CORPORATE GOVERNANCE PRACTICES IN INDIA – A CASE STUDY

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Corporate governance is a buzz word in the corporate world. The concept of corporate governance gained further momentum after the sudden crash of Enron, WorldCom, Xerox, Lehman Brothers and the crisis of Satyam. Lack of transparency and poor disclosures in the annual reports are blocking the stakeholders from ascertaining the well-being of the corporate houses. As a consequence, investor community urged for improvements in governance practices which lead to the implementation of corporate governance codes. In today's world of globalization, the concept of corporate governance has taken an important place. Today, companies are operating in the international arena. For attracting foreign investors and global fund raising, the corporate houses have to demonstrate high quality governance. The key principle for success is to ensure the growth which is sustainable and inclusive. Out of various critical aspects of corporate governance, current study aims at investigating the corporate governance practices followed by Indian companies by taking Clause 49 (Revised) as the benchmark. Clause 49 of the SEBI listing agreement has brought out landmark transformation to improve the quality of disclosure of the Indian companies.

Key words
Corporate governance, OECD, Clause 49, Revised Clause 49, S&P CNX Nifty 50, SEBI, board of directors, independent directors, audit committee, compliance report, Sarbanes-Oxley Act of 2002, Cadbury Report

The Concept of Corporate Governance

The meaning of the term corporate governance is a subject of considerable debate. The concept has been defined in many ways. Organization for Economic Co-operation and Development (OECD) has defined corporate governance as, "procedures and processes according to which an organisation is directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among the different participants in the organisation – such as the board, managers, shareholders and other stakeholders – and lays down the rules and procedures for decision-making."

As per the Cadbury Committee (1992), "Corporate governance is the system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies. The shareholders' role in governance is to appoint the directors and the auditors to satisfy themselves that an appropriate governance structure is in place. The responsibilities of the board include setting the company's strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship. The board's actions are subject to laws, regulations and the shareholders in general meeting".

In a nutshell, the corporate governance is all about governing corporations in such a transparent manner that all stakeholders' interests are protected, and with due compliance with the laid down laws.

Saga of Corporate Governance and Regulatory framework in India

Corporate governance concept has gained public attention in early '90s in India. First special initiative on corporate governance was taken by confederation of Indian Industry (CII) in 1996 by introducing voluntary corporate governance code. The objective was to develop and promote a code of corporate governance to be adopted and followed by Indian companies. CII came up with the recommendations to be followed by Indian industry.

In 1999 Kumar Mangalam Birla committee was appointed to promote the standards of corporate governance. It came with some mandatory and non mandatory recommendations. The committee made recommendations for several issues including board of directors, audit committee, remuneration committee, management, shareholders etc.

In 2000, SEBI introduced mandatory corporate governance code in place of voluntary one through Clause 49 of listing agreement. The term 'Clause 49' refers to Clause number 49 of the Listing Agreement between a company and the stock exchanges on which it is listed (the Listing Agreement is identical for all Indian stock exchanges, including the NSE and BSE). It is mandatory for listed Indian companies to follow the provisions of Clause 49. The equivalent of Clause 49 is US Sarbanes-Oxley (SOX) Act of 2002, which was introduced by Securities and Exchange Commission for the companies listed in U.S stock exchanges.

In 2002, Naresh Chandra committee was appointed by the department of company affairs. This committee took forward the recommendations of Kumar Manglam Birla committee. This committee laid down strict guidelines defining the relationship between auditors and clients.

In 2003, Narayan Murthy committee was setup by SEBI. This committee came out with the recommendations focusing on strengthening the responsibility of audit committee, quality of financial disclosure, proceeds from initial pubic offerings and many other important aspects.

On 29th October 2004, SEBI finally announced revised Clause 49. The revised Clause 49 on corporate governance made major changes in the definition of independent directors, strengthening the responsibilities of audit committees, improving quality of financial disclosures, including those relating to related party transactions and proceeds from public/ rights/ preferential issues, requiring Boards to adopt formal code of conduct, requiring CEO/CFO certification of financial statements and for improving disclosures to shareholders. Certain non-mandatory Clauses like whistle blower policy and training of board members have also been included.

