



REALISTIC CHALLENGES OF CORPORATE GOVERNANCE IN INDIA

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Abstract

With the rise in the number and nature of corporate debacles in India, it is time to investigate the deep governance related issues of an organization. In the present times, it is evident that the equation between ownership and management lacks the balance and is seen to be skewed more towards the earlier part of the present equation. When owners self interest impedes the interest of other stakeholders; good governance takes a back seat due to the lack of transparency and accountability in the transactions, thereby derailing the entire system. Apart from this there are several other issues that hinder the corporate governance. The present paper aims to identify such realistic challenges Indian organizations are facing and suggest the probable remedies to overcome the same.

Keywords: *Corporate Governance, Good Governance, Ownership, Stakeholders.*

I. Introduction

In recent years, the relations between the ownership and management have become the basis of Modern Corporation. Corporate governance essentially lays down the framework for creating long term trust between companies and all its stakeholders. The key aspects of good corporate governance include transparency of corporate structures and operations, the accountability of managers and the boards to shareholders; and corporate responsibility towards stakeholders. Companies around the world are realizing that better corporate governance adds considerable value to their operational performance; India still needs to improve its standard of the same and cover up for the weaknesses.

In the last decade, the frequencies of corporate frauds and governance failures that have dotted the global corporate map have witnessed comparably vigorous efforts of improving corporate governance practices. India has liberalised the regulatory fabric of the country to align its corporate governance norms with those of developed countries. And yet, achieving good governance and ensuring results of such governance practices continue to remain one of the top priorities of stakeholders even today.

Thus, the present paper is an attempt to identify the realistic challenges Indian organizations are facing even when the regulatory standards of our country are in alignment with the norms of the other developed countries.

2. Literature Review

Research on corporate governance in the emerging markets like India is much needed. Various benefits of following better corporate governance practices are noticed (Claessens, 2013). Bhasin, 2012 states that good corporate governance practices help corporations and its stakeholders; to do so various committees that function with transparency and fairness are required in organizations. A corporate governance framework needs to be developed by providing a broad overview of recent corporate governance research. All aspects of corporate governance are important from board structure to ownership structure (Gillan, 2006). In about 26 developing and developed countries major corporate governance reforms took place. These reforms affected investor protection as well as impacted corporate investments (Han, 2013). The role of audit committee is to protect the auditor from dismissal in case of unfavorable report. Independent audit committee members experience a significant increase in turnover rate after auditor dismissals (Joseph, 2003). According to Li and Nair, 2009, corporate governance has become an important issue for China and India as they regularly interact with investors from developed countries. Various aspects of business ethics and its relation to corporate governance can be discussed in detail by understanding various issues related to corporate board of directors and the basis on which they should be



analyzed (Murthy, 2009). Ethics in corporate governance also plays an important role; operational dynamics of corporate governance are a necessary part of modern industrialization.

3. Objectives of the Study

The present research paper aims at examining the current problems of corporate governance in Indian context. The paper aims to understand the challenges in the practice of corporate governance in the light of the regulatory framework in India.

4. Realistic Challenges of Corporate Governance in India

India has been taking consistent measures to ensure that the regulatory framework of corporate governance matches the requirements of business and stakeholders. Table 1 summarizes the series of corporate governance regulations initiated in India along with their outcomes. But even with the emergence of stringent norms, there are other challenges that impede the good governance. This research paper discusses some of the realistic challenges of corporate governance in India.

Table 1: Chronology of Corporate Governance Regulations

Year	Authority	Outcome
1997	SEBI	Substantial Acquisitions of Shares and Takeovers (SAST)
1998	CII	Desirable Corporate Governance: A Code
2000	SEBI	Clause 49 of Listing Agreement. Mandatory disclosure along with Annual Report.
2002	Department of Company Affairs (DCA)	Naresh Chandra Committee Report. Recommendations about Audit Committee functions and responsibilities
2004	SEBI	Revision of Clause 49
2004	Ministry of Corporate Affairs (MCA)	New companies bill draft
2011	SEBI	Revised Substantial Acquisitions of Shares and Takeovers (SAST) 2011
2013	MCA	Companies Act 2013
2014	SEBI	Revised Clause 49 conforming the New Companies Act 2013
2015	SEBI	Listing Obligations and Disclosure Requirements 2015. Clause 49 becomes erstwhile

Source: Selarka 2018, Corporate Governance Practices in India, Working paper 173/2018

1. Desirable composition of the Board: Enough has been said on board and its role as the cornerstone for good corporate governance. To this end, the law requires a healthy mix of executive and non-executive directors and appointment of at least one woman director for diversity. There is no doubt that a capable, diverse and active board would, to large extent, improve governance standards of a company. The challenge lies in ingraining governance in corporate cultures so that there is improving compliance "in spirit". Most companies' in India tend to only comply on paper; board appointments are still by way of "word of mouth" or fellow board member recommendations. It is common for friends and family of promoters (a uniquely Indian term for founders and controlling shareholders) and management to be appointed as board members. Innovative solutions are the need



of the hour – for instance, rating board diversity and governance practices and publishing such results or using performance evaluation as a minimum benchmark for director appointment.

