



Examining the development and issues of corporate governance in India

Kushagra Pareek

Assistant Professor, School of Law, Suresh Gyan Vihar University, Rajasthan, India

Abstract

In reaction to several business scandals across numerous jurisdictions, the notion of corporate governance was formed. Corporate governance is to boost investor trust and promote an accountability culture among the corporation's controllers. Corporate governance is a crucial topic to research because a corporation's entity and officials are distinct. Corporate governance is crucial in protecting the rights of thousands of shareholders who own the firm but are not actively involved in running day-to-day operations. This article intends to investigate the evolution of the corporate governance framework in India, identify and resolve the major issues, and suggest any required changes to the law in order to increase public confidence in Indian companies in the age of technology and a dynamic global market.

Keywords: corporate governance, company act, 2013, corporate scandals, global economy

Introduction

Corporate Governance is a framework for governing a firm that is based on particular processes and principles. The governance makes sure that a business is run and managed in a way that will enable it to achieve its long-term goals and objectives, which include generating value for the business and benefiting all of its stakeholders over time, including shareholders, employees, suppliers, customers, and the general public. In actuality, it is carried out for the benefit of the company's stakeholders by the board of directors and the relevant committees. Corporate governance is all about striking a balance between social, economic, and individual aims. The demand for corporate governance has arisen as a result of growing worries about boards of directors and management of firms not adhering to norms of financial reporting and accountability, which results in significant losses for investors.

There is no standard definition of corporate governance. The definition of corporate governance has been understood differently by different academics. A "system through which firms are directed and controlled" is how the Cadbury committee characterized corporate governance. Corporate governance, according to the SEBI, is the "recognition by management of the inalienable rights of shareholders as the genuine owners of the organization and their responsibility as trustees on behalf of the shareholders. It is about upholding moral principles, conducting business in an ethical manner, and recognizing the difference between personal and corporate funds when managing a corporation. Corporate governance in India is described by the Confederation of Indian Industry (CII) as "corporate governance deals with laws, procedures, practices, and implicit rules that determine a company's ability to make informed managerial decisions via its claimants—in particular, its shareholders, creditors, customers, the State, and employees. The goal of "excellent corporate governance" is widely accepted to be maximizing long-term shareholder value. Corporate governance has been an essential component of the business since the corporate frauds were exposed, especially for publicly traded businesses. Nonetheless, the separation of ownership and control is given significant attention. Every nation needs a

framework for corporate governance because strong corporations perform better. As a result, shareholders and investors prefer to invest in a business that has a solid track record of adhering to corporate governance.

Research methodology

The source of information has been collected from the secondary sources, assembled from existing publicly available open recourses such as books, journal articles, important committee reports, government websites and newspaper articles. The nature of the research is descriptive.

Objectives for the study

1. To study the existing legislative framework of corporate governance in India.
2. To study development of corporate governance.
3. To identify the underlying issues and challenges in the corporate governance.
4. To suggest a feasible solution to the underlying issues and challenges.

Principles of corporate governance

The foundation of the rules and regulations established for the company have grown around a few essential themes.

Transparency

It is vital to promptly and accurately disclose any pertinent information about the company. Knowing their rights and the daily operations of the company aids stakeholders.

Accountability

It guarantees the responsibility of the individual who makes decisions in others' best interests. Hence, individuals like managers, chairmen, directors, and other officers should be answerable to other company stakeholders.

Independence

The independence of the senior management is crucial for the efficient operation of the corporation. The Board of Directors must operate independently from any corporate stakeholders.

Development of corporate governance in India

Since 1991, corporate governance has become ingrained in the Indian corporate structure. When the government implemented the LPG strategy in an effort to boost the economy of the nation. Thereafter, other acts, notably the Companies Act, underwent changes. In addition, the SEBI Act was notified in January 1992 to regulate the securities market with a goal of protecting shareholder rights in the wake of the Harshad Mehta scandal. The act provided SEBI enormous authority to control the capital market as well as important parts of the firm's corporate governance, such as stringent disclosure requirements and enhanced compliance for the board of directors of the company. The evolution of the Indian corporate governance framework could be divided into three phases.

