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Corporate Governance - Indian Scenario

Bindu Tyagi[1], R. L. Tamboli[2]
[1]Research Scholar, Department of Management and Commerce, Mewar University, Rajasthan, India
[2]Professor, Department of Management and Commerce, Mewar University, Rajasthan, India

***Abstract*: The Corporate Governance as the means of accomplishing the impartial wealth for the people of all the various and now a days it has come to be centre stage. It is application of best management practice, compliances of law in true spirit and devotion to ethical standard for effective management and distribution of wealth and discharge of social obligation for effective growth of all stakeholders. This article will discuss about corporate governance with Indian scenario. It will analyse good qualities of corporate governance practices which every country should adopt. In the next section, we will discuss how the corporate governance became integrated part of Indian economy. Next it discuss about how the Ethics, Internal Governance, and Selection of Auditor and Audit Committee play an important role in Indian economy. At the end we will discuss the summery of how India being an emerging economy due to regulating the corporate governance policies.**

***Keywords*: Auditor, Audit Committee, Board of directors, Corporate Governance, Ethics, Internal Governance**

1. Introduction

Corporate Governance is a multi-dimension area of study. It covers a large area of disciplines, ex-accounting, management, consulting law, economics, finance and ethics. [1] The main purpose of the corporate governance is to conduct of business in accordance with shareholder desire (maximize wealth) while confirming to the basic rule of the society embodied in the law and local customs. In case of any dispute because of conflict of interest, It is responsibility of corporate governance to find and cause and solve it and try to bring everyone together. The main function of the corporate governance is to set the standards, managed and administrated accordingly [2] An important question always come to our mind if we are talking about the corporate governance is – few corporate governance practice followed by some of the countries but same corporate governance values are not followed in some companies. [3]

In this paper we will discuss about the corporate governance from India's perspective as India is becoming emerging economy. The corporate governance has its own strength and weaknesses. The objective of this paper is to look how a good corporate governance practices, is not beneficial only for firms or companies but also in a wide range it will beneficial for the country's economy too. While analysing the scope of corporate governance we have to discuss about the influencing factors of corporate governance practices namely ethics, internal governance, and selection of auditor and audit committee. At last, in conclusion we will analyse the role of corporate governance in present economic situation of India.

2. Literature review

There exist a vide amount of literature on Corporate governance that gives innumerable definition about the subject. To get a true and fair view on the subject it would be prudent to give a narrow as well as a broad definition of corporate governance, in a narrow sense corporate governance is defined as a relationship of a company to its shareholders. It involves a set of relationships amongst the company's management, board of directors, shareholders, auditors and other stakeholders. These relationship provides the guidelines through which the objective of the company are set, the path of attaining of these objectives, charted out and the way of monitoring performance is determined. So the key aspect of good governance include transparency of corporate structures and operations, the accountability of the managers to the board and shareholders and corporate responsibility towards stakeholders. However in a broader sense, corporate governance is not just about maintaining long term relationships with the suppliers of finance only. In fact, it calls for a common path that would lead to attainment of all the stakeholders to the corporation and not just the shareholders. All aspects of corporate governance are very important, to do so various audit committee mechanism are required. In present time research on corporate governance with respect to emerging market is much needed. In about twenty six developed and developing countries major corporate governance reforms took place. These reforms affected investor protection as well as impacted corporate investment. The role of audit committee is to protect the auditor from dismissal of the auditor in case of unfavourable report. Independent audit committee members experienced a significant increase in turnover rate after dismissal of auditor. Corporate Governance has become a central issue in China and India as they regularly interact with investors from developed countries. A number of characteristics 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 analysed. Ethics plays an important role in corporate governance. Operational dynamics of corporate governance are a dynamic part of industrialization [1].

