“Good Corporate Governance is a necessity, and no longer a luxury. Unless a corporation follows the highest degree of transparency and the best principles of Corporate Governance, it will not attract world-class investors. Most importantly, corporations have to be fair to all stakeholders. Sustainable success is not possible otherwise. The need of the hour is to create a climate of opinion which says respect is more important than wealth. It is time to make traditional values like honesty, integrity and decency fashionable again.”

– N.R. Narayana Murthy, Former Chairman & Chief Mentor, Infosys Technologies Ltd.
India is the largest democracy in the world, with a population **1.17 billion people** as of **2009**. Its GDP of **$1.209 trillion (2009)** has declined in percentage from **9.00% during 07-08 to 6.7% during 08-09**. However during **1st Quarter and 2nd Quarter of 2009-10**, India has observed the growth rate of **1.8% in GDP** (from **6.1% during 1st Quarter to 7.9% during 2nd Quarter of 2009-10**).

**National Stock Exchange** has about **1319 companies** listed representing the length, breadth and diversity of the Indian economy which includes from hi-tech to heavy industry, software, refinery, public sector units, and infrastructure to financial services. Listing on NSE raises a company’s profile among investors in India and abroad. More importantly, each and every NSE listed company is required to satisfy stringent financial, public distribution and management requirements. High listing standards foster investor confidence and also bring credibility into the stock markets.

As of 26th June 2010 there were **4894 listed public limited companies** (including **594 companies** not required to comply with SEBI clause 49 because of their less than Rs. 3 crore paid up capital or Rs. 25 crores net worth at any time during the previous year and including **1286 companies which were suspended / Z group companies**) on the **Bombay Stock Exchange**. ([http://directorsdatabase.com](http://directorsdatabase.com))

**Table 1.1 Companies Status to file Informations to Bombay Stock Exchange for Directors Database as on 26th June 2010.**

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Status of 3,014 (Total 4894 listed companies – clause 49 is not applicable to 594 companies – Z group companies 1286) companies as on 26 June 2010</th>
<th>No. of companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Companies who have filed informations</td>
<td>2599</td>
</tr>
<tr>
<td>2.</td>
<td>Companies who have filed but data is incomplete/under verification</td>
<td>33</td>
</tr>
<tr>
<td>3.</td>
<td>Companies yet to file</td>
<td>382</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>3014</td>
</tr>
</tbody>
</table>
Segmentation of Board of Directors

15,447 individuals, who are on the boards of these 2,599 companies, occupy a total of 20,998 directorship positions in 3,124 companies listed at national-level stock exchanges and 448 companies listed at regional stock exchanges.

(http://directorsdatabase.com)

Of these 15,447 individuals,

- 12,472 hold only 1 directorship each.
- 6,358 hold only independent directorship positions.
- Only 805 are women (5.2%), occupying a total of 970 directorships.
- There is at least one woman on the board of 754 listed companies.
- 330 hold 5 or more than 5 directorships in listed companies, with 1 person holding 14 directorships.
- There are total of 19,057 directorship position on these 2,599 companies, giving an average of 7.3 directors per company.
- The maximum number of directors in any company is 19 (Larsen & Toubro Ltd.).
- The average age of the directors is 56 years.
- Of the 15,447 individuals, 1,345 are on the board of 3,324 foreign based companies.
- 15,447 individuals are also on the boards of 27,390 unlisted companies / organisations. In all, as such, they occupy a total of 61,301 directorship positions in 30,071 listed / unlisted companies / organisations.

Table 1.2 Total No. of Directors in BSE Listed Companies

<table>
<thead>
<tr>
<th>No. of Directors</th>
<th>No. of Companies</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt; 5</td>
<td>349</td>
<td>13</td>
</tr>
<tr>
<td>5-10</td>
<td>1905</td>
<td>73</td>
</tr>
<tr>
<td>11-15</td>
<td>326</td>
<td>13</td>
</tr>
<tr>
<td>&gt;15</td>
<td>19</td>
<td>1</td>
</tr>
<tr>
<td>Total</td>
<td>2599</td>
<td>100</td>
</tr>
</tbody>
</table>
Though the Board of Directors is the final authority in the business, it is corporate governance that rules to corporate world.

Corporate governance is the new buzzword or rather a concept in corporate management that is yet to catch up prominence in India but which has the potential to significantly improve corporate performance. In the case of corporate governance shareholders are considered as ultimate power wielders. Corporate governance has assumed significance in India after it has been given importance by institutions like World Bank, ADB, and Organization for Economic Co-operation and Development (OECD) etc.

