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CORPORATE GOVERNANCE- A FRAMEWORK IN INDIAN CONTEXT

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Abstract
In today's era of globalization, the corporate world requires a world-class governance system. Corporate governance is the mechanisms, processes and relations by which corporations are controlled and directed. Corporate governance is about promoting corporate ethics, fairness, transparency and accountability. It is an overview of rules and regulations for the people in-charge of an incorporated firm. In recent years, the corporate scandals & corporate collapses like Enron, WorldCom and Satyam, some of which are still unfolding, involving high incidence of improper activities of managers expropriating the resources of a firm at the ultimate expense of shareholders prompt the intense reexamination and scrutiny of some of the existing corporate governance practices and also considerable interest in empirical research on the effectiveness of various corporate governance institutions and mechanisms. This paper makes an attempt to review extensively the literature and empirical research addressing corporate governance. The paper will discuss corporate governance from India's point of view. In addition, it will explain why it is important for any country to follow good corporate governance practices.It will look at how corporate governance became an inseparable part of Indian economy. It discusses ethics, internal governance, choice of auditor and audit committee for India.

Keywords: Indian Corporate Governance, Internal Governance, Audit Committee, Ethics.

Introduction

Corporate Governance refers to the way a corporation is governed, directed and managed. It is actually conducted by the board of Directors and the concerned committees for the company's stakeholder's benefit. Corporate governance leads to an organizational culture of consciousness, openness, transparency, accountability, and security. Corporate governance is a multidisciplinary field of study it covers a wide range of disciplines – accounting, consulting, economics, ethics, finance, law, and management. The Cadbury Committee of U.K. in January, 2002 defined corporate governance as – "the system by which companies are directed and controlled". It also includes the relationships among the various stakeholders (e.g. members/shareholders, management and board of directors) involved.

It is an indisputable fact that scams and scandals are increasingly undermining our lives. In recent years, the area of corporate governance has received increased attention because of striking high-profile scandals and corporate collapses worldwide such as Enron (US), WorldCom (US), Maxwell Pension Scandal (UK), Satyam and Reebok (India), etc. involving unethical conduct, abuse of corporate power and alleged criminal activity by key managerial personnel. An integral part of an effective corporate governance regime includes provisions for civil or criminal prosecution of individuals who conduct unethical or illegal acts in the name of the corporation.

Objectives of the Study

1. To provide an overview of the concept of corporate governance.
2. To present a brief review of literature through survey of important previous researches .
3. To provide an overview of various components of corporate governance to explain corporate governance from the point of view of India.

Literature Review

1. **Ruchi Kulkani and Balasundram Maniam (2014),**explained that how important it is for a company to follow good corporate governance practices & looked at the brief history of corporate governance in India and its present economic and financial situation. Then the paper started going deep into the root cause of factors that affect corporate governance such as ethics, internal governance, and choice of auditors and audit committee.

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2.**Priyanka Aggarwal (2013),** found that corporate governance and corporate financial performance are correlated and governance rating of company has significant positive impact on its financial performance.
3.**Prof (Dr.) H. L.Verma & Sonal Pahwa,(2017),** their studies prove that governance practices have a positiveimpact on firm value and performance in both, private and public sector.
4.**Gulhan Suadiye(2017),** This study investigates the relationship between corporate governance practices and financial performance for listed Turkish companies in BIST star market over the period of 2010 to 2015.
5.**Tromp (2012)** said that concept is an abstract or general idea inferred or derived from specific instances. A conceptual framework is a set of broad ideas and principles taken from relevant fields of enquiry and used to structure a subsequent presentation.

Concept of Corporate Governance
As per Report of the SEBI Committee on Corporate Governance, February 2003 - the fundamental objective of corporate governance is to enhance the long-term shareholder value, while at the same time protecting the interests of other stakeholders by improving the corporate performance and accountability (SEBI, 2003). Corporate Governance lays down the framework for creating long-term trust between companies and the stakeholders. Good governance is integral to the very existence of a company. It inspires and strengthens investor's confidence by ensuring company's commitment to higher growth and profits. SEBI believes that companies having good corporate governance system in place are rewarded by investors and markets with high valuations. In practice, there are four principles of good corporate governance, which are: (1) transparency; (2) accountability; (3) responsibility; and (4) fairness (Aras &Crowther, 2008).

