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**RECURRING FAILURES IN CORPORATE GOVERNANCE: A GLOBAL SYNDROME?**

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**ABSTRACT**

*The recurrence of corporate governance disasters in highly developed, as well as developing, economies reminds us that the price of economic growth and opportunity is indeed eternal vigilance. Understanding the differences in the institutional contexts helps us to realize that what works to curb governance failures in one context may be less effective in another, and that the timing and focus of reforms should reflect the realities of the economic and institutional conditions that different nations face. Ultimately, the most effective and sustainable governance reforms would be those that simultaneously increase the costs of corporate frauds and decrease the benefits that individuals and corporations can derive from ignoring governance norms and laws.*

**KEYWORDS**

corporate governance, economies, growth.

**INTRODUCTION**

Corporate governance is a multi-faceted subject. An important theme of corporate governance is to ensure the accountability of certain individuals in an organization through mechanisms that try to reduce or eliminate the principal-agent problem. A related but separate thread of discussions focuses on the impact of a corporate governance system in economic efficiency, with a strong emphasis shareholders' welfare. There are yet other aspects to the corporate governance subject, such as the stakeholder view and the corporate governance models around the world.

Corporate governance is the set of processes, customs, policies, laws, and institutions affecting the way a corporation is directed, administered or controlled. Corporate governance also includes the relationships among the many stakeholders involved and the goals for which the corporation is governed. The principal stakeholders are the shareholders, management, and the board of directors. Other stakeholders include labor (employees), customers, creditors (e.g., banks, bond holders), suppliers, regulators, and the community at large.

This article reveals various reasons for failure of Corporate Governance in developed economies as well as developing economies.

Article also describes various mechanisms of Corporate Governance like (1) Company's Act (2) Security law (3) Discipline of capital market (4) Nominees on company board (5) Statutory audit (6) Codes of conduct etc. Some factors that influence the Corporate Governance like Ownership structure, Structure of company board, financial structure, Institutional Environment etc. Various systematic problem in Corporate Governance and Recent Corporate Governance failures.

**INDIA'S IT GIANT? SATYAM COMPUTER'S BILLION DOLLAR CORPORATE FRAUD**

On January 7, 2009, B. Ramalinga Raju—founder and chairman of Satyam Computer Services, one of India's largest and most respected software and IT services companies—admitted that he had committed India's biggest corporate fraud, having manipulated the company's income statements, cash flows, and balance sheet for more than 7 years. The \$1.47 billion fraud on the Satyam financial statements and balance sheet included overstated revenues and profits, acts that were perpetrated by the founder and his brother, the company's CEO, to attract more business and avoid any possible hostile takeover. "It was like riding a tiger, not knowing how to get off without being eaten," Mr. Raju wrote in his confession statement (India's Enron, 2009). Prior to this turn of events—which resulted in the arrests of the chairman, the CEO, and the CFO of the company, and pending criminal indictments as well—Satyam had been widely recognized for exemplary corporate governance, and Raju hailed as a role model for successful business and entrepreneurship. The founder and his co-conspirators reported fictitious cash deposits, misstated accounts receivables and accounts payables, understated liabilities, and overstated assets; these falsities only came to the fore when Raju tried to buy two other firms owned by his family. Shareholders revolted against the acquisition proposal because they viewed the planned purchases as attempts to prop up other failing family businesses by tapping cash out of the profitable software firm.

Even before the Satyam scandal erupted, Indian shareholders had already lost more than \$2 billion from corporate frauds and bad governance since 2003 (Corporate India's Governance Crisis, 2009). In a January 7, 2009 report issued by an analyst at one of India's leading investment houses, only 4 out of 68 Indian companies were found to adhere to "highly desirable" disclosure standards; more than half the companies on the list that did not make the grade were well known firms with significant global presence (Bal and Vadyak, 2014).

