CHAPTER 1
INTRODUCTION

1.1 Introduction
'The Corporate governance practices are imperative components in the management and control of organization affairs' (Ogoti & Olweny, 2016). The increasing number of corporate scandals, starting from the ‘first well-documented’ securities manipulation fraud, called as the ‘Dutch Tulip Mania’ in the year 1636 and 1637 followed by the failures of corporates like ENRON, Adelphia Communications, Credit Suisse First Boston, Tyco International Ltd., WorldCom INC. and Glaxo. China in 2014 have stained corporate governance reputation and questioned the efficiency of its existing framework. These financial scams have generated a dire need for assessment of corporate governance practices. As a result, corporate governance has grabbed lot of limelight from the policymakers, investors, corporate boards and rating agencies (Abid & Ahmed, 2014; Brown & Caylor, 2004; Donker & Zahir, 2008) These scandals related to accounting and different frauds purportedly blamed to top firm managers have repeated the question that whether the corporations are governed to safeguard the best interests of shareholders and other company stakeholders (like employees, creditors and the general community) or not (Nandal & Kumar, 2014)

The concept of corporate governance is not new in India. However, the inadequacy and inefficacy of the corporate governance structure in India has been embraced by the massive corporate disasters like the stock market scam by Harshad Mehta, Ketan parekh, UTI and Satyam Computers have turned out to be a nightmare for countless investors, flabbergasted the government and regulators alike and has questioned the accounting practices of statutory auditors and Indian norms for corporate governance (Popli & Popli, 2015; Singh, Kumar, & Uzma, 2010).
1.2 Corporate Governance- Concept and Definitions

The corporate governance has been defined widely and in different ways by different scholars. A simple web search on corporate governance reveals hundreds of different definition on the subject which justify the existence of disagreement of various researchers on one comprehensive universally acceptable definition. These disagreements may be because different countries where in studies on corporate governance are carried out so far vary in culture, economies, governance system and laws. Not only the corporate governance definition differs but the manner in which these definitions are categorized and interpreted by various scholars also differs.

Corporate governance books, journal, thesis, articles, dissertations, conferences and reports of national and international forums on corporate governance, all have published one or the other definition on corporate governance. The world of corporate governance is flooded with varieties of definition on the subject. For the better understanding, in the first part of this section, various definitions on corporate governance quoted by various researchers and scholars in their work are discussed and in second part a comprehensive review on how these definitions are interpreted and grouped on various dimensions and perspectives is discussed.

Most skeptics refers the contribution of great economist (Berle & Means, 1932; Smith, 1776) Noble price holder economist (Friedman, 1970) for defining the concept of corporate governance. However, in the modern era, the wave which grabbed attention of corporate world on the corporate governance is the report by the committee, set up in May 1991 by Financial Reporting Council, the London Stock Exchange and the accounting profession to address the financial aspect of corporate governance chaired by Sir Adrian Cadbury. The report is commonly known and referred as Cadbury Report 1992. Some of the
definitions of corporate governance formulated by various scholars are reproduced in Table 1.2.1 for better understanding on the subject.

**Table 1.2.1 Definitions of Corporate Governance**

<table>
<thead>
<tr>
<th>Author and Year</th>
<th>Definition</th>
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<tbody>
<tr>
<td>Friedman, 1970</td>
<td>“Corporate governance is to conduct the business in accordance with the owner’s or shareholders desire, which generally will be to make as much as money as possible while abiding by the basic rules of the society embodied in law and local customs.”</td>
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<td>Cadbury, 1992</td>
<td>“The systems by which companies are directed and controlled”</td>
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<td>OECD, 1999</td>
<td>“Corporate governance involves a set of relationships between a company’s management, board, shareholders and other stakeholders. It also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined”.</td>
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<tr>
<td>Shleifer &amp; Vishny, 1997</td>
<td>Corporate governance deals with the way supplier of finance assure themselves of getting a return on their investment</td>
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<tr>
<td>Holmstrom &amp; Kaplan, 2001</td>
<td>CG “means is defined as the mechanism through which firms and their managers are governed” (mechanisms such as, executive stock options, takeovers, mergers, involvement of board of directors and shareholders</td>
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<tr>
<td>SEBI, 2003</td>
<td>“as the acceptance by management of the inalienable rights of shareholders as the true owners of the corporation and o their own role as trustees on behalf of the shareholder. It is about commitment to values and above ethical business conduct and about making as distinction between personal and corporate fraud in the management of a company.</td>
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<tr>
<td>OECD, 2004.</td>
<td>“CG is a crucial component involved in improving economic proficiency and growth as well as enhancing investor confidence. CG undeniably, encompasses a bunch of relationships amongst company’s management, its board, its shareholders and other stakeholders. Also, it offers the framework through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are govern”.</td>
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| Ho, 2005        | “Structure and processes among the board of directors, top management, shareholders and other stakeholders, which further
involves the roles of the stewardship process and practising strategic leadership, and the goals of assuring accountability and improving performance”.

