Inspira- Journal of Modern Management & Entrepreneurship (JMME)
ISSN : 2231–167X, General Impact Factor : 2.3982, Volume 07, No. 04, October, 2017, pp. 107-114

ADHERENCE OF CORPORATE GOVERNANCE: A STUDY OF LISTED COMPANIES IN BSE

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ABSTRACT

Looking at the corporate scenario in India and the lackluster behavior of the share holders in the status or future of their holdings, one is duly shocked and surprised. The propensity of Indian investors to leave things to chance and their resultant vulnerability to risk, give a free handle to the corporate to dupe them. Also in the absence of Governmental checks and controls, on the one hand and the loopholes in the existing governing agencies like SEBI, there is a dire need for an overhaul and screwing up of the system. Clause 49 of the listing agreement is taken as the base and the adherence of companies with respect to its various clauses has been studied.

KEYWORDS: *Corporate Scenario, Lackluster Behavior, Corporate Reforms, Corporate Governance.*

Introduction

The modern Indian corporate sector is based on the UK model and the private companies are mostly dominated by their promoters, their family members and associates who have full control over its functioning. There have been a large number of corporate scams in recent years. Banks and other financial institutions also do not exert much control. Their appointed nominees on the board are more or less kind of passive participants in the board processes.

This has negatively affected the securities markets and investors' sentiments globally. Apart from this, most organizations lack a vigorous whistle blowing system to encourage its employees to internally report illegal activities or wrong practices to its trustees and board of directors. While the progress in legislating and introducing the corporate reforms in the last decade is significant, the problem lies in its adherence. Most of the corporate governance policies have largely remained on paper only.

Keeping in view the above issues the present study aims to investigate whether the corporate firms adhere to the corporate governance and if they adhere what are their ways of adherence. Secondly, as far as retail investors are concerned, are they aware of the corporate governance and do they give any weight age to the adherence of the same by the firms in their investment decisions. Are there any other factors which are more important and influence the decisions of investors?

Objectives of the Study

The major objectives of this proposed study are:

- To check the adherence of corporate governance by companies listed in BSE.
- To study the working of audit committee in the corporate units of India.
- To study the remuneration committee in the corporate units working in India.

Hypothesis

The following hypothesis guided/will guide the research process:

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$H1_0$: The listed companies do not adhere to the provisions related to board of directors in corporate governance in India.

$H2_0$: The listed companies do not adhere to the provisions of listing agreement in the working of audit committee.

$H3_0$: The listed companies do not adhere to the provisions of listing agreement in the working of remuneration committee.

Methodology

In the present study the following steps/points are proposed to delve into issues related with corporate governance:

- **The Population:** The population under investigation of this study will include all companies listed in BSE.
- **Sampling Technique to be used:** The proposed study will employ random sampling technique as it is the most relevant technique providing every member of the sample frame with an equal chance of being selected and it also has a high external validity.
- **Sample Size:** For the part I of the study, a sample of 60 companies listed in BSE (20with paid up capital less than 10 crores,20 with paid up capital more than 10 crores but less than 50 crores and 20 with paid up capital more than 50crores) will be taken. It is ensured that sample collection is representative of various classes of the population and free from all kinds of bias. The data collection will be through the responses of retail investors to a questionnaire related to various aspects of corporate governance.
- **Statistical Methods/tools:** As the findings and conclusions from any research endeavor can be scrutinized, it is ensured that appropriate statistical tools and techniques are employed wherever required. Section wise analysis is carried out with the help of the statistical tools such as tabulation, Diagrams, Measures of central tendencies, percentages, proportions, dispersion and summarization measures. Hypotheses are tested via the ANOVA technique.

Scope and Limitations

The study is an attempt to have an insight of the Indian Corporate units regarding their adherence to various statues and regulations concerning corporate governance and on the other side about the awareness of the small investors regarding various issues of corporate governance. However the scope of study is limited to companies listed in BSE. The study is based on the secondary data of the last 5 years collected via the annual reports issued by companies. Though the annual reports are obtained from trustworthy sources, the possibility of misrepresentations and errors cannot be ruled out.

