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CORPORATE GOVERNANCE REFORMS IN INDIA

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Abstract:-The paper aims at reviewing the variousdevelopments of Corporate Governance in India. Corporate Governance has gained a lot of importance during 1990's by the industry association CII, as a voluntary measure to be adopted by the Indian companies. It soon acquired a momentum in early 2000 through the introduction of clause 49 and later on Ministry released a set of guidelines addressing to the same issue.

Currently Corporate Governance Reforms in India are at crossroads, while there is no doubt about the good intention behind the reforms, there is a need to look for a more complete solution, evolved from within, and to craft a solution that would address the specific challenges of India.

This paper provides a history of the evolution of corporate governance in India and identifies issues that are peculiar to the Indian context which are not being fully addressed till now.

Keywords: Corporate governance,stakeholders, dominant shareholders, agency problems etc.

INTRODUCTION

Corporate governance is defined as the set of systems, principles and processes by which a company is governed. It provides the guideline as to how the company can be directed or controlled in order to fulfill its goals and objectives in a manner that adds to the value of the company as well as it is beneficial for all stakeholders.

Corporate governance is based on principles such as conducting the business with all integrity and fairness, being transparent with regard to all transactions, making all the necessary disclosures and decisions, complying with all the laws, accountability and responsibility towards the stakeholders and commitment to conducting business in an ethical manner.

The presence of directors on the board contributes towards ensuring confidence in the market. Corporate governance has become one of the important criteria for foreign institutional investors in deciding which companies to invest in. It also leads to a positive influence on the share price of the company.

NEED FOR CORPORATE GOVERNANCE IN INDIA

A corporation is a congregation of various stakeholders, namely customers, employees, investors, vendor partners, government and society. In this changed scenario an Indiancorporation, as also a corporation elsewhere should be fair and transparent to its stakeholders in all its transactions. This has become imperative in today's globalized business world where corporations need to access global pools of capital, need to attract and retain the best human capital from various parts of the world, need to partner with vendors on mega collaborations and need to live in harmony with thecommunity. Unless a corporation embraces and demonstrates

ethical conduct, it will not be able to succeed. Corporations need to recognize that their growth requires the cooperation of all the stakeholders; and such cooperation is enhanced by the corporations adhering to the best Corporate Governance practices. In this regard, the management needs to act as trustees of the shareholders at large and preventasymmetry of benefits between various sections of shareholders, especially between the owner-managers and the rest of the shareholders.

OVERVIEW of INDIANCORPORATE GOVERNANCE

Since the time of Independence, in 1947 India had functioning stock markets, an active manufacturing sector, a developing banking sector which was all British-derived corporate governance. However, from 1947 through 1991, the Indian government adopted socialist policies. The state nationalized most banks and became the principal provider of capital for private firms. The government agencies who provided capital to private firms were evaluated based on the amount of capital invested rather than return on investment. Competition, especially foreign competition, was suppressed. Private providers of debt and equity capital faced serious obstacles in exercising oversight over managers due to delays in judicial proceedings. Public equity offerings could be made only at government-set prices.Moreover Indian firms looking for outside capital had to rely primarily on government sources. This led to the deterioration of Indian corporate governance.

Since 1991, India has undergone significant corporate governance reform.In 1991, the Indian government faced a fiscal crisis. It responded by enacting a series of reforms including reduction in state-provided financing, bank privatization, and general economic liberalization. The first major change was initiated by Confederation of Indian industry (CII) which came up with the first voluntary code of corporate governance. Although CII code welcomed with much fanfare and even adopted by few progressive companies, it was felt that under Indian conditions a statutory rather than voluntary code would be far more purposive and meaningful, at least in respect of essential feature of corporate governance. Consequently corporate governance initiative was undertaken by Securities and Exchange Board of India (SEBI).SEBI had set up a Commission under Kumarmanlagam Birla. This committee coveredissues relating to protection of investor interest, promotion of transparency, building international standards in terms of disclosure of information. In 1999, the Department of Company Affairs modified the company's 1956 act and introduced the provisionrelating to nomination facilities for shareholders and share buybacks and for formation of Investor education and protection fund. The Department of Corporate Affairs constitutedNaresh Chandra Committee in 2002. The committee talks extensively about the statuary auditor-companyrelationship, rotation of statutory audit firms/partners, procedure for appointment of auditors anddetermination of audit fees, true and fair statement of financial affairs of companies.

