CORPORATE GOVERNANCE REGIME'S AROUND THE WORLD – A COMPARATIVE APPROACH

A DISSERTATION TO BE SUBMITTED IN PARTIAL FULFILMENT OF THE REQUIREMENT FOR THE AWARD OF DEGREE OF MASTER OF LAWS

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LIST OF ABBREVIATIONS

- **CG-** corporate governance
- **GDP-** Gross Domestic Product
- **HDR-** Human Development Index
- **CSR** – Corporate Social Responsibility
- **OECD-** Organisation for Economic Co-operation and Development
- **CA-** Companies Act, 2013
- **DRTs-** Disclosure Guidance and Transparency Rules
- **FCA-** Financial Conduct Authority
- **UKCG-** UK Corporate Governance Code
- **EU-** European Union
- **SEBI-** Securities and Exchange Board of India

CHAPTER I: INTRODUCTION

India boasts the world's largest number of publicly traded companies, and the financial market's performance and stability are vital for the economy and society overall. It is essential to develop and implement a progressive corporate governance scheme since it is an increasingly important component of today's business realities in many countries throughout the world.

To proceed any further it is important to define the term "Corporate governance.'' Corporate governance can be simply defined as a mechanism by which corporations are monitored in order to avoid any malpractices and to cultivate a conscious, transparent, and open corporate culture. It is a fundamental code of conduct for all kinds of corporations. The corporations should adhere to this code of conduct in order to attain its objectives because failure in corporate governance can be counted as a major threat to the future of that corporation.

Companies in both the local and foreign capital markets aggregate funds from a vast investor base. In this perspective, investing is essentially a risk on a company's management's capacity. In order to manage a company's operations and act in the best interests of all stakeholders at all times, a system in which the directors are entrusted with obligations and responsibilities in regard to the corporation must be in place.

Corporate governance is a structure that holds managers accountable to stakeholders for efficient company management. Corporate governance also attempts to address moral standards, ethical behaviour, norms, practice, and behaviour, along with checks and balances, management benefits and communication between management and investors. A transactional relationship involving matters of disclosure and authority is the second factor. To put it another way, good corporate governance is great business

The principles of Corporate Governance are the same rules that have been followed for centuries when running a firm in the public interest. The adoption of these principles by country-specific laws is a novel aspect of these ideas.

Corporate governance encompasses policies, procedures, legal and regulatory framework, internal control, accountability, transparency and a set of relationships that exist between the management of the company such as its board of directors, its shareholders and its stakeholders. It may take different forms and types based on this situation. Corporate governance gained importance all over the world in the late 1990's due to several big corporate scandals that came into lights.

Corporate governance is the result of an interaction of legal conventions, corporate governance codes and instructions, best practices and self-regulation. Various scandals and scams have compelled governments to update corporate governance laws, some countries have moved quickly while others have taken longer. As a result, the expenses of maintaining a healthy corporate governance structure have increased, while the significance of current self-regulation or an enabling governance regime has decreased.

CORPORATE GOVERNANCE EXIGENCIES, RELEVANCE, AND PURPOSE

The "corporation" is often regarded as the economic force that propels the private sector forward. Its competitive performance is dependent on CG. It is especially important at a time when firms' relationships with their capital providers are changing constantly. Entrepreneurs and businesses now have access to a massive and far more comprehensive choice of capital-raising instruments as a result of global deregulation and technology advancement. This means that businesses can support a wide range of R&D activities, spin-offs, capacity growth, and new company formation.

To address the aforementioned major issues in the business community, a model of corporate governance must be implemented that ensures the honesty, fairness, and accountability of management. Proper and viable corporate governance contributes to the development of an ethical corporate culture, which leads to improved performance ease of doing business and long-term profitability. Essentially, it exists to strengthen the responsibility of all

employees and teams within your organization, with the goal of preventing mistakes from occurring in the first place.

Greater capital rivalry puts more pressure on company economic success and puts substantial strain on long-term employee relationships. Failure to adhere to effective governance measures might result in capital market access being limited. Globalisation on the other hand, implies that financial issuers have additional chances to increase their returns. When they are convinced that their growth is built on solid foundations, they are prepared to contribute capital. According to research, well-governed corporations achieve greater valuations in both OECD and developing market nations.

Corporate governance's ultimate purpose is to improve the company's performance in order to increase shareholder value and protect the rights of other stakeholders. Further, its goal is also to create an atmosphere of trust and confidence among those with competing and conflicting interests.

At each and every level of the development process CG is fundamental. Proper asset protection and safe procedures of ownership registration are essential corporate governance measures that impact a firm's capacity to mobilize capital at the outset of the investment process. If the market is to allocate available funds efficiently among competing goals in the second stage, trustworthy and transparent disclosure is deemed necessary.

Procedures for corporate decision-making, authority allocation across business organs, and incentive plan design are examples of governance systems that must be in place to properly oversee the money that is given over to enterprises. By demanding transparency in corporate transactions, in accounting and auditing procedures, and in all business transactions generally, CG attacks the supply side of the corruption relationship, especially in developing countries[1].

Companies that are well-governed face fewer financial and non-financial risks and provide greater shareholder returns. They also have easier access to external capital and are less vulnerable to systemic risks from business crises and financial scandals. Stronger capital

[1] L.S. Som, *Corporate Governance Codes in India*, ECONOMIC & POLITICAL WEEKLY, vol. 41

markets are also aided by reliable financial reporting, timely disclosures, effective boards, and responsible management.

They aid in job creation and economic progress by improving a country's capacity to mobilize, allocate, and oversee investments. Better oversight and monitoring can help discover inefficiencies in companies and reduce their exposure to financial disasters. Lastly, in a developing nation scenario, corporate governance is much more important. Because of its importance in attracting foreign investment, good corporate governance is essential. The number of international employees, customers, shareholders, and the government.

The Financial Market Integrity (FMI) group is located in the Finance and Markets Global Practice in the World Bank Group. Corporate governance (CG) is part of the FMI group's mandate. The CG group within FMI focuses on improving corporate governance in emerging market countries[2].

In emerging market countries, the demand for good corporate governance is raising in order to assist companies and financial institutions in improving their performance, gaining access to affordable external financing, and lowering their cost of capital, all with the goal of advancing financial stability and economic growth.

The governance of publicly traded corporations has a direct impact on the development of capital markets and investor protection. Governance is critical for the banking sector's long-term viability, as well as the development and growth of pension funds and insurance companies, whether they are state-owned or private.

Governments implementing controversial changes gain credibility by indicating to the public that the government is building an effective corporate structure that will create circumstances for future prosperity, rather than just cutting back on welfare expenditure. In unprotected markets, CG is significant in encouraging indigenous businesses to become more efficient in order to compete with Multinational corporations.

[2] The World Bank, 2016 Feb 24, Brief Corporate Governance, https://www.worldbank.org/en/topic/financialsector/brief/corporate-governance

BACKGROUND TO THE RESEARCH QUESTION

As a consequence of rapid era of globalization, increased openness in company disclosure standards is required and corporate governance procedures have become more important than ever. The development of the concept of corporate governance is the outcome of an increasingly competitive business environment along with a changing structure of company ownership.

The focus in the period of liberalized economies is on freedom, independence, and autonomy with no or little government intervention. However, no freedom is unrestrained including those provided by the Constitution. The world's highest courts including our own apex court i.e., Hon’ble Supreme Court have ruled that no freedom is unrestricted, and that all freedoms, even constitutional liberties, are subject to reasonable restrictions.

Similarly corporate governance seeks to strike a balance between exercise of authority and responsibility by developing rules and procedures. The fundamental essence of corporate governance hold on to number of issues such as ethics, transparency, monitoring system, corrective actions etc., The objective of effective governance is to identify risks, evaluate them, and take remedial action to reduce their impact. This necessitates immediate changes in organizational strategy and procedures. So it becomes important on the part of management of the company itself to comply with the principles of corporate governance.

Corporations have a motivation to embrace corporate governance procedures appropriately so that it reflects on the image of that corporation thereby leading to its overall growth and high performance. A combination of self-regulatory regime of governance and mandated disclosure of a company's governance procedures is more likely to result in high compliance than a completely obligatory system.

In recent years, corporate governance has become a major issue in both practice and study. Companies from developing nations must establish effective governance regimes like several developed countries like UK, USA and Australia in order to maintain a competitive position, attract capital, assure sustainability, and combat corruption.

This opens an avenue into considering a self-regulatory regime or an outside model of Corporate Governance in India. Beyond the mainstream narrative, this research would help in pushing the bounds of current comparative corporate governance studies.

INTRODUCING THE RESEARCH AND RESEARCH METHODOLOGY

The purpose of this dissertation is to discuss the prevalence, nature, and evolution of qualitative research in the subject of corporate governance. Based on a detailed literature search of articles published in scholarly peer-reviewed publications, the study presents an overview of published qualitative research in the realm of corporate governance.

A fine-grained search based on key terms yielded 65 qualitative corporate governance papers as a sample. According to a research and content analysis of these works, qualitative governance studies have increased in frequency during the 1990s, although they still make up a tiny portion of the published work on corporate governance. The search reveals a diverse set of theories from various disciplines that are used to generate, elaborate, and refine theorizing about corporate governance and the meanings, mechanisms, processes, and relationships that go along with it.

More qualitative research with substantial clarity and relevance are needed to study the wide range of interactions and processes involved in corporate governance at various levels of analysis and situations. After more than two decades of analysis and reform in the field of corporate governance, issues of practice persist, and corporate governance prescription via codes and other types of legislation is on the rise in the quest for improved governance.

By providing insight on the efficacy of policy prescription, qualitative research such as content analysis, comparative study along with case-studies can help policymakers and practitioners design more successful governance structures. Qualitative research may be used to examine

and challenge some of the most common assumptions and meanings about how governance entities and institutions work.

The research conducted for this dissertation was qualitative in nature. Rather, there are varying pieces of past academic work on the relevance of corporate governance in managing a corporation, not only for India but for other regions of the world as well. As a result, the proposed study took the form of a new study based on an existing research topic.

Qualitative research is defined as, ‘the interpretative study of a specified issue or problem in which the researcher is central to the sense that is made[3].” The major aspect of qualitative research is that it is best suited for small groups, and the results aren't measurable or quantitative. Its primary benefit, as well as its major distinction from quantitative research, is that it provides a comprehensive description and analysis of a research topic without restricting the scope of the study or the type of participant contributions[4].

However, the effectiveness of qualitative research is heavily based on the skills and abilities of researchers, while the outcomes may not be perceived as reliable, because they mostly come from researcher’s personal judgments and interpretations. The study of "how—and sometimes why—participants build meanings and behaviours in specific settings" is achievable using a constructivist perspective within this qualitative approach of research[5]. The qualitative researcher supports a methodology that is suitable for explorative study of a new, or relatively new, topic by retaining a "beginners mind," a mind that is willing to observe everything as though for the first time[6].

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[3] Ian Parker, ‘Qualitative Research’ in Peter Banister, Erica Burman, Ian Parker, Maye Taylor, Carol Tindall (eds), Qualitative Methods in Psychology: A Research Guide (OU 1994) 2.

[4] Collins and Hussey(2003)

[5] Charmaz, 2006, p. 130

[6] Kabat-Zinn, 1990, p. 35

Following this introduction, the next section delves deeper into the nature of descriptive study before mapping out current qualitative research in corporate governance based on a variety of criteria. We provide, to our knowledge, the first descriptive and analytical review of qualitative research in corporate governance using these criteria.

Since all observations, interpretations, and analyses are mediated via their own personal lens, qualitative researchers frequently refer to themselves as "instruments" in research. As a result, it's critical to reflect on your strategy and carefully explain the decisions you made in gathering and interpreting the data while writing up your qualitative research methodology.

This dissertation first comprises of content analysis which explores the theoretical underpinnings with respect to corporate governance under which the stakeholder and shareholder discussed from the perspective of the Berle Dodd debate in order to understand the background behind several governance models. Further, this paper also looks at the historical evolution of a corporation in order to understand the social benefits that occur due to the existence of these corporations.

Thereafter, the second chapter deals with the governance regimes in the two developed markets, that is the United States of America and England. The self-regulatory models existing in both the countries are studied in detail with the necessary background of several scandals in order to understand why there was a need to develop corporate governance in this particular manner. Towards the end, a thorough discussion on the inside and outside models of governance is undertaken.

The last chapter focuses on the corporate governance regime in India followed by its key principles, history tracing its evolution from the time the New Economic Policy was introduced till the 2013 Act, linking corporate governance in India, US and England with central theme of analysing the ideal form of corporate governance that suits India in the most effective manner.

The research design used for the study is thus, of the descriptive kind which meets the criteria of the study's aims. The study made extensive use of secondary data that was readily available. The data was obtained using a secondary survey approach by the researcher. Various articles, books, and websites were used, all of which were counted and documented.

The approach in this dissertation has been analytical with providing necessary details wherever required. The research study builds on the theoretical framework that it begins with and take present day examples to explain the theoretical paradigms appropriately. However, for the reasons of brevity, the research has been confined to comparative study of corporate governance regimes of only three countries, that is, India, England and USA.

LITERATURE REVIEW

Due to the continued emphasis on corporate governance transparency, a large variety of theoretical studies have been conducted throughout the world. For this study, the researcher examined a variety of research articles as well as other relevant data to gain a thorough grasp of the subject. The following is a summary of the available literature that was used in this investigation.

The majority of corporate governance literature centres on developed nations with limited resources that are directed toward emerging economies. The size of the board of directors, the independence of the directors, the legal framework of a nation, the form of ownership, and shareholder engagement are all major dependent factors in most corporate governance studies.

Because of the separation of management and ownership control in modern firms, corporate governance has become extremely relevant. The interests of shareholders and the interests of management are at odds. Due to the disparate interests of the firm's stakeholders, the primary agent problem manifests itself in management and direction issues.

There is no uniform definition of corporate governance instead, it may be regarded from a variety of perspectives. Smith and Berle (1932) are two of the earliest works on the subject "Allocation of ownership, capital structure, management incentive schemes, takeovers, board of directors, pressure from institutional investors," may all be considered structures that have an impact on the process. However, in order to analyse the effectiveness of corporate governance regimes across nations, more studies are focused on the competences and integrity of individual directors. This literature assessment is based on a variety of sources, including academic studies, journals, and business periodicals addressing various elements of corporate governance in various nations.

Sir Adrian Cadbury's work in the United Kingdom was the catalyst for the creation of the Corporate Governance Code. The Cadbury Code, a code of best practice, served as a foundation for corporate governance reform throughout the world, and since then, numerous authorities have released a series of views and studies based on the objectives set by respective nations.

The Cadbury Code report's proposals have been embraced to varied degrees by the European Union, the United States, the World Bank, and others, demonstrating the UK's effectiveness in adopting Corporate Governance. The principles of Corporate Governance established by the Organisation for Economic Co-operation and Development (OECD), the Greenbury Committee on Directors Remuneration focusing on Directors' remuneration, stakeholders' interests, and accountability, and the King's Committee of South Africa highlighting best practices on Board issues, financial reporting, transparency, and audit are just a few explanations.

N. Gopalswamy (1998) wrote a book called "A Corporate Governance: A New Paradigm" that addresses the three main areas of corporate governance, business environment, and globalization in India. He has provided a conceptual overview of corporate governance, including the responsibilities of the board of directors, the audit committee, corporate disclosure procedures, and investor protection. The consequences of concentrated ownership, which is typical in many emerging and industrialized economies, have been explored by researchers.