Literature review

- **Abbasimuoseloo Khalil 'MoazenJavad Mohammad (2015)** in their study **Enterprise Risk Management and Corporate Governance** studied the enterprise risk management and the factors which influence it. He attempted to justify the impact of corporate governance on the non-financial performance of the enterprises.
- **Bansal Aishvarya and Bansal Bhavya, (2014)** were of the view that better governance leads to better management in their paper **Corporate Governance and Risk Management in Insurance Sector: A review of Literature.** They were of the opinion that corporate governance also includes risk management for the insurance companies. Risk cannot be diversified and therefore the insurance business is always at a risky stage. The study revealed that the corporate governance practices differ according to the nature of the insurance industry, composition of board of directors, independent directors, risk taking characteristics and other such features. The study acknowledged the ever-growing importance of corporate governance and risk management in the insurance sector.
- **Corporate Governance Practices in India-A case study, Bhardwaj Neelam, Dr. Roao Ragharendra Batani (2014).** In most of the cases it is felt that corporate governance is followed by of the companies on paper only. In India, it has been observed that majority of the companies are following the mandatory provisions and disclosing the required information as per the revised clause 79. Some companies like Bajaj Auto, Infosys, Dr. Reddy etc., have disclosed the information beyond the requirement of revised clause 49. Infosys got the rating done for its corporate governance practice from ICRA and CRISIL.

- **Bistrova Julija and Tear Onavicience Manuela (2014)** in their research work titled **Corporate Governance as a Crucial Factor in Achieving Suitable Corporate Performance** concluded that corporate governance discrepancies between the good and bad companies, in terms of performance, consist of three parts:
  - General Evaluation of Governance.
  - Quality of earnings assessment.
  - Research on the ownership influence.

  The study also indicates the high importance of transparency of the company in the emerging European concern. Ownership structure analysis proves that the type of major shareholder does not matter when one selects the stock for the equity portfolio.
- **Chadha Shruti (2014) Corporate Governance and Research and Development: Evidence from India** asserted that boards play a crucial role in the company decision making, which is supported by the positive relationship between R&D, intensity and percentage of inside directors. He has concluded that a negative relationship of sales with R&D as companies might be investing in diversification rather than R&D.
- **Chaudhary Priyanka (2014)** in her research titled: **Corporate Governance in Insurance Sector**, observed that adoption of good corporate governance practices enhances transparency of insurance companies operations, ensures accountability and improves firm's profitability. It also helps to protect the interest of the shareholders by aligning their interest with that of the administrators. The results also show that generally corporate governance has positive impact on profitability of insurance companies as well**.** Corporate governance as a subject of research continues to attract academicians and scholars around the world. Alternative theories and models, though in their infant stages are taking shape.
- **Aggarwal Krishna Gopal and Medury Yajulu (2013)** in their work "**Good Governance – A tool to prevent corporate frauds"** gave various suggestive measures like ensuring appointment of independent auditor, role of professionals reviewed and regulated by respective professional bodies, effective implementation of several legislations, setting up of rating agencies would definitely take care to enhance the chances of good corporate governance and by strengthening the fraud preventive measures. Good governance process would require restructuring at political, bureaucratic and corporate level because of corruption and malpractices involved in the governance process.
- **Dharmastuti Christiana and Wahyudi Sugeng10 (2013)** studied **The Effectivity of Internal and External Corporate Governance Mechanisms towards Corporate Performance.** They concluded that concentration of institutional ownership and debt holders are more effective in influencing the corporate financial performance than internal corporate governance. The internal corporate governance is not showing a significant influence towards corporate performance which means that the independent commissioners are not really independent and they cannot act to synchronize principal and management's interests.
- **Bihari Suresh Chandra (2012)** conducted the study **Corporate Governance is key to Better Corporate Image: A study in the Banking Sector in India.** It has been concluded that there is a need for a strong culture of compliance at the top of the organization and necessary to consider how management can respond to ethical or reputation concerns. The biggest challenge in India is to implement the rules of corporate governance at the ground level. It is required to extend the principles of good corporate governance practices to co-operatives, Non-banking Private Companies and other financial institutions.
- In India **Chatterjee Debabrata (2010)** did a comparative study on **Corporate Governance and Corporate Social Responsibility–The case of Three Indian Companies** ITC Ltd., Reliance Industries Ltd., and Infosys Technologies Ltd. He concluded that though the corporate governance practices are exemplary, there exist differences in the way the companies adopt the corporate governance practices. He rated Infosys better than the other two companies.

