

Corporate Governance In India - Issues And Challenges

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INTRODUCTION

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 1956 Companies Act as well as other laws governing the functioning of joint-stock companies and protecting the investors' rights have been built on this foundation. Good corporate governance is characterized by a firm commitment and adoption of ethical practices by an organization across its entire value chain and in all of its dealings with a wide group of stakeholders encompassing employees, customers, vendors, regulators and shareholders (including the minority shareholders), in both good and bad times. To achieve this, certain checks and practices need to be whole-heartedly embraced. Recent events in India have put the spotlight on Corporate Governance practices of Indian companies. A key aspect that is being debated in the corridors of India Inc. is whether we need major regulatory changes to improve corporate governance, or whether improved standards of corporate governance could be achieved through adoption of principle-based standards of conduct. India Inc. has generally been proactive in promulgating corporate governance regulations. In doing so, a good balance has been achieved i.e. headway has been made in terms of helping to ensure that regulations are not stifling our entrepreneurial initiatives. From a purely regulatory standpoint, India compares favorably with most other developing and Asian economies as far as its corporate governance rules are concerned. Corporate governance is a concept, rather than an individual instrument. 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 increasingly 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.

CHANGES IN THE VALUE SYSTEM

We know that the Enron Chief Executive was given a prison sentence for a quarter of a century, which was never given to a murderer. That is where we need to think why it has happened. There was another event where the question was 'How is it that this kind of sentence was given, he is 63, by the time he comes out of prison, he would be 98?' There is a change in the value system in the society; judges five years ago would not have given such prison sentences. In fact, there is a classic case in the UK, where, in a very similar situation, the people were completely let off. It was in Guinness where there was complete insider trading. No such case in the UK has ever come to the level of prosecution where it was successfully prosecuted. But if it happens today, the situation could be different. A person who was the backbone of the Korean transformation, Kim Woo-Choong who wrote a book *Every Street Is Paved with Gold*. He was the Daewoo chairman. As Daewoo chairman, he was sentenced to 10 years in prison. Note that he has done tremendous good to the country.

LACK OF CORPORATE GOVERNANCE

Today, the market perception is that companies are looking for businesses that do well to the community, not

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necessarily make profit. So, today we begin with an assumption that corporate governance is a different concept. It is not just to make money for the shareholders. The whole reason why we brought into being the World Council of Corporate Governance is that we are here not just to look after our shareholders' values immediately, because in order to do that, we must look at the stakeholder. What are we doing? If customers do not buy our products, can we really do well to our shareholders? Who are the customers? The customers now have a very different paradigm. The world consists of two billion teenagers who are fueling the market today. Their value system is very different. They want companies to be transparent, to be accountable. They want honesty and integrity. They want equity, and social and environmental responsibility. If companies do not provide this, companies are not sustainable. Lack of proper corporate governance practices is blocking the prosperity of a billion people in India. Today, our financial system looks after 81,000 individuals. We say growth-the rich have a growth rate of 20%.

GLOBALIZATION FOR ALL

If we raise a question for ourselves : we are talking about globalization, tell me which part of the society has become the biggest winner through globalization, and name the companies; whether it is Bharti, Reliance or it is Tata? Their wealth has grown at least 10 times in the last few years now. So, the big businesses are the biggest beneficiaries of globalization. What is good corporate governance? Look at our growth, it stands at 9.2%. This is India which has the largest number, 74%, of malnourished children.

We know why the world is looking at our country. We have not analyzed that we have the youngest population in the world today. And that is what would fuel the growth. But in order to fuel the growth, we have to look after that population, the population that is our children and seventy-five per cent of these children under the age of six years are anemic. How do we expect them, or the country, to grow? How and where will the corporations derive their workforce from? In order to fuel the economy, we have to look at the fundamentals. Why do we talk of the importance of corporate governance? I will just smoothen over the legal aspects.

PROMOTING EQUITY AND ETHICS

We want corporate governance because we say it is accountable. It promotes equity and ethics. If it does not promote equity and ethics, then it is not corporate governance. This is what we have been doing -manipulation of business of majority of people.

Business has been doing this throughout history. Now things have to change. They have to change because that is what will create value. Promoting gender balance, accepting diversity are issues which will make markets worth for the poor.

Markets should bring prosperity and work for the poor. If markets do not work for the poor, corporate governance is not successful. How can markets work for the benefit of the poor? Not just for 2%, we are now shining in the glory of India, and we say that our stock markets have gone up to 14,000-it may have come down temporarily-we are talking of 9.2% growth, we are talking of US\$190 billion worth foreign exchange reserves and a whole lot of things.

But stock market participation is just 2%. While it is 25% in the US, here it is just 2%. What about the rest of the 98%? How can we bring the rest and why do we think stock markets are important? This is one instrument where it does not matter whether you are from Chennai or from Bangalore or you are from Mumbai. Stock markets do not distinguish between your castes.