A unique feature of the ownership structure of listed companies in India is that, as on March 2009, some 49.81% of equity ownership in 200 companies constituting the BSE 200 index was held by “promoters” or share owners in operational control. Of the 30 companies on the Bombay Stock Exchange sensitivity index (Sensex) 23 fall in the ‘dominant shareholder managed’ category, shareholding ranging from 22% to 90%. In extending international best practices in corporate governance to countries such as India, it is necessary to appreciate its structural characteristic which can have behavioral influence on issues like board independence, CEO/Chair duality and so on.

(The researcher has focused on the structural characteristics rather than any special characteristics.) This is to imply that there can be or may be certain structural characteristics that can or may have behavioral influence on issues like board independence, CEO/Chair duality, etc. For example, “clause 49 of SEBI guidelines”, mandatory for all listed companies, needs to be followed. As per this clause, if the company’s chairman is its executive director, then 50% independent directors are required in the total (number of) directors. And if the company’s chairman is not its executive director, then 33.33% independent directors are required in the total (number of) directors. So such a structural characteristic will
influence board independence. If, for example, the company’s chairman is its executive director, he may be in a position to influence decision making.

1.1 Concept of Governance

The concept of “governance” is as old as human civilization. Simply stated, “governance” means the process of decision-making and the process by which decisions are implemented (or not implemented). Governance can be used in several contexts such as corporate governance, international governance, national governance and local governance.

Corporate Governance looks at the complete governance of corporations from their very beginning; and in entrepreneurship, through their governance structures, company law, privatization, to their market exit and insolvency. The integrity of corporations, financial institutions and markets is particularly central to the health of our economies and their stability.

“Corporate Governance refers to the processes, mechanism, principles and structure by which the business and affairs of the company are directed, managed and governed effectively. Its goal is to enhance long term shareholder value through improving corporate performance and accountability while taking into account the interest of shareholders.”(Swami (Dr.) Parthasarathy, Corporate Governance, Principles, Mechanisms & Practice, 2010)

1.2 Evolution of Corporate Governance - Illegal Tactics of Indian Corporate

Pollution control, avoidance of child labour, etc. issues are ways to improve sustainability of operations of corporate, otherwise it disrupts the operation of the company, introduces additional cost, and thereby reduces profitability.
An overwhelming large number of Indian corporations use several illegal tactics such as cornering of industrial licenses with a view to keep away competitors, using import licenses to make a quick profit, illegally holding money abroad, indulging in bribery, corruption and other unethical practices with impunity.

High rates of income tax of the 1960’s led many companies to devise tax evasion tactics which grew in value over the years, often crossing the lines of legality. Overseas holidays for families shown as business trips, expensive residences shown as office use etc. were relatively common practices for the companies which promised to be honest otherwise.

The net result of such and similar dishonest practices and scams were that the regulators started tightening up especially in the last few years. Also public patience ebbed and intolerance to such issues rose. This fuelled a change in the Indian corporate mindset. These scandals led to the realization that “Corporate Governance” was essential and this was advocated by financial press, some financial institutions, and by more enlightened business associations, as well as the regulatory agencies and government.

### 1.3 Meaning of Corporate Governance

Corporate governance is typically perceived by academic literature as dealing with “problems that results from the separation of ownership and control”. From this perspective, corporate governance would focus on: the internal structure and rules of the board of directors, the creation of independent audit committees; rules for disclosure of information to shareholders and creditors, and, control of the management.

The definition varies according to the analysts, the context of varying degrees of development and from the standpoint of academics versus corporate
managements. According to one analyst, there is a definite need to eradicate corporate misgovernance and promote corporate governance at all costs. It is not only the stakeholders who are keenly interested in ensuring adoption of best corporate governance practices, but also societies and countries worldwide. Corporate governance is just a set of codes and guidelines to be practiced diligently by companies. India has the Cadbury code and the CII code of desirable corporate governance. These codes generally enjoin corporations to ensure changes in their board structures and procedures with a view to making the company more accountable to shareholders.

**Corporate governance is:**

- The process of supervision and control intended to ensure that the company’s management act in accordance with the interests of shareholders (Parkinson, 1994).

- Not the governance role which is concerned with the running of the business of the company per se, but with giving overall direction to the enterprise, with overseeing and controlling the executive actions of management and with satisfying legitimate expectations of accountability and regulation by interests beyond the corporate boundaries.

- The governance of an enterprise which is the sum of those activities that make up the internal regulation of the business in compliance with the obligations placed on the firm by legislation, ownership and control. It incorporates the trusteeship of assets, their management and their deployment.