(Larcker, Richardson, & Tuna, 2007) “as the principles that effect the decisions made by managers, when there is a separation of ownership and regulate (some of these regulatory mechanisms are the boards of directors, institutional shareholders, and operation of the market for corporate control)”.

(Council, 2014) “Framework of rules, systems, relationships, and processes within and by which authority is exercised and controlled within corporations. It involves the mechanisms by which companies, and those in control, are held to account”

(Nerantzidis, 2012) deduced that the definition of corporate governance formulated in the Cadbury report in the year 1992 is considered as the most widely used definition by the researchers and further, the content analysis on the corporate governance definitions has revealed that the narrow definitions are used widely.

(Tricker, 2015) while defining the corporate governance, grouped corporate governance definitions on operational, relationship, stakeholder, financial economics and societal perspective. The definitions given by Sir Adrian Cadbury’s on the Financial Aspects of corporate governance (Cadbury, 1992) in the corporate governance report; definition given by (Hilmer & Rogers, 1993) and the definition by OECD (2001), all focusing on governance structures, processes and practices are grouped together under operational perspective and discussed. In the relationship perspective, the definitions given by The Corporate Library, California Public Employees Retirement System and the definition by (Monks & Minow, 1995) are discussed. In Stakeholder perspective, definition by OECD and the one given by (Demb & Neubauer, 1992) are discussed. In the financial economic perspective definition by (Shleifer & Vishny, 1997) is discussed. In the societal perspective, views expressed by Sir Adrian Cadbury at the Global CG Forum of the World Bank in the year 2000 and the opinion of Blair (1995) are discussed. After discussing
all these perspectives authors have concluded that definition are not mutually exclusive; they overlap, none are all-inclusive; each can be relevant in context.

(Huse, 2007) in his work entitled ‘Boards, Governance and Value Creation The Human Side of corporate governance, generated four groups of definition on corporate governance; “managerial”, “stakeholder”, “shareholder supremacy”, and “company”. The managerial definition highlights what is best for the management. The shareholder supremacy definition focuses on how boards, managers and corporations are instruments for the shareholders. The Stakeholder or interaction or triangulation definition focuses on the interaction between coalitions of actors. The firm definition focuses on how the board contributes to value creation throughout the whole value chain.

The definition and perspectives discussed above revels that the systems and practices of corporate governance are not universally the same in all the countries. Different countries have adopted different systems, standards and practices depending on their social, cultural and economic environment, as well as the government policies and capital market systems, but one thing which is common in all the systems is that the board of directors and practices adopted by them are the most important practices of the corporate governance (Das, 2009)

As seen above that the corporate governance definitions differ and there is no universally accepted single definition. In the same way the concept and models of corporate governance also differ from country to country. In next section of the study, major corporate governance concepts and models are discussed.
1.3 Models of Corporate Governance

Corporate Governance models vary from country to country however the main principle of Governance model derives from fundamental mechanisms of governance as insider (stakeholder model) and outsider (shareholder model) systems. Insider model of corporate governance is mostly based on an interest of stakeholders and often ownership is concentrated (shares owned by family, banks or institutions) by aiming to reach long term goals. Outsider model of corporate governance as opposite to insider model has dispersed ownership (shares owned by individuals in stock markets) and aims to reach fast short term goals for wealth maximization of shareholders (Abdumavlonov, 2011).

On the contrary, (Guillen, 2000) in cross country study on the convergence of corporate governance discussed the Anglo-Saxon, German, U.K. and Japanese approach on corporate governance and argued against the convergences in corporate governance models. In his view the corporate governance models cannot be seen in the isolation, they are tightly coupled with the legal traditions, the way in which firm compete in the global economy and also the social, political and economic actors plays important role which makes it hard to envision convergence.

