

# Corporate Governanace In India

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## Abstract

Corporate Governance is concerned with the establishment of a system whereby the directors are entrusted with responsibilities and duties in relation to the direction of corporate affairs. It is concerned with accountability of concerned persons, who are managing it towards the stakeholders. It is concerned with the morals, ethics, values, conduct and behaviors of the company and its management. This paper deals with the governance of business organization in the context of business corporate sector.

**Index terms**— Concerned, Management, Governance, Corporate

## 1 INTRODUCTION

here is inadequate research available regarding the issues of corporate governance in India. In light of the growing importance of India in the world economy as a source of intellectual capital and outsourcing possibilities, there is an urgent need to understand the governance structures in India 1 , Indian corporate governance codes based on the US and UK experience do not resolve specific governance issues. "Corporate governance issues and problems in India are different from those typically encountered abroad". Despite a long corporate history, the phrase corporate governance remained unknown until the late 1990s in India. The liberalization of the Indian economy in 1991 opened up vast potential for the Indian capital market, which saw spectacular growth in its size. However, cases of fraud, malpractices and inefficiency reveal structural problems in the Indian capital market and call for better implementation of corporate governance standards in the country. 2 According to Lalita S. Som (2006) the issues in corporate governance in the Indian context arise due to (a) "ownership structure in companies", (b) "failure of boards", (c) "accounting practices and transparency". Truly independent directors are "rare" in Indian companies. Corporate governance problems also arise due to problems of (a) "surveillance and enforcement mechanisms and the court system", (b) "insufficient powers of SEBI to police violations of regulations" and (c) "lack of shareholder activism in India". Mo. 09899765526 Email: abhi\_rsmt@yahoo.co abhishekgupta@mdi.ac.in According to Vittal (2001), the need for corporate governance in India has been highlighted because of the scams we have been having almost as an annual feature ever since we had liberalisation in 1991. We had the Harshad Mehta Scam, the Ketan Parikh Scam, the UTI Scam, the Vanishing Company Scam, and the Bhansali Scam and so on. In the Indian corporate scene, we must be able to induct global standards so that at least while the scope for scams may still exist, we can reduce the scope to the minimum 4 . Vittal further feels that the legal and administrative environment in India provides excellent scope for corrupt practices in business. The ethical temperature of any business or capital market depends on three factors. The first is the individual's sense of values. The second is the social values accepted by the business and industry. The third and perhaps the most decisive factor is the system. It is here we face the main challenge. Our system encourages the lack of corporate governance 5 . The central problem in Indian corporate governance is a conflict between the dominant shareholders and the minority shareholders. The governance structures of PSUs are incompatible with the efficient and successful operation. The Board has very little say in the selection of the CEO or in the composition of the Board. As far as audit is concerned, the dominant role is that of the Comptroller and Auditor General (CAG), many operating decisions have to be brought to the Board for decision-making, which pushes the Board into managing rather than directing 6 . Independence of non-executive directors appears to be one of the main issues of corporate governance in India; Very few such competent people are in supply. Any suitable candidate needs to

## 5 ELEMENTS OF GOOD CORPORATE GOVERNANCE

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have a public stature to inspire confidence in the shareholders. Ideally, they should be prominent industrialists and not friends or promoters of the manager<sup>7</sup>. Corporate governance structures in different countries are of two broad categories namely, the market-based system as in British and American models and the bank-based system as in Japan and Germany. The Indian situation is a "combination" of these two models. Although the financial institutions play a much bigger role in financing corporate activity, the "financial institutions in general have failed to fulfill their limited role in corporate governance<sup>8</sup>". "In India, enforcement of corporate laws remains the soft underbelly of the legal and corporate governance system". Boards do not monitor management effectively. There is inadequate protection for minority shareholders and creditors in India". "Nevertheless, with industry organizations and chambers of commerce themselves pushing for an improved corporate governance system, the future of corporate governance In India promises to be distinctly better than the past<sup>9</sup>. II.