SEBI formed Narayan Murthy Committee in 2002 in order to review clause 49. Its report mainly focuses on and makes mandatory recommendations regarding responsibilities of audit committee, quality of financial disclosure, requiring boards to assess and disclose business risks in the company's annual reports.

The principal elements of Clause 49 include:

Firms should have 50% outside directors if the CEO and Chairman are the same person, and 30% outside directors if the firm has a nonexecutive chairman;
Firms should have an audit committee with at least three nonexecutive members, all with experience in financial matters;
The CEO and CFO should certify the firm's Financial statements and the adequacy of its internal controls; and
Firms should provide disclosure similar to that required for firms cross-listed in Europe.

Firms that do not comply with Clause 49 can be delisted and face financial penalties. However, at the 2006 date of our survey, SEBI had not yet imposed sanctions on noncomplying firms. The first enforcement actions were in 2007. Legal reform has been ongoing, with SEBI amending Clause 49, the government amending the Companies Law, and recent Irani Committee report (2005) recommending further changes.

There were many other provisions made regarding the issue are the following-

a) Voluntary Guidelines on Corporate Governance were issued by the Ministry of Corporate Affairs in December 2009. Few guidelines are worth mentioning.

1. Board of DirectorsAppointment of Directors

Companies should issue formal letters of appointment to Non-Executive Directors (NEDs) and Independent Directors as is done by them while appointing employees and Executive Directors. Such a formal letter should form a part of the disclosure to shareholders at the time of the ratification of his/her appointment or re-appointment to the Board.
The offices of chairman of the board and chief executive officer should be separate.

The companies may have a Nomination Committee comprised of a majority of Independent Directors, including its Chairman. A separate section in the Annual Report should outline the guidelines being followed by the Nomination Committee and the role and work done by it during the year under consideration.
Independent Directors and NEDs should hold no more than seven directorships.
The Board should put in place a policy for specifying positive attributes of Independent Directors such as integrity, experience and expertise, foresight, managerial qualities and ability to read and understand financial statements. Disclosure about such policy should be made by the Board in its report to the shareholders. Such a policy may be subject to approval by shareholders.
All Independent Directors should provide a detailed Certificate of Independence at the time of their appointment, and

thereafter annually. Independent Directors should be restricted to six-year terms. They must leave for three years before serving another term, and they may not serve more than three tenures for a company.
Independent Directors should have the ability to meet with managers and should have access to Information.

2) Remuneration of Directors

NEDs should be paid either a fixed fee or a percentage of profits. Whichever payment method is elected should apply to all NEDs. NEDs paid with stock-options should hold onto those options forthree years after leaving the board.
Independent Directors should not be paid with stock options or profit-based commission.
The Remuneration Committee should have at leastthree members with the majority of NEDs, and at least one Independent Director. Their decisions should be made available in the Annual Report.

3) Duties of the Board

The Board should provide training for the directors.
The Board should enable quality decision-making by giving the members timely access to information.
The Board should put in systems of risk management and review them every six months.
The Board should review its own performance annually and state its methods in its Annual Report.
The Board should put in a system to ensure compliance with the law, which should be reviewed
annually. All agenda items should be assessed for its impact on minority shareholders.

4) Audit Committee of Board

The Audit Committee should be composed of at least three members, with Independent Directors in the majority and an Independent Director as the chairperson.
The Audit Committee is responsible for reviewing the integrity of financial statements, the company's internal financial controls, internal audit function and risk management systems. The Audit Committee should also monitor and approve all

5) Auditors

The Audit Committee should be consulted on the selection of auditors. The committee must be supplied with relevant information about the auditing firm.
Every auditor should provide a certificate stating his/her/its arm's length relationship with the clientcompany.
The audit partner should be rotated every three years; the firm should be rotated every five years. Audit partners should have a cooling off period of three years before they work with the client company again; the firm should have a cooling off period of five years.
The Committee may appoint an internal auditor.

6) Institution of a Mechanism for Whistle blowing

The companies should ensure the institution of a mechanism for employees to report concerns about unethical behavior, actual or suspected fraud, or violation of the company's code of conduct or ethical policy.
The companies should also provide for adequate safeguards against victimization of employees who avail of the mechanism, and also allow direct access to the Audit Committee Chairperson in exceptional cases.

b) Amendments in Companies Act

The Companies Bill 2009 is expected to be brought before Indian Parliament for consideration in the forthcoming Budget session. The provisions of the Companies Bill is related to eligibility, power and function of Auditor and Audit Committee, appointment and qualification of Directors,
Independent Directors, meeting of the board and its power.

