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AN EVALUATING ANALYSIS OF CORPORATE GOVERNANCE-INDIAN PERSPECTIVE

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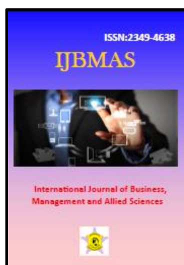

ABSTRACT

Governance is the process of decision-making and the process by which decisions are implementing. Corporate governance is an age old concept which provides for a set of transparent relationships between an institutions management, its board, shareholders and other stakeholders.

Bank and Financial Institutions are the backbone of the economic sector of any country. The healthy economic condition of a nation is depicted through the sound functioning of its banks. Banks form a crucial link of a country's economic sector hence they are universally regulated industry and their wellbeing is imperative for the economy. Working of banks is different from other corporate in many important respects, and that makes corporate governance of bank not only different but also critical. Banking sector contributes substantially towards the overall growth and development to economy within emerging countries like India, and therefore there is a need for healthy investment environment (or not implemented), involving multiple actors.

The present paper is divided into different sections such as; it discusses an introduction, about corporate governance, is corporate governance a recent phenomenon, emergence of corporate governance in India, regulatory & legal framework of corporate governance in India, other provisions and so on.

Keywords: Governance, Corporate governance, financial institutions, backbone, economic sector.

Introduction

Corporate governance is the way the council is run – how we manage ourselves, how we make decisions, run our services and relate to the public. The purpose of corporate governance is to facilitate effective, entrepreneurial and prudent management that can deliver the long-term success of the company. Corporate governance is the system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies.

Corporate governance is a part of Indian corporate sector since the beginning but corporate governance failure and fraud of Satyam Computer Services Limited increased the concerns about corporate governance in India.

Corporate governance in India has tended to assume increased significance only in recent times. But it does not mean that it is only of recent origin? While it is true that focused attention on this phenomenon has begun to be paid only in recent times, particularly in era of globalisation.

> "Corporate governance is the acceptance by management of the inalienable rights of shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders. It is about commitment to values, about ethical business conduct and about making a distinction between personal and corporate funds in the management of a company." - Report of the Committee on Corporate Governance of the Securities and Exchange Board of India, 2003

What is Corporate Governance?

In general words, **Corporate Governance** means set of rules and regulations by which an organization is governed, controlled and directed. It is conducted by the Board of Directors or the concerned committee for the benefit of the company's stakeholders.

Corporate governance' means the way the council is run – how we manage ourselves, how we make decisions, run our services and relate to the public.

Corporate Governance refers to the way a corporation is governed. It is the technique by which companies are directed and managed. It means carrying the business as per the stakeholders' desires. It is actually conducted by the board of Directors and the concerned committees for the company's stakeholder's benefit. It is all about balancing individual and societal goals, as well as, economic and social goals.

Corporate governance is the system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies. The shareholders' role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place.

In other words, Corporate Governance. is about how companies are directed and controlled. Good governance is an essential ingredient in corporate success and sustainable economic growth. Research in governance requires an interdisciplinary analysis, drawing above all on economics and law, and a close understanding of modern business practice of the kind which comes from detailed empirical studies in a range of national systems.

Is Corporate Governance a Recent Phenomenon?

Corporate governance in India has tended to assume increased significance only in recent times. But it does not mean that it is only of recent origin? While it is true that focussed attention on this phenomenon has begun to be paid only in recent times, particularly in era of globalisation. A brush over the history of the corporate world makes it thoroughly clear that corporate governance has always remained an important part of the corporate world in the appearance of the assumption of rationality and consistency on the part of a firm/business organization. Corporate governance has been practiced for as long as there have been corporate entities. Yet the study of this subject is less than half a century old. Indeed, the phrase 'Corporate governance' was scarcely used until the 1980's. The 20th century saw massive growth in serious management thought. Organization theories took great strides, but the board did not appear on the organizations chart. Strategic management acquired new significance, although the contribution of the board seldom received a mention. Important theories and practices were developed for the role of the directors. Board of directors of a company is ultimately responsible for that organization's decisions and its performance. It is the board that is accountable to the owners, members, and other legitimate stakeholders. The directors should be providing direction and supervising the work of executive management. Corporate governance is about the exercise of power over corporate entities. It has become one of the central issues in the running and the regulating of modern enterprise today. However, the underlying ideas and concepts of corporate governance have been surprisingly slow to evolve. The 19th century saw the foundations laid for modern corporations: thus was the century of the entrepreneurs. The 20th century was the century of

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management: the phenomenal growth of the management theories, management consultants, management gurus and management teachings, which all reflected a preoccupation with management. Now the 21st century is the century of corporate governance--------- as the focus swings to the authenticity and the effectiveness of the wielding of power over corporate entities worldwide.