Andrew West (West, 2009) discussed the American, German, UK, Continental European, and Japanese corporate governance in his study on the corporate governance convergence and moral relativism and states that Corporate governance convergence refers to the trend of corporate governance models, at a national or supranational level, to merge in their corporate practices and theoretical perspectives. In a Complete convergence situation national differences would disappear and ultimately a universal acceptable corporate governance model would be practiced and adopted.
Thus from the above discussion it is clear various authors and research scholars in their work on various aspects of corporate governance have considered majorly the American, German, Japanese and other continental European corporate governance system and models. Thus the major models of corporate governance are:

![Corporate Governance Models](image)

**Fig. 1.1 Various Corporate Governance Models**

### 1.3.1 Anglo American Model of Corporate Governance

![The Anglo-American Model](image)

**Fig. 1.2 The Anglo-American Model of Corporate Governance**

Source: Fernando A.C. (2009)
The Anglo American model of corporate governance is also called as Anglo-Saxon model of corporate governance. In this model shareholder elects the board of directors and the board of directors appoints the management personal who in turn manage the company. Regulatory system of the country regulates the company and the stake holder have only stake in the company and the creditors have the lien on the company assets if they are secured creditors. This means that in this model creditor, regulators and other stakeholders have no right to participate in the board and management of the company. Ownership of the company is with the shareholders and they are the ultimate decision making authority but within four corners of the law of land.

1.3.2 Japanese Model of Corporate Governance

![Diagram of the Japanese Model of Corporate Governance](image)

Fig. 1.3 The Japanese Model of Corporate Governance.

Source : Fernando A.C.(2009)
In the Japanese model main bank plays important role along with the shareholders in the formation of the supervisory board. In this model the president act as a bridge between the executive management and the supervisory board. The Japanese model is a relationship model where the main lending bank not only provides the loan but in case of emergencies monitors and supervise the company. The supervisory board has power to ratify the decision of the president.

1.3.3 German Model of Corporate Governance

![The German Model of Corporate Governance](image)

**Fig. 1.4 The German Model of Corporate Governance.**

*Source: Fernando A.C. (2009)*

In the German model corporate governance is exercised through two boards, the supervisory board and the management board therefore this model is also refer as the two-tier board model. In this model fifty percent of the supervisory
board is appointed by the shareholders and fifty percent of the board is appointed by the labour unions. In this model the labourers and employees participates in the management. This approach of corporate governance is typically a societal-oriented approach. This approach is adopted by the countries like Holland, France and Germany. Therefore it is sometime referred as the Continental European approach. The creditor in this model has the lien on the company assets if they are secured creditor and the Regulatory and legal system of country monitors and regulate the company through various legislation but they have no active participation in the management of the company.

1.3.4 Indian Model of Corporate Governance

![Diagram of Indian Model of Corporate Governance]

Fig. 1.5 The Indian Model of Corporate Governance.
Source: Fernando A.C. (2009)
The Indian model of corporate governance is influenced by the UK model of corporate governance. This model share some feature of German and the Japanese models. In Indian model the structure of the board is determined by the shareholder as well as by the company law. In case of private companies it follows the unitary board approach and in case of public sector under taking government plays important role in the board and management of the company. The Indian model is basically the outcome of the recommendation of three committees: Kumar Mangalam Birla Committee, Narayan Murthy Committee and Naresh Chandra Committee. The Security Exchange Board India SEBI and the company law act as the regulator and monitors the activities of public listed companies. The Indian models as shown in figure 1.5 depicts the external and internal environment which influence the corporate functioning. The model also depicts the outcome of such influence on corporate governance which results in the transparency, accountability, disclosure, investor protection, Business Ethics. Some scholars are also of view though the Indian model is influenced by external and internal environment it tends to be an unitary board model, therefore it is more or the less resembles with the Anglo-American model.

The above discussion on the various models of corporate governance reflects that the corporate governance models differs from one economy to economy. The developed economies like UK, US, Germany, Japan also differ in the corporate governance practices. However broadly the models can be classified in the Unitary board model where there is only one board of directors and the Two-tier board model where governance is done through two distinct board one supervisory and the other the management board. This distinction of the models cannot be said to be a clear distinction because some countries or models have mix of both. In common all models talks about the working in the best interest of the company by adopting best practices of corporate governance.
1.4 Corporate Governance Theoretical Construct

The corporate form of business has gained widespread acceptability in developed as well as developing economies in post-independence era. Due to numerous differences in institutional, cultural, political, legal system and resource availability, different theoretical construct has emerged in the field of corporate governance. Corporate governance has now become a multifaceted issue owing to the development of complex corporate organizations (mergers, acquisitions, joint venture etc.). corporate governance is of growing importance specially for the developing country like India, as the corporations are contributing substantially in overall growth of the country’s economy.