**CHINA'S TOXIC MILK SCANDAL: IGNORANCE OR CRIMINAL INTENT?**

In September 2008, the Sanlu Group—maker of one of the oldest and most prevalent brands of infant formula in China—was charged with a monstrous act: the company was alleged to have added the toxic chemical, melamine, to its baby milk powder in effort to boost the mixture's protein content. By the time of the discovery, Sanlu's adulterated baby milk powder had affected nearly 294,000 Chinese infants, and killed 6. Sanlu, which is 43% owned by New Zealand's Fonterra, received a bankruptcy order from a Shijiazhuang Court in December 2008, and four of its top executives were given long prison sentences in January 2009. Under the Chinese Civil Servants Law, which took effect in 2005, and the State Council Regulations on the Punishment of Civil Servants of Administrative Organs, enacted in 2007, heads of administrative bodies who fail to fulfil their duties and cause serious problems that could have been avoided face removal from their jobs and other, more severe, punishment. Indeed, several senior government officials in China have been brought down by the scandal, including the head of the General Administration of Quality Supervision, Inspection, and Quarantine (AQSIQ).

Milk powder from 22 other Chinese companies tested positive for melamine, too, with Sanlu's product at the top of the ranking. Apparently, adding melamine to increase the protein content of dairy products had been an industry-wide practice. Some of the affected companies recalls their dairy products, and other countries began testing Chinese dairy products or removing them from stores. The scandal decimated Chinese dairy exports, and re-exposed long-standing concerns about food security, corruption, malpractices and lack of political willingness and balances (Das and Roy, 2013).

**U.S. FINANCIAL GIANTS QUESTIONABLE CONDUCT: EXECUTIVE PAY-OUTS**

Since mid-2008, the U.S. banking industry has experienced the deepest recession since the Great Depression of the 1930s. While investors have borne the bulk of the losses and taxpayers have shelled out trillions of dollars to keep financial giants afloat, executives and employees of these banks appropriated disproportionate shares of the profits when the market was booming (Bank Incentives, 2009). In the 3 years prior to its collapse, Bear Stearns paid \$11.3 billion in employee compensation and benefits, while its shareholders only received around \$1.4 billion of J.P. Morgan Chase stock—currently worth only half of that amount—after its fall. Lehman Brothers distributed \$21.6 billion in the 3 years before 2007, while its shareholders got nothing because the company went bankrupt. Merrill Lynch paid staff over \$45 billion during the 3 years prior to 2007, but its shareholders got shares in Bank of America that are now worth just \$9.6 billion, less than one-fifth of the original offer value. Citigroup paid \$34.4 billion to its employees in 2007, but is now valued at just \$18.1 billion. The most outrageous case is probably AIG, the insurance and financial services giant: it lost \$61.7 billion in the fourth quarter of 2008 and received more than \$170 billion in federal bailouts.



However, AIG paid over \$165 million in bonuses to executives by March 21, 2009 as part of a total pay-out of \$450 million. These highly visible and notorious examples have reinforced the public perception that banking is simply a “gravy train” for employees (Attacking, 2009).

While the specific form of corporate governance failure, the magnitude of the fraud, and the final effects on employees, customers, or shareholders may be different across these three national contexts, what is common is the frequency of occurrence of large-scale breakdowns in corporate governance in both developed and developing economies. Understanding why these failures recur, and the intended and actual effects of proposed governance solutions in each of these contexts, is a worthwhile exercise—even if it only serves to illuminate the complexity and magnitude of challenges confronting regulators and governments keen to restore confidence in their country’s corporate sector and financial markets.

## WHY DO GOVERNANCE FAILURE OCCUR?

### GOVERNANCE FAILURE IN THE DEVELOPED ECONOMY (UNITED STATES)

Roe (2012) traces the recurring breakdowns in American corporate governance to two core and enduring instabilities in the American governance context:

1. The separation of ownership and control, with ownership resting with distant and diffuse shareholders while control is exercised by hired managers.
2. A decentralized and porous regulatory system, in which multiple regulators with partial authority contribute to a flexible, specialized, and comprehensive regulatory framework while there is no single, unified regulatory agency that oversees the disparate regulatory efforts and resolves potential conflicts and inconsistencies across regulatory agencies. These two core attributes of the United States governance framework have obvious strengths, but they are also tormented by weaknesses that come to the fore each time U.S. corporations and stakeholders experience a governance crisis.

