An Analysis of Corporate Governance Issues in the Indian context: Challenges and prospects

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ABSTRACT:

Corporate governance is the set of processes, customs, policies, laws, and institutions affecting the way a corporation (or company) is directed, administered or controlled. Corporate governance is a process that aims to allocate corporate resources in a manner that maximizes value for all stakeholders – shareholders, investors, employees, customers, suppliers, environment and the community at large and holds those at the helms to account by evaluating their decisions on transparency, inclusivity, equity and responsibility. There are many different models of corporate governance around the world. These differ according to the variety of capitalism in which they are embedded. The market model, control model of corporate governance, Anglo-American "model" tends to emphasize the interests of shareholders. The coordinated or multi-stakeholder model associated with Continental Europe and Japan also recognizes the interests of workers, managers, suppliers, customers, and the community. In India both the Anglo-American model and business house model were practicing in the governance and hence, the Indian companies are changing from family owned and widely held controlled structure to professionalized companies.

KEYWORDS: CG, board effectiveness, CG and its issues, and control mechanisms of CG

INTRODUCTION:

The World Bank defines governance as the exercise of political authority and the use of institutional resources to manage society's problems and affairs. Governance is a goal and a precondition for positive development results as well. A responsible private sector is an absolute precondition for economic growth and for poverty reduction. Corporate governance also includes the relationships among the many stakeholders involved and the goals for which the corporation is governed. In contemporary business corporations, the main external stakeholder groups are shareholders, debt holders, trade creditors, suppliers, customers and communities affected by the corporation's activities. Internal stakeholders are the board of directors, executives, and other employees. Regulators face a difficult dilemma in that correction of governance abuses perpetrated by a dominant shareholder would often imply a micro-management of routine business decisions which lie beyond the regulators' mandate or competence. The capital market on the other hand lacks the coercive power of the regulator, but it has the ability to make business judgements. Corporate governance is concerned with holding the balance between economic and social goals and between individuals and company goals. The corporate governance frame work is there to encourage the efficient use of resources and accountability for the stewardship of these resources. Its aim is to align as nearly as possible to the interest of individuals, corporations and society[3]

NEED FOR THE STUDY:

Corporate governance is typically perceived by academic literature as dealing with problems that result from the separation of ownership and control, accountability, transparency, audit and fair disclosure of reports to the stakeholders and also emphasize on problems and prospects of corporate governance in the Indian context. From this perspective, corporate governance would focus on internal structure and rules of the BOD's, the creation of independent audit committees, rules for disclosure of information to shareholders and creditors, and control the management. Hence, An Analysis of Corporate Governance Issues in the Indian context: Challenges and prospects topic relent to the current scenario.

OBJECTIVES OF THE STUDY:

- To analyze the issues of corporate governance in the Indian context
- To know the problems and diagnoses of corporate governance
- To understand governance mechanisms and solutions about corporate governance

METHODOLOGY:

The required information has been collected from the secondary source of information. The research paper is descriptive in nature. The relevant information was gathered from journals, books, governance reports, related websites, publicly available an annual report, financial report, notice to call AGMs and AGM results, Companies' websites, and other relevant information.

POPULARLY CHAMPIONED PRINCIPLES OF CORPORATE GOVERNANCE IN THE WORLD WIDE:

Good CG is the key to that. CG describes the relationship and the rules that govern the relationship between the companies' management, its shareholders, regulators and other stakeholders[2]. It characterizes the structures, the framework and the processes of all economic measures. Policy makers are now more aware to the contribution good CG can have to the financial markets stability, to the economic growth and to a sustainable development. CG lies at the heart of the global corporate social responsibility discussion. Businesses all over the world have begun to engage in activities to enhance their positive impact on societies and good CG is the foundation for everything that comes after. CG and CSR are both value-driven. They foster the democratic values of fairness, accountability, responsibility and transparency in corporations and companies. While good CG serves as the basis, CSR builds upon this basis to foster sustainable development. German companies are already making good progress in that respect, in particular the many small- and medium-sized businesses. Often, German enterprises are actually already exceeding legal and international requirements for labor standards for instance as well as social and ecological standards worldwide. Corporate governance is of crucial importance for economic development in partner countries. Not only companies but regulators as well, need to drive forward improvements in CG and collaborate with others in order to provide the right incentives. Sustainable development policy and CSR are natural allies.