Definition of Corporate Governance
The OECD (1999) proposes “Corporate governance refers to the mechanisms by which enterprises are directed, and in particular, to the means by which those who control an enterprise’s on-going operations are held accountable for that enterprise’s performance”. Corporate Governance is the set of relationships between a company’s management, its board, shareholders and other stake holders (OECD, 2004).

The Securities and Exchange Board of India Committee on Corporate Governance defines corporate governance as 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 & corporate funds in the management of a company.”

Corporate Governance Committees
a) Cadbury committee on Corporate Governance –1992 :The stated objectives of the Cadbury Committee was “To help raise the standards of corporate governance and the level of confidence in financial reporting and auditing by setting out clearly what it sees as the respective responsibilities of those involved and what it believes his expected of them. The committee investigated the accountability of the board of directors to shareholders and to society. It submitted its report and associated “Code of Best Practices” in 1992 wherein it spelt out the methods of governance needed to achieve a balance between the essential power of the board of directors and their proper accountability.

b) The Paul Ruthman Committee: The committee was constituted later to deal with the said controversial point of Cadbury Report. It watered down the proposal on the grounds of practicality. It restricted the reporting requirement to internal financial controls only as against “the effectiveness of the company’s system of internal control” as stipulated by the Code of Best Practices contained in the Cadbury Report. The final report submitted by the Committee chaired by Ron Hampel had some important and progressive elements, notably the extension of directors’ responsibilities to “all relevant control objectives including business risk assessment and minimizing the risk of fraud…”

c) The Greenbury Committee: This committee was setup in January 1995 to identify good practices by the Confederation of British Industry (CBI), in determining directors' remuneration and to prepare a code of such practices for use by public limited companies of United Kingdom. The committee aimed to provide an answer to the general concerns about the accountability by the proper allocation of responsibility for determining directors' remuneration, the proper reporting to shareholders and greater transparency in the process. The committee produced the Greenbury Code of Best Practice which was divided into the four sections : Remmuneration Committee, Disclosures, Remuneration Policy and Service Contracts and Compensation.

d) The Hampel Committee : The Hampel committee was setup in November 1995 to promote high standards on Corporate Governance both to protect investors and preserve and enhance the standing of companies listed on the London Stock Exchange. The committee developed further the Cadbury report. And it made the following recommendations.
i) The auditors should report on internal control privately to the directors.
ii) The directors maintain and review all controls.
iii) Companies should time to time review their need for internal audit function and control.

e) The Combined Code: The combined code was subsequently derived from Ron Hampel Committee's Final Report, Cadbury Report and the Greenbury Report. The combined code is appended to the listing rules of the London Stock Exchange. As such, compliance of the code is mandatory for all listed companies in UK. The stipulations contained in the Combined Code require, among other things, that the boards should maintain a sound system of internal control to safeguard shareholder's investments and the company's assets. The directors should, at least annually, conduct a review of the effectiveness of the group's system of internal control covering all controls, including financial, operational and compliance and risk management, and report to shareholders that they have done so.

f) The Turnbull Committee :It was set up by the Institute of Chartered Accountants in England and Wales (ICAEW) in 1999 to provide guidance to assist companies in implementing the requirements of the Combined Code relating to internal control. The committee provided guidance to assist companies in implementing the requirements of the Combined Code relating to internal control. It recommended that where companies do not have an internal audit function, the board should consider the need for carrying out an internal audit annually.

