ROLE OF INDIAN FINANCIAL MARKETS AND CORPORATE GOVERNANCE

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Abstract

The Indian financial market is experiencing significant structural transformation since liberalisation. As per recent report nearly one-fifth of listed companies in India do not comply with public shareholding reporting norms set by SEBI. Poor corporate governance standards in India have been a major grievance of domestic and foreign investors in Indian financial markets. In order to improve financial market efficiency, to make financial market transactions more transparent, curb unfair trade practises and to bring the financial market up to international standards, there is an urgent need of stringent corporate governance norms. Empirical evidence from emerging market like India shows that regulatory move is imperative on corporate governance for long term success of the economy. The future of Indian financial market is undoubtedly very bright but it requires corporate transparency. The real fruits of corporate governance may not accrue immediately but the long term development and stability of Indian financial market largely depends upon the effective implementation of corporate governance.

Keywords: Corporate governance, SEBI, Financial stability, Regulating norms

1. Introduction

Change is the essence of the life. Advancement in science and technology has changed the way we live. Globalisation and liberalisation has changed the way we do our business. There is a change in business environment and business culture. This change has resulted in decline in ethics and values that ought to be followed by everyone including corporate

Concept of governance has been known both in political and academic circle for a long time, referring generally to the task of running enterprises.

According to World bank, Good governance is epitomised by predictable, open and enlighten policy making, a bureaucracy imbued with professional ethos acting in furtherance of the public good, the rule of law, transparent processes and strong civil society participating in public affairs.

Corporate governance is a concept rather than an instrument. It focuses on appropriate management and control structure of a company. Also included in the concept are power relations between owners, the BOD, management & stakeholders.

Corporate governance is a field where company has to move forward through “Evolution rather than Revolution” to achieve long term strategic goals to satisfy shareholders, creditors, employees, customers and suppliers.
2. Objectives
The main objectives of corporate governance can be listed as under.

1. To maximise confidence of investors to the capital market.
2. To enhance quarterly disclosures.
3. To maximise long term shareholders’ value.
4. To disclose capital deployment detail.
5. To change the codes with changing context & time.
6. To present analysis and comments on audit qualifications.
7. To make available long and medium term strategy in standard formats.

3. Research Methodology
This research paper has been prepared by studying and analysing the current and former corporate governance committee reports and past research work done by experts at national and international level.

Research method is based on analysis of secondary data collected from the available sources.

4. Literature Review
Researcher has reviewed following literatures.

1. Corporate governance importance arises in modern corporations due to the separation of management and ownership control in the organizations. The interests of shareholders are conflicting with the interests of managers. The principal agent problem is reflected in the management and direction related problems due to the differential interests of firm’s stakeholders. There is not a single definition of corporate governance rather it might be viewed from different angles.

2. Berle and Means (1932) and the even earlier Smith (1776). Zingales (1998) defines corporate governance as “allocation of ownership, capital structure, managerial incentive schemes, takeovers, board of directors, pressure from institutional investors, product market competition, labour market competition, organisational structure, etc., can all be thought of as institutions that affect the process through which quasi-rents are distributed (p. 4)”.

3. Garvey and Swan (1994) assert that “governance determines how the firm’s top decision makers (executives) actually administer such contracts (p. 139)”.

4. Shleifer and Vishny (1997) define corporate governance as “the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment (p.737)”.

5. OECD in 1999 defined corporate governance as "Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance.”

6. Oman (2001) defined corporate governance as a term refers to the private and public institutions that include laws, regulations and the business practices which governs the relationship between the corporate managers and the stakeholders. The Ministry of Finance, Singapore (CORPORATE GOVERNANCEC 2001) defines corporate governance as “the processes and structure by which the business and affairs of the company are directed and
managed, in order to enhance long term shareholder value through enhancing corporate performance and accountability, whilst taking into account the interests of other stakeholders. Good corporate governance therefore embodies both enterprise (performance) and accountability (conformance).” (Fin, 2004, pp 13-14).

7. La Porta, Silanes and Shliefer (2000, 2002) view corporate governance as a set of mechanisms through which outside investors (shareholders) protect themselves from inside investors (managers). The Organization for Economic Cooperation and Development provides another perspective by stating that “corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as the Board, managers, shareholders and other stakeholders, and spells out the rules and procedure for making decisions on corporate affairs. By doing this, it also provides the structures through which the company objectives are set, and the means of attaining those objectives and monitoring performance.

5. Analysis Part

1. Shareholders are spreaded throughout the nation:
At present companies have a large number of shareholders scattered throughout the nation and majority of them are unorganised. The shareholders’ democracy remains limited to the Memorandum of Association and the Articles of Association. But it requires the support of corporate governance.

2. Ownership Pattern:
Nowadays the ownership structure has changed drastically as FII(foreign institutional investors), DII(domestic institutional investors), HNI(high networth investors), MF(mutual funds) etc are becoming the big investors in the private sector enterprises. They are the main force behind compelling the corporate to follow the codes to establish good image in the mind of investors.

3. Corporate Frauds:
In recent times corporate scandals have generated negative effects in the mind of investors towards company management. The Satyam computer services in 2009, his chairman Ramalinga Raju confessed that the company’s accounts had been falsified. This scandal destroyed the wealth of shareholders and ruined the image of corporate. Hence corporate governance is need of hours to restore the faith of investors.

4. Higher expectations of society:
With increase in level of awareness among the people of society, they demand better quality products, pollution control, proper and efficient use of natural resource and so on. To satisfy the general public and society as a whole, certain genuine steps are needed for making organisation socially aware.