An understanding of theoretical foundation is necessary to capture the efficiency of existing corporate governance practices and mechanisms in different contextual conditions. The role of theory in amplifying corporate phenomena and understanding interactions within and amongst the organisations cannot be over emphasized. Theories shape meanings and help analyses of concepts and their implications (Adelopo, 2010).

This segment provides an insight on different theories in order to understand their relative strengths and relevance in analysing corporate governance issues. According to the (Solomon, 2007) theoretical framework evolved to explain and analyse the corporate governance approaches corporate governance form different perspective, arising from different discipline, such as agency theory arises from the economics and contractual relationship, stakeholder theory arises from social perspective etc. These theoretical framework differ from one another as well as they overlap at some point or other. Most commonly used theoretical frame work are discussed in this segment.
1.4.1 Agency Theory

Agency theory is concerned with streamlining the interests of owners and managers and is based on the premise that there is an inherent conflict amongst the interests of a firm’s owners and its management (Nicholson & Kiel, 2007). A central point of agency theory is the design of ideal contracts between the principal and the agent and whenever an individual depends on the acts of another, an agency relationship arises. The principal-agent theory, or in short Agency Theory, is part of political science and economics and describes the relationship between the principal (i.e. provider of capital) and the agent (i.e. the manager) (Goldstein & Vives, 2005)
Agency theory suggests that firms with better corporate governance standards perform better because of lower agency costs and more effective monitoring mechanisms. This prediction is supported by empirical studies. Better-governed U.S. firms have higher accounting performance and market performance (Sami, Wang, & Zhou, 2011).

The pioneering work of (Berle & Means, 1932) has directed CG towards separation of ownership and control consequentially leading to principal-agent problems evolving from the dispersed ownership in the modern corporations. They considered CG as a mechanism where a board of directors is a crucial monitoring device to reduce the problems emerged due to the relationship between the owners or the board of directors (principal) and the managers (agents) (Heenetigala, 2011).

(Jensen & Meckling, 1976) suggested that the firm can be viewed as a network of contracts, implicit and explicit, among various parties and stakeholders including shareholders, bondholders, employees and the society. Agency problems arise when the interests of agents are not aligned with those of principals. Agency problems, depending upon the parties concerned in the conflicts, can be categorized as: managerial agency (between management and stockholders); debt agency (between stockholders and bondholders); social agency (between public and private sectors); and political agency (among the agents of the public and the rest of society or taxpayers). However, shareholders are the residual claimants after all the other stakeholders, and consequently their rights are the feeblest. CG is therefore primarily designed to protect and promote the interests of shareholders (Lei, 2006).

However, a basic argument or conclusion of agency theory is that the a value of a firm cannot be maximized as in general managers hold the executive power which allows them to expropriate value for their own interest (Turnbull, 1997). Irrespective of this claim, agency theory provides a broad analytical framework.
to examine how successful corporate governance systems can curb opportunistic managerial behaviour, securing a fair return on investment for the suppliers of finance (Manawaduge, 2012)

Ignoring third party effects is a weakness of agency theory. Third parties are those affected by the contract but who are not party to the contract. Individual board members are likely to take account of such third party effects, but by so doing they may not be enhancing shareholder value. Also contributing to an expectations gap is the assumption that shareholders are only interested in shareholder value and have no interest in third party effects. The growth of ethical funds suggests that such a singular view of shareholder objectives is inappropriate. (Brennan, 2006)

1.4.2 Stewardship Theory

In contrast to the agency theory, stewardship theory speculates that managers are not opportunistic agents and so are good stewards of the resources entrusted to them. Stewardship theory is based on two premises one, that managers are naturally trustworthy and that agency costs will be decreased usually, as senior executives are unlikely to disadvantage shareholders for fear of jeopardising their reputations. Stewardship theory reflects classical idea of corporate governance that the director are legally duty bound towards their shareholders not to themselves. (Nicholson & Kiel, 2007)(Manawaduge, 2012), (Rashid & Anderson, 2008) (Nam & Nam, 2004).