## 2 CODES OF GOOD CORPORATE GOVERNANCE IN INDIA

The Cadbury Code of Best Practices (1992), adopted by the London Stock Exchange as the listing requirement for companies in the UK, is the first modern corporate governance code, consisting of elements of good governance of business corporations. Following the example of the Cadbury Code, different countries and markets developed codes of best practices to be followed by their companies. By the end of the century, there were more than sixty CG codes adopted by different national economies. Numerous international codes were also issued aimed at uniformly raising the governance standards of firms in different countries in order to attract investors and reduce the cost of capital. The different CG codes prescribe appropriate management and control structures of a company and the rules relating to the relations between owners, the Board of Directors and the management led by the CEO. In its broadest sense, corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as closely as possible the interests of individuals, corporations and society<sup>10</sup>, III.

## 3 CORPORATE GOVERNANCE INITIATIVES IN INDIA

Corporate governance initiatives In India began in 1998 with the desirable Code of Corporate Governance -a voluntary code published by the Confederation of Indian Industries (CII). SEBI, the regulator of companies listed in the stock exchanges, introduced the first regulatory framework for corporate governance in the listed companies in February 2000, following the recommendations of the Kumar Manglam Birla Committee, appointed by SEBI in this regard. The Kumar Manglam Birla Committee stated that, "It is almost a truism that the adequacy and the quality of corporate governance shape the growth and future of any capital market and economy. Studies of firms in India and abroad have shown that markets and investors take notice of well-managed companies, respond positively to them, and reward such companies with higher valuations". The Narayana Murthy Committee (2003), appointed by SEBI, stated that "investment is ultimately an act of faith in the ability of a corporations management. When an investor invests money in a corporation, he expects the board and the management to act as trustees and ensure the safety of the capital and also earn a rate of return higher than the cost of capital. In this regard, investors expect management to act in their best interests at all times and adopt good corporate governance practices".

IV.

## 4 OBJECTIVES OF GOOD CORPORATE GOVERNANCE

Good governance is integral to the very existence of a company. It inspires and strengthens the investor's confidence by ensuring the company's commitment to higher growth and profits. Corporate Governance must be based upon the principles of transparency in board processes and independence of boards, accountability to stakeholders, fairness or all stakeholders; and social, regulatory and environmental concern. Based upon the above principles, the Institute of Company Secretaries of India recommended that the Board should be properly structured with adequate number of non-executive and Independent Directors. Board procedures and practices should be transparent and decisions should be informed, independent and objective. The board should keep the shareholders informed of the relevant developments of the company. The board should monitor functioning of the management team and remain in effective control of the company<sup>11</sup>.

V.

## 5 ELEMENTS OF GOOD CORPORATE GOVERNANCE

According to the Institute of Company Secretaries of India (ICSI), good corporate governance requires inter alias, identification of powers and accountability of the board, CEO and Chairman of the Board, transparent and ethical management environment, an efficient and effective board consisting of competent persons appointed, following due procedure, training and continuous education of directors, appointment of sufficient number of independent directors, provision of independent legal and professional advice to directors at the company's expenses. Further, ICSI also recommended for code of conduct for all managers and its effective monitoring, long-term strategic plan

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for the company, corporate social responsibility, regular and accurate financial statements, regular information about financial position of the company to the shareholders, evaluation by the board of its own performance, independent Audit Committee and effective risk management plans 12 . VI.

## **6 BOARD OF DIRECTORS: SELECTION PROCESS, QUALIFICATION, TENURE, AGE, LEGAL PROVISION, ROLE & RESPONSIBILITIES**

In this research we have studied the selection procedure, tenure, age and qualifications for public sector boards prescribed under the legal provisions and directives and also the need for orientation of the BODs. All these decide who will become directors and what qualities to look for in directors. In selecting members, the board must assure itself of their commitment to learn the business of the BODs (and) importantly, devote the necessary time and effort (NACD Report). In case of public sector companies of India we may say that the Selection committee for BODs positions should take the above into consideration while making selections to these positions whether it is executive director or non-executive director. The bottleneck is at the head of the bottle goes and old saying. No business can be better than its top management, have broader vision than its top people, or perform better business needs a central governing organ and an organ of review and appraisal. On the quality of these two organs, which together comprise BODs, its performance, results and spirit largely depend. Therefore the selection process followed for identifying directors is an important aspect to be focused on while studying BODs.