1. **Rights and equitable treatment of shareholders**: Organizations should respect the rights of shareholders and help shareholders to exercise those rights. They can help shareholders exercise their rights by effectively communicating information that is understandable and accessible and encouraging shareholders to participate in general meetings.
2. **Interests of other stakeholders**: Organizations should recognize that they have legal and other obligations to all legitimate stakeholders.
3. **Role and responsibilities of the board**: The board needs a range of skills and understanding to be able to deal with various business issues and have the ability to review and challenge management performance. It needs to be of sufficient size and have an appropriate level of commitment to fulfill its responsibilities and duties. There are issues about the appropriate mix of executive and non-executive directors.
4. **Integrity and ethical behavior**: It is a necessary element in risk management and avoiding lawsuits. Organizations should develop a code of conduct for their directors and executives that promotes ethical and responsible decision making. Because of this, many organizations establish Compliance and Ethics Programs to minimize the risk that the firm steps outside of ethical and legal boundaries.
5. **Disclosure and transparency**: Organizations should clarify and make publicly known the roles and responsibilities of board and management to provide shareholders with a level of accountability. Disclosure of material matters concerning the organization should be timely and balanced to ensure that all investors have access to clear, factual information.
6. **Proper accountability to the executive's remuneration:**

   Accountability requires in all level of board and openness will need to implement fair corporate governance practices. Though well-established corporation significantly implement the standards governance practices. Corporation must be disclosed and report to all stakeholders regards executives' remuneration. The Cadbury committee and Kumar Mangalam Birla committee has been recommended to all listed companies for disclosure of performance based executives remuneration.

7. **Effective board optimization, effectiveness and evaluation:**

   The performance of board effectiveness and efficiency preserves on their board optimization. The board performance appraisal ensured by the board dynamics. In the 21st century corporations are changing their board pattern in to professionalization.

8. **Responsibilities of the board:** the OECD guidelines provide a great deal of details about the functions of the board in protecting the company and its shareholders. These include concerns about corporate strategy, risk, executive compensation and performance as well as accounting and reporting system.

CHALLENGES TO EFFECTIVE CORPORATE GOVERNANCE:

Issues and challenge for directors and executive management is to find outside directors who are sufficiently independent but still knowledgeable about and engaged in the business of the company on whose board they will sit. Independence reflects qualities of objectivity, experience, insight, and force of character. The need for directors to possess this blend of knowledge plus independence is critical, given the increased technical complexity of most business activities and the rapid pace of change in financial markets and practices. Another challenge in selecting outside directors is how to balance general business knowledge with specific industry knowledge and technical expertise in areas such as accounting, finance, and labor markets. Finding such outside directors can involve a tough balancing act and its very difficulty of finding qualified directors who have the time to devote to the affairs of the company and who are willing to face the risk of shareholder lawsuits. The risk is that as outside directors' compensation increases, their independence may wane and, instead of functioning as watchdogs for shareholders, they may increasingly function as lapdogs for management. Getting the right balance of expertise and independence so that the board does not rubber-stamp the decisions of top management is a major challenge. 1. Unsophisticated equity market vulnerable to manipulation and with rudimentary, traditional analyst activity. 2. Dominations and monopoly of family firms. 3. High level of corruption, become visible only after a revelation of big financial scam. 4. Weak and non-transparent monitoring system. 5. Lack of respect for shareholders and low financial disclosure.

There are some practices prevalent in the market and in our society which are posing challenges to corporate governance in our country.

- Executive compensation vs. Regulation of RPTs
- Board composition vs. Competence of directors
- Investor activism vs. State activism
- Market-driven incentives vs. Non-market mechanisms
- Fiduciary duty to shareholders vs. Subpar disclosure and internal controls
- Board-management relations vs. Independence from controlling shareholder
- Regulating increasingly sophisticated issues vs. Capacity gaps for rigorous enforcement
- Cycles of scandals, corruption and collapse vs. More of same (nepotism, self-dealing, market abuse)
- Board of directors vs. the board have board committees
- Protection of shareholder interest, expectation and their rights
- Disclosure, communication and audit
- A company socially responsible corporate citizen
- Appointments to the board and directors' re-election

MECHANISMS AND CONTROLS:

Corporate governance mechanisms and controls are designed to reduce the inefficiencies that arise from moral hazard and adverse selection. For example, to monitor managers' behavior, an independent third party (the external auditor) attests the accuracy of information provided by management to investors. An ideal control system should regulate both motivation and ability.

Internal corporate governance controls

Internal corporate governance controls monitor activities and then take corrective action to accomplish organizational goals. Examples include:

Monitoring by the board of directors:

The board of directors, with its legal authority to hire, fire and compensate top management, safeguards invested capital. Regular board meetings allow potential problems to be identified, discussed and avoided. Whilst non-executive directors are thought to be more independent, they may not always result in more effective corporate governance and may not increase performance. Different board structures are optimal for different firms. Moreover, the ability of the board to monitor the firm's executives is a function of its access to information. Executive directors possess superior knowledge of the decision-making process and therefore evaluate top management on the basis of the quality of its decisions that lead to financial performance outcomes, *ex ante*. It could be argued, therefore, that executive directors look beyond the financial criteria.

Internal control procedures and internal auditors: Internal control procedures are policies implemented by an entity's board of directors, audit committee, management, and other personnel to provide reasonable assurance of the entity achieving its objectives related to reliable financial reporting, operating efficiency, and compliance with laws and regulations. Internal auditors are personnel within an organization who test the design and implementation of the entity's internal control procedures and the reliability of its financial reporting.