Emergence of Corporate Governance in India:

'Corporate Governance' is set of rules and regulations by which an organization is governed, controlled and directed. It is conducted by the Board of Directors or the concerned committee for the benefit of the company's stakeholders. As a voluntary measure to be adopted by Indian companies, 'Corporate Governance' is the new golden term coined in the corporate sector in the late 1990's by the Industry Association On Confederation of Indian Institute which was the first initiative in India. It has outlined a series of voluntary recommendations to integrate best-in-class practices of corporate governance in listed companies which touches the four cornerstones of

- fairness,
- transparency,
- accountability and
- responsibility

in managing the affairs of the company.

The second major initiative was taken by Security Exchange of India (SEBI) as Clause 49 of the Listing Agreement.

The third key initiative to effectively introduce Corporate Governance was taken by Naresh Chandra Committee and Narayana Murthy Committee who previewed Corporate Governance model working in companies from the viewpoint of shareholders, investors and other stakeholders of the company.

Corporate governance guidelines both mandated and voluntary have evolved since 1998, due to the sincere efforts of several committees appointed by the Ministry of Corporate Affairs (MCA) and the SEBI. The real change in the corporate sector could be felt with the introduction of 2009 Mandatory Corporate Governance Voluntary Guidelines which has to be comply by companies listed on stock exchange by Clause 49 of Listing Agreement including mandatory codes to be followed by companies pertaining to board of directors, audit committees and various disclosures with respect to related party transactions, whistleblower policies etc.

A company that has good corporate governance has a much higher level of confidence amongst the shareholders associated with that company. Active and independent directors contribute towards a positive outlook of the company in the financial market, positively influencing share prices. Corporate Governance is one of the important criteria for foreign institutional investors to decide on which company to invest in.

The corporate practices in India emphasize the functions of audit and finances that have legal, moral and ethical implications for the business and its impact on the shareholders. The Indian Companies Act of 2013 introduced innovative measures to appropriately balance legislative and regulatory reforms for the growth of the enterprise and to increase foreign investment, keeping in mind international practices. The rules and regulations are measures that increase the involvement of the shareholders in decision making and introduce transparency in corporate governance, which ultimately safeguards the interest of the society and shareholders.

Corporate governance safeguards not only the management but the interests of the stakeholders as well and fosters the economic progress of India in the roaring economies of the world.

While, Banks constitute the largest financial intermediaries around the world and possess stupendous powers of leverage. Unlike in the corporate world, authorities like RBI and the government play a direct role in bank governance through bank regulation and supervision. This role is justified by the need to ensure systemic stability, financial stability and deposit insurance liability considerations. Banks enjoy the benefit of high leverage with the downside protection of deposit insurance which weakens their incentives for strong management monitoring. While a ubiquitous form of corporate control and concentrated

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ownership will raise new barriers to effective corporate governance, large investors may manipulate the firm contrary to the broad interests of the bank and other stakeholders.

The need or emergence for corporate governance has arisen because of the increasing concern about the non-compliance of standards of financial reporting and accountability by boards of directors and management of corporate inflicting heavy losses on investors.

The collapse of international giants likes Enron, World Com of the US and Xerox of Japan are said to be due to the absence of good corporate governance and corrupt practices adopted by management of these companies and their financial consulting firms.

Of course, in the last decade, corporate fraud and governance failure is occurring frequently which is why we require good corporate governance in the country. India provides proper norms and laws aligned with international requirements to govern a corporate.

As per Section 118 of Companies Act, 2013,the final assent to Corporate Governance practices in the effective management of the company can be seen as introduction to new significant provisions introduced in the Companies Act, 2013 in form of independent directors, women directors on the board, corporate social responsibility and mandatory compliance of Secretarial Standards issued by Institute of Company Secretaries of India.

In view points of corporate governance and Indian banking sectors, '**RBI**' in India plays leading role in formulating and implementing corporate governance. The corporate governance mechanism as followed by Reserve Bank of India is based on three categories for governing the banks. They are:

(i) Disclosure and transparency,

(ii) Off-site surveillance,

(iii) Prompt Corrective Action. Jan 28, 2017.

Corporate governance of banks is an essential element of a countries governance architecture. It can have systemic financial stability implications and shape the pattern of credit distribution and overall supply of financial services. Hence the necessity and importance of enforcing effective corporate governance in the banking sector.