The positive impacts of corporate governance are not just confined to manufacturing corporate but to service industry as well.

Findings and Discussions

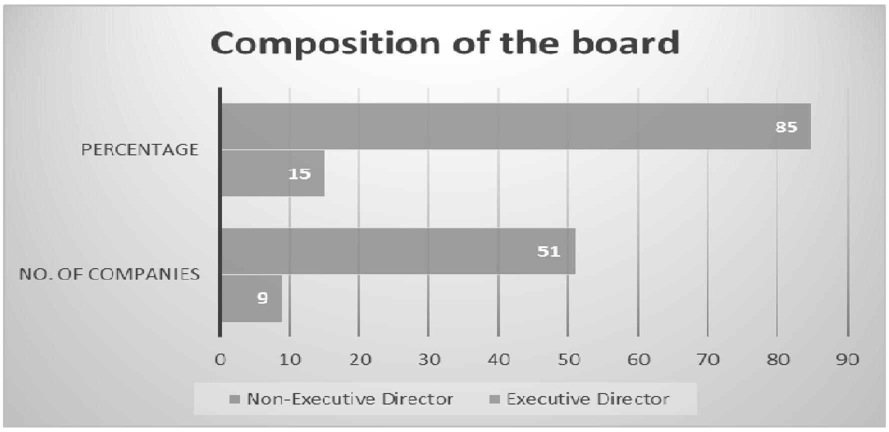
- **Composition of Board of Directors**

According to the provisions of the Clause 49-I(A) of the Listing Agreement, the composition of the Board shall have an optimum combination of executive and non- executive directors. It also suggests that a Board should not have less than 50% of the non-executive directors at least 1/3rd of the Board should comprise dependent directors. If the Chairman of the board is an executive director at least half of the board should comprise independent directors. Considering this provision as a benchmark, the sample units provide the following facts. All the sample units have disclosed their its Board composition in detail in their Annual Report. The Chairmanship of the Board is mentioned in the following table:

Composition of the Board

Chairmanship with	No. of Companies	Percentage
Executive Director	**09**	**15**
Non-Executive Director	**51**	**85**

The above table reveals that 51 of the sample units i.e.85% have non-executive directors as Chairmen of the boards while 09 of the sample units i.e. just 15%have executive directors in the chair. It is also a positive improvement shift as the previous researches have shown a very low percentage of companies having non-executive directors.