Governance Theories

1. **Agency Theories:** Agency theories arise from the distinction between the owners (shareholders) of a company or an organization designated as "the principals" and the executives hired to manage the organization called "the agent." Agency theory argues that the goal of the agent is different from that of the principals, and they are conflicting. The assumption is that the principals suffer an agency loss, which is a lesser return on investment because they do not directly manage the company. Part of the return that they could have had if they were managing the company directly goes to the agent. Further, a board developed from the perspective of the agency theory tends to exercise strict control, supervision, and monitoring of the performance of the agent in order to protect the interests of the principals.
2. **Stewardship Theories:** Stewardship theories argue that the managers or executives of a company are stewards of the owners, and both groups share common goals. Therefore, the board should not be too controlling, as agency theories would suggest. The board should play a supportive role by empowering executives and, in turn, increase the potential for higher performance .Stewardship theories argue for relationships between board and executives that involve training, mentoring, and shared decision making .
3. **Resource-Dependence Theories:** Resource-dependence theories argue that a board exists as a provider of resources to executives in order to help them achieve organizational goals. Resource-dependence theories recommend interventions by the board while advocating for strong financial, human, and intangible supports to the executives. For example, board members who are professionals can use their expertise to train and mentor executives in a way that improves organizational performance.

4. **Stakeholder Theories:** These theories are based on the assumption that shareholders are not the only group with a stake in a company or a corporation. Stakeholder theories argue that clients or customers, suppliers, and the surrounding communities also have a stake in a corporation. Therefore, managers have special obligations to ensure that all stakeholders (not just the shareholders) receive a fair return from their stake in the company.

Principles

1. OECD Principles: Organization for Economic Co-operation and Development (OECD) was one of the earliest non-governmental organizations to work on and spell out principles and practices that should govern corporate in their goal to attain long-term shareholder value. The OECD were trend setters as the Code of Best practices are associated with Cadbury report. The OECD principles in summary include the following elements:

i) The rights of shareholders
ii) Equitable treatment of shareholders
iii) Role of stakeholders in corporate governance
iv) Disclosure and Transparency
v) Responsibilities of the board

2. Sarbanes- Oxley Act, 2002: The Sarbanes-Oxley Act (SOX) is a sincere attempt to address all the issues associated with corporate failure to achieve quality governance and to restore investor's confidence. The Act was formulated to protect investors by improving the accuracy and reliability of corporate disclosures, made precious to the securities laws and for other purposes. The act contains a number of provisions that dramatically change the reporting and corporate director's governance obligations of public companies, the directors and officers which are given below:

1. **Establishment of Public Company Accounting Oversight Board (PCAOB):** It creates a new board consisting of 5 members of whom two will be certified public accountants. All accounting firms have to get registered with the board. The board will make regular inspection of firms.
2. **Audit Committee:** The committee is responsible for appointment, fixing fees and oversight of the work of independent auditors.
3. **Conflict of Interest:** The public accounting firms should not perform any audit services for a publically traded company.
4. **Audit Partner Rotation:** The act provides for mandatory rotation of lead audit or co-ordinating partner and the partner reviewing audit once every 5 years.
5. **Improper influence on conduct of Audits:** According to act, it is unlawful for any executive or director of the firm to take any action to fraudulently influence, coerce or manipulate an audit.
6. **Prohibition of non-audit services:** Under SOX act, auditors are prohibited from providing non-audit services concurrently with audit financial review services.

Why Is Corporate Governance In India Important?

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.

India and Corporate Governance

Corporate governance has played a very important role in the present economic condition of India. India successfully started its move towards open and welcoming economy in 1991. From then onwards it has seen an

amazing upward trend in the size of its stock market, that is, number of listed firms was increasing proportionately. If India wants to attract more countries for foreign direct investments, Indian companies have to be more focused on transparency and Shareholders value maximization. Even though corporate governance practices can be backdated to as early as 1961 around the world, India was lagging behind. It was not until 1991 when liberalization took place and corporate governance established an international context.

There have been several major corporate governance initiatives launched in India since the mid-1990s. The first was by the Confederation of Indian Industry (CII), India's largest industry and business association, which came up with the first voluntary code of corporate governance in 1998. The second was by the SEBI, now enshrined as Clause 49 of the listing agreement. The third was the Naresh Chandra Committee, which submitted its report in 2002. The fourth was again by SEBI — the Narayana Murthy Committee, which also submitted its report in 2002. Based on some of the recommendation of this committee, SEBI revised Clause 49 of the listing agreement in August 2003.Subsequently, SEBI withdrew the revised Clause 49 in December 2003, and currently, the original Clause 49 is in force.