Regulatory framework of Corporate Governance in India:

Today, India's corporate governance framework requires listed companies to have independent directors manning one-third of their Board, disclose all related party deals, disclose comparative metrics on managerial pay, appoint audit and nomination committees, and require the CEO and CFO to sign off on the governance norms being met in the financial statements. Minority shareholders with 10 per cent voting rights also have the right to drag companies to Court for 'oppression and mismanagement'.

Secretarial standards issued by ICSI (Institute of Company Secretaries of India) It is an autonomous body constituted by the Company Secretaries **Act**, 1980. It is a body to regulate and develop the profession of Company Secretaries in India. It issues secretarial standards as per the provision of **the Companies Act**,2013.May 12, 2017

In a broad sense, regulation of Corporate Governance includes the legal framework and also contractual requirements such as; those defined by the stock market, investor, and banking organizations. Regulation may also includes Codes of Best Practices designed to promote better performance of all types of companies on a voluntary basis. This broad scope helps to clarify the questions of whether more legal requirements or voluntary efforts are more effective to promote better 'corporate governance'.

By and large, the Indian statutory framework has, been in consonance with the international best practices of corporate governance. Broadly speaking, the corporate governance mechanism for companies in India is enumerated in the following enactments/ regulations:

1. The Companies Act, 2013 :

The new Companies Law contains many provisions related to good corporate governance like Composition of Board of Directors, Admitting Woman Director, Admitting Independent Director, Directors Training and Evaluation, Constitution of Audit Committee, Internal Audit, Risk Management Committee, SFIO Purview, Subsidiaries Companies Management, Compliance center etc. All such provisions of new

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Company Law are instrumental in providing a good Corporate Governance structure.
Few provisions are:-

- **Section 134**, which mandates to attach a report to every Financial statement by Board of Directors containing all the details of the matter including the statement containing director's responsibility.
- **Section 177**, which requires Board of Directors of every listed company or any other class of committee to constitute an Audit Committee. It also provide the manner to constitute the committee.
- **Section 184**, which mandates the Director disclose his interest in any company or companies, body corporate, firms, or other association of Individuals. The director is required to disclose any such interest at the first meeting of the board and if there is any change in the interest then the first meeting held after such change.

2. Securities and Exchange Board of India (SEBI) Guidelines:

According to "Securities and Exchange Board of India" i.e.;SEBI is a regulatory authority having jurisdiction over listed companies and which issues regulations, rules and guidelines to companies to ensure protection of investors.

3. Standard Listing Agreement of Stock Exchanges: For companies whose shares are listed on the stock exchanges.

4. Secretarial Standards issued by the Institute of Company Secretaries of India (ICSI):

ICSI is an autonomous body, which issues secretarial standards in terms of the provisions of the New Companies Act. So far, the ICSI has issued Secretarial Standard on "Meetings of the Board of Directors" (SS-1) and Secretarial Standards on "General Meetings" (SS-2). These Secretarial Standards have come into force w.e.f. July 1, 2015. Section 118(10) of the New Companies Act provide that *every company* (other than one person company) shall observe Secretarial Standards specified as such by the ICSI with respect to general and board meetings.

5. Accounting Standards issued by the Institute of Chartered Accountants of India (ICAI):

ICAI is an autonomous body, which issues accounting standards providing guidelines for disclosures of financial information. Section 129 of the New Companies Act *inter alia* provides that the financial statements shall give a true and fair view of the state of affairs of the company or companies, comply with the accounting standards notified under s 133 of the New Companies Act. It is further provided that items contained in such financial statements shall be in accordance with the accounting standards.

Key Legal Framework for Corporate Governance in India:

The council's powers and duties are set out in various Acts of Parliament. Some of these powers are mandatory, which means that the council must do what is required by law.

A legal doctrine is a framework, set of rules, procedural steps, or test, often established through precedent in the common law, through which judgments can be determined in a given legal case.

The Government of India has recently notified Companies Act, 2013 ("New Companies Act"), which replaces the erstwhile Companies Act, 1956. The New Act has greater emphasis on corporate governance through the board and board processes. The New Act covers corporate governance through its following provisions:

- To introduces significant changes by the 'New Companies Act' to the composition of the boards of directors.
- New Companies Act for the first time codifies the duties of directors.
- Every company is required to appoint 1 (one) resident director on its board.
- Nominee directors shall no longer be treated as independent directors.
- Listed companies and specified classes of public companies are required to appoint independent directors and women directors on their boards.
- Listed companies and certain other public companies shall be required to appoint at least 1 (one) woman director on its board.

