

Corporate Governance in India: The Changing of Corporate Board System

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Abstract

The paper discussed the corporate governance of India on the changing the outline of the corporate board system. The board structure is well established and closely aligns with Anglo-Saxon model. At present the system of corporate governance in India has undergone drastic changes in strengthening the regulatory framework and aligning with international standards. The paper suggests that the corporate governance system in India still need to address the mechanism to evaluate board performance. The regulatory frameworks are broadly in place; the regulatory bodies and other responsible authorities are actively finding the best way to strengthen its regulation and enhanced governance system. The major challenge remains that as how to make the effective implementation and stringent enforcement of governance framework and the relevant on the ground.

Keywords: *Corporate Governance, Board Structure, Anglo-Saxon Model, Board Diversity.*

Introduction

Corporate governance is a new emerging concept and a major focus of corporations in this present century. The unprecedented corporate fallouts witnessed in the 2000s, Enron, WorldCom, Tyco in the US, and others across the world, make a new surge of regulation and underpinned to strengthen corporate governance landscape (Claessens & Yurtoglu, 2013; Tricker & Tricker, 2015). The global financial crisis in 2008 and 2009, have led to identifying the basic corporate governance problems on growing complexity of the companies that boards governed. The recent boardroom failures were different from the previous corporate fallout; in 2001 corporate scandals were mainly based on management malfeasance and fraud (Lorsch et al., 2009; Tricker & Tricker, 2015). Aftermath of the crisis, the board structure and its outlook has drastically changed. Many countries introduced corporate governance codes to improve governance, focus more on board independence and the role of board of directors (Denis & McConnell, 2003; Gordon, 2006; Dahya & McConnell, 2007; Oshry et al., 2010). The balance board structure of the company has the direct correlation to the higher performance of the firm (Klein, 1998). At present, the corporate governance at board level is emphasized more on the board diversity, mainly gender representation, age, and board independence (Kang et al., 2007). The corporate governance reform in India has experienced a major change during economic liberalization in 1991 and onwards (Goswami, 2002; Chakrabarti et al., 2008; Afsharipour, 2009; Varottil, 2010). In 1992, Securities and Exchange Board of India (SEBI) was set up as the

main regulatory body for India's capital markets, and help to improve the corporate governance standards and practices (Chakrabarti et al., 2008; Afsharipour, 2009). So far, more than seven committees have already set up for recommendations of corporate governance code and relevant regulatory frameworks. From Confederation of Indian Industry 1998, a voluntary recommendation of corporate governance code to the latest SEBI Kotak Committee 2017, focussed on board structure and independence, roles and responsibilities of the board and other governance aspects. In 2013, the new Companies Act was enacted and witnessed a new paradigm shift in corporate governance system and practices in India. To correspond and consistent with the relevance of corporate governance provisions under Companies Act, in 2014, SEBI revised Clause 49 of the Listing Agreement, and to align with international standards particularly the OECD Principles and improve good corporate governance practices. In 2015, SEBI enacted another new regulation on the listing obligations and disclosure requirements (LODR), to make more stringent disclosure standards, greater public shareholder participation and proactive engagement for listed companies. And in mid-2017, the Kotak committee was set up and further recommends strengthening the corporate governance system in India.

The paper discussed the corporate governance of India on the changing the outline of the corporate board system. The paper used a sample of three main existing regulatory frameworks and latest recommendation of corporate governance: (i) Companies Act 2013, (ii) (SEBI) Listing Obligations and Disclosure Requirements (LODR) Regulations 2015 and (iii) Kotak Committee 2017. The paper presents the basic characteristics features influencing corporate governance and compares the latest three regulatory frameworks on board structure. In addition, the paper discussed the significant change in board diversity, independent directors and other relevant aspects.

This paper is organised as followed. Part 1 discusses a brief outline of corporate governance and highlights the method of the study. Part 2 presents the basic characteristics features influencing corporate governance system in India. Part 3 compares the latest regulatory frameworks and recommendation of corporate governance in India; on board size, composition and its subcommittees, board diversity, independent directors and other relevant aspects and Part 4 concludes the paper.

Corporate Governance System in India

Like the UK, Indian companies, public and private limited are incorporated by common law and governed through the rule of companies Act and other listing regulations (Goswami, 2002; Vasudev, 2007; Mallin, 2016). Table 1 provides the basic characteristics features influencing corporate governance system in India. The corporate ownership is largely predominating by concentrated control family groups, promoters and the state (Porta et al., 1999; Sarkar & Sarkar, 2000; Goswami, 2002; Varottil, 2010). Subsequently, different jurisdictions involve while dealing the matters of corporate governance issue, it uses several combinations of law and regulation frameworks as well as codes and principles concurrently. At present, in India, to implement the corporate governance standards and practices requires Companies Act 2013 as well as SEBI (LODR) 2015 (OECD, 2017).

