CORPORATE GOVERNANCE IN INDIA: ISSUES FOR CONSIDERATION

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ABSTRACT

In order to promote good corporate governance, the national strategy must encompass measures to enforce the system of accountability to the shareholders, strengthening of the democratic process and strengthening the media to ensure public awareness, undertaking the regular policy reviews and effective corporate leadership. Accountability, transparency, efficiency and discipline are the important ingredients that go a long way in building trust of the shareholders to the corporate world. There is no denying to the fact that without shareholders trust in the corporate world, it is very difficult for the big corporate firms to mobilize the necessary resources and ensure their abundant support in the corporate activities of the firms. All in all, a well planned harmonization between various factors underlying corporate governance together with complementary institutions providing enforcement do play an important role in good corporate governance .

Keywords : Corporate Governance, accountability, transparency, discipline, Government policy and regulations.

INTRODUCTION:

Just as economic and political forces around the world are driving change in corporate governance, society's changing expectation, particularly in the developed world, are also prompting change. Society's expectations of corporate entities operating in their midst are broadening. Norms for corporate social responsibility and sustainability are becoming commonplace in the advanced world. The inevitable differences between cultures, jurisdictions and stages of economic development could be recognised more specifically in defining governance requirements, and appropriate risk profiles could be created, avoiding the process of merely adopting advanced country norms.

Just as society's expectations of corporate entities are changing, so are its expectations of the performance and behaviour of individual directors. The concept of good governance is founded on trust. If a corporate entity is to be trusted, its governing body must be trusted, and that means that individual directors must be trusted, too. Honesty, integrity, openness, putting the needs of the members ahead of personal interest is inherent in the idea of good governance. This perspective is likely to be reinforced in the years ahead as the pressures on corporate entities and the challenges facing directors expand.

IS CORPORATE GOVERNANCE A RECENT PHENOMENON?

Corporate governance in India has tended to assume increased significance only in recent times. But it does not mean that it is only of recent origin? While it is true that focussed attention on this phenomenon has begun to be paid only in recent times, particularly in era of globalisation. A brush over the history of the corporate world makes it thoroughly clear that corporate governance has always remained an important part of the corporate world in the appearance of the assumption of rationality and consistency on the part of a firm/business organization. Corporate governance has been practiced for as long as there have been corporate entities. Yet the study of this subject is less than half a century old. Indeed, the phrase 'Corporate governance' was scarcely used until the 1980's.

The 20th century saw massive growth in serious management thought. Organization theories took great strides, but the board did not appear on the organizations chart. Strategic management acquired new significance, although the contribution of the board seldom received a mention. Important theories and practices were developed for the role of the directors.

Board of directors of a company is ultimately responsible for that organization's decisions and its performance. It is the board that is accountable to the owners, members, and other legitimate stakeholders. The directors should be providing direction and supervising the work of executive management.

Corporate governance is about the exercise of power over corporate entities. It has become one of the central issues in the running and the regulating of modern enterprise today. However, the underlying ideas and concepts of corporate governance have been surprisingly slow to evolve.

The 19th century saw the foundations laid for modern corporations: thus was the century of the entrepreneurs. The 20th century was the century of management: the phenomenal growth of the management theories, management consultants, management gurus and management teachings, which all reflected a preoccupation with management. Now the 21st century is the century of corporate governance--------- as the focus swings to the authenticity and the effectiveness of the wielding of power over corporate entities worldwide.

CORPORATE GOVERNANCE

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

Well-defined and enforced corporate governance provides a structure that, at least in theory, works for the benefit of everyone concerned by ensuring that the enterprise adheres to accepted ethical standards and best practices as well as to formal laws. To that end, organizations have been formed at the regional, national, and global levels.

In recent years, corporate governance has received increased attention because of high-profile scandals involving abuse of corporate power and, in some cases, alleged criminal activity by corporate officers. An integral part of an effective corporate governance regime includes provisions for civil or criminal prosecution of individuals who conduct unethical or illegal acts in the name of the enterprise.