Phase I

The colonial laws that were followed by the Indian corporation prior to independence included the body of laws that are still in effect today in India, such as the partnership act of 1932 and the negotiating instrument act of 1881. Also, the 1866-passed businesses statute had undergone numerous revisions. The idea of corporate governance was not developed at that time since there was little to no protection for investors and shareholders and a company internal structure rife with corruption and management inefficiency. The Indian government concentrated on crippling the economy after independence by enforcing a strict licensing raj. As a result, the restricted economic policy was to blame for the economic crisis' peak. Due to the balance of payment issue, structural measures were later implemented.

Phase II

India began to open its economy after 1991, and the years between 1990 and 2008 saw the enactment of a number of laws and the creation of numerous committees with the goal of tackling various issues, particularly those related to corporate governance. The audit committee and board of directors' independence and oversight were given additional attention during this phase.

Phase III

The Satyam scandal had shaken the country in the beginning of 2009. It revealed the actual level of corporate governance in India, which significantly influenced the Indian government to reevaluate the enforcement and transparency mechanisms for good corporate governance. The scandal prompted the CII to form a task force to improve corporate governance, and later, NASSCOM under the leadership of N. R. Narayana Murthy established the Corporate Governance and Ethics Committee. The committee's recommendations were based on preserving and enhancing the stakeholder, audit committee, and whistleblower policy. In 2009, the government responded by having the SEBI Committee on Disclosure and Accounting Standards publish a discussion paper.

Importance of corporate governance in India

Corporate governance promotes the economic development of India in the booming economies of the world by protecting not only the management but also the interests of stakeholders. A corporation that practices sound corporate governance enjoys substantially greater levels of confidence

among its shareholders. Independent, self-assured directors help the company have a favorable outlook on the financial markets, which boosts the value of the shares. Foreign institutional investors use a number of critical factors when choosing which companies to invest in, including corporate governance.

legislation for corporate governance in India

A. The companies act, 2013

The old act from 1956 was repealed on August 29, 2013, when the Companies Act of 2013 received presidential approval. The act has improved compliance and promoted a progressive process in the interests of management, stakeholders, and the company director. The Company Act of 2013 is essential to India's system of corporate governance. The structure for corporate governance is provided in the section that follows.

1. Board of Director: Section 149 of the act specify the minimum number of Director on the board, which is 3 and 2 in public company and private company respectively and specifies the maximum number of Director to be 15.
2. Women Director: Rule 3 of companies (appointment and qualification of Directors) Rules, 2014 and section 149(1) of the act provide for the appointment of a minimum of one-woman director to a specific class of company having a minimum paid-up share capital of Rupees 100 or having a turnover of Rupees 300 crores.
3. Independent director: Independent director plays a crucial role in the board of directors because of its unbiased nature and capability to exercise independent judgment, bridge the gap between shareholders and the board of directors and protect the right of minority shareholders. Section 149(6) of the act prescribes the qualification for appointment of an independent director; the act prescribes for the requirement of one-third independent director for the publicly listed company on the board.
4. Resident Director: Section 149(3) of the act provides for the compulsory appointment of a minimum of one resident director on the board of directors. The resident director has to stay a minimum of 182 days in India to be a qualified residential director.
5. Stakeholder Relationship Committee: Section 178(6) provides for the safeguard of stakes holders of the company, i.e. the creditor's debenture holders, investors, shareholders, via establishing a stakeholder relationship committee with the aim to safeguard and resolve the conflicts and grievances of the stakeholders.
6. Serious Fraud Investigation Offence (SFIO): section 211(1) of the act states for the appointment of the Serious Fraud Investigation Offence (SFIO) to inspect internal corporate fraud.
7. Related Party Transactions: section 188 of the act provides for certain compliances and disclosure which need to be made if the parties are entering into related parties transactions. This provides greater transparency to the shareholders.
8. Audit committee: The audit committee holds a significant place in the corporate governance structure of the company. Section 177 of the act provides for the constitution of an audit committee with the composition of a minimum of three and a majority of independent

directors. Further, it requires the presence of a financially literate individual in the committee.

