International Journal of Interdisciplinary and Multidisciplinary Studies,2014,Vol 1,No.3,46-50.
Available online at http://www.ijims.com
ISSN: 2348 – 0343

Corporate Governance in India "Evolution and Challenges"

Srivastava Shefali
Department of MBA
Axis Institute of Planning and Mangement, India

Abstract
While recent high-profile corporate governance failures in developed countries have brought the subject to media attention, the issue has always been central to finance and economics. The issue is particularly important for developing countries since it is central to financial and economic development. Recent research has established that financial development is largely dependent on investor protection in a country – de jure and de facto. With the legacy of the English legal system, India has one of the best corporate governance laws but poor implementation together with socialistic policies of the performer has affected corporate governance. Concentrated ownership of shares, pyramiding and tunneling of funds among group companies mark the Indian corporate landscape. Boards of directors have frequently been silent spectators with Department of financial institutions' nominee directors unable or unwilling to carry out their monitoring functions. Since liberalization, serious efforts have been directed at overhauling the system with the Securities and Exchange Board of India (SEBI) instituting the Clause 49 of the Listing Agreements dealing with corporate governance. Corporate governance of Indian banks is also undergoing a process of change with a move towards more market-based governance.

Keyword: Corporate Governance, Virtue Ethics, Evaluation and challenges, Financial and Economic Development.

Introduction

The subject of corporate governance leapt to global business limelight from relative obscurity after a string of collapses of high profile companies. 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[1]. 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,

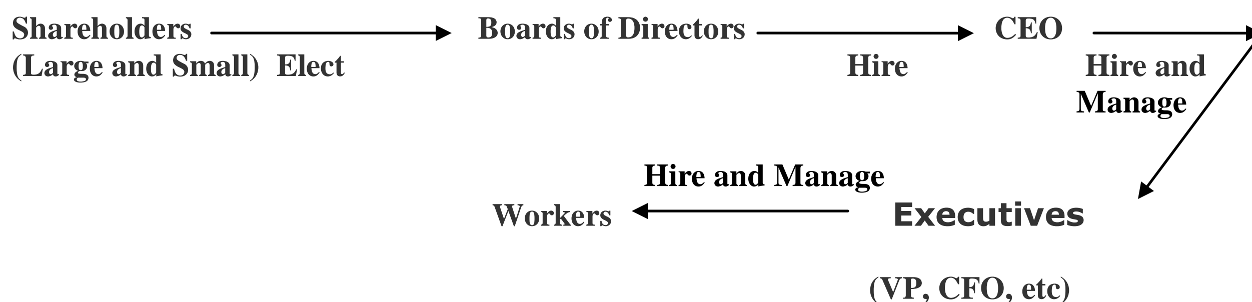
amidst public outcry over excessive compensation. It was clear that something was amiss in the area of corporate governance all over the world[2]. Corporate governance has, of course, been an important field of query within the finance discipline for decades. Researchers in finance have actively investigated the topic for at least a quarter century and the father of modern economics, Adam Smith, himself 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[3].

Central issues in Corporate Governance

The basic power structure of the joint-stock company form of business, in principle, is as follows. The numerous shareholders who contribute to the capital of the company are the actual owners of business. They elect a Board of Directors to monitor the running of the company on their behalf. The Board, in turn, appoints a team of managers who actually handle the day-to-day functioning of the company and report periodically to the Board. Thus mangers are the agents of shareholders and function with the objective of maximizing shareholders' wealth.

The reality is even more complicated and biased in favor of management. In real life, managers wield an enormous amount of power in joint-stock companies and the common shareholder has very little say in the way his or her money is used in the company. In companies with highly dispersed ownership, the manager (the chief executive officer (CEO) in the American setting, the Managing Director in British-style organizations) functions with negligible accountability[4]. Most shareholders do not care to attend the General Meetings to elect or change the Board of Directors and often grant their "proxies" to the management. Even those that attend the meeting find it difficult to have a say in the selection of directors as only the management gets to propose a slate of directors for voting. On his part the CEO frequently packs the board with his friends and allies who rarely differ with him. Often the CEO himself is the Chairman of the Board of Directors as well. Consequently the supervisory role of the Board is often severely compromised and the management, who really has the keys to the business, can potentially use corporate resources to further their own self- interests rather than the interests of the shareholders.