- The relationship between shareholders and their companies and the way in which shareholders act to encourage best practice (e.g., by voting at AGMs and by regular meetings with companies’ senior management). Increasingly, this includes shareholder ‘activism’ which involves a campaign by a shareholder or a group of shareholders to achieve change in companies.
Corporate Governance is consisting of the structures, process, cultures and systems that engender the successful operation of the organization (Keasey and Wright, 1993).

The system by which companies are directed and controlled (The Cadbury Report, 1992).

Corporate governance involves full set of relationships between a company’s management, its board, its shareholders and its stakeholders. Strong corporate governance and capital market’s strength decides stability and prosperity as quality governance. In making the legal, institutional and regulatory framework within which governance works, Government plays crucial roles. The efficiency of governance will directly depend on the framework conditions, which would include legal rights of shareholders and its protection strategies.

All the broader vision of corporate governance and the consequent improvements that have been effected in the systems, procedures and the frameworks are the direct outcome of the increasing public awareness about the necessity to have better governance practices. In this effort, not only governments are involved, but are also world-level organizations such as the World Bank, OECD, and Asia Pacific Economic Co-Operation (APEC).

1.4 **Corporate Governance - the concept**

- **Noble laureate Milton Friedman** defined corporate governance as “the conduct of business in accordance with the shareholders desire, which generally is to make as much money as possible, while conforming to the basic rules of the society embodied in the laws and customs.”

- **Monks and Minow** have defined corporate governance as “Relationships among various participants in determining the direction and performance of a corporation.”
According to James D. Wolfenshon, President of the World Bank, “Corporate Governance is about promoting corporate fairness, transparency and accountability.”

Standard and Poor’s have defined the corporate governance as “the way a company is organized and managed to ensure that all financial stakeholders (Shareholders and creditors) of the company receive their fair share of a Company’s earnings and assets.”

According to Tricker “Corporate Governance is concerned with the way corporate entities are governed, as distinct from the way business within those companies are managed. Corporate Governance addresses the issues facing the Board of Directors, such as the interaction with Top Management and relationship with the owners and others interested in the affairs of the Company.”

OECD has defined corporate governance to mean, “A system by which business corporations are directed and controlled.” (“Principles of Corporate Governance.” www.oecd.gov)

Cadbury Committee, U.K. has defined corporate governance: “(It is) the system by which Companies are directed and controlled.” It may also be defined as a system of structuring, operating and controlling a company with the following specific aims:

- Fulfiling long-term strategic goals of Owners.
- Taking care of the interest of the employees.
- A consideration for the environment and local community.
- Maintaining excellent relations with the Customers and Suppliers.
- Proper Compliance with all applicable legal and regulatory requirements.

CII- Desirable Corporate Governance Code defined the Corporate Governance as: “Corporate Governance deals with the laws, procedures, practices and implicit rules that determine a Company’s ability to take informed managerial decisions vis-à-vis its claimants - in particular, its Shareholders, Creditors, Customers, the State and the employees. There is
global consensus about the objective of ‘good’ corporate governance: maximizing long term shareholders value.” (Confederation of Indian Industry, Desirable Corporate Governance, A Code, March 1998)

- **The Kumar Mangalam Birla Committee** constituted by SEBI has observed that: “Strong Corporate Governance is indispensable to resilient and vibrant capital markets and is an important instrument of investor protection. It is the blood that fills the veins of transparent corporate disclosures and high quality of accounting practices. It is the muscle that moves viable and accessible financial reporting structure.”

- **N.R. Narayana Murthy Committee** on Corporate Governance constituted by SEBI observed that: “Corporate Governance is the acceptance by management of the inalienable rights of the shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders. It is about the commitment values, about ethical business conduct and about making a distinction between personal and corporate funds in the management of the Company.”

- **The Institute of Company Secretaries of India** has also defined the term Corporate Governance as: “Corporate Governance is the application of best management practices, compliance of Law in true letter and spirit and adherence to ethical standards for effective management and distribution of wealth and discharge of social responsibility for sustainable development of all stakeholders.”

### 1.5 Elements of Good Corporate Governance:

1. **Role and Powers of the Board:**
   
The Board as a main functionary is primarily responsible to ensure value creation for its stakeholders. The absence of clearly designated role and powers of the Board weakens accountability mechanism and threatens the achievements of organizational goals.
2. **Legislation:**
   Clear and unambiguous legislation and regulations are fundamental to effective corporate governance. Legislation that requires continuing legal interpretation or is difficult to interpret on a day-to-day basis can be subject to deliberate manipulation or inadvertent misinterpretation.

3. **Management Environment:**
   Management environment includes setting-up of clear objectives and appropriate ethical framework, establishing due process, providing for transparency and clear enunciation of responsibility and accountability.