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- New Companies Act mandates following committees to be constituted by the board for prescribed class of companies:
  - Audit committee.
  - Nomination and remuneration committee.
  - Stakeholders relationship committee.
  - Corporate social responsibility committee.

About Composition Board:

'Composition board', wood product produced in the form of a **board** or sheet, formed of cellulose fibers or particles derived from wood or other sources, and used principally as a building material. ... Such materials typically have a resistance to shearing forces exceeding that of plywood.

What are the positions on the Board of Directors?

Officers are usually appointed by the corporation's board of directors, and while specific positions may vary from one corporation to another, typical corporate officers include:

- Chief Executive Officer (CEO) or President. ...
- Chief Operating Officer (COO). ...
- Chief Financial Officer (CFO) or Treasurer. ...
- Secretary.

A Few New Provision for Directors and Shareholders:

- One or more women directors are recommended for certain classes of companies
- Every company in India must have a resident directory.
- The maximum permissible directors cannot exceed 15 in a public limited company. If more directors have to be appointed, it can be done only with approval of the shareholders after passing a Special Resolution.
- The Independent Directors are a newly introduced concept under the Act. A code of conduct is prescribed and so are other functions and duties.
- The Independent directors must attend at least one meeting a year.
- Every company must appoint an individual or firm as an auditor. The responsibility of the Audit committee has increased.
- Filing and disclosures with the Registrar of Companies has increased.
- Top management recognizes the rights of the shareholders and ensures strong co-operation between the company and the stakeholders.
- Every company has to make accurate disclosure of financial situations, performance, material matter, ownership and governance.

Additional Provisions:

- Related Party Transactions – A Related Party Transaction (RPT) is the transfer of resources or facilities between a company and another specific party. The company devises policies which must be disclosed on the website and in the annual report. All these transactions must be approved by the shareholders by passing a Special Resolution as the Companies Act of 2013. Promotors of the company cannot vote on a resolution for a related party transaction.
- Changes in Clause 35B – The e-voting facility has to be provided to the shareholder for any resolution is a legal binding for the company.
- Corporate Social Responsibility – The company has the responsibility to promote social development in order to return something that is beneficial for the society.
- Whistle Blower Policy – This is a mandatory provision by SEBI which is a vigil mechanism to report the wrong or unethical conduct of any director of the company.

Responsibilities of Directors

Directors look after the affairs of the company, and are in a position of trust. They might abuse their position in order to profit at the expense of their company, and, therefore, at the expense of the shareholders

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of the company.

Consequently, the law imposes a number of duties, burdens and responsibilities upon directors, to prevent abuse. Much of company law can be seen as a balance between allowing directors to manage the company's business so as to make a profit, and preventing them from abusing this freedom.

Directors are responsible for ensuring that proper books of account are kept.

In some circumstances, a director can be required to help pay the debts of his company, even though it is a separate legal person. For example, directors of a company who try to 'trade out of difficulty' and fail may be found guilty of 'wrongful trading' and can be made personally liable. Directors are particularly vulnerable if they have acted in a way which benefits themselves.

- The directors must always exercise their powers for a 'proper purpose' – that is, in furtherance of the reason for which they were given those powers by the shareholders.
- Directors must act in good faith in what they honestly believe to be the best interests of the company, and not for any collateral purpose. This means that, particularly in the event of a conflict of interest between the company's interests and their own, the directors must always favour the company.
- Directors must act with due skill and care.
- Directors must consider the interests of employees of the company.

How is corporate governance of Banks different?

Corporate Governance has fast emerged as a benchmark for judging corporate excellence in the context of national and international business practices. From guidelines and desirable code of conduct some decade ago, corporate governance is now recognized as a paradigm for improving competitiveness and enhancing efficiency and thus improving investors' confidence and accessing capital, both domestic as well as foreign. Banks are different from other corporates in important respects, and that makes corporate governance of banks not only different but also more critical. Banks lubricate the wheels of the real economy, are the conduits of monetary policy transmission and constitute the economy's payment and settlement system.

Bank and Financial Institutions are the backbone of the economic sector of any country. The healthy economic condition of a nation is depicted through the sound functioning of its banks. Banks form a crucial link of a country's economic sector hence they are universally regulated industry and their well being is imperative for the economy. Working of banks is different from other corporate in many important respects, and that makes corporate governance of bank not only different but also critical. Hence corporate governance is conceptually different for banks. If a corporate fails, the fall outs can be restricted to the stakeholders, but if a bank fails, the impact can spread rapidly through other banks with potentially serious consequences for the entire financial system and the macro economy. Thus though various guidelines are provided for working of a bank, corporate governance cannot be overlooked or discarded. Regulations, guidelines and corporate governance are complementary to each other in banking industry.