La Porta et al. (1998) analyzed corporate governance practices in 27 countries and find that the primary accountability challenge in major firms throughout the world is preventing minority shareholders from being expropriated by dominating owners. In recent years, the intellectual discussion on corporate governance has shifted to two distinct topics.

The first is whether corporate governance should be limited to preserving the interests of equity claimants, or if it should be extended to address the problem of the other group: non-shareholder groups, or stakeholders. The second significant problem for corporate governance researchers starts with the premise that corporate governance is only concerned with the difficulty of safeguarding minority claimants and attempting to describe ways in which the organization might better defend their interests.

The Modern Corporation and Private Property (based on United States corporate law) was published in 1932 by Adolf Berle and Gardiner Means, and though the book didn't specifically include the phrase corporation governance. Berle and Means created a theory on governance in public firms to explain how boards of directors might become so overburdened by management and executives that their supervisory function becomes useless.

Corporate governance was not coined until the 1970s, and it has grown in popularity since then. Other factors contributing to the rise in corporate governance include the decline of unions in the 1970s, which reduced conflict between management and labor, resistance to increased government intervention, increased stock ownership by US households, technological advancements, and an increase in the number of financial analysts.

Following the Great Depression, the Anglo-Saxon corporate governance model became well-known in developing countries, since it cleared the path for a country's financial and economic progress. Following that, corporate scandals (such as Enron, WorldCom, and Arthur Anderson) as well as the Great Recession of 2008 raised the necessity of corporate governance even more.

Corporate governance began as a way to cope with the agency problem, and Shleifer et al (1997) characterized it as a way to guarantee investors that they will obtain a return on their investment. The majority of the literature they reviewed at the time focused on what is known as the Anglo-Saxon model, which is widely used in the UK and the United States and is more akin to the Berle and Means view of the world.

Corporate governance rules have progressed to match what was deemed best practice in the United Kingdom and the United States, requiring listed businesses to have unitary boards, independent outside directors, and board committees. These principles largely focused on improving shareholder value, in keeping with the underlying assumptions of the theoretical framework. The approach paid senior executives richly and acted as the foundation for governance regulations all across the world.

Effective governance ensures that the management are responsible for attaining the corporate objectives, regardless of what it is. The importance of effective corporate governance to society as a whole cannot be overstated. First and foremost, it encourages the effective use of limited resources both inside the company and throughout the economy.

Second, it directs resources to sectors or organizations where products and services are produced successfully and returns are sufficient to meet stakeholder needs. Third, it enables managers to maintain a continual emphasis on improving corporate performance guaranteeing that they are fired if they fail to do so. Finally, it puts pressure on the company to follow the law as well as meet the expectations of society.

CHAPTER II: THEORETICAL UNDERPINNING OF CORPORATE GOVERNANCE

In capitalistic economies, a corporation is seen as the principle organized form of economic association.[7] The advent of the Industrial Revolution made corporations into the most popular form of business enterprise. The two principles in the modern economy that contributed towards this popularity of corporations were based on the ideas of capitalism and the *laissez faire* doctrine.

In order for the Industrial Revolution to be a success, it was understood that the there was a need of circulation of capital in the economy. For this, there was a need to establish a relationship between an entrepreneur and a capitalist so that the unutilized funds could be transformed into capital. This led to the emergence of Joint Stock Companies in 1844.[8] This brought a drastic change in the way corporations were seen in an economy. Earlier such body corporates could only be formed through a Royal Charter or a statute passed by the Parliament as the state sought to regulate the market economy.[9] The Joint Stock Companies Act, 1844 marked the beginning of the era of relaxation in these regulations. As this act drew largely from the principles under the law of partnership, the basis of a modern corporation also drew heavily from the contract law approach.[10]

The major step that laid the foundation corporation in existing form, was the introduction of the concept of limited liability in 1862.[11] This concept was an extension of the *laissez faire* doctrine. This doctrine was scene new wave of competition in a market which was largely

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[7] S. Wheeler, THE BUSINESS ENTERPRISE: A SOCIO-LEGAL INTRODUCTION, A READER ON THE LAW OF BUSINESS ENTERPRISE, p. 9 (1994).
[8] L.C.B. Gower, GOWER'S PRINCIPLES OF MODERN COMPANY LAW, p. 23 (edn. 6, 1997).
[9] J.H. Farrar, FARRAR'S COMPANY LAW, p. 16 (edn. 3, 1993).
[10] P. Ireland, *Property and Contract in Contemporary Corporate Theory*, LEGAL STUDIES, vol. 23, pp. 453-457 (2003).
[11] Gower, *supra* note 2, at 40.

oligopolistic in nature, which resulted in exclusion of a significant number of people from trade. Unlimited liability involved the threat of greater risk of insolvencies and incarceration, which acted as a deterrent for the public at large from establishing businesses.[12] Hence, the ability to form a body corporate, which has limited liability was seen as the *sine qua non* for a truly free society.

In current times, a corporation has acquired a greater role than merely being a vehicle to channelize capital. Corporations' benefits to society can be beneficial to society while still being driven by profit. Having a business offers you a competitive advantage over your competitors. Businesses are important not just because they generate financial stability, but also because they bring fulfilment and wealth in a variety of ways.

It is impossible to underestimate the significance of business in social and economic progress. Business is essential to a country's economic progress and riches. Business success relates to a company's and its people' economic well-being through creating jobs and improving the country's citizens' quality of life.

Major and minor enterprises are strong contributors of economic growth and prosperity since they provide vital services, goods, and tax revenues that directly benefit the community's health. They also provide jobs, boosting the economic stability of the communities where they are located. The progress of corporation in general has a direct impact on the global economy. Businesses are built to meet a specific demand that people have and to deliver dependable goods and services to meet that demand.

The economic prosperity and well-being of the residents of the city, region, state, or nation in which such firms operate are inextricably linked. Profitable enterprises promote economic health, which in turn improves individuals' quality of life. A country's economy relies heavily on business. Businesses may influence the prosperity of a whole country, for example, by contributing to a country's gross domestic product, or GDP, which influences its global status. Everyone wins when a country promotes firms that provide in-demand goods and services.

[12] R. Mcqueen, A SOCIAL HISTORY OF COMPANY LAW: GREAT BRITAIN AND THE AUSTRALIAN COLONIES 1854–1920, p. 77 (2016).

Corporation has taken the form of a social organization and a way of economic organization. The "modern corporation" is seen as an institution where wealth of several innumerable individuals is concentrated in vast aggregates, which is controlled by a unified direction.[13]

In the 19th century, the businesses were primarily owned by individuals or small groups and their appointees were responsible for the management of the same. Now, these private businesses have taken the form of large organisations having huge amounts of assets owned together by a large number of investors from the public and provide a livelihood to thousands of employees being controlled by a smaller group of management. The management body, that is, the Board of Directors occupy a central role in the structural hierarchy of corporations due to their expertise in organising the resources of the firm.[14]

Effectively, there is a diversion between the individuals who own resources and the person who control the businesses. This can ultimately result in conflict of interests between these two entities, that is, the management, and the owners. Such a direction of these organizations by persons other than the owners has raised doubts about the efficiency of these business enterprises. These concerns led to imposition of fiduciary obligations on the directors.

DIFFERENCE BETWEEN GOVERNANCE AND MANAGEMENT

The Cadbury Report defined Corporate Governance as "*the system by which companies are directed and controlled*".[15] This indicates that corporate governance pertains to that branch of the corporate world which monitors the functioning of the company through various processes such as reporting, auditing and internal controls. It mainly falls under the domain of the board of directors and auditors and mainly concerns with the independence of the functioning of these entities.

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[13] Adolf A. Berle and Gardiner C. Means, THE MODERN CORPORATION OF PRIVATE PROPERTY, Revised edn. (1967).
[14] *Id.*
[15] R Smerdon, A PRACTICAL GUIDE TO CORPORATE GOVERNANCE, p. 1 (edn. 2, 2004). The author recognises that there are other definitions of corporate governance, more specifically based on shareholder value or responsiveness to the needs of the other stakeholders. For instance upholding the shareholder view, Sir Alastair Ross Goobey said at a meeting on International Corporate Governance that "*Corporate Governance is only about reducing cost of the capital*". However, the Cadbury Committee report definition is very basic and hence fits every situation well.

Management on the other hand is simply the act of running the business which is carried by officers of the companies such as the Chief Executive Officer. This function is delegated to them by the board.

The strategic task of determining the entity 's goals direction, restrictions, and accountability structures is known as "governance" whereas "Management" refers to the process of allocating resources and monitoring the organization's daily operations and activities.

In the basic terms, board members are in duty of monitoring and planning, while management is in charge of day-to-day operations. The division of tasks and obligations for each division is significantly more detailed. The distinctions between governance and management are unique and different regardless of whether you pursue a wide or restricted approach to the subject. Those who are well-versed in their designations realize the importance of avoiding blur the distinctions between them. Corporations are more likely to function smoothly when board directors and management keep in their own lane.

The board of directors is in charge of the company's governance. The process of the board of directors meeting to make decisions on the company's future is known as governance. Governance responsibilities include supervision, strategic planning, decision-making, and financial planning. The company's bylaws, which are a collection of essential policies that describe the company's goal, goals, vision, and structure, are created by the board. The board proposes and adopts significant policies on a day by day basis.

In an ideal corporate environment, all managers and workers are aware of their roles and obligations and carry them out professionally. They're trustworthy and diligent individuals who value ethics and honesty. However, this is not always the situation. Every business faces both recognized and unforeseen challenges. Boards of directors may act when it is required for the corporation's welfare, especially in unanticipated crisis situations.

Depending on the size and type of corporation, management structures can take on an unlimited variety of forms. Management choices support and implement the board's aims and objectives in all instances. Managers are in charge of making routine operational decisions as well as all of the administrative tasks that keep the company running smoothly. Almost every department in the organization is connected to administration. Managers have a wide range of duties and obligations that are distinct from those of the board of directors.

THEORIES OF CORPORATE GOVERNANCE

Corporate governance is a comparatively fresh discipline and it has been affected by theories from a variety of fields, including law, economics, finance, and management. This section provides a theoretical overview of corporate governance as well as a review of how the main theory, the agency theory, as well as other theories such as stewardship theory, stakeholder theory, resource dependency theory, and transaction cost economics theory, have influenced the evolution of the discipline.

This section provides a foundation for additional research, analysis, and reform in the area of corporate governance. The prevailing Anglo paradigm's beliefs and methods are shown to have flaws. The cultural specificities of several views employed in corporate governance analysis are explained.

There are several theories of corporate governance that have addressed the difficulties of business and company governance at various times. Corporate Governance refers to the process of making choices and putting those choices into action in big organizations. There are several ideas that explain the interaction between various stakeholders in a business when the firm is operating.

- Agency Theory - The connection between principals (such as firm shareholders) and agents is outlined by agency theory (such as directors of company). According to this viewpoint, the company's owners engage the agents to do the tasks. The directors or managers, who are shareholders' agents, transfer the task of operating the firm to the principals. The agents are expected to behave and make choices in the best interests of the principal by the shareholders.

  The agent may submit to self-interest and opportunistic behavior, falling short of the principal's expectations. The separation of ownership and control is a major component of agency theory. People or workers are held accountable in their tasks and obligations, according to the notion. Agents' priorities can be corrected through rewards and punishments.

- Stewardship Theory - The steward idea asserts that via company performance, a steward preserves and maximizes shareholder capital. Stewards are firm leaders and managers who work for the benefit of the shareholders, protecting and increasing earnings. When the company achieves success, the stewards are happy and driven. It emphasizes the need of employees or executives acting more independently in order to optimize shareholder profits. Employees take responsibility for their tasks and work hard at them.

- Resource Dependency Theory - The Resource Dependency Theory examines the function of board directors in ensuring that the company has access to the resources it requires. It argues that via their connections to the outside world, directors play a crucial role in delivering or acquiring crucial resources to a company. The availability of resources improves organizational effectiveness, as well as the firm's survival.

  The board of directors contributes knowledge, expertise, and access to essential stakeholders such as suppliers, customers, public policymakers, and social organizations, as well as credibility to the company. Insiders, business experts, support specialists, and community influentials are the four types of directors.

- Stakeholder Theory - Stakeholder theory included management's accountability to a wide range of stakeholders. Managers at firms have a network of connections to service, which includes suppliers, workers, and business partners, according to the study. The approach focuses on management decision-making, and all stakeholders' interests have inherent worth, with no one group of interests thought to be more important than the others.
- Transaction Cost Theory - According to transaction cost theory, a corporation has a number of contracts, either inside the firm or with the market, through which it generates value. Each contract with an external entity has a cost attached to it, which is referred to as transaction cost. If the cost of using the market for a transaction is higher, the corporation will conduct the transaction internally.

- Political Theory - Rather of acquiring voting power, political theory proposes that shareholders create voting support. It emphasizes how corporate power, earnings, and advantages are distributed based on the governments favour.

The theories of corporate governance are all mostly based on a particular model which is formulated on the basis of allocation of value to each of the constituencies of the firm. These arguments are largely based on efficiency considerations. There can be two approaches to this, the shareholder primacy approach and the stake holder approach. These approaches will be analysed through the historical debate between Berle and Means and Dodd.

THE SHAREHOLDER PRIMACY APPROACH

Shareholder primacy is a shareholder-centric form of corporate governance that prioritizes generating shareholder profit over other business stakeholders' interests, such as society, the community, customers, and workers. For a long time, there has been a discourse between a shareholder and a stakeholder approach.

The shareholder theory highlights the importance of corporations as sources of employment, higher-quality products for consumers, and social responsibility improvements in the general community, while the stakeholder approach promotes the relevance of corporations as sources of employment, higher-quality products for consumers, and social responsibility improvements in the general community.

One of the central issues in the shareholder primacy dispute is who truly owns these firms and if corporations can be “owned.” The widely held belief is that companies are controlled by their shareholders, who have ultimate authority over the firm. As a result, employees, directors, and executives are all members of the business, and they must work in order to enhance shareholder value.

Others, on the other hand, think that stockholders do not truly own the firm and that corporations are legal entities in their own right. The notion of shareholder primacy has come under fire since the global financial crisis of 2008. However, because shareholder-centric firms have a clear litmus test to gauge overall success, shareholder primacy is still widely discussed in favour of. The principle of shareholder primacy provides a consistent and persuasive rule of

thumb for corporations to follow since shareholder wealth is one persuasive way to judge performance.

Although most people prefer shareholder primacy, there are significant limitations and drawbacks to a shareholder-centric strategy to business. The following are some of the major issues:

- Short-term objectives may cause fast decision-making and decisions defined by short-term incentives and bonuses to achieve particular objectives, resulting in hasty decision-making and decisions defined by short-term incentives and bonuses to meet particular objectives.

- Lack of desire to take chances and invest in new technology may restrict corporate growth and the opportunity for improved goods to promote general well-being.

- More dividends given out by enterprises to provide income to shareholders rather than using the money to make more and better strategic investment decisions, such as R&D.

The issue of whether or not shareholder primacy should exist became a running debate in the 20th century. Milton Friedman was and one of the first ardent supporters of free markets. He insisted that a business has only one major social responsibility, which is to increase their profits following the rules of fair business and earn returns for their shareholders. This implied that the concern of a corporate business does not extend to employees, creditors or other stakeholders who are merely the agents and customers of the corporation. Extended the responsibility to other constituencies goes against the principles of property rights and free market.[16] Friedman's famous line aptly describes his approach towards the theory of a corporation,

> "*…there is one and only one social responsibility of business to use its resources and engage in activities designed to increase its profits so long as it stays within*

[16] M. Friedman, CAPITALISM AND FREEDOM, p. 112 (1982).