The definition of corporate governance most widely used is "the system by which companies are directed and controlled" (Cadbury Committee, 1992). More specifically it is the framework by which the various stakeholder interests are balanced, or, as the IFC states, "the relationships among the management, Board of Directors, controlling shareholders, minority shareholders and other stakeholders".

The OECD Principles of Corporate Governance states:

"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."

While the conventional definition of corporate governance acknowledges the existence and importance of 'other stakeholders' they still focus on the traditional debate on the relationship between disconnected owners (shareholders) and often self-serving managers. Indeed it has been said, that corporate governance consists of two elements:

1. **The long term relationship** which has to deal with checks and balances, incentives for manager and communications between management and investors;
2. **The transactional relationship** which involves dealing with disclosure and authority.

This implies an adversarial relationship between management and investors, and an attitude of mutual doubt. This was the basis for much of the rationale of the Cadbury Report, and is one of the reasons why it prescribed in some detail the way in which the board should conduct itself: consistency and transparency towards shareholders are its watchwords.

CORPORATE GOVERNANCE AND ECONOMIC GROWTH

Does corporate governance lead to economic growth? In other words, what is the relationship between corporate governance and economic growth? Although, it is very difficult to answer this question, yet an attempt involving a close examination of the issues pertaining to the two reveals that corporate governance means good corporate governance, which in turn implies the speeding up in economic growth through the growth of the corporate world. One key element of improving microeconomic efficiency is corporate governance. Corporate

Governance affects the development and functioning of capital markets and exerts a strong influence on resource allocation. It impacts upon the behaviour and performance of firms, innovative activity, entrepreneurship, and the development of an active SME sector.

In an era of increasing capital mobility and globalisation, corporate governance has become an important framework condition affecting the

industrial competitiveness of various countries. Meanwhile, in transition economies, privatisation has raised questions about the way in which private enterprises should be governed. Poor corporate governance mechanisms in various countries have proved, in part, to be a major obstacle for improving the competitiveness of firms. Better corporate governance, therefore, within countries should apparent itself in improved corporate performance and can lead to higher economic growth.

In this regard, different countries, depending upon their priorities, have tended to follow different types of policies in respect of corporate governance. The impact of these policies has tended to index important variations across space and time. Accordingly, one comes across successes as well as failure stories regarding corporate governance and its impact. It can however be maintained that on the whole, the countries which have caught up speedily in this regard have successed in experiencing comparatively faster growth than those who have lagged behind in this respect. As such, India can draw some important lessons from both the successes and failures experienced by other countries in this regard.

IMPLICATIONS FOR INDIA

No doubt even a positive relation exists between the corporate governance and economic growth yet definite generalizations are still inappropriate. The various implications of corporate governance for India can be stated as:

First, It has come to be commonly perceived in policy making that corporate governance has a developmental effect. Without declining the value of such a perception, it is, however, not irrelevant to note that such a view point does not necessarily mean automatic improvement in terms of investor protection. This, in turn, has serious implications in regard to enforcement of the law, envisaging protection of investors' right in general and that of small investors in particular. The media can play an important role in informing and education the investors about their entitlements.

Second, due to the tendency on the part of a large number of unprincipled firms fixing thousands of crores of rupees of all types of investors in the various scams as have been witnessed in recent times in India, there are comparatively fewer listed firms which have been left in the arena. A characteristic feature of a large number of these firms has been that ownership and control in them is heavily concentrated. To put the point straight, these firms or business groups are organized through extensive cross ownership. As such, these firms often get dominated by a controlling family, and have often good contacts in the government. Shareholders protection laws may not be a relevant standard for assessing the working of capital markets due to the fact that group based corporate structure is usually as a response to lack of capital market institutions. The facts shows that the group membership and firm's profitability are positively correlated. Moreover, such a relationship is said to be statistically significant. In view, of this, it seems quite reasonable that given the type of prevailing environment in which the firms operate, they, with all their gloom, lack of outside accountability, and insider dominance, do not at least harm their shareholders. In spite of this, the monitoring of these firms or business organisations by government can play an important role in ensuring and assuring the investments made by small investors.