Literature Review

Various studies on corporate governance have mainly focused on the corporate governance problems of the developed countries. Research focusing exclusively on the corporate governance issues in India gained momentum over the last decade.

Gupta et al (2003) have analyzed the corporate governance reports of 30 companies listed in BSE for the year 2001-02 and 2002-03. This research found that the reporting practices of the companies vary to a large extent. Also it was found that in some cases mandatory requirements as per Clause 49 have not been adhered to.

Gruszcznski Marek (2006) has confirmed that the degree of corporate governance for listed companies in Poland is correlated with their financial performance. This study has shown a significant relationship between their governance rating, operating profit and debt leverage ratio. This study was conducted for the financial statements of 2002 and sample included 53 companied listed in Poland. The results of study have shown that companies with higher profit margin and lower debt leverage ratio are expected to have better rating of corporate governance.

Hossain Mohammed (2007) has analyzed the level and extent of corporate governance disclosure of the banking companies in India. This study covered 38 banks. The results of this study have shown that assets, ownership and financial performance variables are significant and other variables such as age, board composition are insignificant in explaining the level of corporate governance disclosure.

Tsamenyi Mathew, Elsie and Onumah Joseph (2007) have presented the result of the study that investigated the disclosure practices of Ghanaian listed firms. The data for the study are gathered from 22 listed companies in the Ghana stock exchange. This study addresses the two issues such as level of disclosure and transparency among Ghanaian listed firms and the impacts of ownership structure, dispersion, firm size and leverage on the level of disclosure and transparency. The results of study have revealed that the disclosure level in Ghana is generally low.

Reema Sharma and Fulbag Singh (2009) have examined the voluntary corporate governance practices of the Indian companies over and above the mandatory requirements as per Clause 49. A sample of 50 listed companies has been taken from four industries; Software, textile, sugar and paper. A voluntary corporate disclosure index has been prepared. Total 40 items has been selected from the corporate governance section of the annual report for the study. It has been observed that the companies followed less than 50% of the items of disclosure index. This study has suggested that there is a need to extend the scope of existing mandatory Clause further by covering the items from voluntary index.

Leung, Stouraitis and Tan (2010) have examined the impact of corporate governance on future company stock returns and future company risk. They examined the impact of the level of corporate governance and the impact of changes in governance by using Hong Kong data. They constructed index following three rating exercises in 2002, 2004 and 2005. The findings of study revealed that family firms and firms with concentrated ownership are associated with bad corporate governance. Overall the quality of corporate governance is very significant in explaining future stock returns and risk. Improvements in governance are associated with significantly higher stock returns and lower company risk.

Sulphey M.M and Janardhanan Rajesh (2010) have analyzed the position of Indian Companies in the quest for corporate governance. This study is done to find out the current patterns of corporate governance among Indian Companies. Clause 49 of listing agreement of SEBI is taken as benchmark and the reports of corporate governance in the annual reports for the year 2008-09 with respect to 50 Nifty companies has been studied. The analysis of this study has revealed that certain companies have not provided the due importance to the aspects provided in the Clause 49.

Anurag Pahuja and B S Bhatia (2010) have analyzed the determinants of corporate governance disclosure. Their study seeks to determine the extent to which Indian listed companies disclose their corporate governance practices by examining the annual reports of 50 listed companies. The study reveals that there is a considerable gap in the sphere of extent, quantum and quality of disclosure made by companies in their annual reports. This study concluded that there is a substantial scope for improvements in the corporate governance disclosure practices.

Izyani Wan and Zunaidah (2010) examined the relationship between corporate governance mechanism and extent of disclosure for listed companies in Malaysia. This study addresses two issues:

1. Level of corporate governance disclosure by listed companies in Malaysia.

2. To what extent corporate governance affects the company disclosure.

This study reveals that that the companies with a more family members sitting on the board are significantly have lower level of disclosure in their annual reports.

Jiao Yawen (2011) has found the relationship between corporate disclosure, Market valuation and Firm performance. This study has shown a positive relationship between changes in disclosure rankings and the future unexpected operating performance. Tobin'Q has been used as measure of market valuation. This study has also found positive association between disclosure rankings and future net profit margins, research and development intensity.