1. The CII Code: More than a year before the onset of the Asian crisis, CII set up a committee to examine corporate governance issues, and recommend a voluntary code of best practices. The committee was driven by the conviction that good corporate governance was essential for Indian companies to access domestic as well as global capital at competitive rates. The first draft of the code was prepared by April 1997, and the final document (Desirable Corporate Governance: A Code),was publicly released in April 1998. The code was voluntary, contained detailed provisions, and focused on listed companies. Since 1998, CII has been trying induce companies to disclose much greater information about their boards.

2. Kumar Manglam Birla Committee Report And Clause 49: Consequently, the second major corporate governance initiative in the country was undertaken by SEBI. In early 1999, it set up a committee under Kumar Mangalam Birla to promote and raise the standards of good corporate governance. In early 2000, the SEBI board had accepted and ratified key recommendations of this committee, and these were incorporated into Clause 49 of the Listing Agreement of the Stock Exchanges. The control and reporting functions of boards, the roles of the various committees of the board, the role of management, all assume special significance when viewed from this perspective. These recommendations are expected to be enforced on listed companies for initials disclosures. This enables shareholders to know, where the companies are in which they have involved. Now to protect investors especially shareholders from any malpractices and injustice the SEBI appointed committee on corporate governance on May 7, 1999 under chairmanship of Shri Kumar Managalam Birla.

The constitutions of Committee: The committee has identified the three key constituents of corporate governance as the share holders, the Board of Directors and the Management. Along with this the committee has identified major 3 aspects namely accountability, transparency and equality of treatment for all shareholders.

3. Naresh Chandra Committee Report: The Naresh Chandra committee was appointed in August 2002 by the Department of Company Affairs (DCA) under the Ministry of Finance and Company Affairs to examine various corporate governance issues. The Committee submitted its report in December 2002. It made recommendations in two key aspects of corporate governance:financial and non-financial disclosures: and independent auditing and board oversight of management. The committee submitted its report on various aspects concerning corporate governance such as role, remuneration, and training etc. of independent directors, audit committee, the auditors and then relationship with the company and how their roles can be regulated as improved. The committee stingily believes that "a good accounting system is a strong indication of the management commitment to governance.
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4. Narayana Murthy Committee Report Corporate Governance: The fourth initiative on corporate governance in India is in the form of the recommendations of the Narayana Murthy committee. The committee was set up by SEBI, under the chairmanship of Mr. N. R. Narayana Murthy, to review Clause 49, and suggest measures

to improve corporate governance standards. Some of the major recommendations of the committee primarily related to audit committees, audit reports, independent directors, related party transactions, risk management,directorships and director compensation, codes of conduct and financial disclosures.

Ethics

Business Ethics refers to carrying business as per self-acknowledged moral standards. It is actually a structure of moral principles and code of conduct applicable to a business It is the worth of right and wrong things from business point of view. Business ethics not only talk about the code of conduct at workplace but also with the clients and associates. Companies which present factual information respect everyone and thoroughly adhere to the rules and regulations are renowned for high ethical standards. Ethical decisions in a business have implications such as satisfied work force, high sales, low regulation cost, more customers and high goodwill. Some of ethical issues for business are relation of employees and employers, interaction between organization ,customers and shareholders, work environment, environmental issues, bribes, employees rights protection, product safety etc.