4. **Board Skills:**
   To be able to undertake its functions efficiently and effectively, the Board must possess the necessary blend of qualities, skills, knowledge and experience. Each of the directors should make quality contribution.

5. **Board Appointment:**
   To ensure that the most competent people are appointed in the Board, the Board positions should be filed through the process of extensive search. A well-defined and open procedure must be in place for reappointment as well as for appointment of new Directors.

6. **Board Induction and training:**
   Directors must have a broad understanding of the area of operation of the Company’s business, corporate strategy and challenges being faced by the Board.

7. **Board Independence:**
   Independent Board is essential for sound Corporate Governance. This goal may be achieved by associating sufficient number of independent directors
with the Board. Independence of Directors would ensure that there are no actual or perceived conflicts of interests. It also ensures that the Board is effective in supervising and is challenging the activities of management.

8. **Board Meeting:**
Attending the Board Meeting regularly and preparing thoroughly before entering the Boardroom, increases the quality of interaction at Board Meeting. Board meetings are the forums for Board decision-making. These meetings enable the Directors to discharge their responsibilities meaningfully.

9. **Code of Conduct:**
   It is essential that the organization’s explicitly prescribed norms of ethical practices and code of conduct are communicated to all stakeholders and are clearly understood and followed by each member of the organization.

10. **Strategy Setting:**
The objectives of the organization must be properly documented in a long-term corporate strategy including an annual business plan together with achievable and measurable performance targets and milestones.

11. **Business and community obligations:**
   Though the basic activity of a business entity is inherently commercial yet it must also take care of community’s obligations. Commercial objectives and community service obligations should be clearly documented after approval of the Board.

12. **Financial and operational reporting:**
The Board requires comprehensive, reliable and timely information which has a quality that is appropriate to discharge its functions of monitoring corporate
performance. The information so provided should not be as extensive and detailed as to hamper comprehension of the key issues.

13. **Monitoring the Board performance:**

The Board must monitor and evaluate its combined performance and also that of individual directors at periodic intervals, using key performance indicators besides peer review.

14. **Audit Committee:**

The Audit Committee is *inter alia* responsible for liaison with the management, internal and statutory auditors, for reviewing the adequacy of internal control and compliance with significant policies and procedures, and reporting to the Board on the Key issues. The quality of the Audit Committee significantly contributes to the governance of the company.

15. **Risk Management:**

Risk is an important element of corporate functioning and governance. There should be a clearly established process of identifying, analyzing and treating risks, which could prevent the company from effectively achieving its objectives. It also involves establishing a link between risk-return resourcing priorities.

The OECD identifies the following **Key elements of good corporate governance:**

1. **Rights and Obligations of Shareholders:**

A corporate governance framework should protect shareholder rights. It should ensure that there is one vote for one share. It should ensure that management provides sufficient and relevant information. It should encourage shareholders to participate in Annual general meeting and vote. Shareholders should able to share in residual profit (dividends). Minority shareholders
should be protected. It should ensure financial transparency in the operation of the company.

Obligations of the shareholders is to use their voting rights wisely, however, at times the shareholders are not aware of their rights and as a part of a good corporate body, it becomes the duty of the management to encourage the shareholders to use their rights.

2. **Equitable treatment of shareholders:**
OECD and APEC have stressed on the point that all shareholders including minority and foreign shareholders should get equitable treatment. All shareholders should have equal opportunity for redressal of their grievances and violation of their rights. Any change in their voting rights should be subject to a vote by shareholders. Directors should disclose any material interests regarding transactions.

3. **Role of stakeholders in corporate governance:**
OECD recognizes the fact that there are other stakeholders in corporations apart from the shareholders. Apart from dealers, consumers and the government who constitute the stakeholders’ group, there are others too who ought to be considered. Banks, bondholders and workers, for example, are important stakeholders in the way in which companies perform and make decisions. For active stakeholder participation, it should be ensured that the stakeholders have access to relevant information.

4. **Disclosure and Transparency:**
A number of provisions for the disclosure and transparency must be disseminated to those who are entitled for such information. Transparency / disclosure includes disclosure of information on financial / operating results, ownership structure, member of the board of directors and management,
quantitative and qualitative matters concerning employees and the stakeholders in the corporation, governance structures and policies, corporate target and prospects and execution of unusual and complex transaction, transactions including derivative products and their level of risks.

5. **Responsibilities of the board:**
The OECD guidelines explain in detail the functions of the Board in protecting the company, its shareholders and its other stakeholders. These functions would include concerns about the corporate strategy, risks, executive compensation and performance, accounting and reporting systems, monitoring effectiveness and changing them, if needed. Also the guidelines include establishment of rights and responsibilities of managers and directors.

