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   STATEMENT OF THE PROBLEM

   OBJECTIVES

   HYPOTHESES

   RESEARCH METHODOLOGY

   RESULTS & DISCUSSION

   FINDINGS

   RECOMMENDATIONS/SUGGESTIONS

   CONCLUSIONS

   SCOPE FOR FURTHER RESEARCH

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A STUDY OF CRITICAL FACTORS GOVERNING CORPORATE GOVERNANCE

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ABSTRACT
This paper attempts to showcase the critical factors which make or mar the much hyped and concept in spotlight 'corporate governance'. This papers purveys deeper insight by enlisting the factors and their consequences thereon. Since, corporate governance as a concept is flaring up and there is an urgent need of the hour, we discuss certain points to be highly vigilant about even after the presence of stringent codes and regulatory mechanisms.

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INTRODUCTION
During this contemporary times, corporate governance has attained significance all over the world. Few important factors have lead to rapid developments in the field, namely the integration and globalization of financial markets and a surge of corporate scandals such as Enron, World Com and others. Lately, Brazil, Russia, India and China (BRIC) countries have emerged as an influential economic power in the global economy. It is estimated that the combined GDP of the BRIC countries is likely to be higher than that of developed countries1.Studies have projected that amongst the BRIC economies, India has the potential to grow the fastest over the next 30-50 years (Wilson & Purushothaman, 2003). The phenomenal growth has changed the nature and character of the world economy including the foreign investment flows (Khanna and Palepu, 2006). Foreign investments in India come directly and through secondary markets. The cumulative foreign direct investment (FDI) to India until August 2010, was US $137,960 million (RBI Bulletin, 2010)2. There has also been a significant increase in cross border acquisitions and a number of firms list their shares in multiple exchanges (Chemmanur and Fulghieri, 2006; Bell, Moore & Al-Shammari, 2008). Foreign institutional investors have made substantial investments in the capital market for instance an amount $4.78 billion in the Indian capital market in November 2010 alone and a total investment of $ 38 billion until March 2011.

Investors from developed countries are demanding that Indian Companies follow international best practices with an emphasis on corporate governance. A McKinsey survey conducted in 2002, found that investors were willing to pay a premium of up to 25% for a well governed company (Barton, Coombes, & Wong, 2004). The scandals related to the Indian markets (Goswami, 2002), the global financial crisis of 2008 and the more recent corporate fraud at Satyam has raised a lot of concerns about governance practices in India. Consequently, there has been an increasing effort around corporate governance structures and mechanisms by both regulators and corporations. Since it is well recognized that the institutional context of an economy i.e. the combination of formal rules, informal constraints, and the enforcement characteristics varies significantly across countries and has an influence on corporate financial and governance structures (Walsh & Seward 1990; North, 1990), understanding the state of corporate governance research in the Indian context is therefore of great academic interest.

There has been a steady and growing interest in the field of corporate governance in India. The convergence of the importance of certain topics like Performance and regulatory mechanisms between international and Indian journals can be seen as indicative of the presence of the common body of knowledge in the field of corporate governance research. There is however, a need for more empirical research in the Indian context and also the development of theories that are embedded in local realities. (Srinivasan, Padmini, and Vasanthi Srinivasan. "Status of Corporate Governance Research on India: An Exploratory Study." *IIM Bangalore Research Paper* 334 (2011).

LITERATURE REVIEW
The convergence of the importance of certain topics like Performance and regulatory mechanisms between international and Indian journals can be seen as indicative of the presence of the common body of knowledge in the field of corporate governance research. There is however a need for more empirical research in the Indian context and also the development of theories that are embedded in local realities. Given that the institutional context of an economy impacts significantly the nature of governance practices, more papers that explore the institutional contextual realities of India are needed.[**Source** : Srinivasan, Padmini, and Vasanthi Srinivasan. "Status of Corporate Governance Research on India: An Exploratory Study." IIM Bangalore Research Paper 334 (2011).]