Klai Nesrine and Omri Abdelwahed (2011) have examined the effect of corporate governance mechanism on the financial reporting quality. This study focused on the characteristics of board of directors and the ownership structure of the firms listed in Tunis Stock Exchange during the period 1997-2007. This study revealed that Tunisian firms were characterized by lack of board independence and the high level of ownership concentration. The Governance mechanism was found to be represented by power of the foreigners, families, block holders, institutional investors and the state. This study concluded that power of state and institutional investors improves the financial reporting quality.

Senan Neeti (2011) has analyzed the study of corporate governance in public and private sector enterprises in India. This study has provided an understanding of corporate governance disclosure levels. This study has focused on disclosure practices in the annual reports of firms for the year 2008-09 of 77 listed Indian companies by constructing Corporate Governance Disclosure Score. The results of the study have revealed that private sector companies adhere to higher standards of corporate governance disclosure than public sector companies.

A perusal of the review of literature reveals that though adequate attention has been paid to the concept of corporate governance throughout the world, but the research studies in the area of corporate governance in Indian companies have shown that disclosure level is poor (Anurag Pahuja and B S Bhatia 2010) and most of the Indian companies are not following the provisions of Clause 49 (Sulphey M.M and Janardhanan Rajesh 2010).

The present study is divided in to four parts. Objectives, research methodology, analysis and findings and conclusion

Objectives of the study:

The study has the following two objectives.

a) To examine corporate governance practices of CNX Nifty 50 companies in India.

b) To benchmark the corporate governance practices of CNX Nifty 50 companies with the revised Clause 49.

Research Methodology: This study is about corporate governance practices of CNX Nifty 50 companies in India. Annual reports of 2010-11and 2011-12 have been used for this study. The revised Clause 49 of the listing agreement of stock exchanges introduced by SEBI is taken as the benchmark and disclosure regarding corporate governance practices in the annual reports is compared. Clause 49 of the SEBI listing agreement has brought about landmark transformation in improving the quality of disclosure of the Indian companies.

Scope (Sample and period of study): This study is about governance practices of CNX Nifty 50 companies in India. It covers two years, 2010-11 and 2011-12. CNX Nifty index undergoes changes. Only common companies present in both the years have been considered for the study. Of the 50 companies, 48 companies were commonly found in the CNX Nifty 50 index for both the years.

In 2010-11, out of the common 48 companies one company named, Housing Development Finance Corporation Ltd was not considered due to non-availability of annual report. In 2011-12 analysis, one company named Sun Pharmaceuticals Ltd was excluded due to non-availability of annual report.

Hence this analysis comprises 47 companies in 2010-11 and 2011-12.

Rationale for considering CNX Nifty 50 companies for the study

1. The CNX Nifty 50 is a well-diversified stock index accounting for 22 sectors of the economy. It is used for a variety of purposes such as benchmarking mutual fund portfolios, index based derivatives and index funds.
2. The CNX Nifty 50 Index represents about 65.87% of the free float market capitalization of the stocks listed on NSE as on December 31, 2012.
(http://www.nseindia.com/products/content/equities/indices/s_n_p_cnx_nifty.htm, accessed on March 16th 2012)
3. The total traded value for the last six months ending December 2012 of all index constituents is approximately 50.23% of the traded value of all stocks on the NSE.
(http://www.nseindia.com/products/content/equities/indices/s_n_p_cnx_nifty.htm, accessed on March 16th 2012)
4. S&P CNX Nifty is professionally maintained and is ideal for derivatives trading.

Data collection: Data were collected for the study from the annual reports of the companies for the two years, 2010-11 and 2011-12.

Analysis and findings

The snapshot of the analysis of corporate governance practices has been provided in the summary table. The detailed analysis is presented below.

Board of Directors

Board of directors is the committee elected by the shareholders of a company, who are responsible for formulating the corporate policy. The analysis is covered under the following three sub headings.

I. Composition of Board of directors: It was found that during 2010-11 out of 47 companies 44 companies had followed the provision of Clause 49. Only 3 companies' composition of board was not as per provision, but it had been disclosed in the annual reports. During 2011-12, the board composition was as per provisions in respect of 45 companies.

II. Independent Directors: It was found that during 2010-11, 44 companies and during 2011-12, 45 companies had shown proper disclosure and followed the provisions of revised Clause 49.

