CORPORATE GOVERNANCE ISSUES IN INDIA

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ABSTRACT

In India, corporate governance is a vital component of the economic environment, as it shapes investor trust, market integrity, and environmentally friendly company practices. This essay offers a thorough study of the main problems with corporate governance that Indian firms are currently facing, looking at their root causes, consequences, and possible solutions. The first section of the essay provides background information on the relevance of corporate governance in India and emphasizes how it promotes responsibility, ethics, and openness in business practices. With India's economy expanding quickly and becoming more integrated into the world economy, strong governance practices are necessary to protect investor interests and keep the market stable.

The report addresses many significant governance concerns that are common in the Indian business environment by drawing from theoretical frameworks and empirical research. These include issues with CEO remuneration, shareholder activism, related-party transactions, and board performance. The study explores the underlying reasons for these problems, which range from insufficient board independence and supervision to governance shortcomings in family-owned enterprises, via the examination of case studies and regulatory changes.

The study also looks at how governance concerns affect stakeholder trust, risk management, and business performance. The historical occurrences of corporate scandals and governance breakdowns highlight the pressing necessity of fortifying governance standards and regulatory enforcement protocols in India. The report addresses potential solutions and best practices for improving corporate governance in India in response to these issues. This includes actions to fortify regulatory supervision, encourage shareholder activism, improve board composition, and increase openness and disclosure procedures.

Introduction

Corporate governance refers to the systems and principles-based framework that governs a firm. It guarantees that the business is run in a way that is in line with the interests of all of its stakeholders and is accountable, open, and moral. A company's governance makes sure that it is managed and directed to meet its aims and objectives, which include generating value for the business and benefiting all stakeholders, including shareholders, customers, suppliers, and workers in the long run. The board of directors and the relevant committees carry it out for the company's stakeholders' benefit. In corporate governance, objectives related to individuals, society, and the economy are all balanced. The Indian government has strengthened corporate governance in the nation by enacting several regulatory measures. A few policies have been put in place by the Securities and Exchange Board of India (SEBI) to improve corporate governance's accountability and transparency. The Indian legal framework for corporate governance has been reinforced by the Companies Act of 2013. According to the laws, businesses must have a board of directors in charge of general business management.

Despite these statutory adjustments, corporate governance in India still has to be improved greatly. A lot of businesses still run their operations against the interests of their stakeholders. The Indian business sector's image has suffered due to a few high-profile examples of corporate fraud and mismanagement. Several actions must be made to guarantee that the Indian corporate sector conducts its business in an ethical and socially conscious way. These consist of fortifying the legal structure, improving openness, fortifying the function of independent directors, fostering shareholder activism, and endorsing ESG investing.

History of Corporate Governance

The emergence of major businesses as dominating economic players in the mid-1900s is considered the birth of corporate governance. During this time, the concept of shareholder primacy gave rise to the conventional form of corporate governance.[1] According to this paradigm, a company's main goal should be to increase shareholder profit; the interests of other stakeholders, including consumers, workers, and the environment, should come second.

[1] Goswami, O., 2002. Corporate governance in India. *Taking action against corruption in Asia and the Pacific*, pp.85-106.

Economists like Milton Friedman were among the first to support shareholder primacy, arguing that a corporation's job was to maximize profits within the bounds of the law.

This strategy was predicated on the idea that firms' pursuit of self-interest would increase wealth for society. Because of this, the main goal of corporate governance in the past was to safeguard the interests of shareholders. The primary decision-making body of the corporation was the board of directors, which was in charge of monitoring management and making sure the company operated in the best interests of shareholders. Additionally, the board was in charge of determining CEO remuneration, and shareholders may cast votes on these issues.

Nonetheless, the shareholder primacy-based corporate governance model came under fire for being overly restrictive and disregarding the interests of other stakeholders. Opponents contended that this strategy promoted short-term thinking and a concentration on profit maximization at the price of sustainability and long-term growth. In addition, many committees have been created by SEBI and the Ministry of Corporate Affairs to alter the current framework of corporate governance in India.

They are as follows:

a) Kumar Mangalam Birla Committees

b) R. Narayan Murthy Committee

c) Naresh Chandra Committee on Corporate Audit and Governance

Corporate Governance and the Board of Directors

- The most direct stakeholder affecting corporate governance is the board of directors. The duty of representing the interests of the company's shareholders falls on directors, who are chosen by the board or elected by the other directors.

- The board is responsible for making crucial choices like dividend policy, executive compensation, and the employment of corporate officers. Sometimes a board's responsibilities go beyond maximizing profits, like when shareholder resolutions demand that environmental or social issues be given top priority.

- Independent and insider members frequently make up boards. Major shareholders, founders, and executives are often considered insiders. The relationships that insiders have are not shared by independent directors. [2]Usually, their selection is based on their background in leading or managing other sizable businesses. Because they help match shareholder interests with insiders' and lessen the concentration of power, independents are viewed as beneficial to governance.

- The corporate strategy, risk management, accountability, openness, and ethical business practices must all be included in the company's corporate governance policies, according to the board of directors.

