development finance institutions (the Industrial Finance Corporation of India, the Industrial Development Bank of India and the Industrial Credit and Investment Corporation of India), together with about thirty other state-government owned development finance

institutions, became the main providers of long-term credit to companies. Along with the central government-owned and managed mutual fund, the Unit Trust of India, these institutions also held (and still hold) large blocks of shares in the companies to which they lent, and invariably had representations on their boards in the form of nominee directors, though they traditionally played very passive roles in the boardroom.

Corporate Governance and Law Reforms in India

Corporate governance has been a buzzword in India since 1998. But the need to have a good mechanism started since the beginning of 1990s when the Indian stock market rocked with many scams. On account of the interest generated by Cadbury Committee Report (1992) in UK, the Confederation of Indian Industries (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. The recommendations of the Kumar Mangalam Birla Committee, constituted by SEBI, led to the addition of Clause 49 in the Listing Agreement. These recommendations, aimed at improving the standards of Corporate Governance, are divided into mandatory and non-mandatory recommendations. The recommendations have been made applicable to all listed companies, their directors, management, employees and professionals associated with such companies. The ultimate responsibility for putting the recommendations into practice lies directly with the Board of Directors and the management of the company. The latest developments include constitution of a high-powered Committee by Department of Company Affairs, Government of India, headed by Shri Naresh Chandra, on August 21, 2002, to examine various corporate governance issues [16]. Other developments include the constitution of a Committee by SEBI 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; setting up of a proactive Standing Company Law Advisory Committee by Department of Company Affairs to advise on several issues like inspection of corporate for wrong doings, role of independent auditors and directors and their liability and suggesting steps to enhance imposition of penalties. Another Committee has been constituted by the Department of Company Affairs known as

the Working Group for examination of suggestions received on good corporate governance. A High Powered Central Coordination and Monitoring Committee (CCMC), co-chaired by Secretary, Department of Company Affairs and Chairman, SEBI was set up to monitor the action taken against the vanishing companies, and unscrupulous 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, Ahmadabad, Bangalore and Hyderabad with Regional

Directors/ Registrar of Companies of respective regions as convener, and Regional

Offices of SEBI and Stock Exchanges as Members. The main task of these Task Forces was to identify the companies, which have disappeared, or which have mis-utilised the funds mobilized from the investors, and suggests appropriate action in terms of Companies Act or SEBI Act. SEBI says that the Corporate governance norms introduced for listed companies vide clause 49 of the listing agreement on the basis of the Kumaramanagalam Birla Committee Report, 1999 have met with encouraging success, since most of the 'A' Group companies listed on BSE and NSE have complied with the Norms [17-18]. However, the corporate governance has remained more on paper is clear from the Report on Corporate

Governance by the Advisory Group constituted by the Standing Committee on International Financial Standards and Codes of the Reserve Bank of India.

The following facts emerged from the report:

- The predominant form of corporate governance in India is 'insider model' where promoters dominate governance in every possible way. Indian corporate which reflect the pure 'outsider model' are relatively small in number.
- A distinguishing feature of the Indian Diaspora is the implicit acceptance that corporate entities belong to founding families.
- The listing agreement, the main instrument, through which SEBI ensures implementation of corporate governance, is a weak instrument, as its penal provisions are not stringent. The maximum penalty a stock exchange can impose on any company that does not follow the corporate governance norms is suspension of trading in its shares. This penalty hurts the investor community more than the management

of the company that violates the listing agreement.

- Regional stock exchanges where a large number of companies are listed lack effective organization and skills to monitor effective compliance with corporate governance norms.
- A vast majority of companies that are not listed remain outside the purview of SEBI's measures.
- The financial institutions that have large shareholdings in most of the listed companies have been passive observers in the area of corporate governance and do not effectively exercise their rights as shareholders.
- The autonomy of the Boards of Public Sector Units and public sector banks has been seriously eroded due to special legislative provisions or notifications and day to day interference by the concerned administrative ministries.