Table 1 in India

| Main Corporate Structure | Ownership Structure | Company Law | Securities Law | Other Relevant Regulations on (CG) | Board Structure |
|--------------------------|---|--------------------|----------------|------------------------------------|---------------------|
| Public limited Company | State-owned, Group of Promoter and Families | Companies Act 2013 | SEBI Act | SEBI (LODR) 2015 | Unitary Board Model |

Source: The Author. Key: (CG) = Corporate Governance

The corporate governance model in India adopts a hybrid of the 'UK model' or 'the Anglo-Saxon model' (Mueller, 2006; Aguilera & Cuervo-Cazurra, 2009; Fernando, 2012), or the insider model (Sarkar & Sarkar, 2000; Varottil, 2010). The corporate governance system of India converges to Anglo-American or Anglo-Saxon model of corporate governance (Afsharipour, 2009) where the board structure is adopted the unitary board system, with a high proportion of IDs in the board (Tricker & Tricker, 2015). The present corporate governance system barrier in India arise mainly conflicts between the majority concentrated and minority shareholders. In the emerging economies, the prevailing corporate ownership and control are primarily held by widely and concentrated family groups (Young et al., 2008; Dharwadkar et al., 2000) and limited legal protection, especially for minority shareholders and weak enforcement mechanism is prominent (La Porta et al., 1997; Morck et al., 2005; Young et al., 2008). Moreover, the lack of governance parameters such as less publicly traded company, lower firm valuations and levels of dividends, the insufficient information involved in stock prices, incompetent strategy, less focus on investment in innovation and, finally expropriation of minority shareholders and shareholder-shareholder conflicts are the major characteristics in developing countries (Young et al., 2008).

The Board System in India

The Size and Composition Board of Directors

Several corporate governance codes emphasized on the changing of board structure, in terms of board independence, independent directors and board diversity. Board independence particularly independent director considered the most debated and researched areas of corporate governance and investigated whether independent directors have a relationship on firm performance (Jackling & Johl, 2009). Many examined that companies with more members of an independent director on the board have a strong correlation of corporate performance (Shleifer & Vishny, 1997; Coles et al., 2001). Others observed the negative correlation between independent director and corporate performance (Bhagat & Black, 1999, 2001; Berkman et al., 2003). In the companies, the board diversity is a new emerging trend of corporate governance mechanism that influences management as well as monitoring (Boone et al., 2007). A fractional representation of women or minority on the board provides a significant positive impact on firm value (Adams & Ferreira, 2009; Giannetti & Zhao, 2016).

Table 2

| Regulatory Framework | size | | Independent Directors | | Gender Diversity | |
|----------------------|------|------|-----------------------|------|------------------|------|
| | Min. | Max. | Min. | Max. | Min. | Max. |
| Companies Act 2013 | 3 | 15 | 33% | - | 1 | - |
| SEBI LODR 2015 | - | - | 33% (50%) | - | 1 | - |
| Kotak Committee 2017 | 6 | 15 | 50% | - | 1(ID) | - |

Source: The Authors. Key: (-) = No specific provision, (ID) = Independent Director.

In table 2 provides an analysis of the three relevant regulatory frameworks, the new Kotak committee recommendation has drastically changed the governance scenario, particularly on board structure. The Companies Act prescribes a limit of minimum three directors and maximum fifteen directors/members on the board of directors for the public limited company. The Kotak committee recommends for the listed company a minimum size of six directors/members on the board. On independent director's representation, the SEBI LODR, proportion of the IDs depend on position of the Chairman, the IDs will constitute not less than 50 per cent on the board when Chairman is either an executive director or related to any promoter in the company, and not less than 33 per cent of IDs will be in the member of the board when the Chairman is a non-promoter or non-executive director. But Kotak committee focuses on improving governance of the listed companies, irrespective of the post of the chairman of the board of directors whether chairman is an executive or non-executive, it recommends that at least 50 per cent of IDs should comprise in the board. And the Companies Act prescribes that for the public limited company should have not less than least 33 per cent of IDs on the board.

On board diversity, the Companies Act and SEBI LODR required at least one women director on the board of all the listed company. The Kotak committee recommendation has gone extremely beyond the reach on board diversity of a listed company. The committee recommends that all the listed company in the board should have a minimum or at least one woman as an ID. The women representation on the board is comparatively very low in India. At present, around 13-14 per cent of the women representation on the board in NIFTY 500 companies. As compare to countries like the USA (21%), UK (23%), France (34%) and Norway (39%), the women representation on the board is still low. The listed companies have to meet more than 20 per cent of women representation on the board by 2020 (PRIME Database, 2017). If the Kotak committee recommendations were to implement fully, then those National Stock Exchange companies need to appoint around 40 per cent of woman ID on the board (Bhattacharyya & Dave, 2017). With the latest Kotak committee recommendation on the board composition and size, the Indian board structure is closely aligning with the unitary board model. It emphasizes more on the higher number of IDs with the mandatory of one woman ID on the board. With such mandate, the women representation on the board is expected to increase over the years.