9. Class action suit: The class-action case provides enforcement rights to the minority shareholders under section 245.

B. SEBI guidelines and (listing obligations and disclosure requirements) regulations 2015

In order to control the stock market and protect investors and shareholders of publicly traded companies, SEBI develops regulations. The policies serve as a suggestion to the corporate entity. Additionally, a number of SEBI regulations and laws, such as SEBI's LODR, specify the mandatory corporate governance requirements that a listed entity must adhere to. These requirements include having an independent audit committee, a nomination and compensation committee, a stakeholders relationship committee, a grievance redressal mechanism, the preservation of records, a compliance officer, a vigil mechanism, prior notification, and others.

C. Standard listing agreement of stock exchanges

When a company is listed on the stock exchange, the Stock Exchange and the company sign the Listing Agreement, which is the fundamental contract. The listing agreement's primary goals are to make sure businesses adhere to sound corporate governance. Corporate governance is monitored by the Stock Exchange on behalf of the Securities Exchange Board of India. The Listing Agreement has 54 sections that outline the corporate governance requirements that listed firms must adhere to. If they don't, they risk having their securities suspended or delisted. The corporations must also follow the agreement's terms and provide specific information.

D. Accounting standards issued by the ICAI

Institute of Chartered Accountants of India is known by the initials ICAI. It is a legal entity created by the Chartered Accountants Act of 1949. It publishes accounting guidelines for the disclosure of financial data. According to Section 129 of the Companies Act of 2013, a company's financial statements must adhere to the accounting standards announced under Section 133 of the Act. Additionally, it stipulates that the financial statement must present a true and fair picture of the company's financial situation. According to Section 133, the Central government may impose the accounting standards as suggested by the ICAI. Accounting standards are offered so that effective corporate governance within a corporation can be assured. One example of an ICAI-issued accounting standard is:

- Disclosure of the accounting procedures used to create the financial statements
- Values at which inventories are reported in a financial statement are determined,
- Cash flow statements are used to evaluate an organization's capacity to generate cash,
- a requirement to make sure that provisions and contingent liabilities are measured using the proper bases,
- Construction contracts' cost and revenue are treated according to a standard in accounting.

E. Secretarial standards issued by ICSI (Institute of Company Secretaries of India)

It is a self-governing organization created under the Company Secretaries Act of 1980. It is a body established in India to control and advance the field of company secretaries. It publishes secretarial standards in accordance with the 2013 Companies Act's provisions. According to Section 118(10) of the Companies Act, all companies must adhere to the secretarial guidelines set forth by the Institute of Company Secretaries of India during General and Board meetings.

- The goal of Secretarial Standard 1 on Board Meetings is to establish a set of guidelines for managing board meetings. The committee meetings also fall under the umbrella of these principles. Except for one person companies, all board meetings of directors must adhere to the SS-1 standards.
- A set of guidelines are provided for organising and conducting general meetings in secretarial standard-2. This standard also covers how to conduct postal and electronic ballots. All general meetings of corporations, with the exception of one-person companies incorporated under the Act, are subject to SS-2. Meetings of creditors and debenture holders are subject mutatis mutandis to the principles contained in SS-2. Additionally, it mandates that the rules of this standard apply to any meeting of a company's members, creditors, or debenture-holders held at the direction of the Company Law Board, National Company Law Tribunal, or any other authority.