It is interesting to note that despite corporate governance in the form of clause 49 was already introduced in the year 2000; it could not prevent securities scam of 2002. Events in the stock exchanges have exposed the lack of ethical conduct by many Indian corporate:

- Rampant insider trading by the promoters in league with big market players.
- Massive price rigging/ manipulation by the promoters in league with big market players prior to mergers and takeovers.
- Gross misuse of bank funds for clandestine stock market operations.
- Criminally motivated investment in violation of laid down norms.
- Many companies, which raised money from the capital market through public issues, have not paid any dividend for more than five years.
- The total amount of money (collected through public offerings) duped by the vanishing companies is calculated to be Rs 66,861 billion;
- Non-performing assets of scheduled commercial banks amounted to Rs 58,554 billion as on 31 March 2003.

In addition small investors have lost their hard earned money in the stock markets for the following reasons:

- Lack of ethics, selfish conscience, and breach of trust on the part of the promoters.
- Lack of adequate compliance mechanism, supervision, proper inspection, effective regulation and preventive action by regulators like Department of Company Affairs, Registrar of Companies, Board of Stock Exchanges as

well as SEBI.

- Lack of professional ethics on the part of professionals, like Chartered Accountants, Company Secretaries etc, who are holding onerous positions in companies.

It all establish that no matter that most of the companies may be fully complying with the corporate governance norms laid down by clause 49, but absence of good conscience on the part of the promoters to observe ethical practices have created little impact in practice. A number of proposals have been made to improve corporate governance. The various suggested reforms include:

- strengthening the position of internal and outside auditors;
- allowing mergers and acquisitions approved by a panel;
- requiring more independent outside directors on boards;
- introducing the supervisory board or two-tier system;
- allowing banks to own greater equity in shares of the companies;
- enhanced disclosure through consolidated balance sheets and enforcement of accounting standards.

An important mechanism required to make the capital market discipline is liberalization of restrictions on mergers and acquisitions. Secondly, the bankruptcy provisions are allowed to operate without any government interference. Another important commitment necessary on the part of government is that it should discontinue directed lending and permit commercial banks and government financial institutions to be run by their boards in the interest of their shareholders rather than the government. In India, the four clusters of legal arrangements have been developed to respond to corporate governance problems. These are securities market regulations, the fiduciary responsibilities of directors and officers, laws governing takeovers, and rules governing shareholder voice. The two most important laws that control the listed companies are the Securities Contracts (Regulation) Act, 1956 which regulate all new public offerings, dealings in stock market and the functioning of the stock exchanges in India and the Securities and Exchange Board of India Act, 1992 which created the Securities and Exchange Board of India (SEBI), giving it the authority to administer the Securities Contracts (Regulation) Act, and all the other regulation of securities. The major purpose of these laws is to require regular, accurate, and timely

public disclosure of financial. Information by any company that issued publicly traded securities and to instill public confidence in the reliability and accuracy of information so reported. A new law called the Indian Competition Act, 2002 has been enacted to replace the MRTP Act, 1969. The objective of the new law is to prevent practices having adverse effect on competition, to promote and sustain competition in markets, to protect the interest of consumers and to ensure freedom of trade carried on by other participants in markets and for matters connected therewith or incidental thereto.

Committees and Codes on Corporate Governance in India

a. CII Code of Corporate Governance: In December 1995, the CII set-up a Committee under the chairmanship of industrialist Rahul Bajaj to prepare a comprehensive voluntary code of corporate governance for listed companies. The final draft report was released in April 1998. The CII Code on corporate governance recommended that the: key information to be reported, listed companies to have audit committees, corporate to give a statement on value addition, consolidation of accounts to be optional. Main emphasis was on transparency, as stated by Shear Data, the then President of CII, in the foreword to the Report:

"Corporate Governance is a phrase which implies transparency of management systems in business and industry, be it private or public sector - all of which are corporate entities. Just as industry seeks transparency in Government policies and procedures, so, corporate governance seeks transparency in corporate sector.

b. UTI Code of Corporate Governance: In the year 1999, the Unit Trust of India (UTI) also formulated a code of corporate governance. This was followed by the professional bodies like the Institute of Company Secretaries of India (ICSI) to focus the attention of the Indian corporate sector, on the norms of governance and it set up a National award of Excellence in Corporate Governance.