### **7 a) Composition of the Board of Directors:**

In terms of the recent developments in the area of corporate governance world over and especially after the Cadbury Code in the UK and the Blue Ribbon Committee of USA the role of the non-executive especially that of the Independent directors has come into prominence. The Confederation of Indian Industries code on Corporate Governance and the more recent SEBI recommendations based on the Kumar Mangalam Birla Committee report on Corporate Governance are important landmarks in this field in our country. In terms of the SEBI committee recommendations it is mandatory for all listed companies in India to have an optimum combination executive and non-executive director with not less than fifty percent of the board comprising the non-executive directors. The number of independent directors would depend on the nature of the chairman of the board. In case a company has a non-executive chairman, at least one third of the board should comprise of independent directors and in case a company has an executive chairman, at least half of the board should be independent. This is a mandatory recommendation for all the listed companies and these companies are to include compliance to these recommendations on corporate governance in their annual report.

The SEBI recommendations came in 1999 and it was required that all the listed companies should adopt the mandatory recommendations w.e.f. 2000-2001. Therefore all companies started analyzing these specifications and made necessary changes in their BODs executive independent directors on NAVRATNA BODs to begin with. (THE COMPOSITION OF BODs of surveyed companies in 2000-2001 is shown later on in this research.) The BODs consists of three kinds of directors -the executive directors or the functional directors responsible for the actual functioning of an organization, the non-executive directors representing majority shareholders (like the financial institutions' nominees in case of the private sector companies and the government nominees in case of the public sector companies) and the non-executive directors who are independent. Chairman of the BODs may be executive or non-executive. In our survey all the public sector companies have executive chairmen while three out of seven private companies have non-executive chairmen. In the BODs surveyed by us there are Director Finance and Director Personnel, along with a CMD, there are some Technical Directors as well depending on the business in which the company is for example ONGC has Director Exploration, director Production. HPCL have Director operations, Director Refinery and director Marketing and SAIL has Managing Directors for its four different plants and functional directors are in finance, projects, commercial, Research and development and operations. The disciplines of the executive directors in these units. It is observed that while PSEs have directors of the executive directors in these units, it is observed that while PSEs have directors specializing in particular functional areas, the private companies have general directors as inside directors as well. Their specialized requirements are met by the senior managers who may also be designated as vice president or president in particular area of operation. Government directors, referred to as part time official directors, are appointed by the administrative ministries and are officers dealing with the concerned enterprise, Usually there are two part-time official directors -a representative of the administrative ministry and financial adviser of the ministry. These directors provide a link or liaison between the enterprise and the ministry. In all of the nine NAVRATNA PSEs surveyed, at least two part-time official representative of the ministry are there. In fact in two down stream oil companies i.e. PBCL and HPCL.

### **8 b) Selection Process**

The process of short listing and screening is done by the PESB in coordination with the administrative ministry and then the final list of potential candidates to be considered for selection is ready. The respondents in our survey felt that there was need to rationalize the process of screening and short listing potential candidates.

