

STRENGTHENING OF CORPORATE GOVERNANCE IN INDIA: INSTITUTIONAL GATEKEEPERS APPROACH

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ABSTRACT

This paper provides an overview of gatekeepers who are responsible for strengthening corporate governance in India. "Corporate governance depends on effective checks and balances divided between four institutions in corporate world. These include board, management, stakeholders and regulators." Actually, leading issues of conflicts which are hampering the quality of corporate governance in companies are as follows: (i) conflict between the managers and the owners (shareholders), known as the agency problem. (ii) conflict between the majority (dominant) shareholders and the minority shareholders. (iii) safeguarding the interest of all shareholders versus caring of different stakeholders. In present scenario, corporate frauds are the result of these conflicts. Corporate governance is already emerged to remove these conflicts. Effective compliance of regulatory framework enables the corporates to ensure effective corporate governance programme. Moreover, growing importance of institutions of gatekeepers is changing the compliance scenario of corporate governance in India. These institutions are auditors, proxy advisory firms, rating agencies, whistle blowers, shareholders activism etc. Different regulatory authorities have made necessary provisions to empower and regulate these institutions responsible for strengthening corporate governance in India. This paper aims to provide an overall picture of present scenario of institutions engaged in strengthening corporate governance in India.

KEYWORDS: *Corporate Governance, Related Party Transactions, Morality, Empowerment.*

Introduction

Basically, corporate governance is an ethical code upon which a company operates. It determines the best method and mechanism to establish effectiveness, efficiency, and transparency in operational behaviour of a company. It would enable a company to take constructive strategic decisions keeping in mind the interest of different stakeholders.

In a corporate "Corporate governance depends on checks and balances divided between four institutions: board, management, stakeholders and regulators. It is similar to the democratic political governance depending on the four estates of legislature, executive, judiciary and media."¹ In practice, stakeholders comprise governing board members, management, shareholders, employees, clients, etc. Corporate Governance has a direct bearing on the growth and stability of a company. It also impacts the integrity and reputation of the company. It ensures that the governing board members and the managers of the company are transparent and disclose all the business activity of the company to win the investors' confidence.

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Actually, it is considered indispensable for a business organisation to operate in a competitive world. If a company has a strong structure of corporate governance, then the company can conduct its operation with full transparency and can promote the policy of full disclosures to strengthen their relationship with different stakeholders. Good corporate governance ensures stability and growth of the company.

Corporate Governance may be defined as the different rules and procedures which a company has formulated to direct and control its operations. Thus, a company is supposed to undertake its operations for the benefits of different stakeholders. In corporates, the governing board is the highest authority and is responsible for operational performance. In practice, company generally faces following issues of conflict.²

- Conflict between the managers and the owners (shareholders). It is called as the agency problem.
- Conflict between the majority (dominant) shareholders and the minority shareholders.
- Safeguarding the interest of all shareholders versus caring of different stakeholders.

These conflicts are responsible for the emergence of corporate governance. These conflicts instigate the corporate actors to involve in corporate frauds, cheating, mis management and unethical corporate behaviours. "In the last three decades, corporate fraud and governance failures are occurring frequently and they require good corporate governance in the company."³

There are several other reasons also for this type of corporate behaviour. These reasons include unethical leaderships, inefficient internal audit, cheating, corruption, fraud, unqualified board members and weak board of directors.

These situations compel the companies to deviate from their corporate governance strategy. They are bound to send signals to their shareholders that they cannot be trusted. These signals erode the confidence of shareholders in the business and they lead them to feel cheated or misled and ultimately, they have to incur losses.

"Major examples of corporate governance failure in India include: (i) Harshad Mehta Scam (ii) Ketan Parekh Case (iii) Rebock India Case (iv) The Satyam Scam (v) PNB Nirav Modi Scam (vi) The Sardha Group Chit-Fund Case (vii) Kingfisher Airlines Scam (Vijay Mallya) (viii) Tata-Mistry Fallout (ix) Yes Bank–Rana Kapoor Case (x) ICICI Bank–Videocon Bribery Case (xi) Bank of Baroda Case (xii) Jet Airways–Naresh Goyal (xiii) Cafe Coffee Day (xiv) Malvinder and Shivinder Singh–Religare Enterprises, Religare Finvest Ltd. (RFL)" etc.

Thus, these serious cases forced the corporates to evolve alternative strategy-strengthening the process of corporate governance. There is urgent need to strengthen the system of corporate governance in India to safeguard the interest of different stakeholders. In this context, following watchdogs or gatekeepers are involved in strengthening the process of Indian corporate culture.