Concept of Corporate Governance in India

The corporate governance structure in India:

- Provisions about Independent Directors, Board Constitution, General Meetings, Board Meetings, Board Procedures, Related Party Transactions, Audit Committees, and other subjects are included in the Companies Acts, 2013.

- The Ministry of Corporate Affairs (MCA) and the Securities and Exchange Board of India (SEBI) are responsible for corporate governance initiatives in India. SEBI standards mandate that firms adhere to the recommended best practices, which also serve as a safety for investors.

- Standards for Accounting Set by the Institute of Chartered Accountants of India (ICAI), an autonomous body that creates accounting guidelines. In addition, financial statement openness has been mandated by the ICAI, as mandated by Section 129 of the Companies Act of 2013.

- There are criteria for "Meetings of the Board of Directors," "General Meetings," and other subjects specified by the ICSI (Institute of Company Secretaries of India). The Companies Act, 2013 gives an independent body the power to set rules that any business must abide

[2] Almaqtari, F.A., Al-Hattami, H.M., Al-Nuzaili, K.M. and Al-Bukhrani, M.A., 2020. Corporate governance in India: A systematic review and synthesis for future research. *Cogent Business & Management*, *7*(1), p.1803579.

by to be exempt from legal action under the Companies Act.

- Numerous organizations and charters, such as the Institute of Chartered Accountants of India (ICAI), Confederation of Indian Industry (CII), and National Foundation for Corporate Governance (NFCG), have been established by MCA and the Government of India.[3]

Importance of Corporate Governance in India

In India, corporate governance holds great significance since it forms the basis for cultivating investor trust, augmenting company transparency, and advancing sustainable economic expansion. Effective corporate governance procedures are necessary in the Indian setting to ensure responsibility among business entities, mitigate agency conflicts, and safeguard shareholder interests. The importance of corporate governance in India stems mostly from its ability to draw in both international and indigenous capital. Because there is less chance of fraud, poor management, and value erosion when investing in firms that follow strict corporate governance guidelines, investors—both individual and institutional—are more likely to do so. Furthermore, strong governance standards boost the capital markets' legitimacy and influx of money, which increases liquidity.

In Indian enterprises, corporate governance is also essential for increasing operational effectiveness and strategic decision-making. Companies may improve their performance and competitiveness in the market by putting in place efficient risk management frameworks, independent board monitoring, and transparent reporting methods. Furthermore, good governance procedures support long-term sustainability and growth by bringing the interests of many stakeholders—such as shareholders, staff, clients, and regulators—into alignment. Regulating bodies in India have imposed strict governance frameworks and standards to guarantee company responsibility and compliance following corporate scandals and governance breakdowns in the past. The significance of governance practices is emphasized by the Companies Act, of 2013, and laws enforced by the Securities and Exchange Board of India (SEBI), which require disclosures, openness, and board independence.

[3] Chakrabarti, R. and Megginson, W.I., 2009. Corporate governance in India. In *Global Corporate Governance* (pp. 151-176). Columbia University Press.

The Principles of Corporate Governance

A company's management and operations are guided by a set of principles known as corporate governance. By adhering to these values, the business will be able to operate in a way that serves the interests of all of its stakeholders and is transparent, ethical, and accountable.[4]

- **Fairness:** The board of directors is required to treat communities, vendors, workers, and shareholders with fairness and equality.

- **Transparency:** All parties involved in the business, such as shareholders, staff members, clients, and suppliers, should get timely, accurate, and thorough information from the company. Transparency guarantees that stakeholders may trust a company's management and decision-making procedures.

- **Accountability:** It ensures that the person making decisions in the best interests of others is held accountable. As a result, other stakeholders in the organization should keep managers, chairmen, directors, and other officers accountable.

- **Responsibility:** The board is in charge of managing operations and overseeing business affairs. It needs to be conscious of and supportive of the company's continuous, effective performance. The hiring and recruitment of a chief executive officer (CEO) is one of its duties. The company's and its investors' best interests must be its priority.

- **Independence:** To serve the company's best interests, the board of directors should be impartial and free from outside influence from any one person or organization.

- **Risk Management:** The board and management are responsible for deciding which risks to take and how best to handle them. To manage risks and notify all pertinent parties about the presence and status of risks, they must implement those guidelines.

Issues Regarding Corporate Governance in India

- **Performance Evaluation of Directors:** Although it has always been a feature of India's legal system, the regulator has recently been interested in director performance reviews.

[4] Thapar, M. and Sharma, A., 2017. Corporate governance in India: An analysis. *Economic and Social Development: Book of Proceedings*, p.312.

India's capital markets regulator, SEBI, published a 'Guidance Note on Board Evaluation' in January 2017. This note provided ways for identifying assessment objectives, criteria, and techniques, and touched on several areas of performance evaluation. It is frequently demanded that the findings of performance evaluations be made public to attain the intended effects on governance procedures. Nevertheless, appraisal is always a delicate topic, and making disclosures to the public might backfire. In a peer review setting, unfavorable comments might not be disclosed to prevent media attention.[5]

- **Directors who are self-employed:** Independent directors are chosen for a subject that does not seem to be getting enough attention right now. The real situation seems to be worse, even after SEBI instructed businesses to form an audit committee or provide a comprehensive description of independent directors.