3. India and Corporate Governance

Corporate Governance has done a very significant role in the

present economic scenario of India. It has started move towards and welcomed in Indian economy in 1991. From then, it has seen amazing upward trend in the size of its stock market that is number of listed firms was increasing very fast. If India wants to attract more countries for foreign direct investment, Indian companies have to be more focused on transparency and shareholder value maximization. In earlier, 1961, corporate governance were backdated around the world. India was also at backseat till 1991, when liberalization took place and corporate governance established international level. The most important initiative of 1992 was reform of Securities and Exchange board of India (SEBI). Earlier the main objective of SEBI was to supervise and standardize stock trading but gradually it formed many corporate governance rules and regulations. The confederation of Indian Industry was the next major changes of Corporate Governance. The act towards corporate Governance for Indian companies developed the set of laws in 1996. Then two committees Kumar Manglam Birla and Narayan Murthy under securities and exchange board of India started lying the ground work for formalizing the best practices on corporate governance. Based on suggestions from these committees [3].The Clause 49 was introduced as part of the listing agreement to the Indian stock exchange. Due to scandals like Enron, Satyam, World.com etc., the Clause 49 forced to be reformed to incorporate and overcome the problems that caused these companies to collapse and shelter the economics of the respective companies. Clause number ‘49’ mentions the term Clause 49 of the listing agreement between a company and the stock exchanges on which it is listed. The listing agreement is identical for all Indian stock exchanges including the NSE & BSE. It comprise all the regulations and requirement of minimum number of independent directors, board members , audit committee and different necessary committees , code of conduct, rules and limits etc. If any firm does not follow these principles it can be removed from the listing and has to pay the financial penalties. Clause ‘49’ is based on the principles of “Public company accounting reform and investor protection act, which is known as Sarbanes-Oxley Act of 2002. The act was developed for the companies listed on the US Stock exchanges.Clause 49 and Sarbanes-Oxley Act of 2002, both are same as the responsibility of management and number of directions were concerned. Both have same rules regarding insider training, refusal of loans to directors and so on. The basic difference between the two is - in Sarbanes-Oxley legislation, if fraud or misconduct of reports takes place, up to 20 years of imprisonment can be charged, but there is no such condition in case of clause 49. Being the controller of the market, a criminal proceeding for the unembellished commence decide by SEBI. In case, SEBI decides to give an unadorned punishment, then it can embark a criminal proceeding or raise the fine for not agreeing with clause 49, which automatically delists the company. [2]

Corporate governance causes the job market to flourish because it affects the corporations as well as countries in different ways such as firm’s access to outside financing increase, which leads to more investments better growth opportunities. Capital cost will be decreased and the firms are valued at higher cost. Firms can be paying attention by this which leads it to growth and again to condensed unemployment. Wealth is generated by better distribution of resources and good management practices because of better operational performance. A good corporate governance can be associated to reduce financial crises. Due to this financial crisis it has devastating effects of any countries economy.

A good corporate governance practices always creates better connection with the stake holders. The role of corporate governance is important and vital in the investment process. As corporate governance be responsible for property protection and safe modes of ownership registration, it automatically affects the firm’s capital mobilization. It has to be constant and translucent in disclosing its facts for any firm to gain funds from the market efficiently. At last, due to effectively handler the capital received any company should have proper resource allocation, authority distribution and well planned incentive scheme as some of the necessary steps.

The fraudulent behavior of companies has caused many countries to go through financial crisis. So corporate governance became a critical issue for all the countries around the world. Either it will Satyam Computers Limited of India or Enron of the U.S., the array is more or less same. The failure of companies of these enormous sizes formed devastation in the industry and had caused the economic meltdown. The immediate action that the Indian authority tools in response to the scandals reveal how government in emerging economies also feel the need to promote good corporate governance practices. Further more understanding corporate governance standard and issues is also important to executives of foreign multinationals planning to do business with India. So we can Bay India and corporate governance has become an inseparable entity. Now we are going to discuss some specific issue regarding corporate governance ethics, internal governance and selection of auditors and audit committee. [2]

A. *Ethics*

Business Ethics is based on the corporate governance. It is the topic related to the reliability and justice. Business ethics means to apply the general principal ruler to business problem and finding the solutions in the right way in all aspect. Business problems arises when the decision made by the board is going to affect either profitability or its shareholders in the end.

Some basic function that come under business ethics umbrella e.g. outlining proper behavior, set up firms values, defining responsibilities, present leadership and guidance relate conclusions to stakeholders as well as shareholders, increasing liability, always keeping in mind the consequences, continues inspections and option for improvement etc. [3]

Corporate governance works as a bridge between shareholders, stakeholders and board of directors. It should be competent to reinstate the trust and confidence of management

and the company to the shareholders in the company. It is essential for a company to follow good corporate governance practices, which are eventually ethical too. Companies need to do much more practice of good corporate governance. The good corporate governance constantly strive for fulfilling the best interest of all its members. The focuses is to deciding the management structure in any organization such as Board of Directors, audit committee and selection of independent auditors, shareholders committee, Independent directors etc. [1]

The elementary concern with governance is that there is no impartial extent against which it can be said if it is good or bad. There the companies ethics come into play corporate governance practices should be planned in such a way that it will encourage a suitable atmosphere for corporate social responsibility and ethics. It is one of the most suitable principles of corporate board of directors that was authorized by the national association of corporate directors in 2008. Business ethics mostly have to deal with choice of conflict of interest and value corporate directors, have accountable duty toward the stakeholders. Board members are the eye and ear of the shareholders.

