Growth and dynamics of corporate governance in India-An emerging trend towards global market economy

Dr. Iti Bose

Indian Institute of Technology, Bombay

India

Business Ethics –the need of the hour

- Ethics in general and of business ethics in particular provides a conceptual discussion of the dynamics of ethics in society and the dynamics of business ethics in the market place.
- Ethics is more than business foundation, it is a life foundation. It can not be compartmentalized.
- Business ethics has come to be considered a management discipline, especially since the birth of social responsibility movement in the 1060s. In that decade, social awareness movement raised expectations of businesses to use their massive financial and social problems such as poverty, crime, environmental protection, equal rights, public health and improving education.

Corporate governance …

And economic development are intrinsically linked. Effective corporate governance systems promote the development of strong financial systems-irrespective of whether they are largely bank-based or market-based –which, in turn, have an unmistakably positive effect on economic growth and poverty reduction.

Anglo-Saxon countries US & UK	Pursues the interest of Shareholders
Japan, Germany, France	Interests of all Stakeholders employees, customer as well as Shareholders

Corporate governance is….

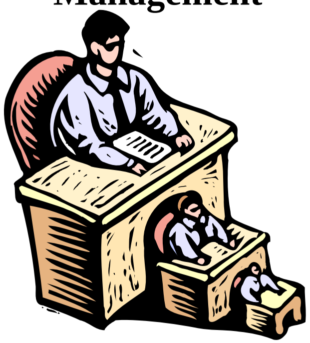
- A means whereby society can be sure that large corporations are well-run institutions to which investors and lenders can confidently commit their funds.
- Is a term that refers broadly to the rules, processes, or laws by which businesses are operated, regulated, and controlled. The term can refer to internal factors defined by the officers, stockholders or constitution of a corporation, as well as to external forces such as customer groups, clients and government regulations.
- (Creates).. safeguards against corruption and mismanagement, while promoting fundamental values of a market economy in democratic society.
- (Considering the ethical failures in the last several years and the resulting crisis in confidence)..A sincere commitment to creating and sustaining an ethical business culture in public and private sectors..(has never been so important).

Corporate governance norms

- **Corporate governance are the policies, procedures and rules governing the relationships between the shareholders, (stakeholders), directors and managers in a company, as defined by the applicable laws, the corporate charter, the company's bylaws, and formal policies.**
- **Primarily it is about managing top management, building in checks and balances to ensure that the senior executives pursue strategies that are in accordance with the corporate mission. It consists of a set of processes, customs, policies, laws and institutions affecting the way of a corporation is directed, administered or controlled. Corporate governance governs the relationship among the many players involved (the stakeholders) and the goals for which the corporation is governed.**