- **Accountability to Stakeholders:** Increased responsibilities and responsibility for directors are necessary to support the empowerment of independent directors. The Indian company law, which was revised in 2013, stipulates that directors have obligations not just to the firm and shareholders, but also to the community, workers, and the environment. Even though all directors are subject to these broad obligations, the absence of enforcement action has led to a complacent attitude among directors, particularly independent directors. Requiring the full board to attend general meetings might be a good approach to promote accountability since it would allow stakeholders to engage with the board and ask questions.[6]

- **Management of Risk**: Large corporations are now subject to constant observation by national media outlets and business media. The board's authority in a company's operations is limited to monitoring, thus creating, and enforcing a risk management strategy is essential. In this regard, Indian company law mandates that the board include a declaration detailing the creation and execution of the firm's risk management policy in its report to the shareholders. It is the independent directors' responsibility to evaluate the company's risk management procedures. A strong risk management strategy that outlines important guiding concepts and procedures for reducing risks in routine operations is

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[5] Nadaf, S.M. and Navi, B.S., 2016. Corporate governance: Issues, opportunities and challenges. *International Journal of Commerce and Management Research*, *3*(7), p.66072.

[6] Dahiya, S.B. and Gupta, D., 2001. Foreign investment and issues of corporate governance in India.

necessary for a governance model to be effective.

- **Privacy and Data Protection:** Data security and privacy are major governance concerns and are essential components of risk management. Every director should be required to have a solid awareness of the principles of cyber security in this day of digitalization. Only until leaders can interact with and comprehend the experts within their company can good governance be realized. The board must determine the possible danger of handling data and take action to safeguard it against potential exploitation. To guarantee that the purpose of data protection is met, the board must commit a fair amount of time and resources.

- **Corporate Social Responsibility (CSR):** As one of the few nations with CSR laws, companies must have contributed at least 2% of their income to CSR projects during the preceding three years. If not, the reports ought to provide accurate explanations for the failure. Businesses do not seem eager to commit to these kinds of expenses.

The Future of Corporate Governance in India

Some actions must be made to guarantee that the Indian corporate sector conducts its business in an ethical and socially conscious way.

- **Strengthening the Legal Framework:** The Companies Act of 2013 is a positive start, but more work must be done to fortify India's corporate governance laws. The government should make sure that the regulatory bodies have the authority to properly enforce the regulations and raise the penalty for non-compliance.

- **Enhancing Transparency:** To make sure businesses run morally, transparency is essential. Companies should be forced by the government to provide greater details about their business practices and financial results. As a result, stakeholders will be able to choose the businesses in which to invest with knowledge.

- **Strengthening the Role of Independent Directors:** To make sure that businesses run ethically and socially responsibly, independent directors are essential. The government should make sure that independent directors are appointed transparently and that they

possess the knowledge and experience needed to carry out their duties.[7]

- **Encouraging Shareholder Activism:** To make sure that businesses run ethically and socially responsibly, shareholders are essential. The government needs to support shareholder activism and see to it that investors have access to the data and resources they need to hold businesses responsible.

- **Promoting ESG Investing:** The concept of environmental, social, and governance, or ESG, investment is becoming more and more well-liked. By offering tax breaks and other advantages to investors who fund businesses that uphold moral and social values, the government ought to promote ESG investment.

Conclusion

One of the main pillars of India's economy is corporate governance, which has a big impact on market integrity, investor trust, and sustainable company practices. It is clear from the examination of different governance techniques and the problems they present that good governance is essential to promoting accountability, ethics, and transparency in organizations. India is still struggling with some enduring problems, such as stakeholder involvement, CEO remuneration, and boardroom dynamics, despite significant advancements in governance reforms and legal frameworks. These difficulties highlight the necessity of ongoing attention to detail and modification of governance procedures to meet changing stakeholder expectations and complexity.

Furthermore, corporate scandals and governance blunders highlight the need for stricter regulation monitoring and stricter governance standards since they serve as harsh reminders of the negative effects of weak governance procedures. In the long run, corporate governance in India seems to be headed in a positive direction, with a growing focus on digitization, sustainability, and stakeholder inclusion. To fully realize the benefits of governance changes, companies, regulators, and legislators must work together to promote an environment that values responsibility, honesty, and openness.

[7] Sarkar, J., 2009. Board independence & corporate governance in India: Recent trends & challenges ahead. *Indian Journal of Industrial Relations*, pp.576-592.

In India, corporate governance has great importance, and businesses must conduct themselves in an ethical and socially responsible manner. Although the government has made some progress, more work has to be done to enhance corporate governance nationwide. To make sure that the Indian corporate sector runs in a socially and ethically responsible manner, it is imperative to strengthen the legal framework, improve transparency, strengthen the role of independent directors, encourage shareholder activism, and promote ESG investing. India has the potential to lead the world in corporate governance and serve as a model for other nations if the proper measures are taken.