> *the rules of the game, which is to say, engages in open and free competition, without deception or fraud.*"[17]

Friedman's argument are based on the conception of property rights and ownership being absolute in nature.[18] He contends that if corporate officials are to accept the gauntlet of corporate social responsibility, this will be subversive to the interests of the shareholder.[19]

On the other hand Easterbrook and Fischel justify shareholder primacy by their theory of allocation of risks. According to them, it is more efficient if the shareholders assume the greater risk in the functioning of corporation as they have better access to information of the functioning of the corporation. Being the greater risk takers, they are the residual owners of the corporation and hence the board must function in their interests.[20]

THE STAKEHOLDER APPROACH

The impact of corporate activities on all identified stakeholders is the subject of the stakeholder theory of corporate governance. In the governance process, corporate management should consider the interests of each stakeholder, according to this approach. This involves attempting to minimize or eliminate conflicts between stakeholder interests. It considers the interests of any third party who is reliant on the company in some way, in addition to the typical members of the organization (officers, directors, and shareholders). Internal and external stakeholders are the two types of stakeholders.

Internal Stakeholders are those who are directly involved in the corporate governance process, such as corporate directors and workers. Whereas creditors, auditors, clients, suppliers, government agencies, and the general public are examples of external stakeholders.

These stakeholders have a say in the process but aren't actively participating. The notion that all stakeholders interact with the business in some way with the hope or expectation that the

[17] *Id.*
[18] Section 12, TRANSFER OF PROPERTY ACT, 1882.
[19] Friedman, *supra* note 10, at 113.
[20] F. Easterbrook & D. Fischel, THE ECONOMIC STRUCTURE OF CORPORATE LAW, pp 39 (1991)

organization will give the sort of value requested or expected is central to the stakeholder theory.

In the context of the stakeholder theory, the corporation is considered as an entire ecosystem in which stakeholders including the employees, directors and other officers are operating in the society in a manner that they add towards the firms infrastructure. The firm's purpose is to create value for all the stakeholders by converting their stakes into goods and services and generating profits, salaries and remuneration in return.[21] Other scholars also insisted on the on the overall responsibility of the corporation towards the society and the environment.

Freeman was the pioneer of this argument. He stated that:

> "*CSR as a concept has been recognised the world over as a no d to the belief that there are many obligations upon the corporation. The nature of such obligations differs and can be anything from economic, legal, ethical or even philanthropic*"

The theory puts the obligation upon the directors to consider the interests of the company's stakeholders too, apart from those of the shareholders.[22] Thus, the development of the stakeholder approach has also coincided with the emergence of the global CSR movement.[23] The directors under this theory are required to manage the firm in such a manner that the interests of all the stakeholders are protected.

THE BERLE-DODD DEBATE

The discourse over the purpose of a corporation occurred during the debate which took place between Prof. Adolf A. Berle of the Colombia Law School and Prof. E. Merrick Dodd of the Harvard Law School. The debate began with Prof. Berle asserting that the managerial powers of the corporate officials are to be exercised for the good of the sole beneficiaries i.e. the stockholder.[24] To which Prof. Dodd relying upon the public perception of a corporation stated

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[21] M. Clarkson, *A Risk Based Model of Stakeholder Theory*, presented at Second Toronto Conference on Stakeholder Theory (Centre for Corporate Social Performance and Ethics, University of Toronto, Canada, 1994) [unpublished].

[22] C. A. Williams and J. M. Conley, *An Emerging Third Way? The Erosion of the Anglo-American Shareholder Value Construct*, 38(2) CORNELL INTERNATIONAL LAW JOURNAL, pp. 493-494 (2005).

[23] R.E. Freeman, *A Stakeholder Theory of the Modern Corporation* in ETHICAL THEORY AND BUSINESS, pp. 60, 69 (edn. 5, 1997).

[24] A.A. Berle Jr., *Corporate Powers as Powers in Trust*, HARVARD LAW REVIEW, vol. 44(7), pp. 1049, 1070 (1931).

that a corporation now has the twin goals of serving as a social institution and a profit making machine. He further postulated that this view will gain more currency with the passage of time.[25]

In response to Prof. Dodd's comments that the obligations upon a corporation had expanded, Prof. Berle responded that as there was no clear mechanism to allocate responsibility for the new interests which had developed and with no legal rules to check this new obligation, it cannot be expected that stockholders will agree to them.[26] Hence, a unilateral statement that corporations are now supposed to look after new interests cannot be expected to stand. Interestingly, twenty-two years down the line Prof. Berle conceded that time had proven Prof. Dodd right.

The treatment meted out by the judiciary to disputes between stakeholder and shareholder supremacy proves Prof. Dodd's point. *Dodge* v. *Ford Motor Co.* is a prominent example of Prof. Berle's views. In this case, it was held that henry Ford cannot run the company in a charitable manner for his employees or customers but, it has to be run for the benefit of the shareholders. The principle of shareholder primacy was recognised. Similarly, 'business judgment rule' was also recognised, allowing Ford latitude in running the company.[27] In *Revlon Inc* v. *MacAndrews & Forbes Holdings Ltd,* the court held that fiduciary duties owed by directors are to the shareholders and the corporations.[28] The mention of the corporation in exclusion to the shareholder shows that shareholder primacy is not supreme. In *Green* v. *Hamilton* International,[29] it was recognised that the fiduciary duty of the director was not only limited to the shareholder but everyone in the corporation. Subsequent cases like *A.P. Smith Mfg. Co.* v. *Barlow*[30] and *Shlensky* v. *Wrigley*[31] are amongst the few instances where courts in different states have rejected *Ford Motor Co.*

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[25] E.M. Dodd, *For Whom are Corporate Managers Trustees?* HARVARD LAW REVIEW, vol. 45(7), pp. 1145, 1149 (1932).

[26] A.A. Berle Jr., *For Whom are Corporate Managers Trustees: A Note*, HARVARD LAW REVIEW, vol. 45(8), pp. 1365, 1372 (1932).

[27] Dodge v. Ford Motor Co., 204 Mich. 459 (Supreme Court of the State of Michigan).

[28] Revlon Inc v. MacAndrews and Forbes Holdings Ltd, 506 A 2d 173 (Supreme Court of the State of Delaware).

[29] Green v. Hamilton International, 437 F Supp 723 (US District Court for the Southern District of New York).

[30] A.P. Smith Mfg. Co. v. Barlow, 98 A.2d 581 (N.J. 1953) (Superior Court of New Jersey, Chancery Division).

[31] Shlensky v. Wrigley, 237 N.E.2d 776 (Ill. App. Ct. 1968) (Appellate Court of Illinois).

CHAPTER III: THE EVOLUTION OF CORPORATE GOVERNANCE REGIMES AROUND THE WORLD

The origins of corporate governance are examined in this Aspect, with the recognition that corporations have always been governed, that significant developments occurred in the seventeenth and eighteenth centuries, and the enormous significance of the invention of the joint-stock limited liability company.

The evolution of corporate governance across the world in the twentieth century is examined, with complicated organizations, private businesses, and top management controlling shareholder authority first appearing in the interwar years. There are several unsolved concerns in both theory and practice. Various corporate governance ideas are explained and compared.

In the United States, the word "corporate governance" first appeared in the Federal Register in 1976. After the word was officially coined, authorities and businesses could begin to define how structured boards and best practices might be quantified into a benchmark. The New York Stock Exchange was the first to recognize this, requiring listed corporations to establish an audit committee on their board of directors, with members who must be Independent Non-Executive Directors (INEDs).

Governance, on the other hand is continually changing with the current economic downturn hastening the process. The method through which firms are directed and governed is known as corporate governance. The governance of their companies is the responsibility of their boards of directors. The economic crisis of 2008 was likely the worst economic disaster since the Great Depression. It resulted in the failure of investment banks such as Lehman Brothers, as well as bailouts and palliative monetary and fiscal measures to keep the global financial system from collapsing.

A number of things led to this, but the main culprit is a glaring lack of governance and control. The payment methods (created by the compensation committee) were very problematic, with out-of-control incentives encouraging CEOs to chase short-term growth rather than long-term sustainability. Prior to the crisis, corporate governance rules had been strengthened, but maybe not implemented, raising the vexing question of whether the board directors were unaware of the impending disaster or just turned a blind eye.

The most important requirement is for an environment in which effective executive challenge is expected and delivered in the boardroom before important risk and strategy choices are made. Finally, as time passes and the world becomes more aware of the most pressing challenges, governance will continue to evolve, with investors and boards defining and leading the way. Corporate earnings are no longer the exclusive measure of success, and worldwide acknowledgment of businesses' power and responsibilities is growing.

As was observed in the previous chapter, the broader question was, whether the duty of care was limited to the shareholders of the company or other constituencies were equally important. In this chapter the evolution of the corporate regime will be analysed from the perspective of experiences in three countries, namely, Unites States of America (USA) and England. Towards, the end, an analysis will be made as to whether the models adopted by England and USA are the effective approach for governance of every country or not.

EVOLUTION OF CORPORATE GOVERNANCE IN ENGLAND

Decades ago, the term "governance" didn't even exist. It is now widely used not just in businesses, but also in charities, universities, local governments, and NHS trusts. It has become a shorthand for a company's management style, with a focus on responsibility, integrity, and risk management. While difficulties that require corporate governance answers are inherent to the corporate structure, the phrase "corporate governance" only began to appear regularly in talks of public corporations in the United Kingdom as the 1990s progressed.

The Cadbury Committee's work, known as the Committee on Financial Aspects of Corporate Governance, is well recognized for helping to encourage the emergence of corporate governance in the United Kingdom at the time. The Cadbury Report on the financial elements of corporate governance, which was accompanied by a code of best practice, kicked off the revolution in the early 1990s. The "Cadbury Code," which was aimed at listed firms and focused on principles of corporate behaviour and ethics, was eventually recognized by the City and the Stock Exchange as a benchmark of good boardroom practice.

The Greenbury Report added a set of principles on executive director remuneration in 1995 (in response to a number of “fat cat” scandals, including the one involving British Gas chief Cedric

Brown, whose 75 percent pay hike infuriated both unions and small shareholders), and the Hampel Report combined the two in 1998, resulting in the first Combined Code. In each case, the studies were spurred by shareholder concerns about corporate structures and their capacity to respond to bad performance, or by government threats of regulation if the corporate sector did not clean up its act.

The expression corporate governance was not uncommon in American law journals in the 1970s, as at that time the country was going through several corporate scandals. This term was then imported to England, it took a firm root when Sir Adrian Cadbury was asked in May 1991 to chair the Committee on Financial aspects of Corporate Governance by the Financial Reporting Council, the London Stock Exchange and the accounting profession. The Cadbury was born out of various scandals that hit London during 1980s. [32]

THE GROWTH OF CORPORATE GOVERNANCE AS A DISCIPLINE DURING 1980'S

Sir Adrian Cadbury writes that, until the Second World War, governance was not an issue as the structures of the company was such that the board of directors were relatively weak and the shareholders were not in a position to hold them accountable.[33]

Even after the war ended, reconstructions was the main focus everywhere and corporate governance was not seen as an agenda. Sir Cadbury draws an interesting analogy of the situation through a comparison with a salesman and a rationer and says that during that time coping with shortages was the main goal. He further states that the technological development and global competition was also at primitive stages during 1950s and 1960's, and everyone seemed to be benefiting from the rising economic tide so there was no need to interfere with the private enterprise.[34]

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[32] Smerdon, *supra* note 9, at p. 2.

[33] As pointed out by Berele and means, the separation of management and ownership, and the fragmentation of the ownership had neutered the power of shareholders to exercise effective control on the shareholders putting the agency problem firmly on the corporate agenda. But in England, in terms of power, it was still the executive management which in the corporate driving seat and hence, the boards were not seen central to the way in which companies are run. Principle D.2, THE COMBINED CODE (Gee Publishers Ltd, June 1998), *as cited in*, A. Cadbury, CORPORATE GOVERNANCE AND CHAIRMANSHIP A PERSONAL VIEW, pp. 6-7 (Indian edn. 1, 2003).

[34] A. Cadbury, CORPORATE GOVERNANCE AND CHAIRMANSHIP A PERSONAL VIEW, p. 7 (Indian edn. 1, 2003).

This tranquillity in the corporate affairs was first broken by the collapse of Penn Central in 1970. Penn Central was USA largest railway company and the sixth largest company of the country. The official report of the Securities Exchange Commission criticized the Penn Central Board for its misreporting of earnings and lack of independence of directors. The report state that somnolent boards are a problem that exist in most of the giant corporations of the world.

These developments in the USA acted as a wake-up call in England. In England, in order to increase the accountability to shareholders, the approach of threatening through unwanted takeovers was adopted. The takeover were seen as an efficient mechanism, because it was believed that the highest bidder will be able to generate best returns from the company resources. Moreover, takeovers were financed from debts, hence the new board team would have to concentrate on generating profits to finance the debt which will ultimately ensure greater accountability to shareholders. This would also create an environment of healthy competition for achieving the goal of higher level of performance.[35]

The immediate response to this was that the boards started raising several defences of ingenuity. Besides, the takeovers turned out to be more costly than expected. The takeover tactics was seen as casting the boards and investors as loggerheads. A change in this position was observed when rather than takeovers, the investors adopted the approach of involvement with the board. This meant that the investors exercised influence over the boards on the basis of the investments that they have made. This was a move aimed at resolving the problem of conflict of interest.[36] The result was that fragmented shareholding converted into concentrated shareholding, by investors which included pension and retirement funds and insurance companies. In some companies around eighty-five percent of the shares were held by such investors.[37]

The advantages of having institutional investment is two-fold. First, due to their greater stakes in the company, they have a greater influence on the functioning of the board. Second, as the stake are higher, the investors have a greater incentive to use their influence in order to improve the performance of their portfolios.

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[35] *Id*., at p.8.
[36] Cadbury, *supra* note 28, at p. 9.
[37] Department of Trade and Industry Company Law Steering Group, MODERN COMPANY LAW: FINAL REPORT, vol. 1, p. 141 (Unite Kingdom).

At this juncture, The Committee on the Financial Aspects of Corporate Governance, 1991 (Cadbury Committee), chaired by Sir Cadbury came into existence.

CADBURY COMMITTEE AND THE CONTEMPORARY CORPORATE SCANDALS

Following Cadbury 1992, the UK has been at the vanguard of corporate governance reforms. Since then, the business climate has changed, and the level of corporate governance in the United Kingdom has substantially improved and become internationally recognized. Corporate governance difficulties arose in the United Kingdom as a result of high-profile corporate scandals in the late 1990s, such as Polly Peck and Maxwell, giving this long-standing issue a fresh lease on life.

A few of the corporate issues that occurred, there were numerous financial reporting inconsistencies, creative accounting, unanticipated business failures, the auditors' restricted involvement, and an uneven relation between director compensation and firm success, to name a few[38]. Following that, the Cadbury Committee, the first corporate governance committee, was established in 1991 in an attempt to address concerns about corporate scandals, resulting in the publishing of the Cadbury Report in 1992.

The Cadbury committee was sponsored by three bodies, namely, the Financial Reporting Council, the London Stock Exchange and the accountancy profession. The reason why these entities came together was that during this time, London had seen collapses of companies such as Coloroll and Poly Peck.

The common thread between all these collapses was that none of their audit reports indicated true state of the finance which cast doubts on the veracity of these audit reports and the accounts attached to them. This was seen as a threat to the reputation of accounting practices in England and also to the position of London as a financial centre.[39] The committee had to consider the following issues while formulating their report:[40]

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[38] Agrawal & Cooper, 2017
[39] Smerdon, *supra* note 9, at p. 2.
[40] Cadbury, *supra* note 28, at pp. 10-11.