In India, we have sought to resolve the "shareholder vs. stakeholder'' debate by taking the view that since shareholders are residual claimants, in well performing capital and financial markets, whatever maximises shareholder value should maximise corporate prosperity and best satisfy the claims of creditors, employees, shareholders, and the State. Moreover, there exist well-defined laws to protect the interests of employees, and recently framed legislations have considerably strengthened the rights of the creditors. It is therefore appropriate that corporate governance regulations in India seek to promote the rights of shareholders, while at the same time ensuring that the interests of other stakeholders are not adversely impacted. (**Source:** Report on "CORPORATE GOVERNANCE IN INDIA: THEORY AND PRACTICE, NATONAL FOUNDATION FOR CORPORATE GOVERNANCE, SEPTEMBER 2004")

Since the late 1990s, significant efforts have been made by the Indian Parliament, as well as by Indian corporations, to overhaul Indian Corporate Governance. The current Corporate Governance regime in Indian straddles both voluntary and mandatory requirements like Voluntary Guidelines by Ministry of Corporate Affairs. And for listed companies, the vast majority of Clause 49 of the listing agreements requirements is mandatory. The voluntary guideline on Corporate Governance by Ministry of Corporate Governance is a benchmark for the Corporate Governance practices in the Indian corporations, and hopefully the corporate world will make the best use of it. Efforts are also being made by the legislature to amend the Companies Act 1956. As a result, amendments relating to Corporate Governance are expected to be brought before Parliament in The Companies Bill 2009. India has one of the best Corporate Governance legal regimes but poor implementation together with socialistic policies of the pre-reform era has affected corporate governance. [**Source**: "Corporate Governance in India: A legal Analysis." (2012).]

THEME BASED CRITICAL FACTORS

BOARD
CSR & ETHICS
DISCLOSURE
INVESTORS PROTECTION MECHANISM
GOVERNANCE ORIGIN AND MODELS
OWNERSHIP STRUCTURE
PERFORMAMNCE
REGULATORY MECHANISMS & REFORMS & OTHERS

The top five themes that emerged in the International Journals on Corporate Governance in India are on performance (36.4%), corporate social responsibility (CSR) (11.4%), governance origins and models (10%), disclosure (9%), regulatory mechanisms and reforms (10%). The other broad themes that emerged were board of directors (board), investor protection mechanisms and ownership structure.

There is focus oninternal governance structures and financial performance of Indian companies. The effectiveness of boards of directors, including board composition, board size, and aspects of board leadership including duality, independent directors and board busyness are addressed by authors in the Indian contextor takenIndia as part of the sample..Some CEOs (duality role, CEO being the promoter, and CEO being the only board manager) did not have a detrimental effect on performance. Large board size has a positive impact on performance (Jackling & Johl, 2009) thus supporting the view that greater exposure to the external environment improves access to various resources and thus positively impacts on performance (contrary to findings of Ghosh, 2006) Multiple directorships by independent directors to correlate positively with firm value, but multiple directorships by inside directors are, however, negatively related to firm performance.

(Sarkar & Sarkar, 2009) are some of the far reaching conclusions reached by researchers. Studies have also built governance indices and have tested its association with performance. Performance related research on India shows that shows that effective corporate governance helps in attaining greater performance and market valuation (Klapper & Love, 2004; Chua et al, 2007, Morey et al 2009). Governance reforms have also had a positive impact on the share prices (Khanna & Black, 2007).

In such discourse, increasingly the role of the board to address the issues pertaining to CSR and good citizenship is gaining attention. The Stakeholder framework and the responsibility of a corporation in this context is particularly important for emerging economies like IndiaThe development of corporate governance as an area of research started with the publication of the Cadbury Committee report and further developed through a series of seminal works of La Porta et al (1997). Governance issues stems from agency problems that have been dealt in literature extensivelOne of the major contributions of quality and timely disclosure and reporting is the elimination or at least mitigation to an extent the information asymmetry between parties, where one of the agents has a deeper knowledge than does the others. Most studies have found positive correlation between foreign institutional ownership and performance. (Douma, George & Rezaul, 2006) Firms that depend on government- run financial institutions for external finance shows negative performance. Five papers study the association between disclosure and performance

The governance related reforms started around 2001 with the recommendation of Birla Committee Report. Securities and Exchange Board of India (SEBI) set up in 1992 to regulate the capital market as well as to protect the investors. Subsequently, several committees were formed to look into the corporate governance and other best practices.4 A wide range of changes in corporate governance legislations has been enacted in the last ten years as outcomes of the recommendations. Most of the changes have come through the Listing Agreements of stock exchanges.5 The composition and functioning of the board of directors is the key areas of focus.