1.6 **Factors influencing Quality of Corporate Governance**

Quality of governance primarily depends on the following factors:

- Integrity of the management.
- Ability of the Board.
- Adequacy of the process.
- Commitment level of individual Board members.
- Quality of corporate planning.
- Participation of stakeholders in the management.

The corporate governance framework depends on the legal, regulatory and institutional environment; business ethics and awareness of the environmental and societal interests of the constituencies in which it operates. So far as monitoring of the Corporate Governance is concerned, Creditors, especially Banks play a key role in governance system, and serve as external monitors over Corporate Performance. Employees and other stakeholders also play an important role in contributing to the
long term success and performance of the corporation, while the sovereign States provide overall institutional and legal framework for corporate governance.

1.7 Significance of Corporate Governance – Society at Large

Corporate Governance depends on the economic and business environment that has been created by public governance in the country. There cannot be good corporate governance if public governance is weak. In the Indian corporate scene, it is clear that unless India inducts global standards, the scope for scams may increase in the years to come. To reduce it to the minimum, there is an urgent need to improve corporate governance in the country. The legal and administrative environment in India provides great scope for corrupt practices in business.

For more than six decades since independence, lack of transparency and financial disclosures, corruption and mismanagement have been accepted as a way of life and taken in an insulated, license-ridden and non-competitive environment. As a result, unless a management which is committed to be honest and which observes the principle of propriety, the atmosphere would be too tempting not to observe good corporate governance in practice.

India should approach the issue of corporate governance not merely from the point of view of the companies act, 1956 or SEBI guidelines or the codes involved out of recommendations of committees such as the Kumar Mangalam Birla Committee or the Rahul Bajaj Committee, but should look at the entire network of various rules and regulations impinging on business so that there is an integrated holistic system, created for ensuring that transparency and good corporate governance prevail.
Corporate governance is important to the society because of following reasons:

- It lays down the framework for creating long-term trust between companies and the external providers of capital.
- It improves strategic thinking at the top by inducing independent directors who bring in a wealth of experience and a host of new ideas.
- It rationalizes the management and does monitoring of risks that a firm faces globally.
- It limits the liability of top management and directors by carefully articulating the decision making process.
- It ensures the integrity of the financial reports.
- It helps to provide a degree of confidence that is necessary for the proper funding of a market economy.
- In developing countries where shares of most forms are not actively traded on stock markets, adopting standards for transparency in dealing with investors and creditors will bring benefit to all and also it helps to prevent systemic banking crises.
- With strong corporate governance, the firm provides protection to the minority shareholders which have larger and more liquid capital markets. Studies of countries that have their laws on different legal traditions show that those with weak systems tend to result in most companies being controlled by dominant investors while those with strong systems tend to have a widely dispersed ownership structure.
- Corporate Governance gives proper shape to the market system where market system weak, i.e. it makes market system very strong in the long run.
- Corporate Governance provides transparency in all business transactions.
1.8 Benefits of Adoption of Good Corporate Governance Practices

Many large corporations are multinational and/or transnational in nature. This means that these corporations have an impact on citizens of several countries across the globe. It is, therefore, necessary to look at the international scene and examine possible international solutions to corporate governance difficulties. Corporate governance is needed to create a corporate culture of consciousness, transparency and openness. It refers to a combination of laws, rules regulations, procedures and voluntary practices to enable companies to maximize shareholders’ long-term value. It should lead to increasing customer satisfaction, shareholder value and wealth. The following are the major benefits for corporations:

- Good corporate governance secures an effective and efficient operation of a company in the interests of all stakeholders. It provides assurance that the management is acting in the best interest of the corporation, thereby contributing to business prosperity through openness in disclosures and accountability.

- Good Corporate Governance creates and enhances competitive advantage for the corporation which facilitates the creation of value for its buyers. It provides innovation strategy to the corporation for managing the process of delivering value. Corporations which develop their strategies by involving all levels of employees create widespread commitment to make the strategies succeed.

- The code of best conduct – policies and procedures governing the behaviour of individuals of a corporation – form part of corporate governance. This enables a corporation to compete more efficiently in the business environment and prevent fraud and malpractices that destroy business from outside.

- Corporate governance is a set of rules that focuses on transparency of information and management accountability. It imposes fiduciary duty on
management to act in the best interests of all shareholders and properly disclose operations of the corporations.

- Improved management accountability and operational transparency fulfill investors’ expectations and instill confidence on management and corporations, and in return, increase the value of corporation.
- With the development of capital markets and the increasing investment by institutional shareholders and individuals in corporations that are not controlled by particular shareholders, jurisdictions around the world have been developing comprehensive regulatory frameworks to protect the investors. More rules and regulations addressing corporate governance and compliance have been and will be released. Compliance has become a key agenda in establishing good corporate governance. After all, corporate governance ensures the long-term survival of a corporation and thereby enables its shareholders long-term benefits.