1) The responsibility on both executive and non-executive directors towards the shareholders and other investors to ensure that the company is performing well and to report this

performance to these stakeholder from time to time in a clear, unambiguous and transparent manner

2) The role of audit committees of board, their responsibilities and composition

3) The extent and importance of audits and the liabilities of an auditor

4) The linkages between the board of directors, shareholders and other investors and the auditors.

5) Other matters of relevance

After the work was initiated in this regard, the financial sector in England was shook by another scandal, which was the failure Bank of Credit and Commerce International, as which was a result of the unveiling of scams purported by Robert Maxwell. He would borrow money from banks and disperse it into his private companies which meant that the debt on Maxwell Communications kept on mounting leading to its bankruptcy which also resulted in collapse of the banks that were their key creditors.[41]

Hence, the Cadbury Committee had broader issues to cover in its mandate. This lead to the creation of the Code of Best Practice, 1992 (the Code) in England. An important feature of the Code was that it was meant to be seen as guidelines, which are not mandatory in nature. They were to be followed by individuals and companies, "*in the light of their own particular circumstances*". The consequences that followed the publishing of this court were that corporate governance became a broad agenda in the regulation of companies. The boards of most companies started introducing the Code in their governance practices in some manner or the other. [42]

The Code had 19 provisions and 14 notes, dealing with board and committee structures, disclosures in relation to remuneration and financial reporting, and describing the relationship

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[41] Cadbury, *supra* note 28, at p 11.
[42] Cadbury, *supra* note 28, at p 11.

of the boards with the auditors the Code also emphasised on the need to have a system of checks and balances to ensure that no single entity enjoys unfettered powers in relation to running of the company. The code also placed a requirement of establishing auditing committees comprising of 3 non-executive directors, and majority of these directors to be independent. The independence was benchmarked against the degree to which they could be considered disinterested from the affairs of the company. This was recommendation was central in addressing the concerns related to board standards of reporting. [43]

Further the Code recommended that the selection of these independent directors must be through a formal process. It was also provided that the remuneration of these independent directors must be contractually determined to avoid the monetary influence of board on them. The Cadbury Committee also emphasised on the role of institutional investors in corporate governance and stated that they must exercise positive influence on boards by emphasising on

Based on these recommendations, the London Stock Exchange also altered the Listing Rules. Now a requirement of "*comply or explain*" was placed in the Listing Rules. This meant that all the listed companies had to state in their annual report whether they had complied with the Cadbury Code, and if they had not, then they were expected to provide reasons for it in the report itself.

BARINGS SCANDAL AND GREENBURY COMMITTEE

As investor trust dwindled in the 1990s as a result of the corporate world's crises, the problem of directors remunerating themselves above what was considered appropriate became a hot topic. Investors, in particular, saw little relation between firm success and board compensation.

The Study Group on Directors Compensation was founded in January 1995 by the Confederation of British Industry (CBI) under the chairmanship of Sir Richard Greenbury with the mission of identifying good practice in establishing directors' remuneration and preparing a code of conduct for UK PLCs. The group's final report was issued on July 17, 1995, and is known as the Greenbury report.

[43] Smerdon, *supra* note 9 at, p. 2.

While the Cadbury Committee Report and the Code was gaining popularity, seeking to make the companies more accountable, England was struck by another major scandal by the collapse of Barings bank. The mastermind of this scandal Nick Leeson who was the CEO of Barings Bank. He engaged in a lot of derivative trade of futures and options contracts on SIMEX, which was the budding stock exchange in Singapore. As per the Board of Banking Supervision Report, although the derivatives trade allowed Leeson to take greater risk than what was reasonable, the collapse of Barings was a direct result of his ability to act without authority that led its demise.[44]

Alongside corporate scandals was the rise of "fat cats" or the senior executives of newly privatised monopolies who were being rewarded by independent remuneration committees (or rather paying themselves), with huge remuneration which unreasonably excessive and being given out in a non-transparent manner. This resulted in an array of suspicion among the public not just with the boards of companies but also institutional investors' generally flaccid approach, and hence a need was felt to bring about a legislation which would ensure accountability of these powerful directors. Hence the Greenbury Committee on remuneration of directors was convened in January 1995 which submitted its report in July 1995.[45]

It was provided that to avoid potential conflicts of interest the board must set up a remuneration committees of independent directors to make recommendations to the board within agreed terms of reference, on the company's agreed terms of reference and its costs. The terms of reference meant specified packages for each director which also included pension rights and compensations[46].

Hence, the Greenbury Committee divested the responsibilities given to the board by creating a remuneration committee for the company. However, the Committee fell a step short from making this a mandatory requirement and these recommendations were also in the nature of "follow or explain" being enforced through the listing agreements.

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[44] J. Dine, THE GOVERNANCE OF CORPORATE GROUPS, pp. 138-141 (2000).
[45] Dine, *supra* note 37, at 141.
[46] Smerdon, *supra* note 9 at, p. 2.

THE COMBINED CODE

The major criticism of the both the preceding committee reports was that they were largely based on a "box-ticking" approach towards corporate governance .This implied that once the guidelines mentioned in the Codes were complied with, regardless of however superficial the compliance is, the company was taken to be in a good condition. This myth of deeming good conditions once the boxes are checked was shattered when scandals such as Maxwell and Baring happened due to the abuse of power by the chief executives. [47]

Moreover, there was a realisation that most of the institutional investors are still sitting idle, even though they have been empowered with voting rights which enable them to exercise some degree of control over the decision making process of the boards.[48]

Both the Cadbury Committee and the Greenbury Committee had envisaged in their regulations that a committee established in order to review their findings. This led to the birth of Committee on Corporate Governance under the chairmanship of Sir Ronald Hampbel. The final report was published in January 1998 which lead to the enforcement of the Combined Code.[49]

The Hampel Committee recognised the need to shift from the usual "box ticking" approach. There was a need of real application of the mind of the board on certain principles. Specific 42 provisions listed in the Combined Code purported to underpin and supplant these principles. So now, the requirement was two-fold. In order to claim compliance, the companies had to explain how the principles underpinned by these provisions were applied. On the other hand, in case of non-compliance, the company had to explain the reason why it has not complied.

The Combined Code was divided into two sections, first was addressed to the companies and the second to the institutional shareholders. Major changes that were brought under the scheme of this code include requirement of training for newly appointed directors, requirement of justification if the posts of chief executive and chairman were combined, identification of non-executive independent directors in the board report and the requirement of disclosures of

[47] Smerdon, *supra* note 9 at, p. 3.
[48] Smerdon, *supra* note 9 at, p. 3.

[49] Smerdon, *supra* note 9 at, p. 3.

interests of directors in the Director's report was identified. The board was also required to report to the shareholders each year on remuneration.

There were other requirements of accountability and audit on the board of directors. They were required to prepare a balanced and unambiguous analysis of price sensitive reports for the perusal of shareholders and regulators. They were also asked to review the internal control mechanism periodically and prepare a report in that regard. The Turnbull Committee laid down the mechanism in which such reporting must be done.[50]

For shareholders, the Combined Code provided that all proxy votes must be counted except in the case where a poll by show of hands is called in which case the proxies will indicates separately. Further, every resolution was required to be passed separately to avoid bundling of resolutions. The was done to insure the shareholder understands all the issues clearly and is not forced to unwantedly vote on certain issues merely because they are bundled with certain other issues that are of importance to that particular shareholder. Further, requirement of sending a notice to the shareholders, 20 working days before the annual general meeting is held was also recommended.[51]

INSTITUTIONAL INVESTORS AND THE MYNERS REPORT

Parallel to the aforementioned developments, there was a rise of shareholder activism whereby the big institutional investors insisted on following certain voting policies for non-executive directors, separation of the position of CEO and Chairperson and directives on remuneration of these executives.

In 2001, the Treasury Commissioned Mr Paul Myners, the chairman of Gartmore Investment Management to write a report on best practices in Institutional Investment in UK. The main emphasis was that the pension funds must provide clear objectives to their managers as regards the management of their funds.[52]

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[50] Smerdon, *supra* note 9 at, p. 3.

[51] Smerdon, *supra* note 9 at, p. 4.
[52] Smerdon, *supra* note 9 at, p. 4.

While making an investment all possible asset classes and major investment opportunities must be considered. Further it provided the characteristics that must be considered while making an investment which includes the risk factors, expected profits, investment objectives etc.[53]

The reported further urged the managers of these fund to incorporate the principles of US Department of Labor Interceptive Bulletin on activism, and should have "*an explicit strategy elucidating the circumstances in which they will intervene in a company, the approach they will use in doing so, and how they measure the effectiveness of this strategy.*" [54]

CORPORATE LAW REFORM

After the introduction of the Combine Code and the subsequent developments, there had been minimal instances of corporate malpractices in England. However, during the period of economic downturn from 1997 to 2003 in USA, the country saw major economic scandals including Marconi, Enron, Worldcom and Tyco. Common features in all these scandals were fraudulent accounting and malpractices in auditing, coupled with non-executive directors who were over respectful to the power executive, in most case as the former lacked the required expertise in the field of the business that the company was transforming itself into. Further the independence of these executives was often compromised by inappropriate remuneration and commercial side deals.

Alarmed by the situation in USA, the Treasury in England and the Department of Trade and Industry combined three studies. First was a review of the role of and effectiveness of non-executive directors by Mr Derek Higgs, second was the review of the Combined Code and a report on auditing and accounting arrangements. The Higgs review had specifically criticized the lack of true independence among non-executive directors.[55]

[53] Smerdon, *supra* note 9 at, p. 4.
[54] Smerdon, *supra* note 9 at, p. 4.

[55] Smerdon, *supra* note 9 at, p. 5.

This lead to the creation of a new Combined Code in 2003 which has 17 main principles, 26 supporting principles and 47 provisions. The revised code largely drew from Higgs report on the points related to director's independence, the recruitment process and the procedure for post appointment appraisal.[56]

EVOLUTION OF CORPORATE GOVERNANCE IN THE USA

In the 1990s, corporate governance became a hot topic, especially in the wake of global accounting scandals. Stakeholders in organizations, particularly investors and regulatory authorities, are pressuring corporations to implement effective corporate governance standards. With the most established securities market, the United States of America has always been a leader in developing and implementing corporate governance standards.

The purpose of this section is to present the major milestones in corporate governance in the United States (US), including the stock market crash of 1929, which prompted the Securities Act of 1933 and Securities Exchange Act of 1934, the Foreign Corrupt Practices Act of 1977, and the Sarbanes-Oxley Act of 2002. In addition, significant international treaties impacting US practice will be discussed in this context.

The corporate governance requirements in USA have been in place since the time of enactment of the corporate law and securities regulation. These requirements have been further supplanted by certain recent regulations which include the Sarbanes-Oxley Act, 2002. The Sarbanes-Oxley Act, 2002 focuses on improving the state of public disclosure, as required by the securities regulation, both in form and substance. This is sought to be achieved by improving the independence of the external auditing firms and individual auditors, as well as that of directors. The Sarbanes-Oxley Act, 2002, however is limited to the disclosure requirements and does not deal with a director's broader obligation to the company.

[56] Smerdon, *supra* note 9 at, p. 5.

CORPORATE LAW IN THE USA

The corporate law provisions in the USA can be divided into 3 categories. The first category deals with the provisions in relation to formation of the corporations. Generally, corporations are formed and created when one or more investors transfer assets into a separate account, that is the corporation, and in return he gets a divisible interests in the assets of the company. This divisible interest constitute a share. The function of these two contemporaneous and simultaneous transactions is that a separation in ownership of the shares from the ownership on the company's assets is created. This implies that a company is a separate legal entity. Moreover, the liabilities son the assets owned by the corporation and those incurred by the conduct of the business of the corporation are not owed by the shareholders.[57]

The second set of provisions in the corporate law in USA pertain to corporate constitutions. These provisions pertain to the company's internal arrangements for exercise of control over accounts, which means, duties in relation to the resources, the assets and the risk of the corporation. It is often observed that the directors delegate the duties to corporate officers, such as the CEO (Chief Executive Officer), of the CFO (Chief Financial Officer) to manage the affairs of the company as well as to take care of the ordinary, day to day business of the company. As per the law in the USA, shareholders control on a corporation is limited to election of directors and auditors which are often appointed by the CEO. Whereas the director's role is limited to appointing the CEO. The CEO and other officers are the persons who actually engage with the third parties on behalf of the corporation for the purposes of business. The other officers are the ones to whom certain functions have been delegated by the CEO, say financial functions are delegated to the Chief Financial Officer. Apart from interacting with the third parties the functions of these officers also include making the initial proposals for shareholder resolution and further organize the mechanism for the decision making process.[58]

These officers also have a duty to report to the directors and shareholders their corporation. This obligation comes from the concept of separate legal personality of the corporation, as they are acting on behalf all these stakeholders, they have the duty to report to them.[59]

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[57] B. L Nelson, *The American National System of Corporate Governance*, CORPORATE GOVERNANCE AROUND THE WORLD, p. 74 (A. Naciri ed, 2008).
[58] *Id.*, at pp. 74-75.
[59] *Id.*, at pp. 75.

The third set of provisions in the USA corporate law regime deal with the law concerning the liability of the directors and the officers to the company and the shareholders. These provisions in the corporate law jurisprudentially draw heavily from the contract and agency law provisions. These provisions talk about the liability of these actors in pursuance of the actions undertaken by them in the name of the corporation. The most important limbs of these fiduciary duties are duty of liability and duty to take care. The directors and officers of the company who do not adhere to these duties can be personally held liable for their actions. Their position is comparable to the position of a bailee in this regard, as although they do not have the title to the assets of a corporation they do have the possession of these assets.[60]

In relation to the limbs of duties, the duty of care means that the officers will pursue the corporation's duty in the manner as if they are the owners of the corporation. They must act "*within the scope of their authority*" and they must not act "*negligently*". However, this duty of care is subject to the business judgement rule which means that any decision taken with the *bonafide* belief, that it will lead to benefit of the business of the corporation and will generate profits in future will not be considered as an act not in accordance with the duty of care.[61]

On the other hand, the duty of loyalty means that all sorts of conflicts of interests as regards the company's interest and directors' or officers' personal interests shall be avoided by such a director or officer. Three principles must be followed in this regard. First that the director or the officer must always act in the "*best interest*" of the corporation. Second that such officers or directors must not acquire assets which would lead to a conflict of interest situation with the interests of the corporation. This acts as a prohibition on the directors from acquiring entities that pose a competition to the corporation. Third and the most important aspect, in recent times is that in the vent of a conflict of interest situation, the directors are required to disclose the information. These disclosure requirements are the main focus of the Sarbanes-Oxley Act, 2002. [62]

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[60] Nelson, *supra* note 50, at pp. 75-76.
[61] Nelson, *supra* note 50, at p. 77.
[62] Nelson, *supra* note 50, at p. 78.