India's largest corporate governance failures

1. Harshad Mehta Scam (1992)

It is one of the most cleverly executed technical scams from the year 1992. The scam's main perpetrator, Harshad Mehta, gave a group of stockbrokers access to 3500 crores of rupees in bank funds. The stock market then had a spike to over 4500 points as a result of these monies being invested selectively. Share prices and indices were sharply affected by the Harshad Mehta scam. In terms of market capitalization, the market suffered a loss of 0.1 million crores. Due to this, SEBI's approval of Private Sector Mutual Funds was delayed. The swindle caused the several companies' planned Euro-Issues to be postponed.

2. Ketan Parekh scam (1999-2001)

The Pied Piper of Dalal Street is how Ketan Parekh is referred to. He used to purchase shares when they were trading for a cheap price, and when the price reached a certain level, he pledged to the bank those shares as security for funds. His financing strategy was fairly straightforward. He also took out loans from various businesses, including HCFL. The scandal included Rs. 1500 crore in money.

3. Satyam scam (2009)

Satyam Scam took occurred in the year 2009 and it is recognised as "Debacle of Indian Financial System". In one of the biggest accounting scandals, the main character Ramalinga Raju admitted to fabricating Satyam Computers' financial records and inflating the company's bank balances and accounting entries, which included the sum of Rs. 8000 Crores.

4. Saradha chit fund scam (2013)

One of the largest Ponzi schemes using phoney collective investments, it was run by Sudipta Sen and involved around Rs. 4000 crores. After a crackdown by SEBI and the Central Bank of India, the chit fund ultimately failed and defaults occurred. Aside from leaving small depositors in the lurch, the default also prompted Saradha to close 10 media terminals, which resulted in the loss of 1000 jobs for journalists.

5. PACL Scheme Scam (2015)

It was a scheme to defraud up to 55 million investors by collecting funds with the help of fraudulent allotment letters. The issue entailed the alleged collecting of \$6.8 billion from nearly 55 million investors nationwide totaling about 450 billion rupees.

challenges for corporate governance in India

1. Agency issue

Because ownership and administration are separated, the agency problem results. The shareholders appoint management (agents) to oversee corporate matters. Although in theory the management should act in the interests of the shareholders, in practice the decisions are made to enhance those interests. As a result, the cost of the agency is increased by the disagreement between the shareholders and management. Although the intrinsic problem has not been addressed by the current legislative framework, it may be by reorganizing the management compensation structure with an incentive to act in the owners' best interests.

2. Independent director

An independent director is essential to a corporation's corporate governance. All committees, including the board of the corporation, must have an independent director present in order to comply with legal requirements. Yet, a problem occurs when friends of the directors are appointed, which jeopardizes the independent director's judgment. Before, the appointment of independent directors was subject to the whims and interests of the promoters, which led to the independent director's nomination being unintentionally prejudiced in favor of the promoter's interests. The SEBI notification dated 3 August 2021 addressed this fundamental problem, and the new rules will take effect on 1 January 2022. They provide that independent directors in publicly traded companies must be appointed, reappointed, and removed by special resolution of shareholders. For a resolution to be adopted, there must be at least three times as many votes in favor as against. As a result, the current notification tries to address the issue and assures that an independent director has support.

3. Family domination

Majority ownership patterns are familial across Asia, notably in India. The majority of the corporation is owned by the promoter. Due to increased internal problems and inefficiencies brought on by a lack of checks and balances over the Promoters' actions, the dominance of promoters creates problems with corporate governance. Thus, a corporation's ownership structure needs to include provisions to address family dominance.

4. Minority and majority shareholders

There are currently a different set of conflicts between minority and majority shareholders. In the well-known case of *Foss v. Harbottle*, which established a precedent that "minority shareholders are obligated by the action of majority shareholder," the majority rule was implemented. Conflict between minority and majority shareholders has grown in India. The problem of a dominant shareholder is common in Indian corporate structures, such as public sector businesses where the government holds a disproportionate amount of power, multinational corporations where a foreign parent company holds a disproportionate amount of power, and Indian entities where family ownership predominates. Section 241-246 of the act do provide some safeguard to the minority shareholders through a class action, but the problem arises to meet the requirement of minimum numerical threshold to file a class action suit under section 244 of the act. Further power of waiver by NCLT is discretionary.