Strong ideas were also expressed by 22 respondents regarding the first right of the insider candidates to board positions. The respondents felt that those insider candidates who have worked have worked in the organization throughout identify themselves with the organization and their loyalties and aspirations are strongly liked to organization growth and development and besides these they have better understanding of the organizational functioning having worked there at different levels and in different locations. The insiders who become directors are regarded as their own by other employees and required information and other technical inputs are other technical inputs are made available to them more easily. The PESB takes into account the performance in the interview and the track record as brought out in the confidential reports in respect of candidates from the PSEs or from organized services are concerned. For candidate from the private sector, such confidential respects are not available; if such candidates are selected, a confidential investigation is done by the Government before their appointment. Which was due to the time taken by the administrative ministry in taking clearance from the Central Vigilance Commission (CVC). Now PESB directly informs the CVC of the empanelled names at the same time as forwarding names to the administrative ministry. Meanwhile the CVC can takes its time in conveying vigilance clearance. While in the administrative ministry, the process for obtaining approval of the Appointments Committee of Cabinet and the President is commence. Once all the approvals are obtained, subject to CVC clearance, the appointment is done.

### 9 c) Weakness in the Selection Process

The process of selection of the functional directors of the PSEs has been streamlined and improved. Still the board members of the NAVRATNA public sector enterprises surveyed don't find the process very satisfactory. The respondents observed that there were some discrepancies in the selection and short listing stages of this process. For example one member from ONGC BODs mentioned that in the short listing for ONGC CMD's nominations recently, two senior managers i.e. Group General Managers (now Called ED) were in the list of those short listed for considered by PESB while two recently appointed directors were not considered as they had not put in one year in present post. Here just because of their elevation to BODs level these Directors lost the chance of being considered. Here what the respondents felt was we need a rational and logical process and solutions to all such situations should also be built in the system. The need for a fair and timely carried out selection exercise was emphasized by everyone. It was observed by 25 of the respondents that the process for selection to fill up the Board vacancies is not completed on time and this leads to last minutes confusion when the vacancy occurs. Here the point was made that time lag is very long between the issue of circular indicating a vacancy six months in advance and issue of actual appointment letter. There are cases where selection process began six months in advance and appointment letter was issued after the retirement of existing incumbent due to indecision or dispute. Court case has also been done by dissatisfied candidates.

### 10 d) Relevance of Qualifications

The respondents felt that qualifications matter in board level selections, as a qualified person will not only be able to take sound decisions but also command respect of subordinate (Table ??8). It is normal human reaction that we give more regard to a person who is more qualified as we see him / her as an expert in his area and we presume that he is more rational and analytical in his approach and capable of taking better decisions. Only four respondents in our survey felt that there can be no link between success at BODs level and qualifications as they felt that BODs role was based more on common sense. These respondents were ex-BODs members who it was later confirmed were not highly qualified only one respondent who was himself very highly qualified felt qualifications were not relevant. Thus qualifications were given their importance by all the respondents in our survey for appointment to PSE BODs. But it was also emphasized that need is more of generalists with proven leadership skills and business acumen. In selecting the functional directors, the norms specified by the PESB are followed and therefore qualifications are given due importance. It was observed in our survey that technical and related qualifications are there in the present in position directors previous experiences may however have been different as some of the BODs members said that they had under-qualified colleagues in some disciplines and faced problems of difference in approach to some issues of organizational relevance.

### 11 e) Tenure and Age for BODs positions

The issue of tenure of BODs members is taken up with the BODs members in our survey and they all strongly agreed that the term of the BODs director should be at least five years. This is essential to provide long term stability and continuity in board functioning and strategy formulation and its implementation and monitoring. In the private sector the board term is for a fixed period but normally the BODs continues to get re-elected till any real problem occurs. In fact there is a general agreement that the BODs should be allowed to continue subject to achieving acceptable level of performance. But in the public sector the decision for continuance of a BODs member at a particular level is taken based on a prescribed procedure. Here the maximum term is five years for functional directors or upto the time of superannuation whichever is earlier. All respondents in our survey agreed that minimum term of a BODs member should be 5 years.