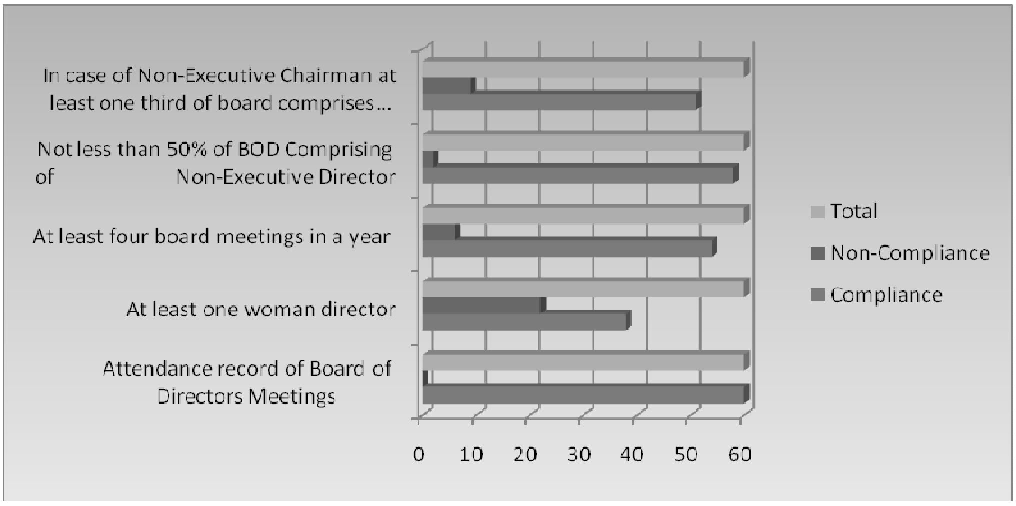
- **Board Composition**

For good governance, it is very important to maintain independent element on the board. All the codes related to corporate governance provide guidelines on the proportion of the board to be maintained as independent. In the U.K., the recommendation is that the non-executive directors should comprise not less than one third of the board size and that the majority of the non-executives should be independent. The Naresh Chandra Committee has recommended the minimum board size of all the public limited companies to have 7 members of which 4 should be independent directors for a company having paid up share capital and free reserves of Rs.10 crore and above or turnover of Rs. 50crore and above. It was to examine the entire range of issues pertaining to the Auditor-Company relationship, professional regulatory bodies and role of independent directors, Securities& Exchange Board of India (SEBI), in line with its counterpart world-wise has been moving to get listed companies to appoint independent directors with a view to improving the standards of corporate governance. Subsequently, it constituted a committee on corporate governance under the Chairmanship of Mr. N R Narayan Murthy.

As per the provision of Clause-49, if the Board has a Non-Executive Chairman, at least one third of the Board should comprise independent directors and if the Board has an Executive Chairman at least half of the Board should comprise independent directors. UK's system of corporate governance has been progressively developed over the years and for the last 10 years it has been subject to a series of reviews: Cadbury, Greenbuy, Hampel, the Combined Code, Turnbull and now the Myners Review. In 1998 London Stock Exchange Published "The Principles of Good Governance and Code of Best Practice" commonly called. ‘The Combined Code’ following consultations on the final report of the Hampel Committee, The Hampel Committee was established in November 1995 to review the Cadbury and greenbury committee reports. The Combined Code requires listed companies to report compliance with the following provision. The Board should have a formal schedule of matters specially reserved to it for decision. There should be a procedure agreed to by the board of directors in the furtherance of their duties to make independent professional advice if necessary, at the company's expense. All directors should have access to the advice and services of the company secretary, who is responsible to the board for ensuring that board procedures are followed and that applicable rules and regulations are compiled with. All directors should bring an independent judgment to bear on issues of strategy, performance, resources (including key appointments) and standards of conduct. These issues have been dealt with in India on similar lines in Kumar Mangalam Birla's Report which has been adopted as SEBI's guidelines. The Centre for Corporate Governance has published its own guidelines, which cover environmental reporting in addition to financial-reporting. All this sounds solid. So, where is the real problem? The issue essentially comes down to the quality of the Board, how well it is Chaired, the choice of directors and how far they understand their role and how well they are able to discharge it effectively. It also depends, on how far and how well the shareholders, principally in the form of the large institutional investors, play their part. The key role of the independents is to ensure that the Board functions well. They are not there to manage the business, but to ensure that the business is well managed.

Compliance / Non-Compliance of Firms to Board Composition and Meeting Requirement

Particulars	Number of Companies		Total
	Compliance	Non-Compliance	
Attendance record of Board of Directors Meetings	60	0	60
At least one woman director	38	22	60
At least four board meetings in a year	54	06	60
Not less than 50% of BOD Comprising of Non-Executive Director	58	02	60
In case of Non-Executive Chairman at least one third of board comprises of independent directors.	51	09	60