C. Birla Committee Report on Corporate Governance: SEBI constituted a Committee on corporate governance with as many as 18 members under the chairmanship of Shri Kumar Mangalam Birla, to promote and raise the standards of corporate governance in respect of listed companies on 7th May 1999. This Committee, after a good deal of deliberations with industrial associations and professional bodies, submitted its report on 25th January 2000, and recommended various new

norms of corporate governance. SEBI accepted the recommendations, which culminated in the introduction of clause 49 in the standard Listing Agreement for implementation by all stock exchanges for all listed companies, within a time frame of three years commencing from the financial year 2000-2001. The main recommendations of this Committee related to the composition of the board including independent directors, constitution of audit committee in certain sized companies to look into the financial aspects of a company, remuneration of directors, director's report to include management discussion and analysis report, better disclosure norms to the shareholders through annual report, etc.

Regarding the composition of the board of directors of a company, the Committee was of the view that the composition of the board of directors is critical to the independent functioning of the board as it determines the ability of the board to collectively provide the leadership and ensures that no one individual or group is able to dominate the board. The committee recommended that the board of a company should have an optimum combination of executive and non-executive directors, with not less than fifty percent of the board comprising the non-executive directors. As the executive directors are involved in the day-to-day management of companies, the non-executive directors bring external and wider perspective and independence to the decision-making. It has been the practice of most of the companies in India to fill the board with representatives of the promoters of the company as independent directors. This has undergone a change and now the boards comprise of following groups of directors: Promoters' directors, Executive directors, non-executive directors, and a part of who are independent.

Based on these recommendations, the Companies (Amendment) Act 2000 introduced many provisions relating to corporate governance including (a) additional ground of disqualification of directors in certain cases, (b) setting up of audit committees, (c) director's responsibility statement in the directors' report, (d) introduction of postal ballot for transacting certain items of business in the general meeting, and (e) enforcement of accounting standards.

Corporate governance was also introspected by the Advisory Group constituted by the Standing Committee on International Finance Standards and Codes of the Reserve Bank of India under the Chairmanship of Dr. Y.V. Reddy the then Deputy Governor and later on the Governor of RBI.³ All these efforts focused the attention of the corporate

boards that they should manage the affairs of companies with better accountability to shareholders and achieve transparency of operations with disclosure of both financial and non-financial data through annual report and other periodical reports. As a result, annual report of listed Indian companies, now reflect in adequate measure the new norms of governance.

d. Basel Committee - For Banking Organizations: Basel Committee published its report on Corporate Governance for Banking Organization in September, 1999. According to the committee the boards of directors add strength to the corporate governance of a bank when they⁴

- Understand their supervisory role and their "duty of loyalty" to the bank and its shareholders; serve as a "checks and balances" function *Vis-à-vis* the day-to-day management of the bank;
- Feel empowered to question the management and are comfortable insisting upon straight forward explanations from management.
- Recommend sound practices gleaned from the other situations;
- Provide dispassionate advice;
- Are not ever extended
- Avoid conflicts of interest activities with, and commitment to, other organizations;
- Meet regularly the senior management and internal audit to establish and approve policies,
- Establish communication lines and monitor progress toward corporate objectives.
- Absent themselves from decisions when they are incapable of providing objective advice;
- Do not participate in day-to-day management of the bank.

It is found that in a number of countries, bank boards have found it beneficial to establish certain specialized committees. Let us look at a few of them"

- Risk Management Committee: it provides oversight of the senior management's activities in managing credit, market liquidity, and operational legal and other risks of the banks.
- Audit Committee: it provides oversight of the bank's internal and external auditors, approving their appointment and dismissal, reviewing and approving audit scope and frequency, receiving their reports and ensuring that management is taking appropriate corrective actions in a timely manne^{4r} to control weaknesses, non-compliance with policies, laws and regulations, and other problems identified by auditors.
- Compensation Committee: it provides oversight

of remuneration of senior management and other key personnel ensuring that compensation is consistent with the bank's culture, objectives, strategy and control environment.