THE USA SECURITIES REGULATIONS

Securities regulations, like other consumer protection regulations are enacted to protect the buyers by mandating the sellers to provide information. In case of securities regulations that requirement related to disclosures related to the business of the company.[63]

In USA, public disclosures can be divided into two categories. First are the disclosures by the corporation and the promoters as regards the securities that they are issuing. This is called initial public offering or an IPO. The Second includes disclosures related to resale of the publicly traded shares. The first pertains to original title and the second pertains to derivative tile. The law governing IPOs in the USA is the Securities Act, 1933 and the law governing subsequent trade is the Securities Act, 1934.[64]

There are disclosure requirements for both kinds of trade in securities. The disclosure requirements for the IPO are issued by the Securities Exchange Commission (SEC). These disclosures have to be made at the time of the issue. The SEC requires that all the information reasonably necessary to assure "*full and fair*" disclosure of the character of the securities, publicly available for sale in the US. Further, when there are specific disclosure requirements, any omission of material information and any misstatement will lead to penalties.[65]

The periodic disclosure requirements for companies whose shares have already been issued are provided in the Securities Act, 1934. These requirements are considered even more important than the requirements of disclosures at the time of issue. The most crucial and important element of these periodic disclosures are the annual and quarterly reports, for corporations whose securities are traded on exchanges. These reports provide financial data, the returns from the ongoing operations, the information about the market segment performance, information about future products and new plans. Additionally, information about activities of material subsidiaries and research and development activities of the corporation must also be disclosed.[66]

[63] Nelson, *supra* note 50, at p. 83.

[64] Nelson, *supra* note 50, at p. 84.
[65] Nelson, *supra* note 50, at p. 85.
[66] Nelson, *supra* note 50, at p. 86.

The quarterly reports are to be published every three months. In addition to this, whenever the company undergoes a material change, the information of such change must be published through current reports and press releases. The ideas is to keep the investors and traders abreast of the status of the business and affairs of the company.[67]

Apart from these periodic reports, there are is also a concept of "*proxy statements*" in these disclosures. These materials are different from the usual public disclosures. They are released keeping in mind solely and in entirety the shareholders as opposed to traders. These proxy statements are required in those situations where a shareholder approval is required to take a corporate action. Generally in the US, the shareholder is mostly needed for the elections of directors and auditors. Hence, the proxy statement mostly pertain to information that is reasonable required to make an informed decision in relation to the election of auditors and directors.[68]

THE COLLAPSE OF ENRON AND WORLDCOM

Enron Corporation was a company providing electricity and natural gas services. Enron went into bankruptcy December 2001, with its stock value on New York Stock Exchange at $0.26, which led to loss of jobs to about 20,000 of its staff members. Worldcom, on the other hand was a long distance phone company which went bankrupt in July 2002.

The common reason that is seen behind the fall of both of these companies are accounting malpractices and executive self-dealings. In Enron, the accounting policy that was followed is mark to market policy, which means the assets are valued on the basis of their current market value and not on the basis of what the actual returns would be. This allowed Enron to overprice its assets. Further, the Chief Financial Officer, was convicted for indulging into self-dealings, by creating partnerships with the sole objective of buying Enron's loss making assets which helped them keep the prices still overvalued. Considering the stature of Enron in American

[67] Nelson, *supra* note 50, at p. 86.

[68] Nelson, *supra* note 50, at p. 86.

business circles and the strong relations of the founder Kenneth Lay, with the Bush family, even the trade analysts refrained from giving Enron a lower rating.[69]

The top level officers and directors in Enron were found to be unaware of the financial practices of the firm. Even the auditing firm Arthur Anderson that was responsible for looking at Enron's account admitted that certain information was withheld for him. These corporate malpractices created a stir in the country and there was a demand for stronger regulations.[70]

The House Committee on Financial Services held its first meeting on Enron in December 2001 and proposed a bill which was passed shortly after its introduction in the Congress in April 2002. The Senate finally acted on the bill after the filing of Worldcom bankruptcy in July 2002.

SARBANES AND OXLEY ACT, 2002

In 2002, Congress approved the Sarbanes-Oxley Act ("Sarbanes-Oxley"), which introduced substantial reforms in numerous sectors of corporate governance in response to recent corporate accounting and fraud scandals. The Sarbanes–Oxley Act of 2002 will serve as a stark reminder of the necessity of professional responsibility and financial transparency. This bill is a massive reform package that mandates the most significant changes to the corporate sector since the FCPA of 1977 and the SEC Act of the 1930s.

It aims to prevent similar crises and restore investor trust by establishing a Public Company Accounting Oversight Board, amending auditor independence regulations, rewriting corporate governance requirements, and considerably raising the criminal penalties for securities law infractions[71]. Sarbanes Oxley strives to improve corporate governance by implementing procedures that increase internal controls and, as a result, corporate responsibility. Sarbanes Oxley requires organizations to do a risk assessment of their present information security

[69] J. A. Cohan, *"I Didn't Know" and "I Was Only Doing My Job": Has Corporate Governance Careened out of Control? A Case Study of Enron's Information Myopia*, JOURNAL OF BUSINESS ETHICS, vol. 40(3), pp 275-299 (October, 2002).
[70] *Id.*
[71] Gallegos,2003

policies to see whether they need to be updated in order to maintain the integrity of corporate financial data.

The Sarbanes and Oxley Act, 2002 was enacted on July 2002 as a reaction to the aforementioned scandals. This enactment significantly changed the corporate governance reporting requirements applicable to any company required to file reports with the SEC as it had listed securities on either the New York Stock Exchange or the NASDAQ.

Its major provisions include:

- certification of financial reports by Chief Executive Officers and Chief Financial Officers;
- ban on personal loans to Executive Officers and Directors;
- accelerated reporting of trades by insiders;
- prohibition on insider trades during pension fund blackout periods;
- civil penalties added to disgorgement funds for the relief of victims;
- additional disclosure;
- auditor independence, including outright bans on certain types of work and pre-certification by the company's Audit Committee of all other non-audit work; and
- criminal and civil penalties for securities violations.

The penalties for willful breaches of the Securities and Exchange Act of 1934, including the accounting sections of the FCPA, were considerably raised by Sarbanes-Oxley (penalties for violations of the antibribery provisions of the FCPA were not affected by Sarbanes-Oxley.

The role of Sarbanes and Oxley Act, 2002 is limited to adopting measures that are reasonably necessary for a reliable corporate financial reporting and the prevention of fraud in corporate securities trading.

Sarbanes and Oxley Act addresses four major issues, broadly:[72]

(i) The substance of securities disclosures

[72] Nelson, *supra* note 50, at p. 92.

(ii) The independence of auditors in auditing periodic financial reports

(iii) Procedure for preparation and presentation of periodic reports

(iv) Increase in potential personal criminal penalties for violation of the securities regulations by corporate officials

As per the substance of securities disclosures requirements, any material change is required to be disclosed rapidly and in a clear manner under the act. This requirement is very similar to the requirements in Securities Exchange Act, 1934. The Act also provides for a having a separate subsection for "Management's Discussion and Analysis", which required issuers to explain the off-balance sheets separately.[73]

Issuers were also required to disclose all non- Generally Accepted Accounting Principles (GAAP) measures undertaken by the corporation .These non-GAAP measures must be reconciled with the most directly comparable GAAP measures in a presentation that is issued with the disclosures.[74]

Issuers are also required to disclose the code of ethics under this Sarbanes and Oxley Act, 2002. This code of ethics is supposed to apply to the company's principle executive officer and principle finance officer. A company without such code is also required to disclose this fact and explain why such code has not been put in place. A company is also required to make the disclose any waivers or amendment to the code of ethics relating to any of the aforementioned officers.[75] The requirements of the code of ethics include:

"*honest and ethical conduct, reliable financial disclosures and compliances with applicable regulations, including the ethical handling of actual and apparent conflicts of interest between personal and professional relationships*."

In relation to publicly listed companies the SEC has made these requirement specifically applicable to the CEO and the CFO of the company.

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[73] Section 401(a), SARBANES AND OXLEY ACT, 2002 (The United States of America).
[74] Section 401(b), SARBANES AND OXLEY ACT, 2002 (The United States of America).
[75] Section 407, SARBANES AND OXLEY ACT, 2002 (The United States of America).

In relation to the independence of auditor, there was a call for creating the public accounting oversight board for the purpose of regulating accountants who audit public companies and establishing auditing standards. The board consists of 5 members, two of which are certified chartered accountants. The board was supposed to be funded by all companies that are listed on US stock exchanges.[76]

Issuers are further prohibited under the Sarbanes and Oxley Act from engaging their auditors for non-audit services except in the cases when

(i) pre-approval from the audit committees has been obtained,

(ii) public disclosure regarding this non auditing service has been provided

Hence, and auditor will not be considered independent if he received some compensation based on selling certain engagements to clients for purposes other than auditing. The independence will also be considered to be impaired if the auditor has any material direct or indirect business relationship with the corporation that is being audited by them

Now, when we look at the requirements for periodic disclosures, a lot of elements have been added. In each annual report to the shareholder, the management's responsibilities and the effectiveness in carrying out these responsibilities must be discussed in very detailed manner. These responsibilities pertain to "Internal Controls over Financial Reporting". This refers to those controls which are designed to provide a reasonable degree of assurance in relation to the reporting of finances and preparation of annual accounts and financial statements for external purposes in accordance with the GAAP.[77]

Further public companies are required to maintain disclosure procedures in order to ensure that the information required for public disclosures as per the securities disclosures is recorded processed and summarized within the specified periods for such disclosures. The internal control of financial statements are a part of the general disclosure controls. These are required to be fled with the SEC in a time bound manner and must be reviewed by the Senior

[76] Section 208, SARBANES AND OXLEY ACT, 2002 (The United States of America).

[77] Section 404, SARBANES AND OXLEY ACT, 2002 (The United States of America).

Management on a quarterly basis. The CEOs and CFOs are required to personally review the company's annual and quarterly reports and they are subject to civil and criminal penalties.

The issuers are also required to have an audit committee composed of independent directors in its entirety and it must disclose the name of at least one financial expert together with the whether the expert is truly independent of the management. If there is no audit committee there is a disclosure and explanation requirement in that regard.[78]

The Sarbanes and Oxley Act, 2002, categorically prohibits the directors from exercising any fraudulent and coercive influence on the auditors for the purposes of manipulating the financial statements. This has been illegal since the Security Exchange Act, 1933 and it is subject to personal criminal penalties. Misstatement and material omissions are also prohibited since 1976.[79]

A responsibility has also been imposed on securities lawyers to report evidence of material violation of security laws or breach of fiduciary duties or similar violation by the principle officers of the company to the CEO or the CLO. If these officers do not respond to the evidence appropriately then the attorney has the right to approach the auditing committee or the board of directors.

In terms of penalties, it has been provided that officers, directors and employees will be subject to criminal penalties which extend up to 20 years of imprisonment, for violations such as destroying records of auditing, falsifying documents and for possessing knowledge of violation of other securities regulations.[80]

CEOs and CFOs might be required to give up their incentive compensation or gains from the sale of the company for a period of one year, and might be even required to forfeit business. Further, as discussed earlier, such violations may also amount to violation of duty of care under the securities regulations.

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[78] Section 406, SARBANES AND OXLEY ACT, 2002 (The United States of America).
[79] Section 303, SARBANES AND OXLEY ACT, 2002 (The United States of America).

[80] Section 1102, SARBANES AND OXLEY ACT, 2002 (The United States of America).

In the United States, different corporate governance standards have been in place since the 1930s. The Securities Act of 1933 and the Securities Exchange Act of 1934 were the first corporate governance standards, followed by the FCPA in 1977, which was the sole legislation in the world for the next 20 years. The United States Congress passed this laws and regulations, which included important corporate governance and transparency changes as well as a completely new regulation scheme for the accounting profession.

Corporate governance will remain the primary mechanism for safeguarding stakeholders' rights in the future. Examining the growth of corporate governance in the United States, it can be concluded that corporate governance laws have gotten more structured and difficult. In order to thrive, businesses must adapt to these changes.

The Sarbanes-Oxley Act of 2002 is a modern development in corporate governance. This legislation not only altered the regulatory environment for corporations operating in the United States' capital markets, but it also had an impact on governments all over the world.

CHAPTER IV: EFFECTIVE GOVERNANCE REGIME

Divergences in the interests of various entities result in significant expenditures. Corporate governance is the result of these agents' interactions and connections. The best corporate governance structure is one that minimizes the institutional costs of these competing interests colliding.

Governance frameworks may also influence employment and labor relations: if labor has a significant part in shaping firm strategy, there may be losses in the efficient redeployment of resources. Employees who are kept totally out of the information flow and decision-making process within the business, on the other hand, may have a poorer commitment to the business's progress and may face higher societal costs in the future.

However, there are substantial policy implications. In terms of economic policy, growing institutional and transaction costs in the sphere of corporate decision-making and finance have an influence on economies' competitiveness corporate investment levels, and capital market allocative efficiency. Corporate governance is directly relevant to policymakers from an institutional standpoint since laws, institutions, and regulations are one of its most essential sources.

Company law, securities regulation, bank, pension fund, and insurance company prudential regulation, accounting, and bankruptcy laws all have an influence on how organizations make choices and behave in the market and with their many constituents. To return to Hart's adage, the legal and institutional framework determines the majority of non-contractual interactions. In each jurisdiction, policymakers are responsible for finding the appropriate balance between required legislation and contract, resulting in the optimal mix of flexibility and predictability[81].

The inability to write complete contracts between principals and agents on the exact tasks of the latter is the result of two main incidents: the long string of agency relationships that characterize today's large firms; and the inability to write complete contracts between principals and agents on the exact tasks of the latter. As a result, "governance structures might be understood as a mechanism for making choices that have not been stipulated by contract," as Professor Hart (1995) described it.

Individual economies have evolved various capital market processes, legal frameworks, factor markets, and private or public organizations to serve as owners or corporate governance principals in the economy through time. Even within the same nation, these arrangements may differ depending on the sector. They are frequently the outcome of institutional, political, and social norms. Understanding and embracing the various methods is a necessary first step in analysing the effects of increased globalization on national systems.

Despite various starting points, a tendency toward corporate governance regime convergence has emerged in recent years. Thus it, together with their respective governments, are becoming increasingly aware that, in order to access this vast pool of global financial resources, they must

[81] See Black and Kraakman (1996) and Black (1999)

fulfil specific governance requirements. In this part, we examine corporate control patterns in key nations in order to develop a broad taxonomy of governance regimes and track their change over time.

There are some whose responsibility route leads to special interests of "insiders": large shareholders, banks, and labor, and those whose accountability trail goes to arm's length, market-based connections between enterprises and their investors (who are therefore "outsiders"). Further, this section provides an outline of how the function of various corporate governance agents has altered in different systems over the previous few decades. Also look at why these agents' behaviour and posture are changing as well as if the varied patterns are convergent. Finally, this dissertation will offer some preliminary results as well as some suggestions on the future form of the corporate governance policy discussion.

The governance of major, widespread limited liability corporations reflects a wide range of equity market ownership structures, corporate finance patterns, and company laws and securities rules. The distinction between “insider” and “outsider” systems has long been used to describe governance regimes.

There has been a global debate on the fact that whether there is a possibility of global convergence on corporate governance or divergence is necessary to ensure that the governance model based on the structural difference in the markets of every country. Nester and Thompson had propounded two models based on the concept of divergence, which are, the outside model and the inside model.[82]

[82] S. Nestor & J.K. Thompson, *Corporate Governance Patterns in OECD Economies: Is Convergence Under Way?*, available at http://www/oecd/org/dataoecd/7/10/1931460.pdf.

THE OUTSIDE MODEL OF GOVERNANCE

This model is mainly followed by the countries such as the USA and England. This model follows the conception formulated by Berle and Means hinting towards a separation of ownership and control which assumes the inherent lack of shareholders in the management. Hence, it propounds for creation of incentives for the shareholders to exercise control on management.[83]

The outsider model is characterized by :

1. distributed equity ownership with huge institutional holdings;

2. the recognized primacy of shareholder interests in company law; and

3. the recognition of the primacy of shareholder interests in company law.