? The respondents in our survey felt that there was needed to rationalize the process of screening and short listing potential candidates. We need a rational and logical process in which solutions to all situations are built

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in the system. ? Strong ideas were also expressed by 22 respondents from PSE BODS regarding the first right of the insider candidates to board positions. ? The need for a fair and timely carried out selection exercise was emphasized by everyone. Time lag is very long between the issue of circular indicating a vacancy six months in advance and issue of actual appointment letter. ? PESB has to play a strong role and endure that concerned Ministry is not allowed to get away with any arbitrary decision and whatever it decides should be done on time to ensure a smooth transition in the company with a proper handing over and taking over. ? All respondents agreed that these selections should not be politicized at any level as it could cause great damage to company functioning, image and employee morale. ? Having non-executive directors from the private sector would be useful to the public sector it was felt by respondents. It would be good for the organization as they would provide a broad macro perspective to BODs deliberations.

? Our respondents agreed that the retirement age should not be less than 65 years. ? It is suggested that some kind of orientation for adopting a macro focus in BODs positions may be encouraged. ? The concept of orientation of non-executive official and non-official directors has not received much focus till now, not only in India but all over the world. ? An Institution of Directors could be of great use in orientation of directors and keeping them updated.

## **12 f) Role & Responsibilities of BODs : PSEs**

This research focuses on the corporate governance i.e. the role of Board members. As a part of this research attempt has been made to interact with BODs of different companies and study what they perceive their role to be in the company and how they state they can fulfill it. Benchmarking with international studies and experiences has also been done in this research. The ideal role of BODs and how to achieve it has been analyzed based on our respondents views on various issued. The director responsibility on company boards should be understood at this stage of our study so that we may have some norms on which we can assess or evaluate a company Board. Directors should use their best efforts to ensure that the company is property managed and constantly improved so as to protect and enhance shareholder wealth in perpetuity and to meet the company's obligations to all parties with which the company interacts -its stakeholders. WHAT THE BODS MUST NOT DO

The discussion on the role should also focus on what the BOD should not do. In our survey the directors agreed that the BODs must not involve itself in day to day functioning of the organization and also that governance does not involve ensuring returns in the short run. Indicates the activities, which our respondents clearly agreed, the BODs must not involve itself in. However how far they succeed at this requires discussion. Though the inside directors on the BODs agreed to this still five non-executive directors when taking of what actually happens in the BODs meetings stressed that considerable BODs time is devoted to mundane and routine matters. Actually the functional directors almost always are from within i.e. they have worked at management levels in the organization and therefore find it difficult to remain aloof from routine matters and day to day activities.

## **13 VIII. FORMULATION AND IMPLEMENTING OF STRATEGIES & POLICIES**

In this research focus is on the actual functions of the directors to perform their role on the BODs. The role of different board members and their responsibilities as board members have already been discussed in great detail in the previous researches. In this part of out analysis an attempt is being made to understand the practices adopted by the BODs in the board room for formulation and implementation of strategies, policies and also towards ensuring compliance to relevant laws. For this purpose, the responses of BODs members, the Company Secretaries and non-executive directors have been considered and analyzed. Board of directors determines the company's strategy, appoints the corporate officers charged with implementing that strategy, supervises management, and ensures that proper information is made available to shareholders and markets concerning the company's financial position and performance, as well as any major transactions to which it is a party.

## **14 IX. BOARDROOM PRACTICES IN SELECTED PSES**

The routine and internal operational affairs of the company are normally handled by the unit heads and their team of senior managers. In each discipline this team of top mangers finally reports to a functional director who is also responsible to ensure smooth operations in his particular. The functional directors are also a part of a management committee, which takes care of the short run operations at the company level. This committee which is headed by the MD meets from time to time and takes decisions for the management of the organization. However whenever an issue of long term significance and policy implications comes up or there is a macro view required on a particular matter the management committee takes to the BODs for deliberation and decision. Sometimes in extreme emergency the management committee takes a decision and then at immediate convenience of the BODs, calls for a BODs meeting for ratification of its decision. In the business of governing the organization the BODs plays the main role and is supported by the team of senior mangers by way of furnishing adequate information to facilitate BODs decisions. In the BODs however normally the functional directors take care of the issued in their area to be brought up for discussion with the approval of the chair. At times the BODs may ask

a functional director to preset some details in particular area of interest of the BODs. CMD may also raise some issues for the attention and decision of the BODs. In fact any BODs member may take up any discussion relating to the company with the approval of the Chair. It is statutory for each registered company have a company secretary who provides up to date legal and compliance related norms for the information of the BODs and also coordinates the BODs meetings. In a way the company secretary provides the infrastructure for BODs meetings and decisions.