Nomination Committee: it provides important assessment of board effectiveness and directs the process of renewing and replacing board members.

e. Naresh Chandra Committee Report on Corporate Audit and Governance (2002): The Enron debacle in July 2002, involving the hand-in-glove relationship between the auditor and the corporate client and various other scams in the United States, and the consequent enactment of the stringent Sarbanes - Oxley Act in the United States were some important factors, which led the Indian government to wake up. The Department of Company Affairs in the Ministry of Finance on 21 August 2002, appointed a high level committee, popularly known as the Naresh Chandra Committee, to examine various corporate governance issues and to recommend changes in the diverse areas involving the auditor-client relationships and the role of independent directors. The Committee submitted its Report on 23 December 2002.

In its report, the Committee commented on:

- The poor structure and composition of the board of directors of Indian companies,
- scant fiduciary responsibility,
- poor disclosures and transparency,
- inadequate accounting and auditing standards,

The need for experts to go through the minutest details of transactions among companies, banks and financial institutions, capital markets etc. On the auditor - company relationship, the Committee recommended that the proprietary of auditors rendering non-audit services is a complex area, which needs to be carefully dealt with. The recommendations of this Committee are more or less in line with the Rules framed by the Securities & Exchange Commission (SEC) in accordance with the provisions of the Sarbanes-Oxley Act 2002. The recommendations of the Naresh Chandra Committee are expected to play a vital role in strengthening the composition and effectiveness of the regulatory framework for good corporate governance.

f. Narayana Murthy Committee Report on Corporate Governance: In the year 2002 SEBI analyzed the statistics of compliance with 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 interests of the investors. SEBI,

therefore, constituted a committee under the Chairmanship of N.R. Narayana Murthy, Chairman of Infosys Technologies Ltd to review the performance of corporate governance in India and make appropriate recommendations. The Committee included representatives from the stock exchanges, chambers of commerce and industry, investor associations and professional bodies. The Narayana Murthy Committee submitted its report on 8 February 2003. In the meantime many of the recommendations of the Naresh Chandra Committee found their acceptance in the form of the Companies (Amendment) Bill of 2003, which was introduced in the Parliament in May 2003, but now had been withdrawn. The mandatory recommendations of the Committee relate to;

- the role and functions of the Audit committee,
- the risk management and minimization procedures,
- the uses and the application of funds received from the initial public offers,
- code of conduct for the board,
- nominee directors and independent directors.

CORPORATE GOVERNANCE IN THE WORLD

During 1990s, financial scams have rocked the U.K. and billions of pounds were lost which forced the U.K., U.S. and Europe corporate world to look into corporate governance. In India, Mr. Hashed Mehta's time 'Creative Accounting' practices was found in corporate reports and forced to form a committee for the corporate governance. The term Corporate Governance has a great deal of importance academically and professionally since the decade of the 1980s.

a. European Union: The EU's approach to corporate governance matters is principle-based. It seeks to ensure the adoption of certain key specific standards throughout the EU, while leaving it to Member States and market participants to determine how to best apply these standards. The EU corporate governance framework, which consists of a mix of binding and non-binding rules, has as its cornerstone the 'comply or explain' principle. Every listed EU. Company is under an obligation to make an annual statement indicating which Code of corporate governance it applies and declaring whether it complies with all the provisions of that Code. If that company does not comply with some provision of the Code, it must state to what extent and give a justification. Alongside the corporate governance statement, the Commission has adopted two non-

binding recommendations on the remuneration of directors and on the role of independent directors, which contain key substantive standards. With these measures, the Commission seeks to encourage national corporate governance codes to converge gradually. The European Corporate Governance Forum, set up by the Commission and composed of fifteen high level experts, seeks to reinforce this through exchanges of views on best practices to promote the convergence of national corporate governance practices within the European Union.

b. UK: In June 2007, the EU adopted the Shareholder Rights Directive to create consistent standards across Member States and simplify cross-border investment. It aims to reduce problems associated with cross-border investment which include: a lack of sufficient information on a timely basis; the inability to trade shares ahead of general meetings (share blocking); and inefficient voting procedures and constraints. National governments are required to implement the Directive within two years. Some of the key measures of the Directive are:

- o Share-blocking is banned. Instead, companies are required to set a record date within a 30-day period before the election, giving the vote to whoever holds shares on that day.
- o Notice of Annual General Meetings (AGM) must be at least 21 days in advance, or 14 days for special meetings.
- o Shareholders must be able to ask questions related to AGM agenda items.
- o Shareholders must have the opportunity to vote by post.
- o Companies must disclose results on resolutions and this should be published on its website no more than 15 calendar days after the AGM.