- **Auditors:** Corporate governance is supposed to protect the interest of different stakeholders by developing accounting and verifiability base of the company. It facilitates the appointment and monitoring process of capable management to achieve ethical standards. An auditor helps in building a strong governance framework which can support the mission and strategic objectives. However, it needs collaborative attitude of governing board and top management of the company. It is a necessary condition for betterment of business of the company. If in actual corporate life, audit process is missing then it will adversely affect the performance of the business.

An auditor is empowered by the company to examine and verify the true and fair picture of the financial statements. He is also makes it certain that company is complying with regulatory provisions. As per the Companies Act, 2013, a person can be appointed as an auditor for a company if he fulfils the following two conditions, (i) he is a Chartered Accountant and (ii) a member of the Institute of Chartered Accountants of India. "A company generally appoints two types of auditors. These auditors are called as internal and external auditors. Internal auditors are those auditors who form a part of the human resources of the company. External auditors are independent and professional auditors. They are expected to play a crucial role in keeping ethical practices and safeguarding stakeholders' interests in the business environment."⁴ An auditor may add value to corporate governance by involving himself in activities like identifying risks, ensuring compliance, providing objective advice and enhancing stakeholders confidence

Actually, auditors are guided by a comprehensive set of regulations and guidelines which are revised from time to time keeping in mind the emerging challenges. If the board, especially the independent directors (IDs), take note of the advice/recommendations of the auditors, or asking questions to the auditors on important issues like Related Party Transactions (RPTs), key audit matters, internal financial controls etc then, they are fulfilling their duties. "All boards have to develop their own culture about how they are going to interact with the auditors. The independent directors (IDs) should evolve questions sheet/questionnaire on critical matters and must have necessary dialogue with the auditor on critical issues relevant with company. Auditors are the first set of people that we can think of as a great help and aid to the independent directors (IDs) and boards."⁵

In the process of corporate governance, system of audit committee has also been developed. "The audit committee is a committee of the board members responsible for oversight of the financial reporting process, selection of independent auditor, receipt of audit results from both internal & external auditors. The committee assists the board in guiding compliance norms and looking after corporate reporting and internal control system."⁶ Audit committee is to be constituted with the help of independent directors who must of 2/3rd of total members of the committee. Besides, chairman of the committee shall be an independent director.

Regulatory framework of corporate governance with regard to auditors includes Companies Act, 2013 and SEBI Regulation 2015. Both the Companies Act as well as the SEBI regulations allow independent directors (IDs) to call auditors as and when needed. The Audit committee is expected to take a lead in facilitating such interactions. Moreover, auditors are also responsible for providing an audit report, reporting governance failure, reporting indictable offences, exercising professional integrity etc. It is the Governing Board who has the highest authority in the company and therefore it becomes its duty to govern the management for optimum performance.

With these responsibilities, auditors create a sound base for effective corporate governance. An auditor is required to concentrate on protecting interests of stakeholders, promoting accountability, managing crisis, mitigating risk factors, maintaining relationship with regulators etc. It is also notable that the role of auditor is quite critical as he is the one who fills the gaps between the executive management and the stakeholders with his knowledge and binds the management to take decisions in the welfare of the all the stakeholders. Auditors are under obligation to examine all the financial statements and eliminate any manipulation in the accounts and it gives them a major role in corporate governance. The effectiveness of any corporate governance directly related with level of professionalism and the quality of the information provided by an auditor. Regulatory authorities have formulated comprehensive guidelines and code of conduct for auditors. However, they generally fail to report back different types of failures etc. to the top management and audit committee. As instances available, some auditors have not shown their interest in their role and responsibilities. In cases of Satyam Ltd., IL & FS Financial Service Ltd. and Yes Bank Ltd. etc. auditors failed to report audit issues on time. Corporate failure was the result and stakeholders were at loss at that time.

The government of India has established National Financial Reporting Authority (NFRA) under Section 132 of the Companies Act, 2013, for the purpose of handling matters related to accounting and auditing standards. "The NFRA is trying to ensure discipline among professional auditors. Main function of NFRA is to monitor and enforce the compliance as per the auditing standards. Professional auditors are required to follow the guidelines made by ICAI (Institute of Chartered Accountants of India), the IAASB (International Auditing and Assurance Standards Board), and the QRB (Quality Review Board). In the last two decades, emergence of corporate governance has consolidated the auditor's position as a watchdog."⁷

- **Proxy Advisory Firms:** Emergence of proxy advisory firms is the recent development in Indian corporate environment. However, they are expected to play an imperative role in protecting the interest of shareholders especially institutional investors of the company. These firms are generally engaged in research and analysis of activities undertaken by the corporates. These firms are expected to develop suggestive framework for corporate decisions which need approval of shareholders. According to SEBI (Research Analyst) regulation, 2014, proxy advisors are "as any person who provides advice in the form of recommendations through any means to institutional investor or shareholders of a company with regard to their voting rights and other related matters."