SATYAM SCAM

Corporate governance has most recently been debated after the corporate fraud by Satyam founder and Chairman Ramalinga Raju. In fact, trouble started brewing at Satyam around December 16 when Satyam announced its decision to buy stakes in Maytas Properties and Infrastructure for $1.3 billion. The deal was soon called off owing to major discontentment on the part of shareholders and plummeting share-price. However, in what has been seen as one of the largest corporate frauds in India, Raju confessed that the profits in the Satyam books had been inflated and that the cash reserve with the company was minimal. Ironically, Satyam had received the Golden Peacock Global Award for Excellence in Corporate Governance in September 2008 but was stripped of it soon after Raju's confession.

For corporate leaders, regulators and politicians in India, as well as for foreign investors, this necessitated a re-assessment of the country's progress in corporate governance. As a consequence of various corporate scams, India's ranking slid from third to seventh position in Asia.

AMENDMENTS in COMPANIES BILL,2012

Although India has been rather slow in establishing corporate governance principles over the last two decades, 2012 was a positive year for progression in the Indian corporate governance arena. The Companies Bill 2012, passed by Lok Sabha (the lower house) on 18 December 2012, includes a number of new provisions aimed at improving the governance of public companies.

The Indian market regulator, the Securities and Exchange Board of India (SEBI), recently issued a consultative paper on the "Review of Corporate Governance" encouraging a wider debate on governance. The paper calls for, inter alia, the splitting of the roles of chairman and chief executive, disclosure of the reasons for an independent director's resignation from office, a limit on the term of appointment of independent directors and greater involvement of institutional investors. SEBI goes on to propose making radical changes which seek to ensure that these corporate governance proposals are implemented in a market which is generally viewed as weak in the implementation of rules and regulations. These changes include:

the appointment of independent directors by minority shareholders,
independent directors to receive compulsory training and pass examinations; and
the adoption of a principle-based approach for certain principles.

ENFORCEMENT of CORPORATE GOVERNANCE

There were substantial delay in the delivery of justice by the Indian legal system on account of the significant number of cases pending in the Indian courts which leads to the slow enforcement of corporate governance norms.

A research paper PRS legislative research places the number of pending cases in courts of India as of July 2009 are 53000 pending with supreme court,4 million with high court and 27 million with various lower courts. This backlog in the Indian judicial system raises pertinent questions as to whether the current regulatory framework in India, as enacted, is adequately to enable shareholder to recover their just dues.

ISSUESOF CORPORATE GOVERNANCE IN INDIA

The main issue noticed is managing dominant shareholder(s) and the promoter(s). Main difference between corporate governance enforcement problem in India and western economies is that the entire corporate governance approach hinges on disciplining the management and making them more accountable. In India the inception of joint stock companies is the stranglehold of the dominant or principal shareholder(s) who monopolize the majority of the company's resources to serve their own needs. That is the agency gap which is actually between majority shareholder and other stakeholders. Secondly much of global corporate governance norms focus on boards and their committees, independent directors and managing CEO succession. In India, boards are not as empowered as in western economy and since the boards is subordinate to the shareholders, the will of the majority shareholder prevails.

CONCLUSION

Since the late 1990s, significant efforts have been made bythe Indian Parliament, as well as by Indian corporations, tooverhaul Indian Corporate Governance. The current CorporateGovernance regime in Indian straddles both voluntary andmandatory requirements like Voluntary Guidelines byMinistry of Corporate Affairs. And for listed companies, thevast majority of Clause 49 of the listing agreementsrequirements is mandatory. The voluntary guideline onCorporate Governance by Ministry of Corporate Governanceis a benchmark for the Corporate Governance practices in theIndian corporations, and hopefully the corporate world willmake the best use of it. Efforts are also being made by thelegislature to amend the Companies Act 1956. As a result,amendments relating to Corporate Governance are expected to be brought before Parliament in The Companies Bill 2009.India has one of the best Corporate Governance legal regimesbut poor implementation together with socialistic policies ofthe pre-reform era has affected corporate governance.

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