1.9 Principles and Processes of Corporate Governance

Fundamental principles of Corporate Governance are:

- People Focus
- Formality Organized
- Common Purpose
- Consistent Purpose
- Predictable Performance
- Performance Orientation
- Integrated Development

Corporate Governance should be people focused. All the activities in a business should be planned, organized, executed and controlled keeping people and service to them in mind. This does not mean that the business should be run for charity without earning any profit. No organization can survive without profit but the
profit motive should be secondary to the service motive. The company should be formally organized with a definite and clear organization structure. The organization and the people comprising it should work for a common purpose. Journey or consistent flow is life, standstill condition is death, hence the business should possess a consistent process of economic activity. The performance of an organization should be predictable with consistent, sustained and increased growth which reflects the performance orientation and integrated development of the company.

Three “P’s” of corporate governance includes Process management, Process compliances, and Process innovation. The process should be established, integrated, documented, automated, implemented and maintained. Process Management has different aspects such as Organization Management, Resource Management, Supply chain management, Marketing and Brand promotion, Outsourced process management, Environment and Energy management, Relationship management, Information System management, Risk and Crisis management. The plant / unit / organization has to comply with various rules, regulations, statutes and laws enforced by state and central government which includes compliance management, Independent Assurance Mechanism and Whistle Blowing. When certain things are going wrong or violating any norms, rule regulation or any act, the employees should have freedom to sound it off to the top management to take preventive action. (A.C. Fernando, Corporate Governance-Principles, Policies & Practices)

1.10 Theoretical Basis of Corporate Governance

There are four broad theories to explain and explicate corporate governance:

- Agency Theory
- Stewardship Theory
- Stakeholder Theory
- Sociological Theory
1. **Agency Theory:**

The fundamental theoretical basis of corporate governance is *agency costs*. Shareholders are the owners of any joint stock, limited liability Company, and are the principals of the same.

The management, directly or indirectly selected by the shareholders to pursue such objectives is the *agent*. In many instances, the objectives of managers are at variance from those of the shareholders. For instance, a chief executive may want to increase his managerial empire and personal stature by using the company’s funds to finance an unrelated diversification, which could reduce long term shareholder value. Such mismatch of objectives is called *agency problems*.

In agency theory terms, the owners are the principals and managers are the agents and the loss occurring due to mismatch of objectives is called the *agency loss*. The Agency theory specifies the mechanisms which reduce the agency losses. Two broad mechanisms that help reduce agency costs and improve corporate performance through better governance are:

1. **Fair and accurate financial disclosure:** Financial and non-financial disclosures, which relate to the role of the independent, statutory auditors appointed by shareholders to audit a company’s accounts should present a fair view of the financial health of the corporation.

2. **Efficient and independent board of directors:** A joint-stock company is owned by the shareholders, who appoint directors to supervise management and ensure that it does all that is necessary legal and ethical means to make the business grow and maximize long-term corporate value. Directors are fiduciaries of the shareholders, not of the management.
2. **Stewardship Theory:**

The stewardship theory of corporate governance discounts the possible conflicts between corporate management & owners and shows a preference for a board of directors made up primarily of corporate insiders. This theory assumes that managers are basically trustworthy and attach significant value to their own personal reputations.

Stewardship theory can be reduced to the following basic concepts:

- The theory defines situations in which managers are not motivated by individual goals, but rather they are stewards whose motives are aligned with the objectives of their principals. (Davis, Schoorman and Donaldson - 1997)

- Given a choice between self-serving behavior and pro-organizational behavior, a steward’s behavior will not depart from the interests of his/her organization.

- Control can be potentially counterproductive, because it undermines the pro-organizational behavior of the steward, by lowering his/her motivation.

- The greatest barrier, however, to the adoption of stewardship mechanisms of governance lies in the risk propensity of principals. Risk taking owners will assume that executives are pro-organization and favor stewardship governance mechanisms.

3. **Stakeholder Theory:**

Stakeholder theory has a lengthy history that dates back to 1930s. The theory represents a synthesis of economics, behavioral science, business ethics and the stakeholder concept. The theory considers the firm as an input-output model by explicitly adding all interest groups – employees, customers, dealers, government and the society at large - to the corporate mix.
The theory is often criticized, more often than not as “woolly minded liberalism”, mainly because it is not applicable in practice by corporations. Another cause for criticisms is that there is comparatively little empirical evidence to suggest a linkage between stakeholder concept and corporate performance.