To understand the rule of board of directors and executive compensation we need to understand what internal governance is. It is discussed in details in the next section. [3]

B. *Internal governance*

Debt holder, shareholders, board or directors, all together contribute to decide internal governance for any origination. For the external governance code, we need to understand how organizations implement the governance code. The brawl that company needs to face and the monitoring environment. The scope of this paper is to look at the internal governance only, being the decision makers of the company the board of directors are the most crucial and inseparable part for any company. [4]

Board of Directors- The proprietor and shareholders are connected to each other through Board of directors. Board of directors are link between managers sitting in the corporate office and the huge group of controllers of a corporation that are all over the world. They have curator duty towards its shareholders because shareholders play an important role in the process of elected them as board of directors. The board is made up international and external director. The internal directors sometimes called as executive directors are usually senior position holder, people from the firms. They usually known about the confidential detail about the company and its performance.

Whereas, the external directors are experts in their subject that is important as per the company. They are also known as Non- Executive directors. They are not the employees of the company. Responsibility of carefulness and of faithfulness are the most important roles of any director.

The American Law Institute lists one of the tasks as choosing, estimating and finding the benefits of the senior executives; another task is to look at the business and its future responsibilities towards the society. They also approve corporate plans for the future and the financial objective that the corporation is making the required changes as per the need of the society. [4]

The board of directors are also liable for looking at the cogency of the financial statements that are been audited. However, it is very questionable about how much authentic these reports are and in what depth the board analyses them. The main reason for the board members is not devoting sufficient time are that they have full time jobs of their own as well as they are board members of various company boards. All this restricts them from managing their time to audit the financial statement of Company in depth.

The board members can be compensated by Executive compensation for the extra time and effort they have to put in this work. But contemporary scandals have given an adverse twist on this topic. In developed countries like USA, Shareholders did not decide executive compensation but the board and the compensation committee has full right to decide on this issue. However, in developing countries like India, insider's starts abusing these kinds of policies rather than having agency problem through managerial compensation other principal agency problem stem up.

To find the solution for this kind of problem in India, Kumar Mangalam Birla Committee, 2000 was appointed by the capital market regulator securities & exchange Board of India (SEBI) which noted that the board of a company provides leadership and strategic guidance, objective judgement, independent of management to the company and exercises control over the company while remaining at all times accountable to the shareholders. To match with the international standards SEBI code was changed many times to implement and accept the best practices around the world.

The board of directors has very bizarre and time-consuming responsibilities and those responsibilities are reliant on the significant information provided by the management of the company, bearing in mind that the provided information is correct. The board needs sufficient pertinent and high quality data to make the best decisions for the common shareholders and stakeholders. This is mainly essential for developing countries like India as they have too much inside dominance. Numerous factors should be taken into attention to get the resolution for all the issues. In this paper we will discuss board size, composition, its profile and diversity. [4]

Board Size and Composition – there is no collectively adequate number for the most satisfactory size of board of directors. Even if the company has a small or a large board, they both have their pros and cons. There is a very complex association between board size, board effectiveness and business performance. The average board size is from 3 to 31 members conferring to the corporate Library's study. 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 advantages of small board size is that the board members

feel more ownership and accountability for the decisions they make. The interaction between the members are at ease. Board members know each other exclusively. The disadvantages are small size which limits several openings due to less capability and perspective. If the board size is large in number it have more expertise in different areas and so the opportunities grow very high. Work is shared among groups. Fundraising events are easier. The drawbacks are big board cannot engage all the members effectively and efficiently. Meetings are difficult to schedule. Some cities think that the optimum member of board member is seven. The two important committees are compensation committee and audit committee. Each committee should have minimum of three members. That makes six member so that none of the committee will have more power. The seventh members is chairperson of the board. The starring role of the chairperson is to make assured the board is functioning appropriately and watching at if the CEO is fulfilling his/her responsibilities.

Board Profile and Diversity – Board profile talk about the area of proficiency brought to the table by the board member. While the board diversity refers to the socio-cultural facet of the member. There are diversities of studies that prove the need of both versatile profile as well as diversity. The judgements made by the board affect the corporation in day to day business. People on the same wave length tend to support each other. This can sometimes take up the company in wrong direction. For the sustainable growth for the corporation, it need diversity in the board. For new though US lags Europe and Asian countries in case of board diversity.

It is essential to understand the internal governance factors so is the process of selection of auditors and the audit committee. The paper will explain how the choice of auditor affects the issues that we have discussed until now [4].