Hence, stewardship theory differs from agency theory with respect to the motive of managers. According to Gay (2002) stewardship theory is also derived from the economic model of human behaviour, classified by McGregor as Theory Y, which assumes that people are inherently motivated to work and perform a good job. Therefore, stewardship theory purports there is no conflict between managers and owners, and the optimum governance structure allows
coordination of the companies to perform most effectively towards the betterment of the owners’ interest (Manawaduge, 2012).

Stewardship theory applies fittingly to family firms as the family owners often have a profound emotional investment in their firms owing to the reality that their fortune, personal contentment, and reputation are tied to success of the firm. Family firms by and large are characterized by an intense relationship between managers and controlling family owners (Swamy, 2011).

As with agency theory, however, there is no clear empirical evidence to support any claim that a preponderance of inside directors provides superior corporate performance. Since stewardship theory is a mirror of agency theory, it is worth reiterating that the over-whelming evidence both from individual studies (e.g. Kesner et al., 1986; Daily and Dalton, 1992a, 1992b, 1993) and meta analyses (Dalton et al., 1998, 1999; Rhoades et al., 2000) fails to establish any clear relationship between board composition and/or leader- ship structure and corporate performance or behaviors (Nicholson & Kiel, 2007).

The stewardship theorists focus on structures that empower and facilitate rather than monitor and control. They reject the highly individualistic model of agency theory that promotes a suspicious “policeman’s” attitude, assumes that principals and agents have different interests and sees agents as essentially self-serving and self-centred. Thus they also reject the view that principals need to invigilate the opportunistic agents by monitoring them and apply sanctions or incentives as means of control. (Habbash, 2010).

According to this theory, corporate governance should be based on the view that the directors, on behalf of stakeholders, want to be good stewards of the corporate assets, and there is no conflict of interest or opportunistic behaviour at the expense of stakeholders. They work diligently to gain high levels of
corporate profit and shareholder return. These concepts have been documented in organisational studies, such as in Muth and Donaldson (1998).

Stewardship theory considers the board of directors as an instrument of assistance to a steward CEO rather than a controlling mechanism (Albrecht et al., 2004). It also considers that management is less likely to practise earnings management. However, the problem lies in the extent to which the management aspires to attain a good corporate performance (Habbash, 2010).

This theory suggests there is no agency cost between the principal (shareholders) and the agent (management). The interests of the management coincide with the shareholders and there is no need to motivate or discipline the management for the value creation of the shareholders.

1.4.3 Stakeholder Theory

The stakeholder concept was first used in 1963 in a Stanford Research Institute Memorandum, where it generalized the belief that managers need to be responsive to the stockholders only (Freeman, 1984). Originally, stakeholders were defined as “the groups without whose support the organization would disappear” (Pathak & Pradhan, 2012).

The stakeholders theory focuses on benefits of various stakeholders who deals directly or indirectly with the company. This theory views that organization should maximize stakeholder profit and follow the ethical code of conduct. Freeman (1984:46) defines stakeholders as “any group or individual who can affect or is affected by the objectives or functioning of the organization”. He argues that job of corporate manager are to maximize the organization wealth and they must have to take into account all stakeholder who are affected or affect the organization decisions. Stakeholder theory argues that the corporation should maximize not only the interest of shareholders, but also that
of other stakeholders such as employees, creditors, suppliers, customers, and local communities as these groups or individuals have a legitimate stake in the company, since their actions could affect the outcomes of the organization.

Fig. 1.7 The Stakeholder Model


1.4.4 Resource Dependence Theory

This is the Fourth major theory in the field of CG is that of resource dependence, which maintains that the board is an crucial link between the firm and the crucial resources that it needs to maximize performance. Resource Dependence Theory says that the boards of directors can be a key source of various resource. This theory strongly supports the role of directors to bring in resources such as information, skill and connect with the external environment. This theory is strongly contingent on the presence of a
competitive environment by assuming the availability of efficient, competent and skilled directors. The resource dependence approach, developed by emphasizing that non-executive directors enhance the ability of a firm to protect itself against the external environment, diminish uncertainty, or co-opt resources that increase the firm’s ability to raise funds or escalate its status and recognition. Firms try to reduce the uncertainty of outside influences to ensure the availability of resources indispensable to their survival and development. The board is hence seen as one of a number of instruments that may facilitate access to resources crucial to company success. These resources could include link to relevant market, know-how and technology, access to capital, business relation, political and other societal networks. (Tricker, 2015)

1.4.5 Legitimacy Theory

Legitimacy theory is another theory which has been extensively reviewed in Corporate governance literature to demonstrate the relationship between stakeholder’s claims that are accepted or expected in a given society. Legitimacy theory is defined as a generalized belief or perception supposition that the actions of corporation are desirable, proper, or appropriate with some socially constructed systems of values, norms, definitions and beliefs.