5. Shareholder and stakeholder

There are two methods of corporate governance: shareholder and stakeholder. While countries like Germany and Japan have adopted the stakeholder model, the US and UK follow the shareholder method. The stakeholders are a sizable group of people interested in the operations of the company, including the community, employees, creditors, and holders of debentures. The interests of stakeholders are largely ignored by the Agency theory, which is primarily concerned with advancing shareholder interests. Because nations are changing how they approach the stakeholders, the friction between the two methods has gotten worse in recent years.

6. Board composition and director

It is questionable whether the board structure satisfies the theoretical criteria of the board's composition. The business statute of 2013 mandates that the board have a minimum of one-woman director. The majority of the corporation, however, has still not complied with the law and has chosen to nominate a female director from the well-known circle of promoters. The performance effectiveness of the board may be lowered by directors serving on the boards of multiple companies. Hence, impede the director's operational performance, which also raises the possibility of an interest conflict between the organizations the director works for.

7. Corporate governance in the unlisted company

The lack of coverage of an unlisted firm is one of the minor difficulties with corporate governance. In a publicly traded firm, corporate governance deals with regulatory compliance to protect the interests of shareholders and stakeholders. A stakeholder is everyone who interacts with the company in any way. As a result, unlisted companies should be required to follow corporate governance standards.

Conclusion and suggestions

The environment in which businesses operate evolves as competition intensifies, and in such a dynamic context, corporate governance structures also need to adjust. When vying for limited money in today's public markets, failing to implement sound governance practises carries a penalty in the form of a large risk premium. Hence, fostering and

upholding honesty, openness, and accountability in the company's management as well as in the manifestation of a corporation's beliefs, principles, and policies is the essence of corporate governance. By studying the many stages of the creation of the corporate governance framework, the current research article examined the problems and challenges in the system and ultimately highlighted a small number of the system's several problems. The crucially needed transparency in corporations is ingrained by corporate governance. As a result, it propels India further ahead in the global race of growing economies. Recent years have seen an increase in the attention on corporate governance due to the emergence of corporate fraud, which serves as a reminder that if the independent director institution had been robust, the Satyam crisis would have likely been exposed much earlier. The current corporate governance framework's solution calls for strengthening the independence of an independent director, enacting stricter compliance regulations for the business, resolving the minority shareholder dominance crisis, and reorganizing the board structure to increase transparency and further instill ethical behavior. According to Dr. Richard Leblanc of Harvard University, "How a firm is governed affects the rights and relationships of organizational stakeholders, and ultimately how an organization is managed, and whether it succeeds or fails. Boards fall short; companies don't."

References

1. Bhumesh Verma, Himani Singh, 'Evolution of Corporate Governance in India' (SCC Blog, 7 April, 2021)
2. Business Ethics and Corporate Governance, Second Edition' (O'Reilly Online Learning, 2021)
3. Arora, Ramesh K and Tanjul Saxena (eds.) (2004). Corporate Governance: Issues and Perspectives. Janur: Mangaldeep.
4. Pathak Binay Kumar, 'Critical Look at the Narayana Murthy Recommendations on Higher Education' (2014) Economic and Political Weekly.
5. Bajaj PS, Raj Agarwal. Business Ethics: An Indian Perspective. New Delhi: Biztantra, 2004.
6. Cadbury, Adrian, Report of the Committee on the Financial Aspects of Corporate Governance, Gee, London, December, 1992
7. Shireen Sultana, 'Corporate Governance in India: Evolution, Legal Framework and Challenges for the Future' (2020) IOSR Journal of Humanities And Social Science.
8. Company Act 2013
9. SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015
10. Verma B, Singh H, 'Evolution of Corporate Governance in India', April 2021.