2. Evaluation of Directors Performance: Although performance evaluation of directors has been part of the existing legal framework in India, it caught the regulator's attention recently. In January 2017, SEBI released a 'Guidance Note on Board Evaluation'. It elaborated on different aspects of performance evaluation by laying down the means to identify objectives, different criteria and method of evaluation. For performance evaluation to achieve the desired results on governance practices, there is often a call for results of such evaluation are made public. Considering this, evaluation is always a sensitive subject and public disclosures may prove counter-productive. To reverse this behaviour, the role of independent directors in performance evaluation is the key.

3. Status of Independent Directors: Independent directors' appointment was supposed to be the biggest corporate governance reform. However, independent directors have barely been able to make the desired impact. The regulator on its part has continually made the norms tighter, has introduced comprehensive definitions of independent directors, has defined the role of the audit committee, etc. However, most Indian promoters practice a tick-the-box way to comply with the regulatory requirements. The independence of such promoter appointed independent directors is questionable as it is unlikely that they will stand-up for minority interests against the promoter. Despite all the governance reforms, the regulator is still found wanting. Perhaps, the focus needs to shift to limiting promoter's powers in matters relating to independent directors.

4. Removal of Independent Directors: While independent directors have been generally criticised for playing a passive role on the board, instances of independent directors not siding with promoter decisions have not been taken well – they were removed from their position by promoters. Under law, an independent director can be easily removed by promoters or majority shareholders. This inherent conflict has a direct impact on independence. Even SEBI's advisory board has proposed measures to enhance the transparency with regard to appointment and removal of directors. To protect independent directors from disputed action and let them act as an independent authority, it is imperative to provide for additional scrutinizing authority in the process of their removal – viz. requiring approval of majority of public shareholders.

5. Responsibility towards Stakeholders: Indian company law 2013 commands that directors owe duties not only towards the company and shareholders but also towards the employees, community and for the protection of environment. Although these general duties have been imposed on all directors, directors including independent directors are seen unworried about it due to lack of enforcement action. To increase accountability, the entire board may be asked to be present at general meetings to give stakeholders an opportunity to interact with the board and ask questions on matters related thereon.

6. Executive Compensation: Executive compensation is a controversial issue especially when subject to shareholder accountability. Companies have to offer competitive compensation to attract talent. However, such executive compensation should be examined by the stakeholders. Presently, under Indian law, the nomination and remuneration committee comprising of a majority of independent directors is required to frame a policy on remuneration of key employees. Also, the annual remuneration paid to key executives is required to be made public. To retain and nurture a trustworthy relationship between the shareholders and the executives, companies may consider framing remuneration policies which are transparent and require shareholders' approval.

7. Succession planning in organizations: In India, founders' ability to control the affairs of the company has the potential of derailing the entire corporate governance system. Unlike developed economies, in India, identity of the founder and the company is often merged. The founders, irrespective of their legal position, continue to exercise significant influence over the key business decisions of companies and fail to acknowledge the need for succession planning. From a governance and business continuity perspective, it is best if founders chalk out a



succession plan and implement it. The best way to tackle with this is widen the shareholder base - as institutional investors pump in capital, founders are forced to think about a succession plan and step away with dignity.

8. Risk Management: Today, large businesses are exposed to real-time monitoring by business media and national media houses. Given that the board is only playing an oversight role on the affairs of a company, framing and implementing a risk management policy is necessary. In this context, Indian company law requires the board to include a statement in its report to the shareholders indicating development and implementation of risk management policy for the company. The independent directors are mandated to assess the risk management systems of the company. For a governance model to be effective, a robust risk management policy which spells out key guiding principles and practices for mitigating risks in day-to-day activities is imperative.

9. Privacy and Data Protection: As a key aspect of risk management, privacy and data protection is an important governance issue. In this era of digitalisation, a sound understanding of the fundamentals of cyber security must be expected from every director. Good governance will be only achieved if executives are able to engage and understand the specialists in their firm. The board must assess the potential risk of handling data and take steps to ensure such data is protected from potential misuse. The board must invest a reasonable amount of time and money in order ensure the goal of data protection is achieved.

10. Board's Approach to Corporate Social Responsibility (CSR): India is one of the few countries which has legislated on CSR. Companies meeting specified thresholds are required to constitute a CSR committee from within the board. This committee then frames a CSR policy and recommends spending on CSR activities based on such policy. Companies are required to spend at least 2% of the average net profits of last three financial years. For companies who fail to meet the CSR spend, the boards of such companies are required to disclose reasons for such failure in the board's report. During the last year, companies which failed to comply received notices from the ministry of corporate affairs asking for reasons why they did not incur CSR spend and in some cases questioning the reasons disclosed for not spending. In these circumstances, increased effort and seriousness by the board towards CSR is necessary. CSR projects should be managed by board with as much interest and vigour as any other business project of the company.

Conclusion

As far as structural and regulatory changes are concerned, India has witnessed several enactments – the **Companies Act, 2013** and **SEBI's listing obligations and disclosure requirements regulations**, which have contributed significantly in strengthening governance norms and in increasing accountability by way of disclosures. Interestingly, these changes have been inspired by the Anglo-Saxon model of corporate governance, which is probably one of the key reasons behind current practices of corporate governance not achieving the desired level of fruition. For achieving desired results, it is important that regulatory measures are modeled based on the practices and business environment in India. To state the obvious, this should be coupled with the board and the promoters' embracing such reforms – in form and spirit.

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