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CHALLENGES TO CORPORATE GOVERNANCE : ISSUES AND CONCERNS

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INTRODUCTION

The emergence of new technologies in the era of globalisation and liberalisation entirely changed the nature of business transactions. By the evolution of business life cycles business transactions became very complex and managing risk became a challenging task for the organisations. Concerns about corporate governance in India were, however, largely triggered by Harshad Mehta stock market scam of 1992 followed by incidents of companies allotting preferential shares to their promoters at deeply discounted prices and the recent scam of sathyam. Good corporate governance became a key word to handle accounting scandals and to mitigate growing concern about the quality of financial statements. Various committees have been formed globally to improve the effectiveness of Corporate governance, especially, Audit committee from Cadbury committee report to sarbane oxaley Act,2002 in US.

Corporate governance deals with the entire networks of formal and informal relationships with the management of the company and company's stakeholders including employees, customers, creditors, local communities, and society in general. The objective of this paper is to examine the challenges faced in the present corporate governance practises in India. Some of the issues are how far "independent" is the "independent director who plays a key role in the audit committee for the practises of good corporate governance. The paper also analyses regulatory deficiencies in corporate governance. Also discussess short comings in the provisions of the companies Act, stock exchange listing criteria, codes of good practise in corporate governance listed companies which have incorporated provisions of corporate governance and required to have audit committee.

Notion of corporations

From the very beginning of the corporate laws notion was that corporation is collective enterprise for the enhancement of the profit for the shareholders. A company is nothing but a legal device hold by shareholders. To increase the value of the shareholders money is it the only goal of board of directors. The board of directors are mere agents of the share holders. The notion still persists as share holders are the important stake holders of the company. But it has to be seriously rethink of the fact that in the era of globalisation for the effective implementation of corporate governance, the role of other stake holders who are contributing to the good governance are also important. Their role must be considered and must extend protection who plays an important role in good corporate governance. The employees, consumers, creditors, societies are also a major stake holders to that of shareholders. Thus corporation is something more than legal device for collective enterprise like partnership. For the two decades of 21st century corporation is enterprise of interest of all share holders. Thus corporation is a device where resourses are pooled managed by a team who chalk out policies and must take care of interest of all.

According to the Peter Drucker (management guru) propounded that profit motive is not the only goal, it is the inevitable consequence of proper management. Capital is the legitimate rights to be recognised and capital alone will not result in good governance. Recent scams points out the loopholes and deficiencies in the existing legal regime and practises to commit corporate frauds through which not only stake holders are affected at the same time economy of our country there by faith in our economic structure and legal protection.

Regulatory issues in Corporate Governance

Rethinking BOD's performance and Need for and effective control over management

Because of abuse of managerial person there was a modernising of corporate management . In all the reform committee the requirement was for independent directors. They are appointed by dominant share holders. Even though board of directors have been appointed by the shareholders, majority share holders of large corporations in India where individual or family. So the govern and control is in the hands of these management. Boards of directors have been largely ineffective in India in monitoring the actions of management, or otherwise because they rarely they differ in their views.

They have fiduciary relationships or are friends and allies of the promoters and managers, in flagrant violation of the spirit of corporate law. The disclosure of interest requirement of s.299 of companies Act to disclose the connections and economic interest of the directors with the company, thus remained ineffective. As every director of a company who is in any way, whether directly or indirectly, concerned or interested in a contract or arrangement, or proposed contract or arrangement, entered into or to be entered into, by or on behalf of the company, shall disclose, the nature of his concern or interest at a meeting of the Board of directors. The section remains futile if the board is mixture of friends and their relatives. Not only that any contract or arrangement entered into or to be entered into between two companies where any of the directors of the one company or two or more of them together holds less than two percent of paid up capital are exempted from disclosure of interest.

In practical , managers enjoy actual control of business and may not serve in the best interests of the shareholders. But to monitor the management is a challenging , it may end up in clash between board and executive. Not only that, to describe the limits of the nature of the contract between shareholder representatives and managers relating to what to do with the funds contributed by the former is highly difficult. The main challenge comes from the fact that such contracts are necessarily "incomplete". It is not possible for the Board to fully instruct

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management on the desired course of action under every possible business situation The list of possible situations is infinitely long. Even if contract is made Consequently, no contract can specify the right course of action in every situation, so that the management can be held for violation of such a contract in the event it does something else under the circumstances. Because of this "incomplete contracts" situation, some "residual powers" over the funds of the company must be vested with either the financiers or the management. Clearly the former does not have the expertise or the inclination to run the business in the situations unspecified in the contract, so these residual powers must go to management. The efficient limits to these powers constitute much of the subject of corporate governance.

The ineffective meeting of shareholders and dispersed manner of owners with no logical meetings or communication between themselves is another issue. But another situation is where shareholders have even no say in knowing the third party transaction that is entered in to by the management. Neither in the annual reports nor in meetings the shareholders come to know about the king of transaction takes place using there own money. In companies with highly dispersed ownership, the manager (the CEO in the American setting, the Managing Director in British-style organizations) functions with negligible accountability.

Another crucial issue is relating to monitoring of the affairs of the company especially of the board and management by the share holders. But the pathetic stage is that most shareholders do not care to attend the General Meetings to elect or change the Board of Directors and often grant their "proxies" to the management. Even those that attend the meeting find it difficult to have a say in the selection of directors as only the management gets to propose a slate of directors for voting. On his part the CEO frequently packs the board with his friends and allies who rarely differ with him. Often the CEO himself is the Chairman of the Board of Directors as well. Consequently the supervisory role of the Board is often severely compromised and the management, who really has the keys to the business, can potentially use corporate resources to further their own self- interests rather than the interests of the shareholders. Thus there is a need to have control of shareholders including minority shareholders in the process of selection of board of directors.