IMPORTANCE OF THE STUDY

A natural question to ask, given the theory behind corporate governance, is why do we need to impose particular governance regulations through stock exchanges, legislatures, courts or supervisory authorities? If it is in the interest of firms to provide adequate protection to shareholders, why mandate rules, which may be counterproductive? Even with the best intentions regulators may not have all the information available to design efficient rules. Worse still, there is a danger that regulators can be captured by a given constituency and impose rules favoring one group over another.

There are at least three reasons for regulatory intervention. The main reason advocated in favor of mandatory rules is that if the founder of the company was allowed to design and implement a corporate charter he likes, he may not clearly address the issues faced by other shareholders and thus would, in the view of the society, conjure inefficient rules. The functioning of the market for corporate control is an example. In absence of regulations, founders could employ anti-takeover defenses excessively and in the process not allow the capital employed, which is owned by the shareholders, to be used most efficiently. Alternatively, shareholders may favor takeovers that increase the value of their shares even if they involve greater losses for unprotected creditors or employees. Thus, in absence of regulations, the collective bargaining process may not yield socially acceptable solutions and may be at the peril of one or multiple stakeholders

Another argument for mandating regulations of corporate governance comes from the externality argument. An externality may be defined as a good, generated as the result of an economic activity, whose benefits or costs do not accrue directly to the parties involved in the activity. An externality is created by one person and experienced by other (s) and may be positive (a well-maintained garden) or negative (pollution). Bad corporate governance practice by a firm can in the same vein be seen as a negative externality. One corporate failure or scandal can potentially erode shareholders trust in the whole of the corporate sector and thus negatively affect the businesses of honest firms as well. This theory is reinforced by the recent corporate scandals in the United States. A few instances of fraud, as seen in the case of Enron and later on in WorldCom, destroy the faith of investors in the entire corporate sector and thus hurt the larger interest of the economy. Thus in such cases where private action fails to resolve widespread externalities involving large numbers of parties, the state has the responsibility to intervene to provide a level playing field and also to prevent market failure.

In case of dispersed shareholding, due to the (individual) large cost of monitoring the company on a regular basis, there remains a possibility that management may change the rules (to their advantage) ex post. Thus the final argument in support of mandatory rules is to avoid a situation where efficient rules are designed initially but due to lack of active tracking by dispersed shareholders, are altered or broken later.

While regulations are necessary, there are however, a few issues that need to be considered. The first relates to policing and punishment. The SEBI envisages that all these corporate governance norms will be enforced through listing agreements between companies and the stock exchanges. A little reflection suggests that for companies with little floating stock — which account for more than 85% of the listed companies — delisting because of non-compliance is hardly a credible threat. The SEBI can, of course, counter that by stating that the reputation effect of de-listing can induce compliance and, hence, better corporate governance.

The second issue is more problematic, and it has to do with form versus substance. There is a fear that by legally mandating several aspects of corporate governance, the regulators might unintentionally encourage the practice of companies ticking checklists, instead of focusing on the spirit of good governance. The fear is not unfounded. Take, for instance, the case of Korea. After the crash of 1998, a part of the IMF bailout package was that a fourth of the board of every listed Korean company must consist of independent directors. They do, but the directors are hardly independent by any stretch of imagination. For most part, they are retired executives of the chaebols, friends of business groups and politicians that have supported the business in the past. And, in any event, they don't do what was intended — namely, to speak for shareholders and ensure that management does what is necessary to maximize long-term shareholder value.

The third concern relates to apprehension about excessive interference. There is an apprehension that over-regulation of corporate governance could disrupt the functioning and quality of boards without resulting in any substantial improvement in the standards of corporate governance. It needs to be ensured that we do not go overboard with corporate governance regulations, and that unwittingly micro-management of companies does not take place.