OBJECTIVES OF CORPORATE GOVERNANCE

- ✿ To design research proposals and carry out research in strategic areas of public policy on corporate governance.
- ✿ To know the impact of economic policies, both national and international on the operating realities of the Indian financial markets.
- ✿ To analyze critically the trends and developments in the institutional, legal and regulatory framework for corporate governance in India.
- ✿ To draw lessons from country experience in corporate governance for India.
- ✿ To identify training and development needs of the officials of the legal, regulatory and other agencies associated with implementation of corporate laws, rules and guidelines.
- ✿ To develop a framework for identifying training needs of independent directors, executives, executives directors

and other board members in companies.

- ✿ To study board practices in closely held companies-family business companies to examine critically the scope for improvements in corporate governance practices in public enterprises.
- ✿ To study the financial reporting requirements and practices of the companies in India.
- ✿ To evolve a framework for performance evaluation of the directors on the board.
- ✿ To analyze the issues of corporate ethics and corporate social responsibility.
- ✿ To suggest improvements in board process and documentation in specific reference to the role of the company secretary.
- ✿ To carry out research for developing the determinants of board effectiveness.
- ✿ To develop linkages and collaboration between research agencies, Chambers of Commerce, universities and practitioners in India and abroad.

SATYAM SCANDAL AND CORPORATE GOVERNANCE

Some ten months ago, when the Satyam debate was still raging, a leading business channel broadcast an interview between a corporate governance expert who runs a business advisory firm and the CEO of a financial services company. The question that the host (the corporate governance expert) put forth was a burning issue that many independent directors face: Can experts, who serve on multiple boards, do justice to such assignments if they also hold regular jobs?

Both the gentlemen incidentally serve on at least a dozen leading boards between them and also sit on the board of a leading software services firm together. So they smiled at the irony of the question as the answer from the CEO was an unconvincing warbling of clichés about 'knowing what one can handle and do justice to'. That prompted them to settle on five or six as the maximum number of boards a person can serve on.

The whole set-up reflected the realities of corporate governance in India. Face it: Indian company boards are a cosy nexus and their proceedings are for the mutual benefit of their members. The public at large is kept in the dark about key information that passes between them.

If events can be harbingers of change, Satyam was a wakeup call for India to clean up its act. But did India Inc. wake up? Experts and industry watchers remain divided in the aftermath. While there is a set of people who believe that Satyam definitely made promoters sit up and make alterations, there is an equally strong lobby that says nothing has changed in the real sense of the term.

The glass-is-half-full brigade says there is a perceptible shift in the general atmosphere of boards and the way they work. *"There has certainly been a bit of a change in the last few months in the way boards are functioning. Audit committees are being more careful to ensure that the external auditors perform their role more diligently. We also find that the chairman of the board and members of the audit committee are being more careful and thorough in their questioning. Boards, too, are taking care to ensure that there are no slip-ups at their end,"* says Adi Godrej, Chairman of Godrej Group.

Noted industrialists, who sit on multiple boards besides their own companies, also find a noticeable change in the behavior of independent directors on boards. In some of the progressive boards, the days of one-sided presentations by the management and mute acceptance of the promoter /management agendas are over, as independent directors begin to assert themselves and ask awkward questions they wouldn't dare earlier. Has the Satyam scandal changed corporate governance in India or is everything still the same?

"We have observed a discernible difference. The attendance of directors has become 100%, nobody's asleep and people come prepared. The duration of board meetings is getting longer. We've seen that change since October 2008. So, clearly, the message is out there." says Aniljit Singh, founder & chairman of Max India.

One of the main factors that is prompting independent directors to sit up and take active interest is the fear of punitive action, like the one that Satyam's independent directors faced after promoter Ramalinga Raju owned up to his fraud. Noted lawyer R.A. Shah, who sits on the boards of FMCG majors like Hindustan Unilever, Colgate, Procter & Gamble, Nestle, Britannia, as well as pharma companies like Pfizer, Nicholas Piramal and Wockhardt, says there's heightened consciousness among independent directors of company boards since the Satyam fiasco. *"Those on the audit committees are especially conscious of their role,"* he says. *"There is a greater degree of discussion and there are more probing questions, especially on related party transactions and important strategic decisions like*

diversification, acquisitions, and sale.”

But is the change that promoters and independent directors are talking about, enough? How deep-rooted is that change? These are the two questions that need deeper probing and if one delves deep into the issue with the promoters and independent directors, that's when the cracks start to emerge in the change-for-the better argument. The naysayer hold that companies have made some cosmetic changes and the tick-box approach to corporate governance still rules the roost. As a result, corporate governance is still not being embraced in its true letter and spirit. “Corporate governance has to be in the DNA of a company because compliance is easy,” says Prithvi Haldea, CEO, Prime Database.

A study of the latest ET-50 annual reports suggests that companies have made minor changes in the working of boards and some additional paragraphs have been inserted on the role of independent directors. The biggest change has just been the movement of independent directors, some have opted out and some new names have been included but in terms of bringing about changes in the way boards function, precious little has been done. Incidentally, since January 2009, 524 independent directors have quit boards out of 2355 companies that have submitted data to the director's database on BSE website. Further, experts feel that the nine lakh unlisted companies are a big black hole as far as corporate governance is concerned.