Principal players of Corporate governance

Management



Board of Directors

Customers

Banks and lenders

Shareholders

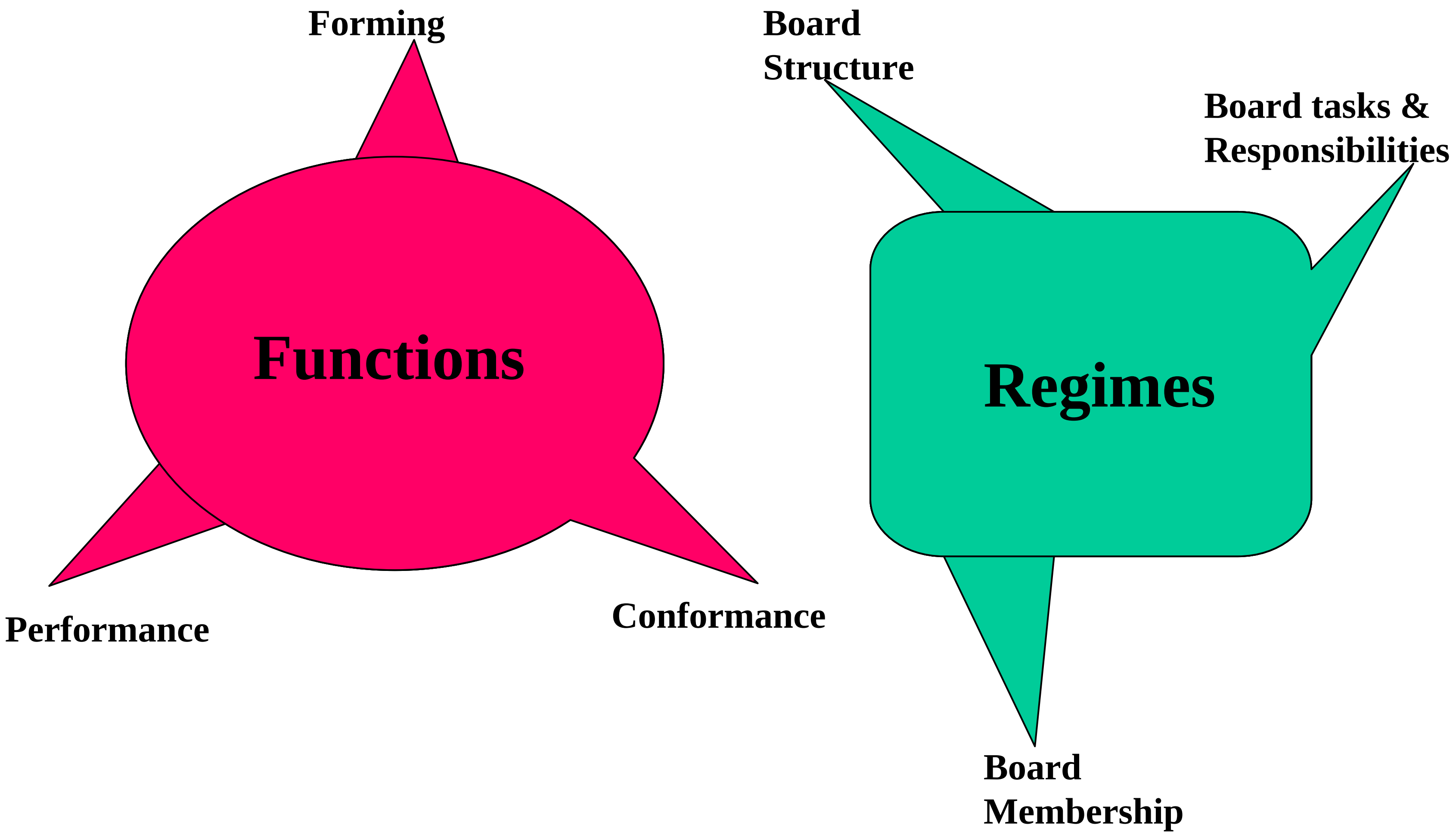
Environment & the community at large

Employees

Regulators

Suppliers

Functions and regimes of corporate governance (Trickler, 1994)



Corporate governance in India

- The Indian corporate scenario was more or less stagnant till the early 90s.
- The position and goals of of the Indian corporate sector has changed a lot after the liberalisation of 90s.
- India’s economic reform programme made a steady progress in 1994.
- India with its 20 million shareholders, is one of the largest emerging markets in terms of the market capitalisation.

Corporate governance of India has undergone a paradigm shift

- In 1996, Confederation of Indian Industry (**CII**), took a special initiative on Corporate Governance.
- The objective was to develop and promote a code for corporate governance to be adopted and followed by Indian companies, be these in the Private Sector, the Public Sector, Banks or Financial Institutions, all of which are corporate entities.
- This initiative by CII flowed from public concerns regarding the protection of investor interest, especially the small investor, the promotion of transparency within business and industry

The National Task Force

- A National Task Force was set up. The Task Force presented the draft guidelines and the code of Corporate Governance (Desirable Corporate Governance Code) in April 1997 (at the National Conference and Annual Sessions of CII.
- Since 1974, CII has tried to chart new path in terms of the role of an Industry Association such as itself. It has gone beyond dealing with the traditional work of interacting with Government of policies and procedures, which impact on industry.
- CII has taken initiative in Quality, Environment, Energy, Trade Fairs, Social Development, International Partnership Building etc. as part of its process of development and expanding contribution to issues of relevance and concern to industry.

Securities and Exchange Board of India

- The Government of India's securities watchdog, the Securities Board of India, announced strict corporate governance norms for publicly listed companies in India.
- The Indian Economy was liberalised in 1991. In order to achieve the full potential of liberalisation and enable the Indian Stock Market to attract huge investments from foreign institutional investors (FIIs), it was necessary to introduce a series of stock market reforms.
- SEBI, established in 1988 and became a fully autonomous body by the year 1992 with defined responsibilities to cover both development and regulation of the market.

SEBI

- On April 12, 1988, the Securities and Exchange Board of India (SEBI) was established with a dual objective of protecting the rights of small investors and regulating and developing the stock markets in India.
- In 1992, the Bombay Stock Exchange (BSE), the leading stock exchange in India, witnessed the first major scam masterminded by Harshad Mehta.
- Analysts unanimously felt that if more powers had been given to SEBI, the scam would not have happened.
- As a result the Government of India (GoI) brought in a separate legislation by the name of **'SEBI Act 1992'** and conferred statutory powers to it.
- Since then, SEBI had introduced several stock market reforms. These reforms significantly transformed the face of Indian Stock Markets.