The system of corporate governance is depected below [5]:



Corporate Governance in India – a background

The history of the development of Indian corporate laws has been marked by 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; 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 procedures. In terms of corporate laws and financial system, therefore, India emerged far better endowed than most other colonies.

The beginning of corporate developments in India were marked by the managing agency system that 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[5].

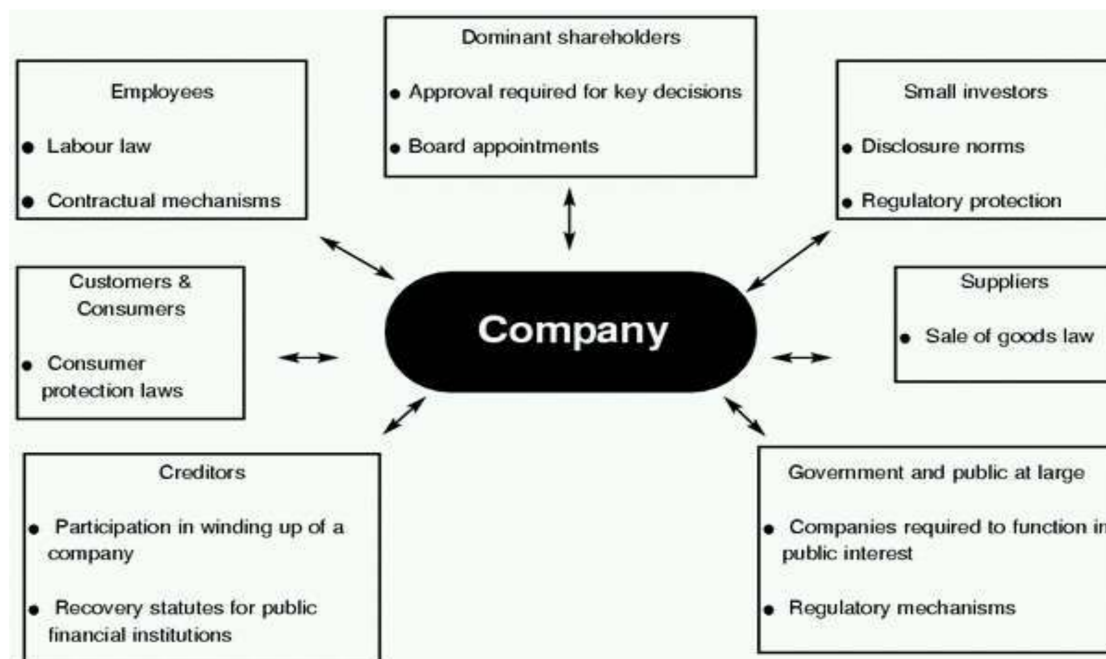


Fig. 1 Company's Responsibility towards stakeholders (Berglof, and SClaessens, 2004) [2]

In the absence of a developed stock market, the three all-India development finance institutions (DFIs) – the Industrial Finance Corporation of India, the Industrial Development Bank of India and the Industrial Credit and Investment Corporation of India– together with the state financial corporations became the main providers of long-

term credit to companies[6]. Along with the government owned mutual fund, the Unit Trust of India, they also held large blocks of shares in the companies they lent to and invariably had representations in their boards. In this respect, the corporate governance system resembled the bank-based German model where these institutions could have played a big role in keeping their clients on the right track. Unfortunately, they were themselves evaluated on the quantity rather than quality of their lending and thus had little incentive for either proper credit appraisal or effective follow-up and monitoring. Their nominee directors routinely served as rubber-stamps of the management of the day.