Balance of power: The simplest balance of power is very common; require that the President be a different person from the Treasurer. This application of separation of power is further developed in companies where separate divisions check and balance each other's actions. One group may propose company-wide administrative changes, another group review and can veto the changes, and a third group check that the interests of people (customers, shareholders, employees) outside the three groups are being met.

Remuneration: Performance-based remuneration is designed to relate some proportion of salary to individual performance. It may be in the form of cash or non-cash payments such as shares and share options, superannuation or other benefits. Such incentive schemes, however, are reactive in the sense that they provide no mechanism for preventing mistakes or opportunistic behavior, and can elicit myopic behavior. In publicly-traded U.S. corporations, boards of directors are largely chosen by the President/CEO and the President/CEO often takes the Chair of the Board position. The practice of the CEO also being the Chair of the Board is known as "duality". While this practice is common in the U.S., it is relatively rare elsewhere. It is illegal in the U.K.

External mechanisms of corporate governance controls

Debt covenants: these are agreements between a company and its creditors that the company should operate within certain limits.

Government regulations: Government has a lot of concern with regulating and administering many areas of human activity, such as trade, education etc. Different political ideologies hold different ideas on what the government should or should not do.

Competition: Despite shortcomings in corporate governance in many countries, leading emerging economies have vibrant products markets and display as much intensity of competition as that observed in advanced countries.

External auditor: external auditors are personnel outside an organization who test the design and implementation of the entity's external control procedures and the reliability of its financial reporting.

Managerial external labour market: Globalization of production, technological change, and continually falling communication and transportation costs all combined to make cross border transport and trade much more feasible and easier in the 21st century.

Print media: Its helps the external stakeholders to understand financial information which are disclosed by the company in print media. A periodical provides tremendous information to ensure financial position of a minority and block shareholders.

Best practices to enhance board effectiveness and independent oversight.
Identification of a specific director contact for investor outreach, Board access to timely information flows, including financial statements and risk management reports, Private meetings of independent directors without the presence of executive management and controlling shareholders; An independent board audit committee, whose members have relevant financial experience.

SUGGESTIONS FOR THE EFFECTIVE CORPORATE GOVERNANCE

There are few features of effective corporate governance: Access to external financing which will lead to greater investment, growth and employment, Lower the cost of capital to reduce risk of financial crisis, Better resource allocation to win trust of stack holders, to improve social and labour relations and for environ mental protection and Transparency in all financial and non- financial matters.

1. The principles for human rights, for fair labor standards, for environmental protection and for anti-corruption. Ensure that it is an active and interactive learning platform also with regard to CG issues, such as anti-corruption. Transparency and anti-corruption have been a focal issue of the Indian companies.
2. Should support the CSR of our partner companies. By coordinating local and international stakeholders and supporting international policy processes. For instance in India, companies are supporting responsible finance trends and voluntary standards of Corporate Sustainability.
3. To have a clear cut strategy on anti-corruption. Advise businesses and national governments on how to apply such anti-corruption measures successfully. A good example of this is business action against corruption in Africa.

4. Greater transparency in the resource sector will lead to improved accountability and will help to fight against corruption.
5. Corrective corporate code action taken voluntarily- is not only overdue but also ethically and morally sound.
6. Due to social, economic and political obstacles in the way of effective corporate governance, there is needed to adopt some measures.
7. Efficient monitoring system can improve transparency in business management.
8. Adoption of a transparent process of appointment at board and management levels.
9. Proper checks and balance system over managerial rights.
10. Accurate information's regarding developments, threats and risks related to financial and economic matters in annual reports and on the company websites.
11. Proper and transparent auditing system to check financial irregularities and frauds.
12. Codes of conduct are ensured to be understood and adhered to by all members of organisation.
13. Ethical behaviour of organisation or of any member at board or management level should be rewarded.
14. There should be an independent and transparent process of evaluation of performance of board members.
15. Independent directors: Even where there are controlling or majority shareholders, there should be enough quality independent directors to staff key committees, particularly the audit committee. At a minimum, this implies at least two or three independent directors constituting at least one-third of the board.
16. Succession planning: The Company should have clear and transparent succession-planning processes to guide the selection of new executive managers.

CONCLUSION

The above background paper covers the basic concepts of Corporate Governance, as they have emerged, mainly during the last two decades; it is intended as background study for the Global convention on Corporate Governance and Sustainability challenges. This paper has argued that structural characteristics of the Indian corporate sector make the corporate governance problems in India very different from that in say the US or the UK. The governance issue in the US or the UK is essentially that of disciplining the management who have ceased to be effectively accountable to the owners. The solution has been to improve the functioning of vital organs of the company like the board of directors. Corporate governance has been proving a very efficient and effective system for our economy and to save the interest of shareholders but some more efficient monitoring and transparent internal audit system, efficient board and management can lead it to effective corporate governance. Focus on corporate governance should broaden to encourage emerging market companies to bolster strategic management of sustainability issues and enhance public disclosure on sustainability performance

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