III. Nonexecutive director's compensation and disclosure: It was observed that during 2010-11 and 2011-12 all the companies had provided proper disclosure except for one company.

Other Provisions relating to the Board:

This heading has been subdivided in to six parts. This includes the following:

i) No. of Board Meetings
ii) Attendance of each director at the board meeting and AGM
iii) Gap between two meetings
iv) As a chairman (for not more than 5 companies)
v) As a director membership in committees (not more than 10)
vi) Code of conduct.

The study revealed that all the companies during 2010-11 and 2011-12 had followed the provisions of revised Clause 49 and made a proper disclosure in respect of the other provisions relating to the Board except for one provision i.e. code of conduct. During 2010-11and 2011-12, 41 companies had made proper disclosure and had attached the certificate of the code of conduct with the annual report; and, 6 companies had not made a proper disclosure in this regard.

Audit Committee

The Cadbury Report termed the annual audit as "one of the cornerstones of the Corporate Governance." Seven aspects have been provided under the heading audit committee, i.e.

i) Composition of audit committee
ii) Chairman of audit committee (Independent Director)
iii) Qualification of audit committee members
iv) Meetings of audit committee (minimum 4)
v) Quorum for meeting (2/3 or 2 whichever is greater of total members)
vi) Role of audit committee.
vii) Review of statements.

This analysis revealed that during both the years 2010-11 and 2011-12 all companies had followed the provisions of revised Clause 49 and had disclosed proper information on each aspect of audit committee.

Subsidiary companies

The results of analysis showed that during 2010-11 and 2011-12, 45 companies had disclosed proper information on subsidiary companies and attached accounts of subsidiary companies along with the annual report. One company had not attached accounts of subsidiary companies, but it had mentioned this fact in the annual report and one company had not disclosed any information on subsidiary companies.

Disclosure

As per revised Clause 49 this aspect has been further divided into eight sub headings, which include:

i) Basis of related party transaction
ii) Disclosure of material transaction with related party
iii) Disclosure of financial statements with management explanation
iv) Risk assessment and minimization procedure by board
v) Proceeds from public/right/preferential issues
vi) Criteria of Remuneration of directors
vii) Management
viii) Shareholders

The present study showed a mixed bag of results under the disclosure aspect. Many aspects like proceeds from public/right/preferential issue had been ignored by the companies. In 2010-11 and 2011-12, only 5 companies had disclosed proper information on this aspect. Others had not disclosed any information on this aspect in both the years. One another important aspect i.e. Risk assessment and minimization by the Board, 7 companies had not disclosed any information in 2010-11 and 2011-12. On Other aspects of disclosures, proper information was given by all the companies in both the years.

CEO and CFO Certification

Revised Clause 49 has mandated the CEO and CFO Certification to board of directors of listed company on specific matters and disclosure of the same in the annual report. As per the analysis, in 2010-11and 2011-12, 22 companies had disclosed proper information and attached CEO certificate with the annual reports. 14 companies had not attached the certificate and 11 companies had not given any information on this aspect.

Compliance report

It was found that all the companies had attached the certificate of compliance with the annual report during 2010-11 and 2011-12 except for one company.

Report on Corporate Governance

The study revealed that all the companies provided the report on corporate governance in their annual reports.

Non mandatory Requirements

Information on the non mandatory requirements had been provided under seven sub headings. The findings were different in case of non mandatory requirements as compared to mandatory requirements.

Analysis revealed that a very few companies had provided proper information on non mandatory requirements.

Board (Tenure of non executive directors): In 2010-11 and 2011-12, only 21 and 22 companies respectively had followed provisions and disclosed properly. 8 companies had not given proper information in both the years and rest of the companies had not disclosed any information.

Remuneration Committee: 41 companies in 2010-11 and 43 companies in 2011-12 had set up remuneration committee and disclosed properly.

Shareholders right is very important requirement of corporate governance. As per revised Clause 49, companies may send annual report to the shareholders residence, but only 8 companies in 2010-11 and 2011-12 had dispatched financial results to shareholders residence, another 33 companies in 2010-11 and 2011-12 had excuse of following green initiative but it could have been sent through emails. Six companies had not provided any information on this aspect.

Audit qualification: In 2010-11 and 2011-12, 13 and 12 companies had not disclosed any information on this aspect.