Legitimacy theory employs the concept of the social contract and from this perception the provision of environmental information in corporate annual reports is an attempt to legitimize the activities of the company by aligning corporate goals with those of society (Gibson & O’Donovan, 2007)

The emphasis of legitimacy theory is on the right of public at large to get benefited from organization. This theory says that organization must consider wellbeing of society at large rather than the wellbeing of only investor.
Legitimacy theory relies on the notion that corporation to continue its operation successfully try to legitimize their action by acting within the society norms and by engage himself in corporate social reporting to get approval from society for continues existence. (Ramdhony, 2015)

1.4.6 Transaction Cost Theory

Transaction cost theory is based on the premise that in contemporary world organizations become so large and complex that price movement outside companies direct production and the markets co-ordinates transactions. It is in the interest of the company to internalize all the transaction to overcome the risk of dealing with suppliers and uncertainties about future product price and quality. (Solomon, 2007)

The transaction cost theory argues that the cost of enforcement and check and balance mechanisms such as internal audit, separation of board chairmanship from CEO and cost involved in establishment of various committees or any other cost involved in corporate governance, should be incurred to the point at which the cost involved is equal to or more than the benefit derived from such enforcement. If cost is more than the benefit than it there is no transaction cost economy. Transaction cost economy is closely related the agency theory, it is derived for the original work of Coarse 1937 (Tricker, 2015)

1.5 Corporate Governance Mechanisms

The theoretical construct on corporate governance suggests that the corporate governance mechanisms broadly revolves around the ownership and management. The consequences of the segregation of management from ownership is that the decision-making power to utilize the capital supplied by the shareholders rest with the management i.e. with the persons other than the
supplier of capital. The segregation of ownership and control has lead to an agency problem whereby there is the tendency for management to operate the firm in their own interests, rather than those of shareholders” (Jensen and Meckling, 1976; Fama and Jensen, 1983).

Corporate governance has focused traditionally on the problem of the separation of ownership and control. With the passage of the time in the contemporary business world a broader framework of corporate governance is expected. It is now accepted that organizations should respond to the broader categories of stakeholders rather than the shareholder and management. In recent years in corporate environment externalities such as market competition product safety, job security, environmental concerns as well as internalities such as; business ethics, social responsibilities, corporate strategy impacts have increased the importance and significance of good corporate governance practices (Fernando, 2009)

According to (Agrawal & Knoeber, 1996), there are seven corporate governance control mechanism. out of these seven mechanism the use of four i.e. Insider Shareholding, outside representation on board, reliance on debt financing and reliance on the external labor market are decided by the firms internal decision maker and other three Institutional Shareholding, Outside Blockholdings, and activities in the market for the corporate control are determined by the outside parties. Thus control mechanism may be broadly classified as internal and external mechanisms as summarized in Figure 1.8 below:
(Becht, Bolton, & Röell, 2003) states that the corporate governance is concern with the reconciliation of conflicts of interest. These conflicts may be between the dispersed investors or between the various corporate claim holders. He discussed the five governance mechanisms for the resolution of conflicts they are partial concentration of ownership and control in hands of large investors, hostile takeover and proxy voting, concentration of control to the Board of directors, Executive compensation, clearly defined fiduciary duties of CEO.

(Davis, Schoorman, & Donaldson, 1997) opined that the agency theory assumption are based on delegation of power and control mechanisms, where control minimizes the potential problem of delegation of power. They also suggest that the governance mechanisms protects the shareholders interest specially minority shareholders, minimize the agency cost and ensure that there is a perfect alignment of agent-principle interest.

(Lel, 2012), considered the firm level governance mechanisms (Ownership structure) and country level governance mechanisms (investor protection...
rights) and uses them to measure the degree of monitoring managerial activity. He also discussed the ex-ante governance mechanisms (executive compensation) ex-post governance mechanisms (monitoring managerial activity).