SEBI and Clause 49

- SEBI asked Indian firms above a certain size to implement Clause 49, a regulation that strengthens the role of independent directors serving on corporate boards.
- On August 26, 2003, SEBI announced an amended Clause 49 of the listing agreement which every public company listed on an Indian stock exchange is required to sign. The amended clauses come into immediate effect for companies seeking a new listing.

Clause 49

- Clause 49, which has recently been revised by the SEBI, of the listing agreement between listed companies and the stock exchanges is all set to enhance the corporate governance (CG) requirements, primarily through increasing the responsibilities of the Board, consolidating the role of the Audit Committee and making management more accountable
- These changes are aimed at moving Indian companies rapidly up the evolutionary path towards business processes and management oversight techniques.

The major changes to Clause 49…

1. **Independent Directors —**1/3 to ½ depending whether the chairman of the board is a non-executive or executive position.
2. **Non-Executive Directors ----**The total term of office of non-executive directors is now limited to three terms of three years each.
3. **Board of Directors-----**The board is required to frame a code of conduct for all board members and senior management and each of them have to annually affirm compliance with the code.
4. **Audit Committee----**Financial statements and the draft audit report / reports of management discussion and analysis of financial condition and result of operations/ reports of compliance with laws and risk management/ management letters and letters of weaknesses in internal controls issued by statutory and internal auditors/appointment, removal and terms of remuneration of the chief internal auditor.

Clause 49..

5. **Whistleblower Policy ----**This policy has to be communicated to all employees and whistleblowers should be protected from unfair treatment and termination.
6. **Subsidiary Companies-----**50% non-executive directors & 1/3 & ½ independent directors depending on whether the chairman is non-executive or executive.
7. **Disclosures----**Contingent liabilities./Basis of related party transactions./Risk management/ . Proceeds from initial public offering/ . Remuneration of directors.
8. **Certifications----**reviewed the necessary financial statements and directors' report; established and maintained internal controls, disclosed to the auditors andinformed the auditors and audit committee of any significant changes in internal control and/or of accounting policies during the year.

Clause 49 amended

The Clause 49 of the Listing agreement of SEBI Act is the outcome of Narayana Murthy Committee, which has come into effect January 1st 2006.

- Amended Clause 49 of the Listing Agreement.
- Aid to Corporate Governance
    1. Control Environment
    2. Risk Assessment and Management

Industrial policy & foreign investment

The industrial policy introduced in July 1991 achieved a dramatic overhaul of regulations governing foreign investment. Government approval for equity investments of up to 51 percent in 35 industries covering the bulk of manufacturing activities is automatic. Requests to increase equity stakes beyond 51 percent still require approval from the Government's Foreign Investment Promotion Board. All sectors of the Indian economy are now open to foreign investors except those with security concerns such as defense, railways, and atomic energy.

Industrial policy

Industrial policy---The government's liberalization and economic reforms programme aims at rapid and substantial economic growth, and integration with the global economy in a harmonised manner. The industrial policy reforms have removed the industrial licensing requirements, removed restrictions on investment and expansion, and facilitated easy access to foreign technology and foreign direct investment.

Foreign Direct Investment—Government wishes to facilitate foreign direct investment (FDI) and investment from Non-Resident Indians (NRI)s including Overseas Corporate Bodies (OCBs), that are predominantly owned by them, to complement and supplement domestic investment. Investment and returns are freely repatriable, except where the approval is subject to specific conditions such as lock in period on original investment, dividend cap, foreign exchange neutrality etc. as per the notified sectoral policy.

FDI

Foreign direct investment is freely allowed in all sectors including the services sector, except where the existing and notified sectoral policy does not permit FDI beyond a ceiling. FDI for virtually all items/activities can be brought in through the automatic route under powers delegated to the Reserve Bank of India (RBI), and for the remaining items/activities through Government Approval. Government approvals are accorded on the recommendation of the Foreign Investment Promotion Board (FIPB), chaired by the Secretary, Department of Industrial Policy and Promotion (Ministry of Commerce and Industry) with the Union Finance Secretary, Commerce Secretary, and other key Secretaries of the Government as its members.

Conclusion

As Indian companies compete globally for access to capital markets, many are finding that the ability to benchmark against world-class organizations is essential. For a long time, India was a managed, protected economy with the corporate sector operating in an insular fashion. But as restrictions have eased, Indian corporations are emerging on the world stage and discovering that the old ways of doing business are no longer sufficient in such a fast-paced global environment.

THANK YOU