The stakeholder model of corporate governance leads to corrupt practices in the hands of managements with a wide option and also to chaos, as it does not differ much from agency model, while increasing exponentially the number of principals the agents have to tackle. (Clive Smallman (2004))

4. Sociological Theory:
The sociological approach to the study of corporate governance has focused mostly on board composition and the implications for power and wealth distribution in society. Problems of interlocking directorships and the concentration of directorships in the hands of a privileged class are viewed as major challenges to equity and social progress. Under this theory, board composition, financial reporting, disclosure and auditing are necessary mechanisms to promote equity and fairness in society.

1.11 Need of Corporate Governance

1. Series of scams that shook investor confidence:
The need for corporate governance was first realized in the country with “Big Bull”, Harshad Mehta’s securities scam that was uncovered in April 1992 involving a large number of banks and resulting in the stock market nose-diving for the first time since the advent of reforms in 1991. This was followed by a sudden growth of cases in 1993 when transnational companies started consolidating their ownership by issuing equity allotments to their respective
controlling groups at steep discounts to their market price. In this preferential allotment scam alone, investors lost roughly Rs. 5000 crore.

Another scam took place in 1995-96. Plantation companies scam saw Rs. 50000 crore mopped up from gullible investors who believed plantation schemes would yield huge returns. The so called non-banking finance companies scam that took place in 1995-97 also saw more than Rs.50000 crore mopped up from the public promising them high returns but vanished. The mutual fund scam saw public sector banks rising during 1995-1998 by nearly Rs. 15000 crore by promising huge fixed returns, but all of them flopped. Yet another scandal was the one in which BPL, Sterlite and Videocon price rigging happened with the help of Harshad Mehta. The IT scam during 1999-2000 saw firms change their names to include ‘infotech’, and investors saw their stocks run away overnight. The year 2001 witnessed yet another scam in which Ketan Parekh resorted to price rigging in association with a bear cartel.

2. Global Concerns:
Fewer concerns are more central to international business and developmental agendas than that of corporate governance. A series of events over the last two decades have placed corporate governance issues as of paramount importance both for the international business community and international financial institutions. Spectacular business failures and serious frauds in the USA as listed earlier, several high profile scandals in Russia and the Asian crisis have brought corporate governance issues to the forefront in developing countries and transition economies. The virtual collapse of the Russian economy in 1998 resulted in large measure from the weakness of governance mechanisms. The consequent distrust predictably resulted in the virtual collapse of external capital of firms; illustrating vividly the fact that corporate misgovernance can shake the very foundations of a society, affecting every member there from. Further, national business communities are gradually realizing the fact that
there is no substitute for getting the basic business and management systems in place in order to be competitive in the globe market and to attract foreign investment.

3. America’s Hall of Shame-2002:
WorldCom improperly booked $3.8 billion in expenses, thus inflating profits. The founder, Bernie Ebbers, borrowed $208 million from the phone company to cover personal debts. Energy firm, Ernon, created outside partnerships that helped hide its poor financial condition. Executives earned millions selling company stocks.

Energy Company, Dygeny, was under investigation for accounting and trading malpractices, in part related to California power crisis. Adelphia Communications made illegal loans to founder Rigas’ family members and was under investigation for accounting malpractices.

The Bush Federal Administration was prompt to slap the punitive measures on erring corporate and preventive steps to avoid future corporate frauds. A new law came into force, known as Sarbanes-Oxley Act, stipulates that CEO’s and CFO’s will be held completely liable for any criminal and civil suits for any omissions, false statements and restatements.

1.12 Need of the Research Study

The history of the development of Indian corporate laws has been marked by interesting contrasts. At independence, India inherited one of the world’s poorest economies but one which had well functioning stock markets with clearly defined rules governing listing, trading and settlements; a well-developed equity culture if only among the urban rich; and a banking system replete with well-developed
lending norms and recovery procedures. In terms of corporate laws and financial system, therefore, India emerged far better endowed than most other colonies.

The beginning of corporate developments in India were marked by the managing agency system that contributed to the birth of dispersed equity ownership but also gave rise to the practice of management enjoying control rights disproportionately greater than their stock ownership. The turn towards socialism in the decades after independence marked by the 1951 Industries (Development and Regulation) Act as well as the 1956 Industrial Policy Resolution put in place a regime and culture of licensing, protection and widespread red-tape that bred corruption and affected the growth of the corporate sector. The situation grew from bad to worse in the following decades and corruption, favoritism and inefficiency became the hallmarks of the Indian corporate sector. Exorbitant tax rates encouraged creative accounting practices and complicated emolument structures to beat the system.