In Indian scenario corporate governance mechanism comprises of internal mechanism which includes Shareholders, board of directors, Auditors, Company Vision Mission and policies, and internal stakeholders. External mechanism includes the Government policies, Rules and Regulations (such as company law, SEBI guidelines, listing agreement), Industry norms, corporate culture, suppliers of finance, creditors, and other stakeholders. These internal and external mechanism form the part of corporate governance practices of any organization. The ultimate outcome of these practices are Transparency, Accountability, Disclosure, Business ethics, Customer relationship, Shareholder value and Investor protection (Fernando, 2009).

(Swamy, 2011), examines importance of role of corporate governance in the performance of Indian unlisted family owned and small and medium enterprises by using the following corporate governance mechanisms; Family Ownership, Board Size, Outside Directors, Audit committee, outsiders in audit committee and Family CEO.

Hence it is clear that the corporate governance mechanisms differs widely from country to country and even from organization to organization. Research scholars and authors also have different view on the corporate governance mechanisms. Therefore for better understanding on corporate governance mechanism in Indian context a diagrammatic is developed.
Fig. 1.9 Corporate Governance Mechanism in Indian context.

Source: Computed
1.6 Automobile Industry in India

The Indian auto industry with an annual production of 23.96 million vehicles in the financial year (FY) 2015-16 has shown a marginal growth of 2.58 percent as compared to the previous year's production of 23.35 million vehicles. (SAIM, 2016). The Indian automobile industry account for 7.1 per cent of India’s gross domestic product (GDP). The industry has attracted foreign direct investment (FDI) of 13.48 billion US$ during the period April 2000 to June 2015, as per the data released by Department of Industrial Policy and Promotion (DIPP, 2016). The Indian Government has aims to make automobiles manufacturing the main driver of ‘Make in India’ initiative. As per the Auto Mission Plan 2016-26 it is expected that the market for passenger vehicles is going to get to tripled, to 9.4 million units, by 2026. (AMP, 2026)

As per the report published by FY and CII the auto industry is one of the important contributor in the Indian economy. The industry employs about 19 million people either directly or indirectly. The auto sector contributes to 4.3% of total export of India and also contributes about 13% of the country's total excise revenue. As per FY report, India is the world's first largest tractor, the second largest Two Wheeler, Fifth largest Heavy truck, Sixth largest Passenger vehicle, and seventh largest commercial vehicle manufacturing country of the world. The automotive market growth affects the auto component sector of India. It is expected that the sector will grow at a CAGR of 13 % from US$ 3.8 billion in FY15 to more than US$ 150 billion by 2026 (EY & CII, 2016).

Historically the Indian automobile industry can be divided into four phases in post independence era : Initiation Phase (1950 -1980), Developmental phase (1980-1990), Growth phase (1990-2000) and Mature or Follow up Phase (after 2000), (Chattopadhyay, 2013). In 1940s the Indian automotive industry was at a very nascent stage and what all the industry had to offer was a 1940s Morris model in the passenger car segment popularly known as the
Ambassador car. The Hindustan Motors Limited came into existence in 1942 in Calcutta by the initiative of the Birla Group. In 1944 the Walchand Group set up the Premier Automobile Limited in Bombay (Chattopadhyay, 2013).

The Indian Automotive Industry started developing in 1970s. During 1970-84 the Government considered cars as a ‘luxury’ product to be used by rich, and the affluent. Therefore, development of car industry was accorded low priority in the governmental policy and planning. (Singh & Gupta, 2012) The idea for manufacturing small passenger cars for Indian consumers was conceived in late sixties with the Government of India approving the proposal of Maruti Ltd’s to set up a manufacturing plant near New Delhi. Unexpectedly, Maruti’s actual performance was poor and the company went under liquidation in 1977. This was the time when the manufacturing of automobiles especially cars were subjected to strict licensing, restrictive tariff structure and limited avenues for expansion (Sarwade, 2015).

In 1981, the Government of India nationalized the defunct car company at Gurgaon that gave rebirth to the Maruti Ltd. as Maruti Udyog Ltd. The joint venture with the partner Japan’s Suzuki Motor company for supplying technology for small car gave birth to new entity Maruti Suzuki where in Suzuki Motor company was having 26 percent stake. The Maruti Suzuki started its production of small car with 800 cc in 1983. Maruti cars gained instant popularity in India and very quickly they captured substantial market shares. This was the starting of new era in the Indian automobile industry and auto component industry started growing rapidly. Suzuki invested extensively in the Indian component manufacturers in order to decrease the cost on component procurement and to increase the quality of the components (Chattopadhyay, 2013).