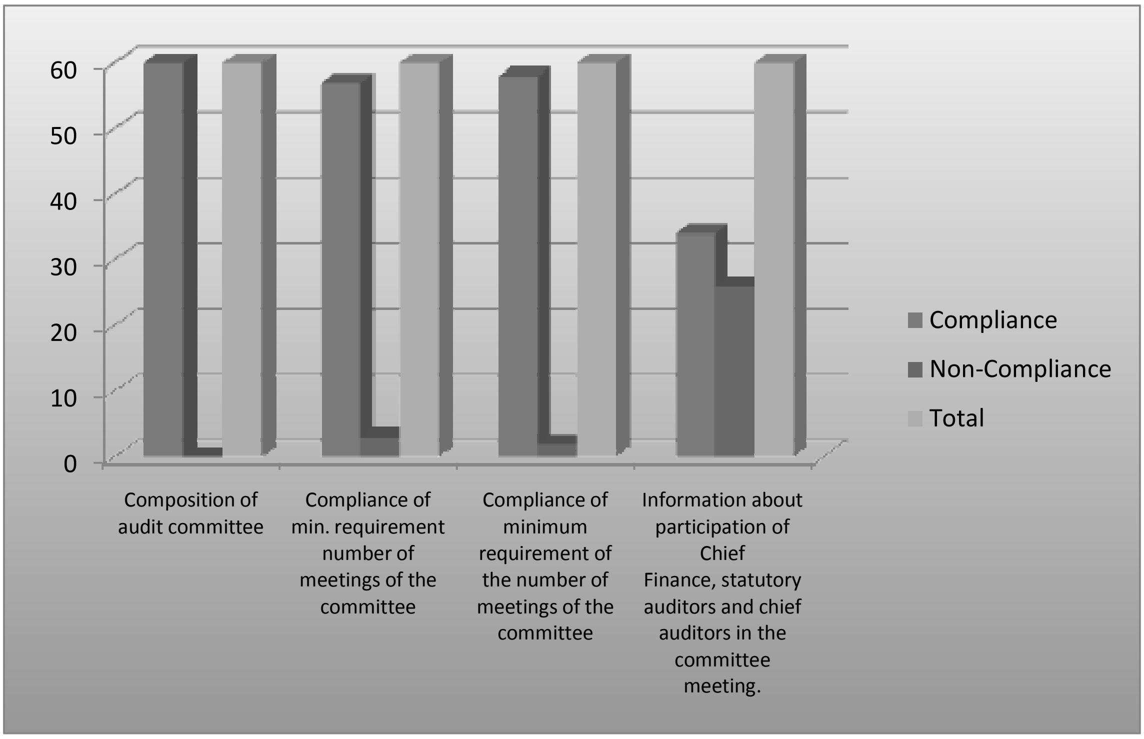
For the purpose of checking and analyzing the composition of board of directors and its procedure related to executive and non-executive directors, separation of CEO and chairman, proportion of dependent and independent directors, attendance of directors in meetings etc. a two- way ANOVA test was applied wherein the value of F obtained was 3.35 and table value was 6.94 at v1 =2, v2=4 at 5% level of significance. Since the table value exceeded the calculated value, null hypothesis was accepted which indicated that companies listed in BSE do not adhere to the provisions of clause 49 of the listing agreement related to the composition of board of directors.

Audit Committee

One of the important jobs of the corporate is to earn credit of their investor and all the related parties. For this purpose, the audit committee plays a vital role. It establishes an assurance of the quality and reliability of financial statement and information used by the board and by the outside world.

Table Showing Number of Companies for Disclosure / Non-Disclosure of Audit Committee

Particulars	Number of Companies		Total
	Compliance	Non-compliance	
Composition of audit committee	60	0	60
Compliance of min. requirement number of meetings of the committee	57	03	60
Compliance of minimum requirement of the number of meetings of the committee	58	02	60
Information about participation of Chief Finance, statutory auditors and chief auditors in the committee meeting.	34	26	60
Information about literacy and expertise committee members.	42	18	60
Publication of Audit Committee	06	54	60



In order to check whether the corporate units of the samples adhere to the provisions of listing agreement related to the formation and functioning of audit committee, null hypothesis was established that the listed companies in BSE do not adhere to the corporate governance in India i.e. there is no significant difference between the provisions stated in clause 49 of the listing agreement and actual practice adopted by the corporate units. A two-way ANOVA test was applied to confirm the relationship, where in value of F was obtained as 1.75 whereas the table value was 6.94 at $v1 = 2$ and $v2 = 4$ at 5% level of significance. The table value exceeded the calculated value and hence indicated the acceptance of null hypothesis at 5% level of significance. It is hence established that the corporate listed in BSE do not adhere to the provisions of clause 49 of listing agreement related to the audit committee.