As the business-nature, banks are highly leveraged. They accept large amounts of uncollateralized public funds as deposits in a fiduciary capacity and further leverage those funds through credit creation. The presence of a large and dispersed base of depositors in the stakeholders group sets banks apart from other corporates. Banks are interconnected in diverse, complex and oftentimes opaque ways underscoring their "contagion" potential. If a corporate fails, the fallout can be restricted to the stakeholders. If a bank fails, the impact can spread rapidly through to other banks with potentially serious consequences for the entire financial system and the macroeconomy. All economic agents tend to behave in a procyclical manner, and banks are no exception, as aptly summed up by Chuck Prince, the former CEO of Citigroup, who said that one had to keep dancing as long as the music was on! Where banks differ is that their procyclical behaviour hurts not just the institution but the larger economy. Among the many lessons of the crisis is the one that financial markets are not self-correcting. This is in part because the signals of financial instability are difficult to detect in real time. On top of that, banks escape some of the disciplinary pressures of the market as their balance sheets are typically opaque. Given the centrality of banks to modern financial systems and the

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macroeconomy, the larger ones become systemically important. That raises a moral hazard issue since systemically important banks will then indulge in excessive risk in the full knowledge that all the gains will be theirs; and should the risks blow up, the government or the central bank will bail them out and thereby the losses can be socialized. Having collectively experienced the biggest financial crisis of our generation over the last three years, we all know that these risks and vulnerabilities of the financial system are not just text book concepts; they are all highly probable real world eventualities. If banks are "special" in so many ways that I have indicated above, it follows that corporate governance of banks has to be special too, reflecting these special features. In particular, boards and senior managements of banks have to be sensitive to the interests of the depositors, be aware of the potentially destructive consequences of excessive risk taking, be alert to warning signals and be wise enough to contain irrational exuberance. Post-crisis, there is a debate on the extent to which failure of corporate governance has been responsible for the crisis. If the directors on the boards of banks didn't know what was going on, they should ask themselves if they were fit enough to be directors. If they did know and didn't stop it, they were complicit in the recklessness and fraud. In fact, the post-crisis verdict on corporate governance of banks is quite damning.

The Institute of International Finance, an association of major international banks, has concluded after an examination of board performance of banks that,

> *"Events have raised questions about the ability of certain boards to properly oversee senior managements and to understand and monitor the business itself".*

As per an OECD report, nearly all of the 11 major banks reviewed by the Senior Supervisors Group (an informal group of senior BIS central bankers' speeches 3 supervisors under the auspice of the Financial Stability Board – FSB) in 2008 failed to anticipate fully the severity and nature of the market stress.

On the positive side, there is some early evidence that banks with stronger corporate governance mechanisms moderated the adverse impact of the crisis on them, had higher profitability in 2008 and provided substantially higher stock returns in the immediate aftermath of the market turmoil. A relevant question in this context is whether there are any additional dimensions to corporate governance of banks in emerging economies.

Hence, corporate governance is conceptually different for banks. If a corporate fails, the fall outs can be restricted to the stakeholders, but if a bank fails, the impact can spread rapidly through other banks with potentially serious consequences for the entire financial system and the macro economy.

Doubtless, in the emerging economies, banks are more than mere agents of financial intermediation; they carry the additional responsibility of leading financial sector development and of driving the government's social agenda. Second, in emerging economies, the institutional structures that define the boundaries between the regulators and the regulated and across regulators are still evolving. Managing the tensions that arise out of these factors makes corporate governance of banks in emerging economies even more challenging.

Conclusion

"Corporate Governance" is not an abstract goal, but exists to serve corporate purposes by providing a structure within which stockholders, directors and management can pursue most effectively the objectives of the corporation.

Corporate Governance ensures transparency which ensures strong and balanced economic development. This also ensures that the interests of all shareholders (majority as well as minority shareholders) are safeguarded. It ensures that all shareholders fully exercise their rights and that the organization fully recognizes their rights.

Corporate Governance has a broad scope. It includes both social and institutional aspects. Corporate Governance encourages a trustworthy, moral, as well as ethical environment.

Indeed, corporate governance of banks is an essential element of a countrys governance architecture. It can have systemic financial stability implications and shape the pattern of credit distribution and overall supply of financial services. Hence the necessity and importance of enforcing effective corporate governance in the banking sector.

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