Third, it is usually believed that external finance constraints the growth of firms. In India, however, the actual or potential role of external finance is not fully clear as yet. The finance, despite of its nature or character, will help only when firms have access to projects characterized by sufficiently low risks on the one hand, and enhanced and high profitability on the other. As against this, the risk premium is very high in India due to a wide variety of factors. Owing to this reason perhaps, if such projects were available in the country, the Indian firms' would probably prefer to draw on internally generated funds before targeting external sources. In such a situation firms/business groups play an important role in that a firm/group, by channelling resources across the firms it is related with, attempts to relax the liquidity constraint at the firm's level. And if it were successful in its attempt, it would, in the event of its controlling some financial institution, undertake to enhance this mechanism. It is again quite possible that legal reform, if it disrupts these channels without establishing new and relatively more reliable ones, may come out to be significantly harmful.

Fourth, it has been experimental over the years that there exist close ties between owners of business and the government. These ties have been regarded as as crony capitalism. What this brand of capitalism signifies is that the economy is trapped in a "Kafkaesque maze of controls". Although this type of capitalism does not seem to be a corporate governance problem in the traditional sense, yet it certainly does affect corporate governance. It is due to the fact that large family owners, more often than not, use their influence to limit competition, to obtain favourable finance from the government, and in several other ways to slant the game in their favour. This is what the Indian corporate sector has been doing in the post independence period. Given that the budget constraints in the country are a common feature, crony capitalism can be a strong restriction to outside investors. Adequate safety nets therefore are required to be introduced in this regard.

SOME DRIVERS OF CHANGE

There are number of ongoing issues that may well affect the future direction of corporate governance principles, policies and practices. These include:

- The 2008 financial crisis prompted by the securitization of subprime mortgage loans in the United States led to the collapse, takeover, liquidation, or nationalization of banks and other financial institutions around the world, raised some fundamental corporate governance issues. Despite the 2007 Base II agreement, which called for professional risk assessment in the financial world, boards failed in their responsibilities. The messages for corporate governance are legion including the need to match directors' reward with performance, to improve strategic risk assessment at board level, and to rebuild confidence and trust through professional corporate governance.
- The growing importance and wealth generating capacities of the emerging economies, particularly India, are likely to have power to influence international corporate governance and accounting standards.
- The acquisition by overseas interest of major companies where the economic performance of a country could be affected. So India too may expect calls for new corporate governance and accounting standards.
- The effects of globalization as international companies apply to common governance and accounting standards across their groups. The integration of both financial and product/service markets around the world will accelerate this trend.
- The potential of companies in India and other emerging economies to become global through cross border acquisitions.
- The trans-national membership of boards of companies operating globally. Though developments are likely to be slow, ultimately a class of directors of global companies may emerge who transcend national boundaries, economic interests and political barriers.
- The replacement of the classical audited annual accounts by more frequent financial reviews, strategic reports, risk analyses, corporate resources reviews, operating statements, and corporate governance reports. The use of probabilities, director's expectations of the likelihood of future events, may become more acceptable than strategic statements in corporate reports. Websites and real time internet corporate commentary have the potential to replace some periodic published company information.
- The structure of public company boards. The need to balance the skills, experience, network connections, and other attributes of directors to produce an effective team will become clearer.
- The qualifications and characteristics of directors. As the challenges and frisks of taking on a directorship in major entities grow, more clarification and better definitions of the skills, knowledge, and experience needed to be capable of meeting the challenges will occur.
- The vital importance of the leadership role of the chairman will be recognised. Going beyond the structures of the compliance codes, more attention is likely to be paid to board dynamics and the chairman's leadership role to achieve corporate success.