In 1991, the Government of India introduced New industrial policy which delicensed the automobile industry. The passenger car industry was, however,
delicensed in 1993 (Sarwade, 2015). This economic liberalization policy and delicensing attracted the foreign holding in Indian companies. The reduction in excise duty to 40%, import duties of CKD to 50%, and of completely built units to 110%, with emphasized on indigenization of Indian automobile industry attracted a large number of automobile companies to India and by 1997, a total of 7 Automobile companies (Fiat, Peugeot, Ford, General Motors, Merc, Daewoo, Audi) had started selling cars, while another 8 companies (Honda, Mitsubishi, Renault, Volkeswagon, BMW, Toyota, Hyundai, Chrysler) were started planning to enter in Indian market during this period. (Mukherjee, 1997)

The dawn of 21 century witnessed introduction of several landmark changes in the policies delicensing of the sector and subsequent opening up for 100 percent FDI through automatic route. Core group on Automotive R&D (C.A.R) was set up in 2003, to identify priority areas for automotive R&D in India (Singh & Gupta, 2012). Foreign manufacturers started looking at India for sourcing auto components. The buyers started dominating the market because of the availability of choices in the form of models, price points and brands. A vibrant economy meant an increase in the GDP and per capita income. These factors turned out to be significant contributors in pushing up the domestic demand (Sarwade, 2015). Indigenously, developed (Made in India) vehicles were introduced in the domestic market and exports were given a thrust.

The Indian automobile industry started showing its mark globally. In the year 2002 India ranked 15th in world car production with a market share of 1.7 percent, which improved to 6th rank and 5.2 percent of the market share by 2012, registering a more than three-fold increase within a period of ten years.

There has also been a continuous rise in inflow of foreign direct investment (FDI) into India's automobile sector. The industry has attracted foreign direct investment (FDI) of 13.48 billion US$ during the period April 2000 to June
2015 which was about 5.6% of total FDI inflow of India, as per the data released by Department of Industrial Policy and Promotion (DIPP, 2016).

The Indian automobile industry has gone global. The some of the indigenous carmaker are have not only started exporting and selling car in foreign countries but has also gone for the overseas manufacturing and acquisition. The Tata Motor's acquisition of Jaguar-Land Rover (JLR) from Ford in 2008 is an remarkable move. Following the path other companies like Mahindra & Mahindra and other also have ambitious plans for global expansion (Chattopadhyay, 2013)

The government of India dedicated Automotive Mission plan 2006-2016, the growth in infrastructure such as highways, expressways and super corridors, growing desire for the car and other automobiles by middle class and upper middle class people for their status symbol as well as for convenience, as well as youth enthusiasm towards motor sports and the advancement of new technology and special economic zones for manufacturing industries are some of the factors which will provide the automobile industry a sustainable future and consistent growth in India.

From the brief insight on the automobile industry it is clear that automobile industry is an important contributor to the GDP and the economy of the country. Therefore it is utmost essential that the good corporate governance practices must be followed by the industry so that there will remain no scope for any collapse, fraud or Scam in the automobile industry which will affect the economy of the country.
1.7 Concluding Remarks on concept of Corporate Governance Practices.

On the basis of above discussions on various aspects of corporate governance practices and the automobile industry, the following are the important points. These points are the base for the present research study and on which review of literature has been designed.

1. Corporate governance practices differ from economy to economy and they do differ from company to company in automobile industry.
2. Corporate governance practices are important for the governance and control of companies incorporate under the law.
3. Disclosure, Transparency, Fairness and Accountability are the core principles of corporate governance.
4. Automobile companies listed in Indian stock exchange follows corporate governance practices.
5. Automobile companies follow the corporate governance disclosure practices.
6. Corporate governance disclosure practices adopted by the automobile companies affect the performance of the companies.
7. There is a linkage between the corporate governance practices disclosure index and the financial performance of the companies.
8. There are some corporate governance factors like corporate board structure, corporate board activity, corporate remuneration and shareholding are likely to affect financial performance of automobile companies.
9. Corporate structure and shareholding has a linkage with the corporate governance practice.

On the basis of these important points, review of literature has been carried out in the next chapter.