This raises a question of how to trace the line that divides voluntary from mandatory. In an ideal world with efficient capital markets, such a question need not arise — because the markets would recognize which companies are well governed and which are not, and reward and punish accordingly. Unfortunately, ideal capital markets exist only in theory. The reality is quite different. Markets are often thin and shallow and operate on the basis of ebbs and flows of pivotal stocks; informational requirements are lax; and regulatory and policing devices leave much to be desired.

Thus, what is needed a small corpus of legally mandated rules, buttressed by a much larger body of self-regulation and voluntary compliance

The corporate governance framework in India primarily consists of the following legislations and regulations: ▯ The Companies Act, 1956: Companies in India, whether listed or unlisted, are governed by the Companies Act. The Act is administered by the Department of Companies Act (DCA). Among other things, the Act deals with rules and procedures regarding incorporation of a company; prospectus and allotment of ordinary and preference shares and debentures; management and administration of a company; annual returns; frequency and conduct of shareholders' meetings and proceedings; maintenance of accounts; board of directors, prevention of mismanagement and oppression of minority shareholder rights; and the power of investigation by the government, including powers of the CLB. ▯ The Securities Contracts (Regulation) Act, 1956: It covers all types of tradable government paper, shares, stocks, bonds, debentures, and other forms of marketable securities issued by companies. The SCRA defines the parameters of conduct of stock exchanges as well as its powers. ▯ The Securities and Exchange Board of India (SEBI) Act, 1992: This established the independent capital market regulatory authority, SEBI, with the objective to protect the interests of investors in securities, and promote and regulate the securities market. ▯ The Depositories Act, 1996: This established share and securities depositories, and created the legal framework for dematerialization of securities. ▯ Listing Agreement with stock exchanges: These define the rules, processes, and disclosures that companies must follow to remain as listed entities. A key element of this is Clause 49, which states the corporate governance practices that listed companies must follow.(NATONAL FOUNDATION FOR CORPORATE GOVERNANCE, SEPTEMBER 2004)

RESULTS AND DISCUSSIONS

There have been several major corporate governance initiatives launched in India since the mid-1990s. The first was by the Confederation of Indian Industry (CII), India's largest industry and business association, which came up with the first voluntary code of corporate governance in 1998. The second was by the SEBI, now enshrined as Clause 49 of the listing agreement. The third was the Naresh Chandra Committee, which submitted its report in 2002. The fourth was again by SEBI — the Narayana Murthy Committee, which also submitted its report in 2002. Based on some of the recommendation of this committee, SEBI revised Clause 49 of the listing agreement in August 2003. Subsequently, SEBI withdrew the revised Clause 49 in December 2003, and currently, the original Clause 49 is in force.

CONCLUSION

The system in Indian context of throwing light on corporate governance has in myriad supported and held back India's ascent to the top of the world's economies. While on the documentation & paper the country's legal system provides some of the best investor protection in the world, enforcement is a major problem, with overburdened courts and significant corruption. Ownership remains concentrated and family business groups continue to be the dominant business model, with significant pyramiding and evidence of tunneling activity that transfers cash flow and value from minority to controlling shareholders.

But for all its shortcomings, Indian corporate governance has taken major steps toward becoming a system capable of inspiring confidence among institutional and, increasingly, foreign investors. The Securities and Exchanges Board of India (SEBI), which was established as part of the comprehensive economic reforms launched in 1991, has made considerable progress in becoming a rigorous regulatory regime that helps ensure transparency and fair practice. And the National Stock Exchange of India, also established as part of the reforms, now functions with enough efficiency and transparency to be generating the third-largest number of trades in the world, just behind the NASDAQ and NYSE.(Chakrabarti, Rajesh, William Megginson, and Pradeep K. Yadav. "Corporate governance in India." Journal of Applied Corporate Finance 20.1 (2008): 59-72.)

Among more recent changes, the enactment of Sarbanes—Oxley type measures in 2004—which includes protections for minority shareholders in family- or "promoter"-led businesses—has contributed to recent increases in institutional and foreign stock ownership. And while family- and government-controlled business groups continue to be the rule, India has also seen the rise of successful companies like Infosys that are free of the influence of a dominant family or group and have made the individual shareholder their central governance focus

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