In April 2007 the Financial Reporting Council (FRC) issued a consultation on the 'Review of the Impact of the Combined Code'. It will address the effectiveness of the 'comply or explain' regime, the impact of the Combined Code on smaller companies, how it supports board performance and whether disclosures are considered useful and proportionate in terms of cost to companies.

c. United States: In the United States, investor protection being governed by the federal and state laws, in addition to the implementation of the Sarbanes-Oxley corporate governance norms, different states have brought in several laws. These include; Under Delaware law:

- Any stockholder can inspect and copy a corporation's stock ledger, a list of stockholders, and certain books and records of the corporation;
- any stockholder can sue for an appraisal by the

chancery court of the fair value of the stockholder's stock in connection with certain mergers; and

- interested director transactions are subject to heightened approval requirements.

Further, the US federal securities laws and the SEC's rules also contain provisions aimed at protecting individual shareholders, such as:

- Requiring heightened disclosure for going private transactions;
- requiring issuers to send proxy materials to all shareholders (not just certain shareholders); and
- Mandating significant disclosures for related-party transactions.

Simultaneously rigorous work on further areas of reforms on the governance is being actively pursued and these include;

- improved quality in compensation disclosure;
- advisory votes on executive compensation;
- access to the management proxy for shareholder designated board candidates;
- reform of shareholder communications and proxy voting mechanics;
- promotion of global corporate governance standards and cross-border voting protections;
- transparency in stock lending, empty voting and the governance impact of hedging and derivative trading strategies;
- reduction of regulatory costs;
- use of technology in disclosure and communications;
- alleviation of short-term investment and business focus;
- Maintaining financial market efficiency and competitiveness.

d. China: The total market capitalization at the end of March 2007 was RMB 12.36 trillion, representing about 55% of the country's GDP last year. From only about a dozen listed companies in 1990, there were 1459 listed companies by March of 2007. There are now 116 securities firms, with over 100,000 practitioners, and 82 million investor accounts. From 1991 to 2005, total funds raised by Chinese companies through public offerings reached RMB 1,159 billion. One of CSRC's major reforms is the requirement to have independent directors on the board to overcome the "insider control" problem in many of China's listed companies. The CSRC Guidelines on Independent Directors (August 2001) required that each listed company should have at least one third of the board made up of independent directors by June 2003. Independent directors are required to serve as chairs

of audit, compensation, and nomination committees and major related-party transactions of the company have to be approved by independent directors. A recent survey showed that, as of December 2005, 4,640 independent directors had been appointed at shareholder meetings for the 1,381 listed companies in China. In most companies now at least one-third of the board are independent directors and it is evident that they are playing a more important role in corporate governance. A listed company is required to publish an audited annual report as well as a semiannual report. From 2002, listed companies are also required to publish un-audited quarterly reports. The rules have recently been revised to simplify and streamline the format of these reports so that they would be more readable and easily understood by investors. To better protect the rights and interests of public investors, the CSRC issued The Provisions on Strengthening the Protection of Rights & Interests of Public Shareholders (December 2004). According to the Provisions, listed companies' major business decisions, such as rights issues and issuing additional new shares, and equity-for-debt plans, should receive a majority of the votes from holders of tradable-shares present at the general shareholders meeting.

e. France: A law passed in July 2005 set things on course by requiring shareholder approval of the pension schemes of executive directors as well as golden parachutes and retirement schemes of managing directors. Another positive step was made with the introduction of a legal requirement for the chairman of the board of directors/ supervisory board to explain the remuneration policy to shareholders, who generally do not find these explanations satisfactory. 1) The compensation review must be exhaustive, 2) compensation must be seen by reference to the relevant business lines, 3) performance criteria must correspond to corporate targets and be simple to determine. Current trends in AGM voting indicate that shareholders are voting against the following: o Authorities to issue shares without preferential subscription rights. o Poison pills and other takeover defenses. o Allocation of free shares to employees and stock option plans. o Amendments to the articles of association relating to the threshold disclosure requirements. o Share buybacks.