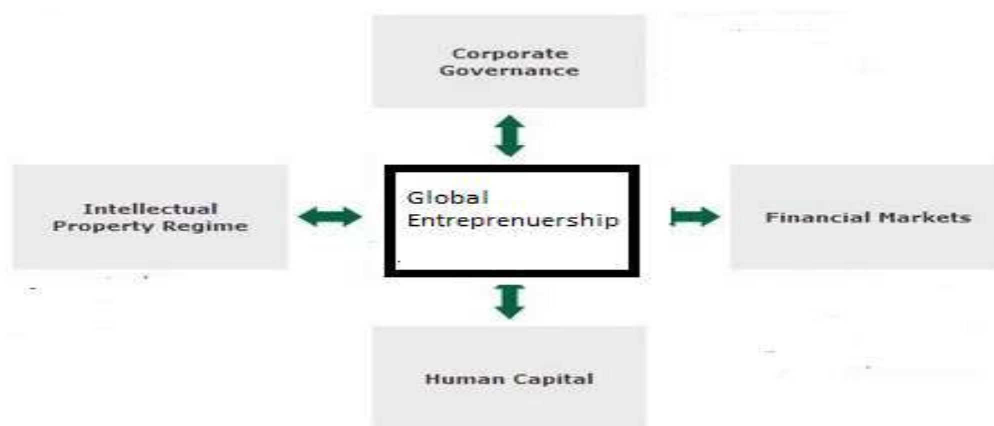


Fig .2 Requisites for Global Entrepreneurship (Gibson)[7]

Conclusions

With the recent spate of corporate scandals and the subsequent interest in corporate governance, a plethora of corporate governance norms and standards have sprouted around the globe. The Sarbanes-Oxley legislation in the USA, the Cadbury Committee recommendations for European companies and the Organisation for Economic Co-operation and Development principles of corporate governance are perhaps the best known among these [8]. But developing countries have not fallen behind either. Well over a hundred different codes and norms have been identified in recent surveys and their number is steadily increasing. India has been no exception to the rule. Several committees and groups have looked into this issue that undoubtedly deserves all the attention it can get.

In the last few years the thinking on the topic in India has gradually crystallized into the development of norms for listed companies. The problem for private companies, that form a vast majority of Indian corporate entities, remains largely unaddressed. The agency problem is likely to be less marked there as ownership and control are generally not separated. Minority shareholder exploitation, however, can very well be an important issue in many cases. Development of norms and guidelines are an important first step in a serious effort to improve corporate

governance. The bigger challenge in India, however, lies in the proper implementation of those rules at the ground level. More and more it appears that outside agencies like analysts and stock markets (particularly foreign markets for companies making GDR issues[7]) have the most influence on the actions of managers in the leading companies of the country. But their influence is restricted to the few top (albeit largest) companies. More needs to be done to ensure adequate Corporate Governance in the average Indian company.

References

1. Bae KH,. Kang JK and Kim J.M. Tunneling or Value Addition? Evidence from Mergers by Korean Business Groups ,Journal of Finance,2002; 57 (6): 2695–740.
2. Berglof E. and Claessens S. Corporate Governance and Enforcement, Working Paper, University of Amsterdam, 2004.
3. Bertrand M., Mehta P, and Mullainathan S. Ferreting out Tunneling: An Application to Indian Business Groups, Quarterly Journal of Economics,2002; 117(1): 121–48.
4. Chibber P K. and Majumdar SK .Foreign Ownership and Pro_tability: Property Rights, Control, and the Performance of Firms in Indian Industry, The Journal of Law andEconomics,1999; XLII, 209-238.
5. Claessens, S. and Fan JPH. Corporate Governance in Asia: A Survey, Working Paper, University of Amsterdam,2003.
6. Das, A. and Ghosh S . Corporate Governance in Banking System: An Empirical Investigation, Economic and Political Weekly, 2004; 1263-1266.
7. Gibson, M.S. (forthcoming), Is Corporate Governance Ineffective in Emerging Markets Journal of Financial and Quantitative Analysis.
8. Dyck, A. and Zingales L. .Private Benefits of Control: An International Comparison, CEPR Discussion Paper No. 317, 2002.