While the Companies Act provides clear instructions for maintaining and updating share registers, in reality minority shareholders have often suffered from irregularities in share transfers and registrations – deliberate or unintentional. Sometimes non-voting preferential shares have been used by promoters to channel funds and deprive minority shareholders of their dues. Minority shareholders have sometimes been defrauded by the management undertaking clandestine side deals with the acquirers in the relatively scarce event of corporate takeovers and mergers. Boards of directors have been largely ineffective in India in monitoring the actions of management. They are routinely crammed with friends and allies of the promoters and managers, in deliberate violation of the spirit of corporate law. The nominee directors from the Development Financial Institutes, who could and should have played a particularly important role, have usually been incompetent or unwilling to step up to the act. Consequently, the boards of directors have largely functioned as rubber stamps of the management.
With the increasing power of the capital market, to discipline the dominant shareholder, by denying him access to the capital market. The newly unleashed forces of deregulation, disintermediation, institutionalization, globalization and tax reforms are making the minority shareholder more powerful and are forcing the companies to adopt healthier governance practices. These trends are expected to become even stronger in future. Regulators can facilitate the process by measures such as enhancing the scope, frequency, quality and reliability of information disclosures; promoting an efficient market for corporate control; restructuring or privatizing the large public sector institutional investors; and reforming bankruptcy and related laws.

A remarkable transformation has been seen in the countries after scams rocking their economies. Not only India but developed countries like US and UK are also not untouched by such scams. Enron or Satyam, both reflect the weakness with the corporate governance and its implementation practices at the ground levels. Capital Markets exerts an influential role on companies by imposing certain rules and regulations relating to firm’s governance roles. Being the center of spectrum, which ranges from companies or firms to that of economies, capital markets not only play a major role in but also impart some forces on both the sides. These forces are again functions of governance practices. To reframe or understand the spectrum of fields of corporate governance, it becomes important to focus on listed companies in capital markets and then study the impact of it on both low frequencies to high frequency ends i.e. companies to country.

But a demarcating line is drawn in impression regarding the developed economies and their governance practices and that of emerging companies which are on transitional stage. Since these economies would be developed in future, this transitional era becomes important to lay their foundations which do not blow out the future of governance practices. Contrast between such economies would suggest where emerging economies and their capital markets need reformation
over the certain era of development.

Recapitulating, the key to better corporate governance in India today lies in a more efficient and dynamic capital market. Of course, things could change in future if Indian corporate structures also approach the Anglo-American pattern of near complete separation of management and ownership.

1.13 **Objectives of the Research Study**

This study was proposed to study the corporate governance practices in dynamic capital market. The main research problem was:

**How does corporate carry out its corporate governance practices in dynamic capital market?**

**Objectives of the Study:**

The objectives of this study, according to the research problem, were:

1. To measure the socio economic models in Corporate Governance and study the effects of the same.
2. To highlight the legal situation in our Country along with a comparative study of the same in various other countries.
3. To study relation between Corporate Governance and capital structure & financial performance of selected Information Technology, Banking, Pharmaceuticals, FMCG and BSE 30 companies.
4. To examine the practice of Corporate Governance through constructing corporate governance index covering various major parameters like Board Independence, Systems & Procedures, Transparency & Disclosure Compliances, consistency in Shareholder & Stakeholders Value Enhancement of selected Information Technology, Banking, Pharmaceuticals, FMCG and BSE 30 companies.
5. To study the Corporate Governance parameters and the importance Company Secretaries weigh to each of these parameters.

(One of the objectives of the research study was to measure the socio economic models in Corporate Governance and study the effects of the same in the parameters on corporate objective, shareholding pattern, governance focus, measures of success, capital market (primary), capital market (secondary), investor commitments, board composition, etc. A detailed model of corporate governance practices – an International Comparison study on socio economic model - has been presented on pages 40 and 41 of the thesis and the results based on the study are represented on page 256, which are clearly indicative of the direction of the study.)

(Objective 2 does highlight the legal situation in our Country along with a comparative study of the same in various other countries. By doing a comparative study of clause 49 and Sarbanes-Oxley Act provisions, the researcher is able to propose a tentative check list for companies as regards to the practices widely held in India. Here the researcher has brought out the flaws and nuances in the practices of corporate governance in a dynamic capital market, specifically in India in comparison to other countries. By doing so, the researcher has tried to understand the practical applications and implications of corporate governance in India.)

1.14 Conclusion

The concept, need and urgency to implement good corporate governance practices in a dynamic capital market have been highlighted by the researcher. The need and objectives of study have been mentioned by the researcher. The research will provide an understanding of the current scenario in Indian markets, and the need to change, if necessary, to imbibe good corporate governance practices, in the forth-coming chapters.