f. Germany: The survey shows that independent non-executive directors today comprise only 28% compared to the European average of 54%. Just 27% of the major companies have an independent chairman. The proportion of independent members

of audit and remuneration committees in Germany is only 26% and 23% respectively. Only 7% of German supervisory boards are international board members compared to the UK with 31% and Switzerland with 45%. However, the 8th EU Directive (auditor directive) to be implemented by June 2008 could lead to a change of this proportion since it requires an independent chairman for the audit committee.

g. Russia: A survey on the corporate governance in Russia by the Russia Institute of Directors brings out the following features. Major areas of where improvement was evident included;

- the practice of recording the property title;
- board authority to approve material transactions;
- regulation of using insider information;
- ways of disclosing information to shareholders before the general meeting;
- cross-ownership of shares;
- dividend payments on common and preferred stock;
- the adoption of a corporate governance code. In respect of governance and control, major improvements were evident in ;
- bringing external (independent) directors to the boardroom;
- the regularity of board meetings;
- the establishment of board committees;
- having a regulatory framework for the board and the executive body;
- the introduction of board members' remuneration practices;
- putting in place the procedures for identifying possible conflicts of interests in the board and amongst top managers;
- the establishment of internal control functions. Improvements observed in the disclosure standards include;
- information about the company's strategy;
- information about the composition of the company's governance and control bodies;
- disclosure about general practices of corporate governance. Weaknesses that persist include; deficiencies in the procurement of goods and services;
- the involvement of independent appraisers;
- the practice of hiring external auditors;
- the existence of an approved dividend policy;
- the absence of formal corporate documents that outline the principles used for the calculation of dividends and the minimal share of net profit; the formalistic nature of many board committees;

- insufficient attention to the professional development of board members;
- the absence of a clear and understandable procedure of executive and board evaluation; the loose link between executive remuneration and the company's performance;
- poorly developed succession practices and succession planning;
- low level of independence and efficiency in the work of the audit commissions. poor disclosure of beneficiary ownership;
- poor disclosure about individual remuneration of members of the governance and control bodies and the principles on which such remuneration is based, insufficient use of available disclosure channels such as the annual report and corporate website.

h. South Africa: Some of the key reforms proposed in a recent Bill on the corporate governance include;

- There should be a uniform accounting standard to ensure that any financial information published by a company is calculated in accordance with generally accepted accounting practice (GAAP), which has to be comparable with the international standards adopted by the International Accounting Standards Board.
- A companies' ombud is created which provides a forum for alternative dispute resolution on company issues.
- The Bill introduces three categories of companies, with the one category, namely a public interest company, having greater responsibility to a wider public and more demanding disclosure and transparency provisions.
- The Bill creates a capital maintenance regime based on solvency and liquidity requirements which is a shift from a regime based on par value.
- The chapter on corporate governance provides for the codification of directors' duties, provisions addressing conflicts of interest and an increase in directors' liability.

The Bill sets out simplified and flexible processes for approval of transactions that will fundamentally alter the structure of a company. The provisions deal with the disposal of substantially all of a company's assets or an undertaking, a scheme of arrangement or a merger or amalgamation. Minority shareholders are also afforded better protection in line with modern international corporate law. Business rescue is being

introduced in place of judicial management. Business rescue will be conducted by an independent supervisor and subject to court intervention. The interests of shareholders, creditors and employees are recognized in the development and approval of a business rescue plan. Notably, the interests of workers are protected by recognizing them as creditors of the company, with a voting interest to the extent of any unpaid remuneration. The Bill tends to decriminalize non-compliance and uses a system of administrative enforcement.