4. A major emphasis on minority investor protection in securities legislation and regulation; and

5. reasonably strict disclosure standards

Equity is often owned by a diverse collection of individual and institutional investors in these nations. Despite the fact that many nations have long experiences of individual stock ownership, a phenomenon known as institutionalisation of wealth is causing an increase in the amount of national income handled by institutional investors.

They have an one core precept: to maximize the return to their investors in accordance with their mandates, and to do so by employing the most cutting-edge approaches in the pursuit of their investment strategies. They usually have little interest in operating the business and have no other ties to it other than their financial investment.

[83] B. Black & R. Kraakman, A Self-Enforcing Model of Corporate Law, HARVARD LAW REVIEW, p. 1912 (1996).

Since it often relies primarily on the financial market to influence behavior the outsider system may also be described as a market-based system. The system is also distinguished by a legislative and regulatory framework that encourages the use of public capital markets and is intended to in-still trust in non-controlling investors

The legal and regulatory framework was built on the basis that the firm is owned by a diverse group of investors who operate independently of one another and require trustworthy and appropriate information flows to make informed investment decisions. Legislation has generally been intended to give investors with relatively comprehensive information and to establish relative equity in terms of information access. Be a result, the system is referred to as "disclosure-based."

Regulatory authorities have typically been ready to let investors take on risk in their own way, even when they have normally imposed strong disclosure criteria to prevent investors from being misled about the amount of risk they are taking on. Outsider systems, unlike other insider systems that thrived in bank-dominated contexts, have typically had two channels of financial intermediation. Finance has tended to be short-term in the banking industry, with banks maintaining “arms-length” ties with business clients. Furthermore, shares tended to constitute a large portion of financial assets and a high part of GDP, reflecting the legacy of widespread stock ownership.

Investors in outsider systems have always been indifferent with corporate governance since it was assumed that they couldn't or didn't want to exercise their governance rights. The primary tool used by investors to discipline management has been the purchase and sale of business stock. Investors sell shares when a firm is poorly managed and/or shareholder value is disregarded, lowering prices and exposing the firm to hostile takeovers. A model like this assumes a lot of information transparency, strong trading regulations, and liquid stock markets.

Much of the early thinking on corporate governance was influenced by the outsider model. Analysts as far back as the 1930s saw possible agency concerns when a scattered group of shareholders were unable to supervise and control management's behavior due to the separation between ownership and management[84].

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[84] See Berle and Means (1933) and Dodds (1932)

Indeed, many experts had foreseen this in the late 1980s determined that the agency issues that plagued outsider systems would almost certainly result in poor company performance. Management was seen to have successfully protected itself from accountability, while shareholders were seen to be more concerned with short-term performance. Many experts compared the market-based system unfavourably to insider control methods in which corporate control was exerted by agents with longer-term economic ties to the corporation.

In recent years, the tide has shifted a bit, with corporations in the United States and the United Kingdom completing significant restructuring and achieving spectacular profit increases. As a result, contemporary commentators have become considerably more optimistic about the capital markets' ability to promote efficient economic behavior.

This model also relies on a self-regulatory approach where the compliances are not made mandatory as the assumption is that in the presence of sophisticate professional, lawyers and the judiciary there is no need for the legislature to exercise excessive control on the functioning of these corporate entities. Such model fits well in the context of developed economies such as the USA and England as their markets are already robust and at a very advanced staged.[85]

However, this approach may not fit very well with countries who are still in the phase of developing or are at nascent stages of development as with them, it will be difficult to assume that the market forces will ensure that these regulations will function effectively.

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[85] 107 B.Cheffins, *Current Trends in Corporate Governance: Going from London to Milan to Toronto*, DUKE JOURNAL OF COMPARATIVE AND INTERNATIONAL LAW. Pp. 5, 7 (2000) “Diffused ownership is a common feature in corporations in the United Kingdom as well as United States. In Britain, there are very few firms which are controlled by business families, and less than one-fifth of the Britain’s publicly quoted firms have an owner who is in control of more than 25% of the shares. Likewise, in USA, shareholdings in the form of majority ownership are uncommon.”

INSIDE MODEL OF GOVERNANCE

The Inside model of governance concerns addresses a developing market situation more effectively as compared to the outside model. There is requirement of mandatory enforcement of rules in this regard.

Ownership and control are held by identifiable and cohesive groups of "insiders" who have longer-term stable relationships with the company in most other OECD countries and nearly all non-Members. Insider groups are typically small, their members are known to one another, and they have some connection to the company other than their financial investment, such as banks or suppliers.

Furthermore, the legal and regulatory structure is more tolerant of insider groups who operate in concert to influence management while excluding minority shareholders. As a result, the agency problem that characterizes the outsider system is far less significant. Traditionally, insider systems have been focused on banks. Corporate finance patterns frequently reflect a heavy reliance on banks and large debt/equity ratios. Banks' ties with corporate clients are more complex and long-term than those with arm's length lenders. In general, capital markets in foreign regimes are less developed.

With the exception of the market-based system, which requires public disclosure of information, the insider system is more open to selective information sharing among insiders. Insiders can control a corporation by possessing a majority of voting shares outright or by controlling a strong minority holding and leveraging a variety of parallel mechanisms to increase their power.

Insider groups usually consist of a mix of family interests, related industrial enterprises, banks, and holding businesses. Insiders may frequently contact with one another with reasonable ease allowing them to operate in concert to monitor corporate management which is under their strict control.

Corporate structures, shareholder agreements, discriminatory voting rights, and processes meant to minimize the effective involvement of minority investors are examples of frequent mechanisms used to transfer ownership. The legal and regulatory system, in general, is relatively accommodating of such procedures.

Some organizational arrangements, particularly "pyramid structures," allow persons with prominent positions in the parent business to exercise influence over the company while owning just a small portion of its total outstanding shares. Other popular methods of transferring control include the issue of various classes of shares with higher voting power for the insider group. Capped voting restricts the amount of votes that investors can cast regardless of their stake in the company[86].

Cross-shareholdings are used in some governance systems to generate large shareholder cores, which are frequently utilized in conjunction with cross-guarantees and shareholder agreements to reduce the impact of non-controlling investors on corporate policy. If the informal group has specific ties to other players in the governance process, this potential may be enhanced.

The combination of corporate financing patterns (i.e. high levels of debt finance), ownership concentration, and further measures to protect management from outside criticism resulted in significant homogeneity among the insider group, which was essentially immune to minority investor discipline. The ability of a relatively small identifiable group to influence management does not necessarily imply that insiders were able to create and follow superior policies. "Insider" firms appear to have significant difficulty defining long-term goals in the absence of a clearly agreed-upon long-term purpose, such as financial returns to shareholders.

Insider frameworks come in a variety of shapes and sizes. Commercial banks play a key role in various European countries, with Germany serving as an example. It is important to note that the banks in these circumstances are powerful, autonomous, and primarily private enterprises.

Each company in Germany has a "house bank" that is responsible for the majority of the business's financial transactions. We've already mentioned that bank-based systems frequently rely on confidentiality when sharing information with corporate clients, an approach that goes opposed to outsider regulations that compel extensive public disclosure.

[86] Pinto and Visentini (1998) provide for a fairly thorough review of such arrangements in their country reviews

While Germany has a traditional bank-centered governance structure, numerous other European nations, including Austria, Switzerland, the Netherlands, and the Scandinavian nations, have significant elements of this structure. Domestic institutional investors, on the other hand, are substantial in the Netherlands, Switzerland, and a few Scandinavian nations, and have some say in corporate governance.

Interlocking share ownership across groupings of financial and non-financial enterprises has been the norm in various nations (for example, France and Japan). The privatisation process in France, which began in the mid-1980s, presented authorities with the dilemma of how to manage enterprises after they were sold to private investors. Control has traditionally been exercised in Japan through keiretsu institutions, which brought together groups of industrial and financial firms, as well as consumers and suppliers. Banks in the Japanese system were similarly intended to play a major role, with the major bank taking the lead within the group.

There are several country variants on these models, and all are experiencing fast change. First and foremost, it is important to note that there have always been a variety of systems that fall somewhere between the insider and outsider models. Smaller English-speaking nations, such as Australia, Canada, and New Zealand, have a more centralized ownership structure than the United States or the United Kingdom, with family-owned businesses predominating.

However, these systems have many characteristics with the United States and the United Kingdom, including a strong recognition of shareholder rights, institutional wealth ownership, a long history of robust legislative supervision of securities markets, and a strong emphasis on accounting transparency. In general, countries with this type of structure have less experience with the phenomena of institutional investor activism as a factor driving corporate governance change.

On the other hand, they have a lot of experience dealing with the issue of balancing the interests of controlling investors and minority investors, notably through rigorous securities legislation, openness and disclosure regulations, and rigorous independence standards for board members.

The reason mandatory rules becomes so important in developed countries as most of the corporations in a large number of developing Asian economies whether public or private are dominated by groups which control the dominant shareholding. These groups are generally

influential business family. As they have a major stake in the corporation they automatically also gain a controlling interest in the country.[87]

So here, the real diversion is not between the shareholder and the management but between the majority and the minority shareholder. The mandatory rules are hence required to protect the minority interests.

The next chapter will undertake the analysis of the market structure in India to indicate why a self-regulatory regime of corporate governance or the outside model is a more appropriate approach for the country in the current times.

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[87] U. Varottil, *A Cautionary Tale of the Transplant Effect on Indian Corporate Governance*, NATIONAL LAW SCHOOL OF INDIA REVIEW, vol. 21(1), pp. 1-50 (2009). "The BRIC countries are apt examples of economies that have historically been bereft of developed capital markets, but that have more recently migrated at a rapid pace to adopt systems and practices from developed economies so as to ensure robustness of their markets and th attract not only a great number of investors, but also those with high quality and credibility."

CHAPTER V: CORPORATE GOVERNANCE REGIME IN INDIA

The long-term viability of India's success narrative is inextricably linked to the country's corporate governance. The purpose of this section is to provide an outline of the corporate governance regime in India. The following section assesses the legal and institutional components of investor protection and corporate governance in India - both the letter of the legislation and how it is actually implemented. Followed briefly by the summarizes of historical evolution of corporate governance in India and also examines changes in corporate governance during the early 1990s particularly trends influencing financial institution corporate governance.

Having looked at the theoretical background and corporate governance practice around the world, now this chapter seeks to apply that understanding in the Indian context by looking at the evolution of governance practices in Indian itself. This chapter will be a combination of descriptively tracing the developments of the Indian corporate governance and regime and normatively analysing it by comparing and contrasting it with the regimes around the world that have been discussed and analysed in the previous chapters along with the underlying theoretical principles.

In India's current economic situation, corporate governance has played a critical role. In 1991, India successfully began its transition to a more open and accepting economy. It has witnessed an incredible growing trajectory in the size of its stock market since then, with the number of listed companies expanding exponentially. If India wishes to attract more foreign direct investment from other nations, Indian firms must focus more on transparency and shareholder value enhancement.

Despite the fact that corporate governance standards can be traced back to 1961 all over the world, India was trailing behind. It wasn't until 1991 that liberalization and corporate governance gained traction on a global scale. The reform of the Securities and Exchange Board of India was the most significant effort in 1992. (SEBI). SEBI's principal goal was to oversee and standardize stock trading, but it also created a set of corporate governance laws and regulations throughout time.

The foundation of the Confederation of Indian Industry (CII) in 1996 was the next significant change, as it drafted a set of regulations for Indian firms in order to start the corporate governance process. Then, under the Securities and Exchange Board of India, two committees led by Kumar Mangalam Birla and Narayan Murthy began building the basis for formalizing corporate governance best practices.

From business standards to accounting standards, from corporate social responsibility to supply chain management, from a means of avoiding prospective financial distress to a tool for ensuring macro/microeconomic stability, to a contributor to the improvement of the overall political economy, corporate governance has become an integral component of a broad spectrum.

Almost all streams of academic law, economics, and finance studies have felt the essential nature and effect of corporate governance by now. For a prolonged period the nexus between corporate governance and a variety of commercial interests and disciplines was mainly theoretical, while the influence of scholarly work on corporate governance was disregarded at best and derided at worst for its apparent lack of good business efficiency.

The industry organization Confederation of Indian Industry (CII) proposed corporate governance in India as a voluntary measure to be implemented by Indian firms in the aftermath of deregulation in the 1990s. It became necessary in the early 2000s with the implementation of Clause 49 of the Listing Agreement, which obliged all firms (of a particular size) listed on stock exchanges to follow certain guidelines. The Ministry of Corporate Affairs issued a set of optional corporate governance standards in late 2009, which cover a variety of corporate governance concerns.

The corporate governance approach adopted in India is largely based on the Anglo-Saxon model of governance, which has certain limitations in terms of application in the Indian context. In the United States or the United Kingdom, for example, the fundamental governance issue is simply one of punishing management that has ceased to be properly responsible to the owners, who are dispersed shareholders.

In India, however, the fundamental problem of corporate governance is regulating the dominant shareholder, who is the primary block-holder, as well as defending the interests of minority shareholders and other stakeholders, in contrast to these nations.

This situation, as well as the complexity that arises from the implementation of a foreign corporate governance model in the Indian corporate and business environment, is exacerbated by the Indian legal system's lack of enforcement of corporate governance rules. Additionally, how can we know whether corporations have internalized the intended governance standards or whether they regard governance as a box-checking activity that is followed more in word than spirit?

Corporate governance regimes in India are currently at a decision point; while corporate governance codes have been drafted with a thorough understanding of global governance standards, more attention must be paid to developing more appropriate solutions that emerge from within and thus more effectively address India's unique challenges.

This chapter gathers a history of India's corporate governance regimes based on a review of available research, highlights challenges unique to the Indian context that are not adequately addressed in the present corporate governance framework.

A Historical Context

Following India's independence in 1947, the country had stock markets, a well-developed banking industry, and certain British-derived corporate practices. The Indian government followed socialist policies until 1991, when it nationalized 19 banks and became the primary source of both equity and debt financing for private companies.

The quantity of capital provided by government agencies to private businesses was examined rather than the rate of return on investment. Competitions held in other countries were banned. Due to significant delays in court processes, loan and equity capital providers encountered several problems.

Only the government's established pricing may be used to sell public stock. In India public businesses were only obligated to follow minimal governance and transparency requirements outlined in the Companies Act of 1956, the Listing Agreement, and the Institute of Chartered Accountants of India's accounting standards (ICAI).

In 1991, the Indian government began the process of modernization, privatization, and globalization, and a number of modifications were undertaken. The Security and Exchange Board of India was established when the position of the Controller of Capital Issues was abolished. It was founded in 1988, but it wasn't given formal authority until the SEBI Act was passed in January 1992.

SEBI enacted a number of laws and policies to regulate the activities of capital market participants, with the goal of encouraging more responsible corporate governance. The demand for capital prompted corporate governance policy changes, and several important corporate governance efforts have been undertaken in India since the mid-1990s, with the majority of these activities aimed at strengthening the corporate governance climate.

The history of corporate governance in India gained significant momentum from 1998 onwards, when the Confederation of Indian Industry (CII) established the CII of Important Corporate Governance a voluntary code of corporate governance for listed businesses.

THE DEVELOPMENT OF A MODERN CORPORATION IN INDIAN CONTEXT

Corporate governance is, to a large extent, a collection of mechanisms through which exiled financial experts protect themselves from expropriation by insiders[88]. The subject of corporate governance has gained significance in recent years, notably during the 1980s, and especially since the Cadbury advisory group's code of corporate administration.