The Board-level Committees

Almost all corporate governance codes prescribe the requirement commonly three board committees - the audit committee, the nomination committee and the remuneration committee

(Tricker&Tricker, 2015). The board roles set the broad range of responsibilities; the constitution of board committees is to enhance the governance through small-group deliberations, focus and diligence on several aspects. The core issue of board committees is to ensure a well-balanced between the delegating duties and upholding the inclusive supervisory role of the board, provides oversight independent judgement of reviewing and approval in important matters, and committees mostly constituted wholly or a majority of ID and non-executive directors(Tricker&Tricker, 2015; Kotak Committee, 2017).

Table 3

| Regulatory Framework | Audit committee (AC) | | Nomination committee (NC) | | Remuneration Committee (RC) | |
|----------------------|----------------------|-------------------|---------------------------|-------------------|-----------------------------|-------------------|
| | CI | Min. Ratio of IDs | CI | Min. Ratio of IDs | CI | Min. Ratio of IDs |
| Companies Act, 2013 | Required | 50% or more | - | 50% or more | - | 50% or more |
| SEBI LODR, 2015 | Required | 66% | Required | 50% | Required | 50% |
| 2017 | Required | 66% | Required | 66% | Required | 66% |

Source: The Authors.Key: (-) = No specific provision, (CI) =Chair

Independence

In table 3 provides a comparison of board-level committee representation and structure, most of the regulatory frameworks are similar to chair independence of each board committees. On AC, all three regulatory frameworks prescribes that an ID has to hold the position of the chairperson of the board committee. The NC and RC, both the SEBI LODR and Kotak Committee required the chairman should be an ID but the Companies Act prescribe that the chairman can be either executive or non-executive director. The representation of IDs in AC, the SEBI LODR and Kotak Committee required at least 66 per cent as members whereas the Companies Act required the public company to have not less than 55per cent. The NC and the RC, both the Companies Act and SEBI LODR prescribe at least 50 per cent of its members as IDs whereas Kotak Committee has increase the proportion to 66 per cent of ID in the committee. The Kotak Committee has recommended further far-reaching roles from the prevailing board committee's roles outline by the Companies Act and SEBI LODR. The AC role is to scrutinize the end utilization of funds of prime circulations. The NC and the RC role are mainly focused to recommend all related payment to the board, in any kind of procedure that is payable to senior management (Kotak Committee, 2017).

Eligibility Criteria for Independent Directors

The Companies Act 2013 and SEBI LODR Regulations 2015 laid down certain objective standards for assessment of independence and integrity of a director; however, there is no restriction on interlocking directorships. However, Kotak Committee recommendation 2017, specifically focuses on promoter group and relatives of promoters cannot constitute the independent directors of listed companies as well as appointed by the arrangement of interlocking directorship. The “board inter-locks” happen due to share of non-independent

directors on boards of listed companies, that is, “if Mr Z is an executive director on Co. X and is also an independent director on Co. Y, then no non-independent director of Co. Y can be an independent director on the board of Co. X” (Kotak Committee, 2017). Such restriction of board interlocking will further ensure the independent oversight mechanism of the independent directors.

Lead Independent Director

The Companies Act 2013 as well as SEBI LODR Regulations 2015, there is no specific provision of a lead independent director. The Kotak committee recommends for the lead independent director in all the listed companies that when the chairman is non-independent, then the lead independent director will hold the authority to handle responsibilities of all the independent directors. In Nomination & Remuneration Committee (NRC), the lead independent director act as the mediator between the chairman of the board and independent directors. When the chairman or vice-chairman is absence in the board meeting, the lead independent director can preside the meeting, including separate independent director's meeting. The lead independent director has the power to call or notice the independent director meeting and make available for discussion and direct communication to concern shareholders.

Conclusion

At present the system of corporate governance in India has undergone drastic changes in strengthening the regulatory framework and aligning with international standards. The board structure is well established and closely aligns with Anglo-Saxon model. The paper suggests that the corporate governance system in India still need to address the mechanism to evaluate board performance. The regulatory frameworks are broadly in place; the regulatory bodies and other responsible authorities are actively finding the best way to strengthen its regulation and enhanced governance system. The major challenge remains that as how to make the effective implementation and stringent enforcement of governance framework and the relevant on the ground.

Acknowledgement: RPNRong would like to acknowledge the financial assistance extended by University Grant Commission (UGC), New Delhi, India, in the form of National Fellowship for Higher Education (NFHE) (Grant No. F1-17.1/2015-16/NFST-2015-17-ST-MAN-2397).

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