A STUDY OF CORPORATE GOVERNANCE PRACTICES IN INDIA

SUMMARY

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Introduction

Corporate governance (CG) has emerged as a very important ideal. The reason is, today companies are substantially contributing to the overall growth and development, particularly in emerging economies such as India and a healthy investment environment is vital. The corporate form of business has succeeded gradually and expanded worldwide. However, not all companies are managed successfully. There has been a spree of corporate frauds worldwide, e.g., Enron in the United States and Satyam Computers in India. The latter had accounting and auditing flaws apart from lack of accountability and oversight by Independent Directors at Board meetings. There was no whistle-blowing in case of Satyam Computers unlike Enron. The Satyam Computers revelation was an outcome of a takeover attempt. It eroded the wealth of shareholders. From this fraud it is evident that we need to review the enforcement of CG practices. The role of the Ministry of Corporate Affairs as one of the stakeholders in case of Satyam Computers has been commendable especially in appointing reputed members on the Board immediately after the fraud, in order to restore confidence among investors, customers, employees and to revive the company. This initiative by the government also encouraged the stock markets to some extent.

CG aims at protecting the interest of stakeholders, mainly equity shareholders, who provide capital to companies without any assurance of returns. The corporate form of business has entailed huge amounts of capital, which are mobilized by firms in the financial markets. So a robust regulatory framework and its enforcement is the foundation for ensuring good CG. For this, CG codes and regulations have been developed in different countries and issued by stock exchanges, corporations, institutional
investors, associations/institutes of directors, various committees and also by regulatory and international organizations. The Securities and Exchange Board of India regulations relating to CG viz., Clause 49 of the Listing Agreement is applicable to listed companies. Clause 49 contains mandatory and non-mandatory CG norms.

Objectives

Good CG requires that a company incorporate elements of Clause 49. Judicious enforcement helps to maintain the overall credibility of a regulatory system. While most listed Indian companies have not reaped the benefits of good CG, several high-performance organizations have implemented initiatives that are noteworthy. So it was decided to carry out a study of CG practices in India. Listed companies having a paid up share capital of Rs. 3 Crore and above or a net worth of Rs. 25 Crore or more at any time in the history of the entity were considered. Such listed companies include public sector units and body corporates i.e., private and public sector banks, financial institutions, and insurance companies. The aforesaid companies are to adhere to mandatory CG norms while adherence to non-mandatory CG norms is voluntary. A total of fifty companies, featuring in the Standard and Poor’s (S&P) CNX NIFTY Index, or more popularly, the Nifty, were chosen for the study. These companies are subject to compliance with CG norms and their credibility among investors is pertinent and vital. Another reason for choosing the sample companies is that they are comparatively medium to large in size. An in-depth study of such companies can bring out model practices in CG for other companies to emulate.
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Scope

The scope of the study covered three financial years viz., 2005-06, 2006-07, and 2007-08. The financial year-end i.e. 31.03.2006 is also considered as reporting on CG practices has been made mandatory since then. Fifty companies comprising the S&P CNX NIFTY in each of the years feature in the study, considering the criteria and schedule of implementation of CG requirements. The results of the study should be viewed in the background of limitations such as sample size, sampling technique, prevalent laws and the duration of the study. Publicly disclosed information e.g., in the annual reports is considered as correct, regardless of whether the company followed it or not in actual practice.

Methodology

It was decided to use secondary data of companies that featured in the S&P CNX NIFTY Index at the end of the years 2005-06, 2006-07 and 2007-08. The companies represented diverse industries and sectors. However, while most of the companies selected for the study are from the manufacturing sector, some of them are from service and allied sectors. The Nifty Index comprises equity shares of fifty companies. Twelve companies presently featuring, were not listed at the National Stock Exchange in all the three years as mentioned above. Further, for certain reasons, four companies were excluded from the sample in order to provide a comparable basis for the study and also to discern trends in CG. Eventually, the sample for the study comprised thirty-four companies.

Seeing the nature of the data collected from sample companies, it was decided to adopt Single-Sample Tests involving proportions. For suitability of statistical tests and
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applications, data were classified into two categories. The first set included those that demonstrated full compliance while the other comprised those whose compliance was either partial or nil. As a part of computation of the Test Statistic, Z score was used.

Findings

A majority of the companies has adhered to most of mandatory provisions of CG as per requirements of Clause 49. However, though a majority of companies complied with the mandatory requirement of certification of financial statements by Chief Executive Officer/Chief Financial Officer, the level of compliance is comparatively lower vis-à-vis other mandatory requirements. Encouragingly, since the year 2005-06, compliance with the certification requirement shows an improving trend. The results further suggest that a majority of the companies has not adhered to all non-mandatory provisions of CG prescribed by the aforesaid clause. A majority of companies has adhered to the non-mandatory provisions of CG with respect to the remuneration committee in all the years studied. However, in case of the whistle-blower policy, the results do not uphold compliance in the year 2006-07 though there is adherence to this requirement in the years 2005-06 and 2007-08. Further, companies follow exemplary CG practices but they do not constitute a majority. However, adherence to such exemplary CG practices over the three years shows an increasing trend, which is heartening.

Conclusion

The picture that emerges is a mixed one as results strongly support a view that there exists compliance with mandatory CG provisions but not so with all non-mandatory provisions and exemplary CG practices.
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Implications

A fallout of the findings is that regulatory attention and if need be, action, are warranted to ensure full compliance with mandatory provisions of Clause 49. Further, regulatory persuasion and self-regulatory impetus are desirable with regard to adherence to non-mandatory provisions of CG, in the larger public interest.

Apart from lack of compliance with non-mandatory provisions of CG, inappropriate size of the Board, lack of formal training to directors in CG matters, lack of evaluation for Non-Executive Directors, a failure to articulate priorities about the protection of interests of shareholders vis-à-vis other stakeholders and the lack of representation of Independent Directors especially on the Board of Government companies may work as barriers to CG reforms.

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