The cornerstones of Clause 49 of the listing agreement are the independent directors who are supposed to be the guardians of the rights of minority shareholders and all stakeholders per se. However, in India, there is a sheer paucity of good independent directors and the few good and competent ones often have multiple assignments. Out of BSE100 companies, 66 independent directors hold five directorships and more, 40% have non-executive chairman, and only 14 have a woman on board. And those are the blue chip companies; the rot goes deeper as you go down the ladder.

And the conscientious directors who want to make an impact are an unsatisfied lot. Their grouse is that things haven't changed even after Satyam and they continue to be under utilized. *“The ritualistic aspects of corporate governance are being met with but the mechanism by which it can translate into action is still missing. I sometimes feel the board is using me and milking my goodwill,”* says a former chairman who sits on the boards of six of India's most respected companies. Of course, the independent directors still rue that the companies don't know how to extract value from their board members and use their collective judgment and advice to its fullest. *“In the last few years, fewer companies have used their boards effectively. There has been very little change since the Satyam episode in the way the boards function. When it comes to activities like setting the board meeting agenda, allowing time for discussion and the quality of discussion, little has changed. And unless that changes, no real change will take place,”* says Arun Maira, Senior Advisor, BCG, who sits on multiple boards.

Independent directors say that when it comes to under utilizing board resources, blame it on the CEOs and the management of successful companies. They are the ones who take the board for granted. Independent directors say that promoters still hustle the board members. Limited time is given for the meetings. Ditto for the audit team, which is often at sea when attempting to comprehend the complexity of the balance sheet? *“Half of the board members can't read the balance sheet. Even after several years in business, some people can't understand all the information in a balance sheet. How can the audit committee members do so in an hour or two?”* asks Haldea. And if you look at the functions of an audit committee, the list is long.

Again, pop a question to the companies on how board affairs are conducted, and how they have changed for the better, and the answers get into ridiculous territory. Here's one. The CFO of a leading New Delhi-based two-wheeler company says, *“As a responsible corporate, we follow good corporate governance practices in all spheres of our business activity. Transparency in dealing with all our stakeholders and being a good corporate citizen towards society forms the basis of our good corporate governance principle. Half of our board comprises of eminent personalities as independent directors, which establishes our commitment towards good corporate governance.”* But at some level, a realization is dawning that change is the need of the hour. Head-hunters say the briefs for new board positions have undergone a sea change. Now they are far more structured. *“Companies are now demanding board directors who understand the business, its drivers, domain, and also its risk. Secondly, companies are also looking at audit committee members with relevant skill sets,”* says Anjali Bansal, CEO of global search firm Spencer Stuart. Even the promoters feel they want completely new skill sets. Only this time, no friends please.

“We still have two searches pending for other directors. So they are neither friends, nor people we've known in the past, nor relations. So we expect them to add value. The only way they can add value is if we give them an open

platform.” says Max India's Singh.

If India Inc. needs to take that next big leap, corporate governance will have to be top notch. Aspects like board compensation (ICICI Bank pays just Rs 3.66 crore to its Independent directors, a pittance compared to global standards), women on board, executive chairman/CEO split, lead independent director, need to be implemented fast; there is no other way to get global glory and funds. Management guru Ram Charan serves a caveat to Indian promoters to get their board act together.

"CEOs will come and go; the boards won't. If you have the wrong board, it's self-defeating for any company. The families here must understand. If your company is going public, the board is more important than the CEO, no matter how rich you are. You will go, but the board will remain. When you go, the succession can be lousy and the board is responsible." Satyam forgot the basics. India Inc. cannot afford to forget Satyam. After the Satyam scandal, I started wondering how corporate governance in India stacks up against other emerging markets. I did a bit of digging around online, and found an interesting site run by a group called Governance Metrics International, or GMI. The New York consulting firm rates about 4,000 companies worldwide on dozens of metrics related to corporate governance: board accountability, financial disclosure, internal controls, shareholder rights, executive compensation, and more. Each company is given a score between 1 and 10.

The 58 Indian companies studied by GMI got an average rating of 4.91, placing India 19th out of 38 countries on the list. Topping the table is Ireland, with an average ranking of 7.55 for the 19 Irish companies assessed by GMI. Canada, Britain, and Australia are right behind. India is No.3 in Asia, behind only Singapore and Thailand. And it comes out ahead of Belgium, Denmark, and France. It's also well above the emerging markets average of 4.09.

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 OECD principles of corporate governance are perhaps the best known among these. But developing countries have not fallen behind either. Well over a hundred different codes and norms have been identified in recent surveys (28) 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) have the most influence on the actions of managers in the leading companies of the country. But their influence is restricted to the top few (albeit largest) companies. More needs to be done to ensure adequate corporate governance in the *average* Indian company.

Even the most prudent norms can be hoodwinked in a system plagued with widespread corruption. 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.

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