5. Controlling unfair takeover of companies:
Several times cases of hostile takeover or unfair takeover take place in the corporate sector. It generates doubts in the minds of investors regarding ethical management of the take over companies. It requires the set of codes to tackle it efficiently.

6. Higher payout of top executives:
Higher payout of top level executives is regarded as a tool to make the company more competitive. But it is not fair to pay higher compensation to top level out of company’s earnings. Recently in n case of Infosys, founder NR Narayana Murthy had expressed anger over the steep hike in compensation which ultimately resulted in sacking of CEO Mr. Vishal Sikka.

7. International presence:
More and more domestic companies are trying to become truly global by getting it listed in the international exchanges. It requires to maintain due diligence in its working. International capital markets are strict in maintenance of corporate governance standards.

### 5.1 Major Issues:

1. **Transparency:**
   Transparency refers to quality of something which helps one to understand the fact easily. In corporate governance, it implies an accurate and proper disclosure of related information about the company to the related parties. Transparency is the basic requirement of the corporate governance, it lifts the public confidence. e.g. major well known companies publish their quarterly, half yearly and annual results in the business newspapers.

2. **Accountability:**
   In common sense accountability refers to the responsibility to explain the results of the decisions taken. In corporate governance it refers to the liability of the BOD including CEO to use company’s resources in the most efficient manner by keeping in mind the interest of all related parties.

3. **Independence:**
   In companies, top level management is the highest authority which must be independence and able to take decisions by keeping in mind the welfare of all the stakeholders. Prudence principle must be followed properly in decision making.

### 5.2 Committees on Corporate Governance

In order to promote good governance, SEBI constituted following committees.

<table>
<thead>
<tr>
<th>Year</th>
<th>Committee</th>
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<tbody>
<tr>
<td>2000</td>
<td>Kumar Mangalam Birla Committee</td>
</tr>
<tr>
<td>2003</td>
<td>Narayana Murthy Committe</td>
</tr>
<tr>
<td>2012</td>
<td>Adi Godrej Committee</td>
</tr>
<tr>
<td>2017</td>
<td>Uday Kotak Committee</td>
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</table>

On the basis of recommendations of the committees, SEBI issued guidelines on **corporate governance**, which are as under.

An overview of SEBI guidelines:

(a) **Board of Directors:**
   i) The BOD of the company will have proper combination of executive and non executive directors.
   ii) There must be one third of independent directors in the board. Independent directors are from non promoter group and eligible for receiving director’s remuneration.

(b) **Audit committee:**
   i) It shall have minimum three members, all being non-executive directors, with the majority of them are independent directors.
   ii) The chairman of the committee will be an independent director.
   iii) The chairman shall remain present at AGM
   iv) The audit committee shall have power to investigate any matter, obtain legal advice whenever required.
v) The audit committee must look after the reporting process and ensure that financial statements are correct and it has power to remove external director, review the audit function deliberately and undertake post audit discussion. Also committee must review firm’s risk management policies.

(c) Remuneration of director:
   i) Disclosure regarding salary, fringe benefits, bonus, pension etc must be made.
   ii) Details of other linked incentives must be disclosed.
   iii) Board meetings shall be held at least four times in a year.

(e) Management:
   i) Management must disclose important points in annual report like SWOT analysis, risk level, segment wise performance etc.
   ii) Management must present clear picture of operational performance and human resource efforts.

(f) Shareholders:
   i) Shareholders must be provided detail resume of new directors.
   ii) Shareholders must be informed about the number of companies in which he holds directorship.
   iii) A board committee shall be formed to look after the grievances of shareholders.

(g) Corporate governance report:
   i) In annual report there must be separate mentioning of the corporate governance activities undertaken by the company.

(h) Compliance certificate:
   i) A company must obtain the certificate from auditors regarding compliance of corporate governance norms.

Table 1 Principles of Conduct for Compensation Policies

| I. | Compensation incentives should be based on performance and should be aligned with shareholder interests and long term, firm-wide profitability, taking into accounts overall risk and the cost of capital. |
| II. | Compensation incentives should not induce risk-taking in excess of the firms risk appetite. III. Payout of compensation incentives should be based on risk-adjusted and cost of capital adjusted profit and phased, where possible, to coincide with the risk time horizon of such profit. |
| IV. | Incentive compensation should have a component reflecting the impact of business unit’s returns on the overall value of related business groups and the organization as a whole. |
| V. | Incentive compensation should have a component reflecting the firm’s overall results and achievement of risk management and other goals. |
| VI. | Severance pay should take into account-realized performance for shareholders over time. VII. The approach, principles and objectives of compensation incentives should be transparent to stakeholders. |


6. Findings
In past, despite having corporate governance, many companies have destroyed the wealth of the small investors. When promoter and MD are from the same family, obviously pointer is tilted towards the executive management and therefore the board becomes ineffective. The situation is not different in most family businesses. Therefore in most family businesses, power is tilted towards the controlling the shareholders or management. Only rules cannot change the mind-set of promoters. Hence the important issues in family businesses are the promoter’s willingness to empower the board and capabilities of independent directors.

7. Conclusion
Independent directors are expected to understand and evaluate among other things, the ethical dimension of a business model and reputational risk and other risks from business strategy. They should provide checks and balances to ensure the management does not adopt unethical practices or expose shareholders’ investment to unwarranted risks.

At present the appointment of independent directors is done through election by majority, as such, they occupy their position at the pleasure of controlling shareholders and may therefore be prone to act in accordance with the will of major shareholders; this would negatively affect the purpose of appointment of independent directors.

In the present context, independent directors and audit committee are at best can only protect investors and depositors from direct fraud on them by promoters or management.