Corporations have been around since the commencement of commerce. With the development of major, European-based companies like the British East India Company in the 17th and 18th centuries, they took on their modern form. Multinational corporations were viewed as instruments of civilisation throughout this time of colonialism, and they played a crucial part in the economic growth of Asia, America, and Africa. Advances in communications had linked international markets more tightly by the end of the nineteenth century, and multinational

[88] La Porta et al. (2000)

businesses were commonly viewed as agents of global relations through commercial connections.

While world war II disrupted global trade in the first part of the twentieth century the repercussions of the conflict resulted in a world economy that was even more intertwined. The majority's perspective of companies has evolved in the previous two decades. As their power and exposure expanded, both governments and consumers began to perceive them in more ambiguous terms.

Just about anywhere in the global economy, there is a growing concern that they are not sufficiently concerned with the economic well-being of the groups and communities in which they operate, and that they are attempting to use their growing power in relation to national government agencies, international trade federations and organizations, and local, national, and international labor organizations to further their own interests.

One major determinant interest in corporate governance is a greater awareness of the evolving balance of power between corporations and society. Corporate governance has long been the focus of concern for reformists, shareholder groups, legislators and regulatory authorities, businessmen, and the general press. It was formerly generally disregarded or seen as a legal formality of importance only to senior executives, boards, and attorneys.

For the longest time after independence, India was still a closed economy and the industries were mostly state owned and controlled. With the opening of Indian markets for global products due to the liberalisation, privatization and globalization policy in India in 1991, a significant rise in capitalistic ideals in the market were observed.

In India, the issue of corporate governance has arisen primarily as a result of economic liberalization deregulation of industry and business, and the desire for a new corporate ethics and stronger adherence to the law. This chapter helps to explain and describe the history of corporate governance issues in India, as well as some of the major problems and concerns to corporate governance in the country.

NEW ECONOMIC POLICY IN INDIA

CG has the potential to act a very major role in India's long-term and stable economic growth, ignoring the fact that adoption of foreign CG methods has made little difference in India. Since independence, India's stock markets have grown substantially in terms of the number of companies listed and the value of the shares listed, or net worth. The development of the Indian stock markets over the previous decade highlights the significance of corporate governance.

Since independence, India's stock markets have grown substantially in terms of the number of companies listed and the value of the shares listed, or net worth. The development of the Indian stock markets over the previous decade highlights the significance of corporate governance. Liberalisation and its related developments, including as restructuring, privatisation, internal and external product market liberalisation, and broad financial liberalisation, have enhanced the role of governance.

The corporate governance regime in India can be classified into two time periods. First is the pre-1991 era and second is post 1991, when liberalization had been introduced in the country. Until the liberalization, privatization and globalization of the economy in the year 1991, India lacked the understanding of the concept of corporate governance. The government policy was fixated on providing more and more loans to the industry as it was believed that this would help the industry to grow at the expected rate.[89]

From the time of independence in the year 1947, the focus of the government was on strengthening the manufacturing sector of the country. In fact, the government went on to provide loans to some companies even after they defaulted, as the belief was that this would help in these companies to come out of distress. Furthermore, the financial institutions were mainly governed and controlled by the government that had given them strict instructions of not interfering with the functioning of the management of these companies at all. Moreover, due to the *licence raj* existing in India, the competition among the financial intermediaries was

[89] R. Chakrabarti, *et al*, *Corporate Governance in India*, JOURNAL APPLIED CORPORATE FINANCE, vol. 10, p. 59 (2008).

almost non-existent. Apart from lack of control from banks, there was lack of control from the external capital market as takeovers and foreign investment were under strict scrutiny.[90]

The New Economic Policy of 1991 that arose out of India's balance of payment crisis brought some positive changes in the corporate governance structures. Some of the major changes that were brought into existence include:[91]

(i) The Securities Exchange Board of India (SEBI) was established in 1992 to provide better regulation of financial institutions in India.

(ii) The government controlled financial institutions were given incentives to control the management as they were in need of public capital, having been ripped of the privilege they historically enjoyed by having direct access to public funds.

(iii) A takeover code was introduced in 1994.

(iv) Restrictions imposed on foreign investment were reduced significantly.

These changes were indicative of the changing corporate structures in India.

CHANGING CORPORATE STRUCTURES

The New Economic Policy of 1991 focussed on concentrated ownership in corporations. However, the Indian corporate structures were mainly like large family business as most of the key positions and stakes in the corporation were controlled by families as opposed to a single individual. As of the year 2006 as much as sixty percent of the large corporations in India were the stronghold of family businesses.[92] Interestingly, about a fifth of the Companies in Bombay

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[90] R. Chakrabarti, *et al*, *Corporate Governance in India*, JOURNAL APPLIED CORPORATE FINANCE, vol. 10, p. 59 (2008).
[91] L.S. Som, *Corporate Governance Codes in India*, ECONOMIC & POLITICAL WEEKLY, vol. 41(39), pp. 4156-4157 (2006)
[92] S. Kumar *et al*, *Indian Family-Managed Companies: The Corporate Governance Conundrum*, ICFAI JOURNAL OF CORPORATE GOVERNANCE, vol. 5, p. 20 (2006).

Stock Exchange are companies that are family governed. Similarly a third of the companies on National Stock Exchange are companies owned and controlled by family conglomerates.[93]

In fact, a study that is published on the website of Bombay Stock Exchange further amplifies the point that there are a large number of family owned companies existing and operating in India. This quote from the study makes the point clearer:

> "*The average BSE 100 Company has a promoter who owns over 48% of the company. Only ten of the BSE 100 companies have promoters holding stakes below the critical 25% threshold ... Looking at the broader BSE 500 set of companies produces similar results: the average promoter owns roughly 49%, and fewer than 9% of promoters have stakes below 25%. This high average concentration of promoter holdings was consistent with the prediction of practitioners*."[94]

Having said this, it cannot be denied that the Indian scenario is observing a diversion in ownership, similar to the ownership structures in the USA, still the change is happening at a very slow pace which means that most of the corporations are still controlled by individuals having large shareholdings in the company. These shareholders are referred to as promoters.[95] These promoters are often in the garb of holding companies, which further indicates how the shareholding pattern in India is such that it is Concentrated in the hands of a few people. A study in this regard indicates that more than half of the share capital of about three thousand companies in India is held by the promoter and promoter groups in India.[96]

Apart from individual promoters and corporate bodies, a significant part of shareholding is also held by institutional investors which belong to countries from all over the world including India. These various inroads in the concentrated shareholding patterns in India indicate that it is in a transition phase, which means a complete separation of ownership control of the company on par with the position of a corporation in USA is yet to happen in its entirety.

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[93] *Id.*

[94] S. Mathew, *Hostile Takeovers in India: New Prospects, Challenges and Regulatory Opportunities*, COLUMBIA BUSINESS LAW REVIEW, vol. 3, pp. 800, 833 (2007)

[95]

LATEST DEVELOPMENTS

The background of corporate governance in India gained much importance from 1998 onwards, when the Confederation of Indian Industry (CII) created the CII of Exemplary Corporate Governance, a voluntary code of corporate governance for listed businesses.

As a reason, SEBI was given the responsibility of leading the country's second major corporate governance effort. It formed a committee in early 1999, chaired by Kumar Mangalam Birla, to promote and enhance the standard of good corporate governance. The Birla Committee made the following recommendations:

- To improve the credibility of financial reports and promote openness, the board should appoint a professional and competent audit committee.

- To enhance corporate governance the Amendment Act of 2000 raised the obligations and responsibilities of directors in businesses by a factor of ten. SEBI agreed to alter the Listing Agreement by introducing a new Clause 49 shortly after the provisions of the Companies (Amendment) Act 2000 went into effect, at a meeting held on January 25, 2000. Thus, Shareholders should be more interested in and active in the selection of directors and auditors, among other things.

- Appointment of the appropriate number of executive, non-executive, and independent professionals.

- The audit committee was set up.

- Corporate governance assessment and review reports

As a matter of fact, the Indian government quickly formed the Naresh Committee in 2002 to investigate and suggest significant changes to the legislation governing auditor-client relationships and the role of independent directors.

The Narayana Murthy Committee's proposals represent India's fourth corporate governance endeavour. SEBI established this Committee, chaired by N.R. Narayana Murthy, chairman and mentor of Infosys, to evaluate Clause 49 and make recommendations for improving corporate governance standards.

Independent directors, audit committees, audit reports, directorship and director remuneration, codes of conduct, financial disclosures, related party transactions, and risk management were among the Committee's suggestions.

The Murthy Committee explored at a variety of corporate governance challenges, including audit committees, corporate boards, and shareholder transparency. Clause 49, entitled "Corporate Governance," now has eight parts dealing with the Boards of Directors, Audit Committees, and other aspects of corporate governance.

NEED FOR CORPORATE REFORMS

Even though there were major changes being brought by the New Economic Policy in India, the concentrated shareholding patterns posed a major roadblock in the evolution of corporations in the country.

One of the main problem was lack of an effective board of directors. They merely acted as rubber stamps in the functioning of corporation and were largely influenced by the family owning major shareholding or the promoters.[97]

The disclosure requirements in the Companies Act, 1956 were also not stringent. The reports were only published on a half yearly basis and there was not requirement of consolidation of accounts for group companies.[98]

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[97] T. Khanna *et al*, *Globalization and convergence in corporate governance: evidence from Infosys and the Indian software industry*, JOURNAL OF INTERNATIONAL BUSINESS STUDIES, vol. 35(6), pp. 484-507 (2004).
[98] *Id.*

Moreover after few years of its establishment, SEBI realised that it did not have enough power to regulate the financial institution adequately. The change in relation to takeovers was also far less than expected as there were still a lot of compliances required which involved very high transaction costs.[99]

CORPORATE GOVERNANCE REFORM AND CODES

As observed earlier, even after the change in economic policy and introduction of new regulations, the position of India had not evolved much from the perspective of corporate governance. Hence there was a need to bring about major reforms in this area. The reforms that were brought about followed the principles of "transparency, accountability and ethical behaviour" in the functioning of corporations.[100]

THE INITIAL STAGES OF REFORMS

Corporate Governance in India was struck by major changes after 1991. The first set of reforms were target towards relationship between the management and the shareholder, which includes both majority and minority shareholders. The major push on reforms in governance came from the side of SEBI, which resulted in formation of the Kumar Managalam Birla Committee. The Committee suggested several stages as regards the governing structure. However the Committee warned against getting influenced from the practices in other jurisdictions. Nevertheless it was clear that the SEBI was influenced to a great extent from the Cadbury Committee Report and the Sarbanes and Oxley Act. Hence, the reforms in India were primarily focussed towards the periodic reports, role of institutional investors and the independence of the boards and their remuneration aspects. Some of these reforms are reflected in certain mandatory requirements included by clause 49 of the Listing Agreements issued by the SEBI.[101]

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[99] *Id.*

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[101] SECURITIES AND EXCHANGE BOARD OF INDIA, *Report of the Kumar Mangalam Birla Committee on Corporate Governance* (2000), Available at http://www/sebi/gov.in/commreport/corpgov.html. This report was built upon the pattern that had been established by the CII Code and recommended that *"under Indian conditions a statutory rather than voluntary code would be far more purposive and meaningful, at least in respect of essential features of corporate governance."*

The following are the key elements of the clause 49 of SEBI:[102]

> "*(i) A minimum number of independent directors in the board of directors of listed companies, with 'independence' defined in a detailed manner;*
>
> *(ii) Listed companies to have audit committees of the board, with a minimum of three directors, two-thirds of whom must be independent; the roles and responsibilities of the audit committees are specified in detail;*
>
> *(iii) Listed companies must periodically make various disclosures regarding financial and other matters to ensure transparency;*
>
> *(iv) The CEO and CFO of listed companies must (a) certify that the financial statements are fair and (b) accept responsibility for internal controls; and*
>
> *(v) Annual reports of listed companies must carry status reports about compliance with corporate governance norms*."

After the implementation of these recommendations, India saw major corporate failures in three areas. Considering the structure of most of the companies in the Indian private sector, finding truly independent boards is a rarity. In India, the board were simply not seen as an institution central to the governance of the company. Although there was an increase in public disclosures, they all seemed to be happening only for namesake, which meant that the general quality of the disclosures was very superficial. In fact, the rise in disclosures was also due to the increase in foreign investments in India. Same was the case with accounting standards that were being followed by the company which gave rise to major malpractices.

Coming to the point of accountability of directors the institutional nominee system seemed to have aggravated the problems even more. This was because the investors were even less accountable as the influence of shareholders on them was reduced. There was an urgent need

[102] Clause 49, SECURITIES AND EXCHANGE BOARD OF INDIA LISTING AGREEMENT.

to include professionally qualified, non-executive, independent directors on the board on these company if the goal of effective corporate governance was to be achieved.

The main problem was that it was not recognised that the Cadbury Committee makes a lot of assumptions that may fit well in the market parlance of England but they were not well suited for the Indian context. The Cadbury Committee recommendations apply well in those corporate markets where there has been a separation between the control and management of the company and the control on the assets of the company. As has been already discussed, this is not the situation in India, as the corporate structures are merely a form of family owned businesses.[103]

In India these dominant families which are usually the majority shareholders of the company already exercise sufficient control over the management of the companies. The question is about protecting the rights of the minority or retail shareholders, that is, the investment from the public. The Cadbury Committee had not considered the differing positions of major shareholders and hence the concept of equitable distribution of right was not a concern for them. This is a problem that is unique to the Indian markets.[104]

Another major assumption that the Cadbury Committee makes the assumption that corporations will be able to exercise a fair degree of supervision on the boards where the independent directors are expected to not only participate in the decision making process of the board in an individual capacity but they were also under an obligation to keep a check on the affairs of the company through supervising the decisions taken by the management. This assumption breaks down in its entirety in the Indian market, as the independence of boards is seldom observed because most of the boards are dominated by members of the dominant family and the independent directors often find them powerless to be able to exercise any sort of control over the rest of the board which is so strongly backed by the majority shareholders and the principle officers of the company.

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[103] J. Banaji and G. Mody, *Corporate Governance and the Indian Private Sector*, University of Oxford, Working Paper Number 73 of 2001, available at http://www.3.qeh.ox.ac.uk/pdf/qehwp/qehwps73.pdf. "Studying the Anglo-American approach to corporate governance in context of the Cadbury Committee Report, they observed that "One should note that Cadbury makes several assumptions. It assumes a corporate culture or system where there is already a widespread and well-established separation of ownership and control. Cadbury is not tailor-made to a context where dominant shareholders eg. Promoters, control management where the corporate governance problem is chiefly one of the protection of the minority shareholder rights.."

[104] *Id.*

Third issue is that in a model company in the Cadbury Committee report, the institutional shareholders were considered to have an incentive to monitor the affairs of the company. This is not the case in India as in the Indian situation the decisions of the management generally reflect the will of these majority institutional shareholders due to the greater degree of influence exercised by the latter on the former.[105]

However, there was one positive deviation from the Cadbury Committee approach and even Sarbanes and Oxley Act. Compliance with the recommendations of the Cadbury Committee was not merely a matter of "self-regulation". The Clause 49 of the Listing Agreement was a subordinate legislation which provided adequate backing to these recommendations.

Overall it can be clearly observed that India is required to adopt an insider model of corporate governance as opposed to an outsider model in order to have an effective governance regime.

PRIVATE SECTOR SPECIFIC CORPORATE REFORMS

The Naresh Chandra Committee Report on Regulation of Private Companies and Partnerships were issues in July 2003. The company recognised that private companies also at times can be quite large in terms of the assets they hold and their turnover. Further, a lot of private companies have a lot of inter-relations through certain significant transactions with the public companies. The Committee Remarked that the promoters of several publically listed companies own a lot of these private companies and partnerships which are used as a mode to siphon of public money invested in these listed companies. This shows that there is a need to regulate the function of the private sector as well.