## 15 X. TRANSPARENCY AND ACCOUNTABILITY

The corporate governance focus is on transparency in operations, accountability to different stakeholders, responsibility for decisions taken and supervision of management actions. The quality of BODs deliberations and the topics discussed are confidential and in our survey the directors should not give graphic details about the same however they did indicate the areas and issues covered during the course of these meetings. They feel that transparency in BODs decisions.

## 16 XI.

## 17 CONCLUSION

## 18 Corporate

Governance involves dual responsibility fulfilling internal organizational and meeting societal needs. The BODs is responsible for macro governance of the organization. Directors of private companies and those on boards dominated by inside directors, ranked safeguarding stakeholder interests and ratifying corporate strategy as the boards most important responsibilities. All the PSE representatives confirmed that they have formulated the corporate vision, mission and objectives in compliance with the above referred circular. It is very important for the BODs to ensure that the team of senior managers has the desired combinations of qualities required at that level to shoulder the responsibilities placed on them, the BODs role consists of two levels one relates to setting mission objectives and policy formulation and the second level functions include monitoring management, and reviewing and controlling their activities from time to time. In our survey the directors agreed that the BODs must not involve itself in day to day functioning of the organization and also that governance does not involve ensuring returns in the short run. There should be a clear Charter of the role of the Government Director, which should recognize that he would function equally as a Director of the Company and as a representative of the Government. With such a Charter, and with a knowledge of the Government's policies and guidelines the Government director should be allowed to function freely and use his own judgment on matters coming up before the Board, without any formal system of briefing by the Ministry, before the meeting or of reporting to the Ministry after the meeting. It should be left to this judgment and discretion whether to seek a briefing or make a report. To sum up we may say that the Board holding comprehensive power over corporate management, should perform the following functions of decision making and management supervision; Setting business goals and strategies, Approving business plans and budgets; Supervising management and supervising management performance; Replacing the management and also reviewing remuneration Monitoring major capital expenditures and corporate take overs; Mediating the conflicting interests among directors, management and shareholders; Ensuring integrity of the accounting and financial reporting systems; Supervision risk management and financial control; Supervising the compliance of statutes and ethics related regulations; Monitoring effectiveness of governance practices. <sup>1 2 3 4 5 6</sup>

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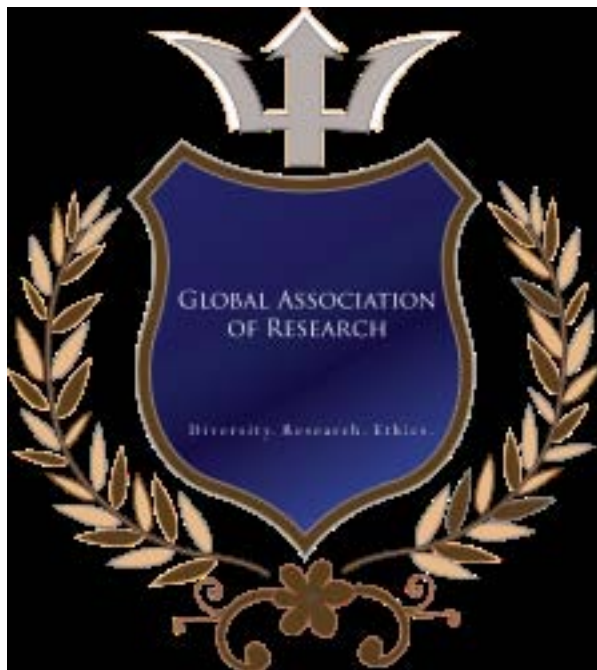


Figure 1:





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