For instance, the separation of ownership and control are acknowledged as facilitating significant economies of scale in the operation of large firms, the hiring and retention of highly qualified managerial talent, the ease of entry into and exit from markets, and the availability of capital to meet the financing needs of entrepreneurs and start-up firms, and so on. However, on the down side, this separation exacerbates the problems posed by incentive misalignment, self-serving behaviours pursued by managers, entrenchment of powerful managers who may lack the skills and knowledge to manage in changing environments, and so forth. Indeed, Roe argues that the separation of ownership and control explains the recurrent breakdowns the United States corporate sector and financial markets have witnessed over several decades, including the problems associated with hostile takeovers and failure of competitive forces in the 1970s and 1980s, insider trading in the 1980s, excessive executive pay in the 1990s, and the collapse of Enron and other corporate giants in the 21st century.

The porous and decentralized regulatory structure, on the other hand, poses challenges that serve to restrain the power of regulators and the effectiveness of governance reforms intended to check egregious corporate conduct. Managers of large firms and their auditors and accountants can influence both the formulation as well as the implementation of regulations and laws through lobbying the SEC, pre-emptively litigating, influencing Congress through elected representatives, and so on. In sum, these fundamental characteristics of the governance system result in instabilities that can never be solved once and for all; instead, each crisis leads to a specific set of solutions that are intended to fix the immediate problems, even though the next breakdown is inevitable given the inherent instabilities of the underlying system. While Roe’s conclusions are quite alarming, and some may disagree that governance breakdowns are inevitable, it cannot be disputed that for all practical purposes it is impossible to design a fail-proof governance system that conserves the benefits of separation of ownership and control and decentralized regulation while preventing the abuses of power and privilege that inevitably accompany these institutions. Interestingly, the governance failures in developing world contexts, including the examples discussed earlier from India and China, cannot be attributed to either separation of ownership and control or decentralized regulation, because neither of these factors exists in these countries to a degree that they can be blamed for recent acts of corporate fraud.

### GOVERNANCE FAILURES IN DEVELOPING ECONOMIES (INDIA AND CHINA)

In contrast to the problems that inspire the governance context in the United States, the governance failures witnessed in developing nations like India and China stem not from the separation of ownership and control, but from the concentration of ownership and control within state-owned, public-sector units, or family owned businesses, and from the pyramidal ownership structures that dominant shareholders use to achieve greater control of the firm (Rajagopalan and Zhang, 2008).

For instance, in India a majority of the largest companies are family owned, and their founders—for example, as in the Satyam case discussed earlier—often exercise control to such an extent that they can misstate financial reports and create shadow companies through complex cross-holdings that deal with one another in financially dubious and even potentially illegal ways. In China, the government controls about 70% of the stakes of publicly listed companies in the Shenzhen and Shanghai Stock Exchanges, and most business people believe that corruption, especially bribery of government officials, is a necessary condition and a norm for conducting business (Rajagopalan and Zhang, 2008).

In both countries, the fundamental problem of concentration of ownership and control in the same hands is further exacerbated by:

1. The lack of incentives for firms and their managers to implement governance transformations.
2. Underdeveloped external monitoring systems and weak controlling agencies.
3. A shortage of qualified competent independent directors.

While India’s formal financial reporting standards essentially meet international standards for accountability and transparency, and its principal regulator—the Securities and Exchange Board of India—is set up to be independent of the government (Bank Incentives, 2013), enforcement of governance laws is often weak and characterized by significant loopholes. Political connections also often undermine the independence and would of enforcement agencies. In other words, while the United States governance context needs to deal with the challenges posed by a decentralized and porous regulatory system, developing countries lack a regulatory structure with the political willingness and judicial support to enforce reforms that are enacted.

## GOVERNANCE REFORMS: WHY DON’T THEY FUNCTION?

### RECENT REFORMS IN THE DEVELOPED ECONOMY (UNITED STATES): MIXED EVIDENCE ON THEIR EFFECTIVENESS

In the wake of Enron and other major scandals in the financial sector that contributed to the recent financial collapse and ensuing global economic crisis, the United States government and regulatory agencies have focused on enacting new laws, such as the Sarbanes-Oxley Act of 2002, and developing a broader range of stricter monitoring and enforcement mechanisms. These mechanisms are intended to not only generally align managerial interests with those of shareholders, but also to ensure greater and more complete transparency in financial accounting, to increase the accountability of executives and directors for reckless and irresponsible risk-taking that results in significant losses to shareholders, to deter potential frauds, and to allow more effective apprehension and prosecution of the perpetrators of these frauds.