Some of the reforms suggested by the Naresh Chandra Committee include:[106]

(i) Management must identify all the liabilities and possible risks along with the comments of the auditor which must be listed be highlighted in the audit report. This would ensure

[105] *Id.*

[106] N. Chandra, *Report on Regulation of Private Companies and Partnerships,* (July 8, 2003).

transparencies and will help the shareholders to know about the potential risks that the company is going to undertake.

(ii) The CEO and the CFO must provide an undertaking that they have reviewed all the balance sheets and there is no material omission and misleading information in the reports of the accounts. The accounts must give a true and fair picture of the affairs of the company.

(iii) The officers must ensure that effective mechanisms are put in place for periodic reporting and controlling the internal affairs. The company must also disclose all significant frauds to the auditor of the company.

These reforms again were heavily influenced from the assumptions under Cadbury Committee which are ineffective in the manner that has been already discussed earlier. However, the positive point in the analysis in this report is that the role that CEO's and CFO's play in the running of the company has been recognised and personal responsibility has been recommended to be imposed on them.

MAJOR CORPORATE SCANDALS

In the wake of recent business and securities market scams, legislation is needed to address these issues. Given the amount of Corporate Governance breakdowns inside a company, governance actions are necessary. Blunders in corporate governance will have a massive effect on stakeholders and investors, as well as the economy.

Every company would have sufficient corporate governance compliance processes in place. When it comes to compliance, however, companies must follow effective processes. It is important to comprehend the definition of governance in order to comprehend the framework that underpins strong corporate governance.

In 2009 where on one hand India had come out of the economic crisis, falsifying all the predictions against it, it was struck by a major scandal which had shook the faith of investors all around the world in Indian Companies. Satyam Scandal came to light when Ramalinga Raju, The CEO of Satyam Computers confessed of having committed a Rs 7, 000 Crore accounting fraud with the connivance of other officers in the country. PwC the, main auditing firm for the company had their licence cancelled as the failed to recognise forged bank statements, which

had inverted ICICI Bank logos on them. It was said that they had failed in their duty of due care.[107]

Earlier around 2000, Naresh Kampani, the notorious independent director of the company Nagarjuna Finance a company which defaulted on several of its liabilities. Although Naresh Kamapni exited from the company before the defaults started coming to light, his involvement could not have be denied as the transactions happened during his time in the company.[108]

These events eroded the confidence both in the functioning of corporates in India and in the institution of independent directors. This was also the time when demands for major changes in the companies act were made.

COMPANIES ACT, 2013: MAJOR CHANGES

The Companies Act, 2013 ("CA 2013"), which supersedes the Companies Act, 1956 ("CA 1956"), was recently notified by the Indian government. We are examining the significant changes and their major consequences for stakeholders in our series of updates on the CA 2013 ("NDA CA 2013 Series"), by laying out the practical effect of the changes brought by CA 2013[109].

We'll look at the various changes brought about by CA 2013 in terms of company management and administration. The amendments to the legislation are intended to ensure better levels of openness and accountability, as well as to match India's corporate governance procedures with worldwide best practices.

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[107] *Satyam Scandal: Who, What and When*, THE HINDU, available at http://www.thehindu.com/specials/timelines/satyam-scandal-who-what-and-when/article10818226.ece
[108] V. Khanna *et al*, *The Role of Independent Directors in Controlled Firms in India: Preliminary Interview Evidence*, NATIONAL LAW SCHOOL OF INDIA REVIEW, vol. 22(1), p. 37 (2010).
[109] Companies Act 2013, June 4 2014, Greater Emphasis on Governance Through the Board and Board Processes, http://www.nishithdesai.com/information/research-and-articles/nda-hotline/nda-hotline-single-view/article/companies-act-2013-greater-emphasis-on-governance-through-the-board-and-board-processes.html?no_cache=1&cHash=ca550459d744bead6c8090812a8c1561

The Company Act of 2013 places considerable responsibilities on independent directors in order to improve management and administration. While CA 2013 provided a list of particular responsibilities, it should not be construed as exhaustive.

The Company Act of 2013 stipulates that an independent director must be a person of integrity, appropriate competence, and experience, but it does not specify the standards to be used in evaluating whether a person satisfies these requirements. Companies would be free to use their own judgment in appointing independent directors, therefore weakening the "independence" requirement. While the Listing Agreement stated that an independent director must have no substantial financial relationship or transaction with the business, Company Act 2013 stipulates that an independent director must have had no pecuniary relationship or transaction with the company.

Moreover, the Listing Agreement previously stated that an independent director should not have had such transactions with the company, its holding company, or other related entities at the time of appointment as an independent director, but Company Act 2013 broadens this restriction to include the current financial year or the two prior financial years.

The Securities and Exchange Board of India ("SEBI") published a circular on April 17, 2014, titled Corporate Governance in Listed Entities- Amendments to Clauses 35B and 49 of the Equity Listing Agreement ("SEBI Circular"), which matched this provision in the Listing Agreement with the Company Act 2013.

There were no provisions in CA 1956 that clearly specified the responsibilities of directors. CA 2013 outlines the following responsibilities for directors:

- To operate in line with the articles of incorporation;
- To act in good faith to advance the company's objects for the benefit of all members, as well as the company's employees, shareholders, community, and environmental preservation.
- Exercise reasonable care, skill, and diligence in the performance of responsibilities, as well as independent judgment;

- The director is not authorized to: Be involved in a scenario where he may have a direct or indirect interest that conflicts with, or may clash with, the company's interests;

- Get or attempt to obtain any excessive benefit or advantage for himself, his relatives, partners, or acquaintances.

Keeping in mind these scandals, the Companies Act, 2013 brought major changes in the functioning of the Companies, the reporting requirements and the duties and liabilities of the directors and auditors. The act moved a step ahead from Clause 49 in making these requirements applicable to unlisted companies as well.

ThComese have received a legislative backing under the 2013 Act as the duties have been codified. These duties are not limited to the shareholders of the company and they extend to all major stakeholders. The directors are entitled to balance several mitigating factors in order to determine the various protective measures to be employed. They directors under the Companies Act, 2013 are considered to be fiduciaries of the company with an enlarged scope of duties than what had already existed.

The Companies Act had broadened the concept of best interests of a corporation to include the environment society and community. This indicates a marked shift from the shareholder to the stakeholder approach and expands the scope of the beneficiaries of the action of boards. In the companies that have a mandatory Corporate Social Responsibility under Section 135 of the Companies Act, 2013, the board has to disclose the composition of the Corporate Social Responsibility Committee under Section 134(3).[110]

[110] Section 135, COMPANIES ACT, 2013 which states that: "(1) Every company having net worth of rupees five hundred crore or more, or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more during any financial year shall constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director.
(2) The Board's report under sub-section (3) of section 134 shall disclose the composition of the Corporate Social Responsibility Committee.
(3) The Corporate Social Responsibility Committee shall,—
(a) formulate and recommend to the Board, a Corporate Social Responsibility Policy which shall indicate the activities to be undertaken by the company as specified in Schedule VII;
(b) recommend the amount of expenditure to be incurred on the activities referred to in clause (a); and
(c) monitor the Corporate Social Responsibility Policy of the company from time to time.
(*4*) The Board of every company referred to in sub-section (*1*) shall,—

Apart from this the Act specifically talks about independent directors under Section 149(4) and their duties are specifically mentioned in the Schedule IV of the Act. Their role has become wider as, among other things, they are now responsible for disclosing any related party transactions, and ensure approval of Corporate Social Responsibility activities, along with acting as an arbitrator among the several constituencies of the company. [111]

The other novelties included by the Companies Act, 2013 include requirements of internal audit under Section 138 of the Act. It also mandated the requirement of having an Audit Committee under Section 177 of the Act. Further, in case of serious frauds, an office for such fraud is required to be set up under Section 211 of the Act which will conduct investigation on receiving information from the registrar or inspectors or in public interest.

These requirements indicate that the Indian regime is becoming more and more mandatory in order to ensure that there are no malpractices considering the unique context in India where, as discussed earlier a voluntary compliance regime will not be very effective. Hence it clear that India needs to follow the insider model of governance.

(*a*) after taking into account the recommendations made by the Corporate Social Responsibility Committee, approve the Corporate Social Responsibility Policy for the company and disclose contents of such Policy in its report and also place it on the company's website, if any, in such manner as may be prescribed; and
(*b*) ensure that the activities as are included in Corporate Social Responsibility Policy of the company are undertaken by the company.
(*5*) The Board of every company referred to in sub-section (*1*), shall ensure that the company spends, in every financial year, at least two per cent. of the average net profits of the company made during the three immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy:"

[111] Section 149(4), COMPANIES ACT, 2013, "Every listed public company shall have at least one-third of the total number of directors as independent directors and the Central Government may prescribe the minimum number of independent directors in case of any class or classes of public companies."

CONCLUSION

The growth of a company's profit and the development of the economy are linked by corporate governance. It also aids in the development of an organization's compliance structure. Frequent assessments must be in place to keep this system under constant surveillance.

As a result of the current period of globalization, increased openness in company disclosure procedures is required, and corporate governance measures have become more important than ever before. The highly competitive economic environment, along with shifting patterns of corporate ownership, has resulted in the creation of the idea of corporate governance, which was previously ignored by the majority of corporations.

MAIN FINDINGS OF THE DISSERTATION – A CASE FOR SELF-REGULATORY REGIME OF CORPORATE GOVERNANCE IN INDIA

Corporate failures in recent years, often due to mismanagement have resulted in a loss of trust in the competence, capability, and stability of corporations and their management. All of these issues have led to the increased visibility of 'good governance.' This notion has piqued the interest of promoters, directors, regulators, government officials, and management experts.

The dissertation first began with discussing the stakeholder and shareholder debate. Taking this framework forward an analysis was made of the regimes of corporate governance in USA and England. The countries having robust market system were great examples of the situations where there is a separation between the control and ownership.

These countries are hence a good example for the shareholder primacy paradigm. The fiduciary duty of the board towards the shareholder and in turn the obligation of the shareholder to exercise control over the board are they key characteristics of this approach. In these situations a self-regulatory model of corporate governance has been able to produce the desired result and hence government intervention in the functioning of corporations in these economies is

less and has been more helpful in striking a balance between corporate and government interests.

Regulative styles differ greatly from one country to the next and from one sector to the next. The economic impact of regulations is determined by the type of the regulation and the quality and efficiency with which it is executed. Also it is important to note that a corporation's success and development are not solely evaluated by the size of its activities and money produced, but by the degree to which it has adopted good governance practices.

Though, in India the shareholding is largely concentrated as opposed to fragmented and the real diversion in interests is between the majority and minority shareholders, but this needs to be addressed through Company law regulations and not by making stringent provisions on corporate governance.

Corporate governance in the present scenario is more about establishing a balance between economic and social objectives, as well as between individual and communal objectives. Thus, its goal should be to align the interests of people, companies, and society as a whole and as closely as feasible.

A self-regulatory mechanism of corporate governance based on the aforementioned approach will also be effective when it comes to developing countries like India, because corporate governance concerns are becoming increasingly important for Indian corporations as they acquire or expand operations outside of India or access foreign financial markets.

In conclusion, it may be claimed that the UK Code's soft law "comply or explain" method to corporate governance has now become more acknowledged as best practice in the EU and throughout the globe. The regulations such as the Sarbanes Oxley Act, 2002, the Foreign Corrupt Practices Act, 1977 in the United States and the UK CG code have extra-territorial application. As Indian businesses progress more globally in their strategy and practices they must be aware of the global implications of their actions.

Also it can be observed that in a relatively short amount of time these self- regulatory regimes of corporate governance in these countries have served as the foundation for a "more comprehensive global governance model" and a worldwide cognitive confluence on corporate governance norms.

Self-regulation, in all of its forms, is an essential component of today's economy. Self-regulatory mechanisms have been employed to manage industrial operations in a variety of areas including medical care, education, manufacturing, commerce, mining, coastal fishing, and nuclear energy. Governments should remember that self-regulation is a vital instrument for regulating fast evolving corporations in today's globalized economy, and that making stringent corporate governance legislations having mandatory force and mere compliance of such legislations is not the best case-scenario.

It is the responsibility of the business world to create precedents by adopting remarkable and innovative corporate governance procedures as a leader, which will be followed by everyone. Though it is important for the government to maintain a constant vigil upon the corporations to follow the set of corporate governance norms properly but this should be done in a more monitoring form and not in a regulating format. This will provide corporations the required flexibility and independence to embrace and enact such internationally recognized standards.

These are the few examples to support the above mentioned scenario- a group of chemical producers created and currently uses a set of guidelines governing how chemicals should be managed on a global scale through their business organization. A collection of huge corporations formed an international non-governmental organization to steer corporate strategy by committing to a set of sustainable development principles.

All of these are variants on the latest fad of corporate self-regulation through voluntary guidelines and ethical principles. They are instances of a key trend that is reshaping our perceptions of corporate conduct, a movement that is occurring both within the business and in the larger worldwide community in which it is embedded.

The premise that the regulators and the regulated are the same in this situation is crucial, and the norms that govern their conduct should be embraced freely as well, as a result it will lead to ease of doing business. In such situations, mandatory intervention of government is not necessary.

In the recent times, India became the first country to mandate CSR (corporate Social Responsibility) via statutory provisions. Though, obligatory CSR is innately contradictory and its fundamental essence is lost in doing so. The main purpose of voluntary CSR is to encourage

the corporations to freely engage in social welfare rather than forcing it through the ' statutory provisions' and to make India an appealing, safe and secure investment location.

The Corporations will be able to designate their operations as CSR under the new rule, with no meaningful change in social welfare. Is a business training program considered " an education promotion"? Is it possible that making a lucrative investment in an energy-efficient machine qualifies as ensuring environmental sustainability even if the company's motivation was solely financial? This is frequently mocked and the term is known as greenwashing. Hence this has certainly led to an increase in greenwashing with no actual increase in green activities and social initiatives.

The government is responsible for identifying high priority societal needs and allocating public funds to these sectors. The government is abdicating one of its major duties with such statutory provisions as regards to CSR. Thus, this further strengthens the argument for having a self-regulatory, outside model based approach in India.

SIGNIFICANCE OF THE DISSERTATION AND SUGGESTIONS ARISING OUT OF IT

If India adopts a self- regulatory model it will aid Indian corporations at all levels – national or international and as a result it will help in the growth of corporate India and help business's flourish. Hence, India's GDP will grow and it will provide better employment which ultimately needs more purchasing power and that in turn leads to better GDP – per capita which finally leads to better HDI (Human Development Index).

Based on the comparative study of different corporate governance regimes of various nations, some recommendations have been put forward here. The aim is to establish the relevance of the entire dissertation through reaching certain concrete initiatives that would fulfil the envisaging of a self-regulatory model of corporate governance regime in India.

- Firstly, developing a corporate bond market in India and bringing out a corporate governance code which is monitory in nature and not regulatory, and
- Second, a move towards striking a balance between corporate and government interests as well as environmental and labour laws.

- Third, a better infrastructure should be provided for corporate India to prosper.
- Forth, corruption and red-tapism should be done away with
- Government authorities should adopt a collaborative, multi-stakeholder approach to drafting code of corporate governance rather than attempting to impose top-down obligatory regulations on businesses.

Therefore, we have to evolve at a similar pace in all aspects and we need to have a viable corporate governance code which would help corporate India and in ease of doing business while ensuring better GDP per-capita.

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