The present scenario is that if the shareholder dissatisfied with a particular management would simply dispose of their shares in the company as it will bring down the share price, the company would become a takeover target. If and when the acquisition actually happens, the acquiring company would get rid of the existing management. It is thus the fear of a takeover rather than shareholder action that is supposed to keep the management. But this happens only if some particular conditions are met.

Another way of siphoning off funds is when Board issues preferential shares to promoters, thus diverting the funds of shareholders. 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 event of corporate takeovers and mergers. Improvements are also necessary in the enforcement of certain laws and regulations like those pertaining to stock listing in major exchanges and insider trading as well as in dealing with violations of the Companies Act – the backbone of corporate governance system in India

The nominee directors from the DFIs, who could and should have played a particularly important role, remained ineffective. Consequently, the boards of directors have largely functioned as rubber stamps of the management. Boards of directors have frequently been silent spectators with the DFI nominee directors unable or unwilling to carry out their monitoring functions. Out of 6.5 lakhs companies only 9000 are listed companies. The provision of clause 49 of the listing companies has to be made applicable to all public companies. One can differently treat SME by having separate schemes.

In Germany the structure of the board of directors is such that they are not elected by the share holders alone, but by the employees too, there is a supervisory body. Patron extended by consumers infrastructure extended by the state. There has to be a change in management structure and the mode of election of board of directors . The chairman of board of directors and CEO should not be the same. There is a need of setting standards in a way to attract all the interested persons together is the need of the hour.

Effectiveness of Audit committee and Independent director

Independent directors in listing agreement defined as "independence" as the absence of relationships that may interfere with the exercise of their independence from management and the company or in other words absence of employment relationships. Such relationships can be either employment, family and business relationships.

The audit committee (unless another committee is charged with the responsibility) should review the company's operations and determine whether management has established and maintains effective programs pertaining, to the extent relevant, to the following:

- antitrust laws and policies
- conflicts of interest
- sensitive payments and political contributions
- insider trading
- the use or misuse of corporate funds and confidential information
- environmental practices
- employment practices,

But if the independence of directors in the audit committee cannot be determined, person with the expertise in the financial statements reviewing with independent thinking, the role of audit committee will become futile.

Thus it could be seen that , independence is more than the absence of apparent conflicts; independence is also about attitude and human behaviour, which are challenging to regulate.

Whistle blower policy

The SEBI had made it mandatory that all listed companies should create a mechanism for employees to report to the management concerns about any unethical behaviour, fraud or violation of the code of conduct. The regulator also asked companies to put in place a suitable mechanism for safeguards against victimisation of whistle-blowers and that they should have direct access to the company's Audit Committee. Effective implementation is a way out to prevent corporate frauds.

Prevention of insider trading

The SEBI Regulations 2002 define 'insider' "as any person who, is or was connected with the company or is deemed to have been connected with the company, and who is reasonably expected to have access to unpublished price sensitive information in respect of securities of the company, or who has received or has had access to such unpublished price sensitive information."As defined under the Act, the definition of insider information is driven by the notion that a person in a fiduciary position should not use the privileged information for his or her own advantage. The practical limitation of the 'person-connected' approach is chiefly the practical difficulties of ensuring that all people who trade on inside information are caught. It may be quite difficult for the prosecution to show the existence of a 'connection', even when they can show that the secondary insider in question has been dealing and using the information. If prosecution fails to prove it ,any person can escape. Rather than personnel connection based approach information based approach be adopted to prevent insider trading.

Conclusion

The interpretation of public company u/s292A of the companies Act needs to be effectively revised looking in to the repercussions it creates. The loop holes in the provisions has to be removed. And the companies should not be let to escape by taking advantage of the limitations of the clause 49 of the listing agreement. The need of the hour is effective stewardship of board of directors. The concept of having specified number of directors have to be reconsidered in the light of over regulation also the number of companies in which one can be a director. There should be restriction in directorship in unlisted companies.

The function of the audit committee has be expanded to include oversight of risk management control systems to create an environment for the adherence to the practises of good corporate governance. Since audit committee is responsible for improving directors understanding and understanding of accounting related issues and other important matters regarding the behaviour of the organisation and integrity of the financial information disclosed in the report to the stake holders. As there is a growing concern about the quality of financial statements for the protection of stakeholders interest , the role of audit committee gains more prominence in this context in its entirety corporate governance. There is a need to ensure the effective implementation and compliance of standards of corporate governance by SEBI rules and regulations at the ground level.

Suggestions

• New method for the appointment of Independent Director is required.
•Independent directors- selection criteria must be transparent, also process of appointment of BOD must be reconsidered.
• It is important to focus on not just Quantity or profits but on the sustainability of business models.
• Need for having regulations of SEBI for the credit rating agencies need to develop criteria that focus on substance rather than the form of governance
• Compensation of executive directors should flow from an objective performance evalution process conducted by the board

- Need for having supervising the functions of management and make them accountable and transparent to shareholders.
- To revise clause 49 of SEBI listing Agreement
- Codes of conduct and whistle blower policies must be framed in such a way as to be possible to put in to practise.
- Need for having supervising the functions of management and make them accountable and transparent to shareholders

• Effective impliementation of code of corporate governance
• Regulators should enhance penalities as well as to fix liability in imposing substantial penalties for non-compliance,

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