C. *Selection of auditor and audit committee*

A company can decide on to have about internal or external auditor. Internal auditors are hired on a contractual basis, they are independent of the entity they are auditing. After collapse of Enron, Sarbanes-Oxley act of 2002, several new rules issued regarding the auditors and their committee. First, the auditor of any company will be involved only in consulting accomplishments. Second, auditing committee is selected by independent board of directors rather than by chief finance officer. Third, public chartered accountants oversight board regulates accountants. They monitor all the accounting firms too. Fourth, accounting partner should be rotated every five years just to avoid any clashes between auditor and the company. Finally to avoid any other kind of duplicitous performance it is mandated all the off balance- sheet transactions to be declared in detail by the company.

The Blue Ribbon Committee (BRC) which is sponsored by NYSE-NASDAQ, standardized the role of audit committee as the ultimate authority and responsibility to select, evaluate and where appropriate dismiss the outside auditor. In addition to that, Securities exchange commission CSEO gave out the rule that management cannot fire an auditor without permission from audit committee.

Over the years Confederation of Indian Industries (CII), Kumar Mangalam Birla Committee, Companies Act and new rules of the Securities and Exchange Board of India (SEBI) have helped in evolution of an audit committee in India. Now a days, an audit committee is viewed as oversight function of corporate governance, financial reporting process, internal control structure, and audit functions.

Table- 1 shown below tells us that most of the Asian countries officially started planning the corporate governance policies from the 1990's.

Table 1
Development of corporate governance code in the Asian countries

Country	Date of main codes	Are independent directors required	Are audit committee required
China	2002/2005	Yes	Yes
Hong Kong	1993/2004	Yes	Yes
India	199/2005/2007	Yes	Yes
Indonesia	2001/2006	Yes	Yes
Japan	2003/2004	Optional	Optional
South Korea	1999/2003	Yes	Yes (Large Firms)
Malaysia	2001/2007	Yes	Yes
Philippines	2002	Yes	Yes
Singapore	2001/2005	Yes	Yes
Taiwan	2002	Yes (Certain Firms)	Yes (Certain Firms)
Thailand	1999/2006	Yes	Yes

Source: Jamie Allex, Asian Corporate Governance Association, Corporate governance Seminar, Organized by Chubb Insurance and Solidarity, Bahrain, 16 April 2008.

From the overview of study and research done on the topic of audit committee it will be impartial to determine that an audit committee's performance is better if its members are independent. They have governance and financial proficiency but do not have any stake in the company at all. For example, having a higher levels of stock ownership in the company can impair the judgment of the member. [5]

Either the country is developed like the US or a developing country like India, it is must that they provide measure that will make auditor Independence, stronger and improve the influence purpose and independence of audit committee. If the outside shareholders perceives that audit committee has enough independence to make the correct decision it can decrease the risk premium of raising capital and so provides another worthy enticement for the companies to capitalize time and energy on both auditor and audit committee independence.

The key role of an audit committee is to hire and protect the sovereignty of external auditor. To keep other factors from influencing an auditor's judgement, auditors independence is must. The sovereignty is also important for vital information about a client as it can turn the auditor to look at the issue from the client's point of view.

We looked at how important is for an organization to select an auditor. We also found how vibrant the part of audit

committee in any firm is. Let us now look at the summary of all the topic we discussed so far [5].

4. Limitations and implication for the future

The study of this paper is limited to India. It discusses only the perception of India's corporate governance. For future research, more developing and developed countries can be compared to see the effects of reforms of corporate governance practices. Also this paper deliberates only four of the influencing factors of corporate governance that are Ethics, Internal governance and selection of auditors and audit committee, other factors that influence corporate governance can be considered for the more research.

Further study can be done to see how firms from developing countries like India, affect the corporate governance of other countries as they develop new relations through foreign direct investments.

5. Summary and Conclusion

In this paper, we saw how important it is for a company to plan good corporate governance practices. We perceived the brief history of corporate governance in India and its present economic and financial situation. The paper overviewed the essence factors that affect corporate governance such as ethics, internal governance, and choice of auditors and audit committee. Being an emergent economy, there is necessity to work more on regulating the corporate governance policies in India. Indian companies still have opportunities for a brighter future for them. They need to recognize and endure with the corporate governance reforms and always keep in mind that this optimistic future will have its own set of contests.

The future of corporate governance is becoming a little clear now as in the future the investor would be promoted to behave like owners rather than just traders. Independent directors will have more distinct roles and duties and the incentives said to be given out to others will be distributed to the shareholders. In log run a market-oriented and shareholder-centered system will develop into a new emerged system as stakeholders-oriented system making finance itself accountable to the public interest.

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