Corporate Governance Mechanisms

Corporate governance mechanisms are tools that principals employ to align incentives between principals and agents and to monitor and control agents. A firm is typically governed by a mix of internal and external governance mechanisms. Internal governance mechanisms are associated with the use of board of directors, large shareholders and debt holders and executive compensation schemes. External governance mechanisms are those involving the market for corporate control, the regulatory environment, product market competition, external auditors, adoption of governance codes, and cross-listings in stock exchanges. In this note, our focus is largely on the internal governance mechanisms and these are detailed below:

1. **Board of Directors:** It shall comprise of such number of minimum independent directors, as prescribed. In case where the Chairman of the Board is a non-executive director, at least one-third of the Board shall comprise of independent directors and where the Chairman of the Board is an executive director, at least half of the Board shall comprise of independent directors. A relative of a promoter or an executive director shall not be regarded as an independent director. Duty of care and duty of loyalty are the most important roles of any director. Listed companies and specified classes of public companies are required to appoint independent directors and women directors on their boards.

2. Board Size and Composition: The Cadbury Committee in the UK sought a majority of the board to be non-executive and independent. This has undergone a change and increasingly the boards comprise of following groups of directors: Promoter, director, executive and nonexecutive directors, a part of who are independent. According to the Corporate Library's study, the average board size is from 3 to 31 members . For India, there is no mandatory number for the board of directors except the rule of minimum of two members in private limited companies and three for public limited companies. 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.

3. Independence of Board From Management: It is widely believed that independent directors play a significant role in monitoring and advising the company’s management. They are required to safeguard overall organizational and stakeholders interest.

4. Seperation of CEO And Chairman: Conflict of interest, concentration of power and reduced board independence are usually observed when the roles of CEO and Chairman of the board are exercised by the same individual.

5. Financial Expertise Of Directors: Directors should be financially literate, so that they can better understand the implications of decisions taken by management.

6. Number of Board Meetings: The committee recommends that the audit committee should meet at least thrice a year. One meeting must be held before finalization of annual accounts and one necessarily every six months. The quorum should be either two members or one third of members of audit committee, whichever is higher and there should be a minimum of two Independent directors.The Independent directors must attend at least one meeting a year.

7. Role of External Auditors: The external auditor should be competent and independent enough to detect and report frauds and manipulations in corporate reports. Simultaneous provision of both audit and non-audit services by external auditors affects effectiveness of audit. Amount of audit fees is also relevant. Every company must appoint an individual or firm as an auditor whereas external auditors are hired on a contractual basis, they are independent of the entity they are auditing. The auditor of any company will be involved only in consulting activities.

8. Committees of the Board:
A) Audit Committee: The audit committee's job is one of oversight and monitoring and carrying out this job it relies on similar financial management and outside auditors. The committee states that audit committee should have minimum three members, all being non-executive directors, with the majority being independent and with at least one director having financial and accounting knowledge. One of the key roles of an audit committee is to hire and protect the autonomy of external auditor.

B) Remuneration Committee: A board remuneration committee helps in deciding the suitable amount of remuneration for the top level executives like CEO. The committee is of the view that a company must have a creditable and transparent policy in determining and accounting for the remuneration of the directors. The Remuneration Committee should comprise of at least three directors, all of them should be non-executive directors, the chairman being an independent one. The chairman of Remuneration Committee should present at AGM. It is important for the shareholders to be informed of the remuneration of the directors of the company, which is mandatory.

C) Nomination Committee: The nomination committee evaluates the skills, knowledge, and expertise needed to become a director and identifies the suitable candidates.

Conclusion
In this paper, we saw how important it is for a company to follow good corporate governance practices. Then we looked at the brief history of corporate governance in India and its present economic and financial situation. India being an emerging economy needs to work more on regulating the corporate governance policies. Indian companies still have the scope to paint a brighter future for them. Despite these wide-ranging developments in regulation and policy, what becomes increasingly apparent in India is that the reform process has not addressed, or effectively addressed, a key challenge at the heart of the governance problem, namely the accountability of promoters to other shareholders.

They need to acknowledge and continue with the corporate governance reform, and always keep in mind that this brighter future will have its own set of challenges. While some leading Indian companies deserve credit for actively pursuing high standards of governance, including producing examples of world-class corporate disclosure, the strong growth of the economy and capital markets has fostered, in our view, a fair degree of complacency towards corporate governance and the rights of minority shareholders.

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