Middle East: The first Code of corporate governance was launched in Oman as early as 2002. Egypt has published two corporate governance Codes, one for listed companies and one for State Owned Enterprises. Egypt has sought to strengthen its listing rules and is focusing on implementation by launching the Egyptian Institute of Directors and a series of training programs being conducted by the Egyptian Banking Institute for bank directors. Bahrain, Morocco, Qatar, and Tunisia have facilitated the review of their legal and regulatory framework and are in the process of preparing a corporate governance Code. Jordan is developing a model corporate governance Code for listed companies. Lebanon has conducted a bank corporate governance survey and conducted a legal review followed by the Central Bank issuing a corporate governance regulation. Additionally the Lebanese corporate governance Task Force has spearheaded the development of a Code of corporate governance for non-listed companies and is working with Lebanese companies for voluntary compliance. In the UAE, the Central Bank has drafted corporate governance guidelines for banks, and the UAE's Securities and Commodities Authority has issued a corporate governance Code, setting a national governance standard, for both the Dubai Financial Markets and the Abu Dhabi Securities Market. Similarly, Saudi Arabia's Capital Market Authority launched corporate governance regulations for its listed companies, and the banking sector is seriously looking at improving corporate governance standards. The West Bank/Gaza is also in the process of developing a Code of Corporate Governance, after a series of corporate governance awareness programs organized by business associations and regulatory authorities. Corporate governance plays an important role in investment decisions. In Brazil, Sao Paulo Stock Exchange launched a new market segment in 2001, The Novo Mercado where companies listed in this exchange have to comply with international standards and not

those applicable to the companies listed in the main board. Institutional investors invested teams of people responsible for reviewing corporate governance practices in the companies in which they are investing.

Corporate governance as "If a country does not have a reputation for strong corporate governance practices, capital will flow elsewhere. If investors are not confident with the level of disclosure, capital will flow elsewhere. If a country opts for a lax accounting and reporting standards, capital will flow elsewhere. All enterprises in that country- regardless of how steadfast a particular company's practices may be-suffer the consequences. Markets exist by the grace of investors. And it is today's more empowered investors that will determine which companies and markets will stand the test of time and endure the weight of greater competition. It serves us well to remember that no market has a divine right to investors' capital".

Organization of Economic Cooperation and Development (OECD) which spearheaded the design and development of corporate governance principles and guidelines defined it as" Corporate governance involves a set of relationships between a company's management, its board, its shareholders, and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set and the means of attaining those objectives and monitoring performance are determined". An institutional point of view presented by Ira Millstein, who worked on drafting the OECD corporate governance guidelines as also the co-chairman of the NYSE-NASDAQ constituted Blue Ribbon Committee (1998) that looked into important aspects of the audit committees, defined "Corporate governance refers to that blend of law, regulation and appropriate voluntary private sector practices which enables the corporation to attract financial and human capital, perform efficiently and thereby perpetuate itself by generating long term economic value for its stakeholders, while respecting the interests of stakeholders and society as a whole". From an academic perspective based on extensive surveys and studies on the subject, Heifer and Vishnu (1997) define corporate governance as the ways in which suppliers of finance to corporations assure themselves of getting a return on their investments.

CONCLUSION

It is true that the 'corporate governance' has no unique structure or design and is largely considered ambiguous. There is still lack of awareness about its

various issues, like, quality and frequency of financial and managerial disclosure, compliance with the code of best practice, roles and responsibilities of Board of Directories, shareholders rights, etc. There have been many instances of failure and scams in the corporate sector, like collusion between companies and their accounting firms, presence of weak or ineffective internal audits, lack of required skills by managers, lack of proper disclosures, non-compliance with standards, etc. As a result, both management and auditors have come under greater scrutiny. But, with the integration of Indian economy with global markets, industrialists and corporates in the country are being increasingly asked to adopt better and transparent corporate practices. The degree to which corporations observe basic principles of good corporate governance is an increasingly important factor for taking key investment decisions. If companies are to reap the full benefits of the global capital market, capture efficiency gains, benefit by economies of scale and attract long term capital, adoption of corporate governance standards must be credible, consistent, coherent and inspiring.

Quality of corporate governance primarily depends on following factors, namely:- integrity of the management; ability of the Board; adequacy of the processes; commitment level of individual Board members; quality of corporate reporting; participation of stakeholders in the management; etc. Since this is an important element affecting the long-term financial health of companies, good governance framework also calls for effective legal and institutional environment, business ethics and awareness of the environmental and societal interests. Hence, in the years to come, corporate governance will become more relevant and a more acceptable practice worldwide. This is easily evident from the various activities undertaken by many companies in framing and enforcing codes of conduct and honest business practices; following more stringent norms for financial and non-financial disclosures, as mandated by law; accepting higher and appropriate accounting standards; enforcing tax reforms coupled with deregulation and competition; etc.