Remuneration Committee

The second important pillar of the corporate governance practices is the existence of remuneration committee, as remuneration to the directors is and will be a sensitive subject in corporate governance all over the world. Shareholders are entitled to expect directors' remuneration to be sufficient to attract, retain and executive directors of the quality required but not more than is necessary for that purpose. For this purpose the directors' remuneration should be linked with their performance and efforts. All the corporate governance codes recommend corporate units to have remuneration committee to establish rigorous and transparent procedures developing remuneration policy for the directors. The combined code of UK recommends that to avoid potential conflicts of remuneration related issues, board should set up remuneration committee of independent non-executive directors to make recommendation to the board, within agreed terms of reference of the company's frame work of executive remuneration and its cost and to determine on their behalf specific remuneration packages for each of the executive directors, including property rights and any compensation payments. The board of directors shall decide the remuneration of non-executive directors. In terms of clause (1) of section-309 of the companies Act-1956 the remuneration payable both to executive and non-executive directors is required to be determined by the board unless the article of association provide that it shall be decided either by the articles of the company or by a resolution or if the articles so required by a special resolution passed by the company in a general meeting. The Chairman of the remuneration committee should be present at the annual general meetings to answer the shareholder queries. On the subject of pay, it has already been suggested that the remuneration policy should be explained and to the shareholders each year. According to Clasue-49 of the listing agreement, the following information is required to be disclosed in the Annual Report. It includes disclosures about directors' remuneration and computation of net profits for the purpose. They are as: All the elements of remuneration package of individual directors summarized under major groups, including their basic remuneration benefits, bonus stock options and all other payables. Disclosures about the fixed components and performance linked incentives of their remuneration along with performance criteria.

Table Showing Distribution of firms for Disclosure / Non-disclosure of Remuneration Committee

Particulars	Number of Companies		Total
	Compliance	Non-Compliance	
Formation of committee	57	03	60
Information regarding number of committee meetings	50	10	60
Compliance with minimum requirement of number of non-executive director on committee	52	08	60
Compliance of provision of independent director as chairman of committee.	52	08	60
Disclosure of sitting fee in Board & Committee meeting	57	03	60
Information about participation of all members in the committee meetings	45	15	60

Adherence to the provisions of clause 49 of the listing agreement relating to remuneration committee was studied, using a two way ANOVA table. Secondary data was collected related to formation of the committee, information regarding no. of committee meetings, minimum requirement of no of non-executive directors on the committee, provision of independent director as the chairman of the committee, disclosure of sitting fee on board and committee meetings, and information about participation of all members in the committee meetings. The calculated value of F was 4.62 at $v1=2$ and $v2=5$ at 5% level of significance whereas the table value was 5.23. Since the table value exceeded the calculated value, null hypothesis was accepted.

Conclusion

The present study is an endeavor to explore the corporate governance policies followed by the Indian corporate relying on the annual reports submitted by them. It is found that most of the corporate are not following the non mandatory provisions with respect to composition of board of directors, audit committee and remuneration committee. They are following the mandatory provisions but most of them seem to barely complete the minimum requirements. It is also observed that the large companies having paid up capital of more than fifty crores are better at adapting corporate governance, the small units having paid up capital of less than ten crores seem to be more at default particularly because of lack of awareness, family ties and less independent directors.

Utility

The present study has enormous relevance and utility. It will be useful in understanding the extent to which the companies listed in BSE adhere to corporate governance policies apart from understanding the investment habits of the retail investors. It will also be helpful for market analysis, future market research and corporate legislation apart from educating the retail investors on the issues relating to corporate governance.

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