CONCLUSION

Corporate governance is of pivotal importance today than ever before owing to the increasing competition being witnessed in terms of time horizon. As regard the policy, it can be maintained that neither theory nor experience of others can provide any magic formula for bringing about good corporate governance.

Though particular solutions do exist, yet the question of optimal degree does not admit of any general solution. Accordingly, instead of searching to a great extent for viable solutions outside, we will have to devise our own mechanisms to fight with our own problems in respect of good corporate governance.

Governance involves a political process. Governing bodies need to ensure that the entity fulfils its mission, meets its aims, whether these are providing goods or services to satisfy markets, offering a social service to meet society's needs or fulfilling some other purpose. In the process the entity may create wealth, provide employment, facilitate innovation, and contribute to society at the local and national levels.

A successful governing body needs a cadre of the competent. Respected leadership is a crucial driving force. Professionalism, with continuous personal development and learning, is fundamental. In future, governing bodies may have to be less rigid, less bounded, and more adaptable. That might mean board styles are transient, more flexible, and certainly less formal.

The original concept of the corporation was founded on trust. Trust was at the heart of the capitalist system. Agreements were sealed with a handshake. Directors were recognized a reliable stewards of the interests of others.

Unfortunately, in recent years it has been corruption, crisis, and corporate collapse that have driven changes in corporate governance practice. Greed seems to have replaced as capitalism's driving force. Indeed, the dominate hypothesis of corporate governance, is embedded in the belief that people are utility maximizers who need to be controlled because they cannot be trusted. Certainly, too often a directorship seems to have been used as a means of self aggrandisement, a basis for power, or a path to personal gain.

The overall challenge in developing corporate governance is to balance conformance with performance: to encourage entrepreneurial risk taking, whereas appropriately rewarding investors, and adequately protecting other stakeholders who may be affected by corporate activities, in both the short and the long term. The place of corporate entities within society needs to be rethought. Above all, governing bodies need people who can be trusted, people who understand their fiduciary responsibilities, people who put the rights and needs of others ahead of their own.

Some might come back with that the socialist trial clearly showed, on a global scale, that it is impossible to build organizations run by people who are not primarily acting in their own best interests. But the best interests of people need not be solely power, personal greed. In the not for profit sector, and indeed in the corporate sector too, people do act responsibly in the interests of others, showing integrity, treating employees and other stakeholders fairly, and contributing to their community's and society's needs , being reliable stewards for others' interests.

It can also be observed that effective corporate governance will often require a combination of threats and co-operation of the main actors. Given the weakness of governments in terms of their growing instability and the exogenous controlling entities in India, fundamental reforms will not take place against the will of the main actors. In view of this problem, the solution, therefore, lies in co-opting of the pivotal groups.

And finally, while the possibility of others viewing it otherwise cannot be ruled out that firm's behaviour is specific and differentiated. As such, it becomes possible to compartmentalize it. And given that different aspects of corporate governance are tried to each other, the greater weight to one than to the others, might not serve the desired purpose. It might rather prove to be counterproductive in that the desired objective might get defeated. Concerted efforts, therefore, are required to be made to synchronise the various aspects so that the trade off, if any can be resolved.

In the light of the above it is safer to argue that in order to promote good corporate governance, the national strategy must encompass measures to enforce the system of accountability to the shareholders, strengthening of the democratic process and strengthening the media to ensure public awareness, undertaking the regular policy reviews and effective corporate leadership. Accountability, transparency, efficiency and discipline are the important ingredients that go a long way in building trust of the shareholders to the corporate world. There is no denying to the fact that without shareholders trust in the corporate world, it is very difficult for the big corporate firms to mobilize the necessary resources and ensure their abundant support in the corporate activities of the firms. All in all, a well planned harmonization between various factors underlying corporate governance together with complementary institutions providing enforcement do play an important role in good corporate governance .

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