A quick review of the most common safeguards in place, however, reveals significant disconnects between the intended benefits and realized effects, and many of these gaps can be attributed to the two fundamental instabilities of the United States governance system discussed earlier in this article (Roe, 2012). On the one hand, managers who control a corporation are inevitably in a better position to manipulate governance mechanisms to promote their own economic well-being, often exploiting legal loopholes, and the dispersed shareholder base can do little to prevent such abuse. On the other hand, decentralized and “siloesd” regulatory agencies are unable to coordinate monitoring and enforcement efforts at a level needed to prevent the commission of frauds that cut across regulatory boundaries. The information gaps and significant lapses in regulatory vigilance that preceded the Enron fiasco were repeated with even more dire consequences in the more recent sub-prime mortgage crisis and ensuing financial meltdowns that decimated once-venerated and iconic Wall Street firms. One widely used government practice that has failed to achieve the desired objective is equity based executive compensation. Agency theory suggests that “the most direct solution to [the] agency problem is to align the incentives of executives with the interests of shareholders by granting (or selling) stock and stock options to the CEO” (Hall and Liebman, 1998). At their peak in 2001, stock options accounted for over 50% of the pay of CEOs of major United States firms. However, stock options give executives a strong incentive to take excessive risk because the downside risk is zero, because the lowest value of stock options is zero, while the upside gain is unlimited. Research has shown that options-loaded CEOs deliver more big losses than big gains (Sanders and Hambrick, 2007). Moreover, the use of options in executive compensation also gives executives an incentive to manipulate the options grant dates, leading to the corporate fraud of stock option backdating. In a recent stock option backdating case, a firm picked a past date when its stock price was particularly low to be the stock option grant date, and thereby increased

the value of the stock options. Heron and Lie (2009) estimated that 13.6% of all option grants to top executives during the period 1996–2005 were backdated or otherwise manipulated. Indeed, some have argued that equity-based compensation is partly responsible for the recent meltdown of the financial sector. The base packages, including pay and bonuses, for executives in the financial sector were sufficiently large to make them feel financially secure. That gave bankers a license to gamble their equity-based pay in hopes of earning the huge pay-outs that would take them into the ranks of the uber-wealthy (Bank Incentives, 2009).

### GOVERNANCE REFORMS IN DEVELOPING ECONOMIES (INDIA AND CHINA): FAILURES IN IMPLEMENTATION

As noted in the previous section, the contexts in India and China pose different challenges compared with the United States and other advanced economies when it comes to governance failures. This is primarily because the broader institutional, economic, and legal-regulatory environments in these nations are in the initial stages of evolution as compared with economies in which the governance context has evolved over many decades of experience with capitalism.

In both India and China, regulatory bodies have advocated comprehensive and rigorous reforms intended to bolster the credibility and integrity of listed companies, to facilitate access to capital for new businesses and expansion of existing businesses, to achieve more transparency and accountability of corporate managers, and to enforce adherence to international standards of accounting and financial reporting. For instance, China's Company Law, enacted in December 1993, was an important starting point in the evolution of governance reforms; it was followed by the China Securities Law in December 1998 and, more recently, the Code of Corporate Governance for Listed Companies in China, enacted in January 2002. The latter, in particular, was designed to further strengthen the requirements related to accounting procedures and information disclosure, selection of independent directors, and shareholder rights and protection.

According to Rajagopalan and Zhang (2008), in India, the most significant milestone in the evolution of corporate governance was the establishment of the Securities and Exchange Board of India (SEBI) in 1992, an event followed by a series of over-arching and comprehensive governance reforms implemented by the Indian government based on the recommendations of four independent governance committees: the Bajaj Committee in 1996, the Birla Committee in 2000, the Chandra Committee in 2002, and the Murthy Committee in 2003. For more details on the recommendations from these committees and the ensuing governance reforms. Notwithstanding the scope and urgency of the reforms enacted in both countries, however, there is widespread agreement that both countries are very weak when it comes to enforcing these reforms. Indeed, in a 2004 report on the implementation of corporate governance codes in India, the World Bank noted serious gaps and lapses, particularly in relation to the role of nominee directors from financial institutions, stock-listing laws and regulations, insider trading, and dividend and share-transfer transactions (World Bank, 2004).