Training of Board members: Only 19 companies in 2010-11 and 20 companies in 2011-12 had followed provisions and conducted various training programs and disclosed properly. In 2010-11 and 2011-12, 8 companies had given vague information; rest of the companies had not disclosed any information on this aspect.

Mechanism for evaluating non-executive directors: Surprisingly only15 companies in 2010-11and 17 in 2011-12 had followed the proper mechanism and disclosed properly.

Whistle blower policy: In the years 2010-11 and 2011-12, 38 and 41 companies respectively were having proper whistle blower policy in place. 7 companies in 2010-11 and 4 companies in 2011-12 had not followed whistle blower policy, but they disclosed in the annual report. 2 companies had not given any information on this aspect for both the years.

The results had shown that companies are not focusing much on non mandatory requirements.

Conclusion

Majority of the sample companies are following the mandatory provisions and disclosing the required information as per the revised Clause 49. A few number of companies' (Bajaj auto, Infosys, Dr. Reddy etc.) disclosure levels are beyond the requirements of the revised Clause 49. And they are following the voluntary corporate governance guidelines 2009 and taking sustainability initiatives and taking steps for corporate social responsibility. In fact, Infosys gets the rating done for its corporate governance practice from ICRA and CRISIL. It is interesting to see the corporate governance practices of the companies outside the CNX Nifty index. This provides scope for further research.

Summary Table

Legend:
DC: Disclosed
APP: As Per Provision
ND: Not Disclosed
NAPP: Not As Per Provision

		Based on (2010-11 and 2011-12) Annual Reports of NIFTY 50 companies					
S. No	Basis of Analysis	DC/APP		DC/NAPP		ND	
		2010- 11	2011- 12	2010- 11	2011- 12	2010- 11	2011- 12
1	**BOARD OF DIRECTORS**						
	Composition of the Board of Directors	44	45	3	2		
	Independent directors	44	45	3	2		
	Non executive directors remuneration and disclosure	46	46	1	1		
1(a)	**OTHER PROVISIONS RELATING TO BOARD**						
	No. Of Board meetings held during the year (Min. 4 required)	47	47				
	Attendance of each director at the board of Meeting and AGM	47	47				
	Gap between two meetings (3 months)	47	47				
	As a chairman (not more than 5 companies)	47	47				
	As a director membership in committees (not more than 10)	47	47				
	Code of conduct	41	41	6	6		
2	**AUDIT COMMITTEE**						
	Composition of audit committee	47	47				
	Chairman of audit committee (Independent Director)	47	47				
	Qualification of audit committee members	47	47				
	Meetings of audit committee(minimum 4)	47	47				
	Quorum for meeting(1/3 or 2 whichever is greater of total members)	47	47				
	Role of audit committee	47	47				
	Review of statements	47	47				
3	**SUBSIDIARY COMPANIES**	45	45	1	1	1	1
4	**DISCLOSURE**						
	Basis of related party transaction	47	47				
	Disclosure of material transaction with related party	47	47				
	Disclosure of financial statements with management explanation	46	46			1	1
	Risk assessment and minimization procedure by Board	40	40			7	7
	Proceeds from public /right /preferential issues	5	5			42	42
	Criteria of Remuneration of Directors	47	47				
	Management	46	46			1	1
	Shareholders	47	47				
5	**CEO /CFO Certification of financial statements and cash flow statement**	22	22	14	14	11	11

		Based on (2010-11 and 2011-12) Annual Reports of NIFTY 50 companies					
S. No	Basis of Analysis	DC/APP		DC/NAPP		ND	
		2010- 11	2011- 12	2010- 11	2011- 12	2010- 11	2011- 12
6	**Compliance report**	46	46			1	1
7	**Report on corporate governance**	47	47				
8	**NON MANDATORY REQUIREMENTS**						
	Board (tenure of non executive directors)	21	22	8	8	18	17
	Remuneration committee	41	43	4	3	2	1
	Shareholder rights	8	8	33	33	6	6
	Audit qualification	31	32	3	3	13	12
	Training of Board members	19	20	8	8	20	19
	Performance Evaluation of Non executive directors	15	17	7	5	25	25
	Whistle blower policy	38	41	7	4	2	2

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