However, inapt application of corporate governance requirements can adversely affect the relationship amongst participants of the governance system. As owners of equity, institutional investors are increasingly demanding a decisive role in corporate governance. Individual shareholders, who usually do not exercise governance rights, are highly concerned about getting fair treatment from controlling

shareholders and management. Creditors, especially banks, play a key role in governance systems, and serve as external monitors over corporate performance. Employees and other stakeholders also play an important role in contributing to the long term success and performance of the corporation. Thus, it is necessary to apply governance practices in a right manner for better growth of a company.

REFERENCES

- Adam Smith "An Inquiry into the Nature and Causes of the Wealth of Nations." Pp no. 112
- La Porta, Rafael, Florencio López-de-Silanes, Andrei Heifer y Robert W. Vishnu (1998), Law and finance, Journal of Political Economy 106, 1115-1155.
- Hutchinson, Marion y Ferdinand A. Gull (2004), Investment opportunity set, corporate governance practices and firm, Journal of Corporate Finance 10, 595-614.
- Lowenstein, Louis (1996), Financial transparency and Corporate Governance: You manage what you measure, Columbia Law Review 96, 1335-1353.
- Omkar Goswami, 2002, "Corporate Governance in India," Taking Action against Corruption in Asia and the Pacific (Manila: Asian Development Bank), Chapter 9.
- The Advisory Group on "Corporate Governance" was set up w.e.f. Feb. 8, 2000, under the Chairmanship of Dr. R.H.Patil. It submitted its report on March 24, 2001, see <http://www.rbi.org.in>
- Confederation of Indian Industry, Desirable Corporate Governance: A Code (1998).
- Unit Trust of India (UTI), Code of Governance (1999).
- The Government of India, in August 2002, constituted a High Power Naresh Chandra Committee to examine the Auditor-company relationship, to examine the role of independent directors and how their independence and effectiveness can be ensured. The Committee submitted its report to the Finance Minister on 23rd December 2002. The Committee recommended that audit committee to be set-up composed of independent auditors, companies to

have at least 50 percent independent directors, certain professional assignments should not be undertaken by auditors, every five years audit partner should rotate but no need for audit firm's rotation.

- The Standing Committee was constituted by the RBI, in consultation with the Government of India, in December, 1999. The Committee submitted its Report in May, 2002. The Report indicated that its main objective was to essentially sensitize the authorities and markets to international practices and to benchmark Indian market practices with international standards and codes.
- Vepa Kamesam, Corporate Governance, Economic Development in India, vol.48, pp.55-84
- The Regulatory Regime: Focus in Europe by Charlie Mccreevy, European Commissioner for the Internal Market and Services, ICGN Year Book 2007
- The UK at the Hear of European Developments, Kerrie Waring, Corporate Governance Manager, Institute of Chartered Accountants of England and Wales, ICGN Year Book 2007
- Regulatory Issues in China: Progress and Challenges, Daochi Tong, Deputy Director General, Public Offering, China Securities Regulatory Commission, ICGN Year Book 2007
- Corporate Governance Progress in France, Josiane Fanguinoveny, Services Director, Governance for Owners, ICGN Year Book 2007
- The Regulatory Regime: US Perspective, Roel C. Campos, SEC Commissioner, ICGN Year Book 2007.
- South Africa's Ambitions: Achieving International Standards of Governance, Mervyn King, Chairman of the Global Reporting Initiative, and Chairman, King Committee on Corporate Governance in South Africa. ICGN Year Book 2007
- A Dynamic and Changing Environment: Middle East and North Africa, Nsser Saidi, Executive Director, Hawkamah Institute for Corporate Governance and Chief Economist, Dubai International Financial Center. ICGN Year Book 2007.

Corporate Governance Model



Source: Omkar Goswami, 2012, "Corporate Governance in India,"