While appropriate in many ways, the response of the Indian government following the Satyam crisis was still criticized as being too slow. For instance, while the disclosure of fraud was made on a Wednesday morning, the first resulting crucial decision—which was to dismiss the entire board of directors—was only made on Friday night. In a scathing critique of the Government's response timing, published in India's leading business journal, *Dubey* (2013) sarcastically notes:

So what if crucial time was lost in the intervening 70-odd hours when the company, its finances, its accounts, and IT infrastructure remained in the hands of people who were part of the management that committed the fraud. So what if the Centre and the State debated for three days about who would initiate legal action against the Raju's. So what if incriminating evidence may have been destroyed as Satyam investigators have discovered . . . they are unable to locate the company's bank statements.

*Dubey* (2013) goes on to note: India must also build a consensus on separating economic fraud investigators and offices such as the SIFO from political clutches such as the Ministry of Corporate Affairs. Business and politics are so well intertwined in the country that political control can potentially influence investigators. All of this could be avoided if business fraud or bankruptcy investigators were given the statutory authority and the independence to swing into action without waiting for a political nod.

As a direct result of the Sanlu milk powder scandal, China passed its first food safety law—effective June 1, 2009—in an effort to restore consumer confidence. Under the new law, consumers can get financial compensation of up to 10 times the price of the product, in addition to compensation for any harm caused by tainted food. The law also bans food safety supervision agencies from advertising food products and states that individuals, including celebrities, who advertise for a substandard product may also be held liable for damages. While this new law represents an important step in the monitoring and strengthening of food safety standards, some are sceptical about its chance of success. The new law did not create a single, powerful body—akin to the U.S. Food and Drug Administration (FDA)—to handle food safety. China's Departments of Health, Agriculture, Quality Supervision, Industry, and Commerce Administration would all share the responsibilities of monitoring the country's food supply. In addition, China has 450,000 registered food production and processing enterprises, with the vast majority employing just 10 people or less. A United Nations report last year noted that the challenge of overseeing these small businesses is one of China's biggest hurdles in ensuring food safety.

### DAUNTING GOVERNANCE FRAUDS: A COST BENEFIT APPROACH

Because financial frauds, product tampering, and many other violations of governance laws can be viewed as corporate crimes, we draw on the broader, well-established economics of crime literature (Eide, et al, 2006) to argue that the likelihood of such violations is contingent upon two factors:

1. The costs associated with committing a fraud, and
2. The benefits derived from committing that fraud. The higher the costs imposed on the perpetrator and the lower the benefits associated with the fraud, the lower the likelihood that the fraud would be committed.

#### DAUNTING FRAUD BY INCREASING THE COSTS

The costs associated with committing a governance fraud generally depend upon three factors. The first is the probability that the deviant behaviour would be discovered, which substantially depends upon the monitoring mechanisms in place. The greater the probability that the fraud would be discovered, the less likely it is that a company or its management would commit a fraud.

The second factor is the size or extent of the punishment (e.g., financial fines, loss of liberty) if a fraud is detected and, relatedly, who would be affected, monetarily or otherwise, by the punishment. Severe punishment—for example, being banned from an industry/functional area if certain violations are uncovered—would discourage a company and the management. In many cases, however, because the company pays for the punishment, the threat of punishment may have limited effect in disciplining management behavior. For instance, in May 2002, Merrill Lynch paid a \$100 million fine to settle with the State of New York after its analysts were caught denigrating the companies they touted to investors during the technology bubble era. Indeed, the major purpose of the SEC's recent requirement for CEOs and CFOs to personally certify their companies' financial statements is to narrow the legal loophole between a company's financial statements and its senior executives' individual responsibilities, thereby enhancing the quality of a company's financial disclosures (Zhang and Wiersema, 2010). Once they have certified their companies' financial statements, subsequent revisions of the statements could potentially expose executives to criminal charges.

The third factor is the likelihood that the punishment would be enforced, which depends upon the effectiveness and speed of the legal system in place. Especially in emerging markets such as China and India, the major problem regarding corporate governance is not the absence of laws but the lack of timely and consistent enforcement of the laws that already exist (Rajagopalan & Zhang, 2008).

Because of the relative maturity and sophistication of governance laws, and the legal and regulatory frameworks in developed economies like the United States, the costs associated with corporate frauds are quite significant; white-collar criminals can access the best legal representation, though, which can sometimes reduce the probability and size of the punishment. In comparison, as noted earlier, monitoring and enforcement of governance laws is particularly lax in both India and China, albeit for somewhat different reasons, and the breakdowns in implementation serve to reduce the costs associated with committing these crimes, especially because the most powerful business people and corporate families are also very well connected with leading politicians, who can in turn often influence regulatory agencies. Therefore, the potential cost of committing a fraud is relatively lower in developing countries than in developed countries.

#### DAUNTING FRAUDS BY REDUCING THE BENEFITS

The benefits associated with a fraud depend upon the utility function of the individual or group committing the fraud. Of course, this utility function can also be generated at more aggregate levels for a top management team or an entire corporation, depending upon growth and profitability targets, schemes for division of profits, and so on. The utility derived from fraudulent acts reflects both financial and nonfinancial benefits (e.g., political power, prestige, social standing). In

both developed and developing economies, the benefits associated with corporate frauds can be substantial although, again, the magnitude and nature of these benefits can vary across these environments. In developed nations, the winner-take-all syndrome, the increasing disparity between pay and performance, and the excessive risk-taking witnessed in the recent collapse of large financial institutions have resulted at least partly from the disproportionate benefits bestowed on a few at the uppermost echelons of the corporate sector. Whether CEOs and senior managers are paid for their performance or not is a topic of continued debate in both academic and business circles. However, the prevalence of huge financial pay-outs for top executives and the low personal risk associated with performance failures have clearly increased the pecuniary benefits associated with deviant corporate behaviours.

In developing nations, the benefits appear to stem from the spurt of economic opportunities created by the opening of once-closed economies and the encouragement of private enterprise in industries once dominated by the public sector. While the overall opportunities for wealth creation have increased, the distribution of such wealth continues to be lopsided. Business press articles in recent years have documented the increasing number of millionaires and billionaires in both China and India, the rapid growth and profitability experienced by the largest business houses and families, and the rapidly increasing salaries and benefits at the top executive levels. The winner-take-all syndrome that may have driven individual and corporate excesses in developed nations is now permeating emerging economies as well, where the asymmetry in the distribution of rewards is further exacerbated by lax governance regimes and poor enforcement mechanisms.

In summary, the recurrence of corporate frauds depends upon both the potential costs and benefits of committing the frauds. Developed nations have been able to deal with the cost side of governance failures relatively effectively, although recent corporate excesses have renewed concerns about these aspects. Developed nations, though, are faced equally with the twin challenges of increasing the costs and decreasing the benefits associated with corporate frauds and excesses. These differences have implications for the direction in which reforms need to be directed, especially because as we argue later, attempts in developing nations to curb the benefits may have the costly effect of curbing individual and corporate ambition and entrepreneurship, with serious debilitating effects on overall growth and prosperity.

### GOVERNANCE ASSESSMENT IN DEVELOPED ECONOMY (UNITED STATES): COSTS Vs. BENEFITS

While there is certainly room for bolstering the monitoring and enforcement sides of the governance situation in the United States, especially in relation to coordinating and sharing information across different regulators, we believe that influencing the payoffs associated with corporate and individual misconduct should be more of a priority than tweaking the regulatory code further. It is indeed gratifying to note that the new Obama administration is beginning to focus on this issue, especially in the context of executive compensation, given that compensation and equity ownership are after all the most significant benefits. Reforms being considered include, among other things, the following:

- (1) Banks receiving federal rescue money must agree to executive pay restrictions and to a ban on big pay checks for departing executives, known as golden parachutes.
- (2) Advisory voting on executive compensation
- (3) Restrictions on deferred compensation
- (4) A clearer definition of performance-based pay
- (5) Limits on severance payments for senior executives
- (6) Broader "claw back" provisions to recoup bonuses
- (7) Higher levels of engagement of the SEC in different aspects of corporate governance, especially in the compensation of senior executives
- (8) Greater transparency in company disclosures, and enhanced personal accountability of senior executives (Attacking, 2009; Solomon and Paletta, 2009).

At the same time, changes to executive compensation systems have to be made very cautiously because past attempts—such as the 1984 decision in the United States to cap severance payments at three times base pay by imposing a special tax on payments above that level and the \$1 million cap imposed on the tax deductibility of executive salaries—have often had unintended negative consequences leading to even higher financial benefits for top executives (Attacking, 2009). Instead, strengthening the ability of shareholders to monitor pay deals ex-ante and making "say on pay" votes by shareholder's mandatory at public firms may curb compensation abuses more effectively than one size- fits-all reforms that unintentionally incentivize the exploitation of loopholes or, even more troubling, thwart innovation and entrepreneurship.

### REDUCTION IN CORPORATE FRAUDS IN BOOMING DEVELOPING ECONOMIES (INDIA AND CHINA): COST Vs. BENEFITS

In developing nations like China and India the governance regime is characterized by relatively low costs of committing corporate frauds, due to lax monitoring and weak enforcement, as well as high benefits, due to rapid growth opportunities and windfall economic gains for the winners. For practical and policy reasons, however, it is difficult for these economies to simultaneously and aggressively tackle both challenges. Attempting to tackle the benefits side too aggressively by controlling/ regulating salary levels, hiring and promotion decisions, investment decisions, and so forth—can have the unintended and potentially disastrous effect of curbing much-needed entrepreneurship, talent retention, and ambitious growth and profitability targets. Given the nascent stage of economic development in countries like India and China, we believe that it may be more prudent to concentrate on the cost side, and focus on stricter implementation and enforcement of monitoring and punishment mechanisms, at least in the short- to mid-term.

For instance, the Reports on the Observance of Standards and Codes (ROSC) noted that many of the sanctions and enforcement rules currently in place in India were inadequate, and that monetary sanctions were particularly in need of adjustment (World Bank, 2008). While the sanctions imposed by the stock exchange included warnings, suspension of trading, and delisting, it did not include monetary fines that were high enough to deter noncompliance. The ROSC also recommended better coordination of the roles and responsibilities of the three regulatory agencies charged with enforcing governance norms over listed companies in order to minimize regulatory lapses and oversights.

Any benefits-side reforms that are considered should be carefully assessed for their potential adverse effects on the managerial talent market, and on the corporate growth and wealth-creation strategies. Given that even developed nations have only recently begun to worry about the benefits side of the equation, a "wait and learn" attitude may be advisable for developing nations. We hasten to add that we are not arguing in favour of completely eschewing benefits-side reforms in developing nation contexts. Indeed, governance reforms should aim to increase the costs and reduce the benefits associated with corporate frauds for maximum deterrence. For example, China's new food safety law has increased consumers' financial compensation for tainted food, from the price of the product up to 10 times the price of the product. While this change certainly increases the costs for a firm to commit the sort of fraud that Sanlu did, it may not be a sufficient deterrent if the economic gains to be reaped from fraudulent acts are potentially huge in relation to the costs. Indeed, to minimize the likelihood of corporate frauds and related crimes, it is imperative not only to increase the costs associated with the crime (ex-post punishment), but also to reduce the benefits derived by the person or group considering such acts (ex-ante utility).

### CONCLUDING REMARKS

The recurrence of corporate governance disasters in highly developed, as well as developing, economies reminds us that the price of economic growth and opportunity is indeed eternal vigilance. Understanding the differences in the institutional contexts helps us to realize that what works to curb governance failures in one context may be less effective in another, and that the timing and focus of reforms should reflect the realities of the economic and institutional conditions that different nations face. Ultimately, the most effective and sustainable governance reforms would be those that simultaneously increase the costs of corporate frauds and decrease the benefits that individuals and corporations can derive from ignoring governance norms and laws.

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