Regulations of SEBI have ensured some discipline among these proxy firms. Sometimes managers of the corporate feels that the proxy advisory firms are always engaged in finding faults with the working of the company. But in practice, these firms provide very useful information to shareholders, and that are well in time. It provides a great help to the independent directors (IDs) whenever they are dealing with a particular situation. A company should develop a practice to thoroughly examine the red-flag raised by the proxy advisory firms from time to time.

In India, the In Govern Research Services is the first proxy advisory firm which was established in 2010. Thereafter, Institutional Investors Advisors Services (IIAS), and Stakeholders Empowerment Services (SES) have also been come into existence to provide proxy services. These firms provide great help to companies also in complying with the provisions of corporate governance. "Investors are the owners of the company and proxy firm help them in understanding the agenda of the corporates. These firms also provide thorough analysis of various proposals and voting related decisions of the company."⁸ Basically, they are supposed to help the shareholders about the implications of decision to be taken by them as an investor in meetings of the company. Corporates are also required to follow the recommendations of these firms. In case of default, it may adversely affect the reputation of the company. It will also damage the confidence of investors.

These proxy firms are working as an institution of gatekeeper for the corporate entity. They are supposed to keep a vigil on corporates regarding their compliance with the regulatory provisions and protecting shareholder's interest. Previously, shareholders and creditors acted only as silent spectator of the meeting etc. of the corporates as they were not well equipped to assess changes in structure of the company. However, proxy firms have changed the whole scenario and at the moment, if these firms feel that changes are not in favour of shareholder then the relevant matter is to be raised with the corporates. Excess salary drawn by Ajit Gulabchand in Lavasa case without the prior permission of central government is an important case and it was exposed by these proxy firms. Similarly, withdrawal of delisting proposal of Vedanta, refusal of renomination of nominee director (Puneet Bhatia) on the board of Shri Ram Transport Financial Corporation Ltd. are the recent examples of aggressive stand taken by these proxy firms. Cases of Paytm, UPL and Zee Enterprises Ltd. are also raised by them.

In January, 2021, the SEBI has also formulated necessary regulatory guidelines for controlling the vested interest of proxy firms. These guidelines include disclosure policies for voting, simultaneous reporting to the company and investors, additional report for needful changes, methodologies, proceedings and sources for recommendations, explicit framework for conflict resolution etc.

- **Rating Agencies:** Rating has been assigned to develop an informational base to assist investors in determining credit worthiness of the company. Credit rating indicates a relative degree of risk involved in timely payment of interest and principal. The analysis for the same is based on past trends and future prospects. In practice, different types of ratings are available in public domain. However, these ratings need to be correctly evaluated and assigned. These ratings provide added incentive for companies to improve their financial performance and corporate governance.

Rating agencies are involved in rating program of corporates for different purposes. "Corporate Governance Rating (CGR) is an opinion on relative standing of an entity with regard to adoption of corporate governance practices. It provides information to stakeholders about the level of corporate governance practices of the company. It enables corporate to get free and fair assessment of the quality and extent of their corporate governance."⁹ The rating process also determines the comparative strength of the company with regard to best practices followed by it in present environment. Companies generally use these ratings for reference purposes and set benchmarks for further improvements. Different stakeholders may also be able to assess the worth of companies based on degree of corporate governance.

In rating programme rating agencies are supposed to assess various documents like agenda papers and Minutes of Board and Board Committees, Minutes of the Annual General Meeting and Extraordinary General Meeting, Annual Return and other documents filed by the company with ROC, SEBI, Stock Exchanges, and all other regulatory bodies. Rating agencies generally, have a dialogue with the chairman of governing board, CEO, independent directors, managers, auditors, creditors and shareholders to seek their opinion about the status of the company. These rating agencies also use seven key parameters in assessment of corporate governance. These include board composition & functioning, ownership structure, organisation structure and management information system, shareholder relationship, disclosure & transparency, financial prudence and statutory compliance.

- **Whistle-Blowers:** Non-transparency and irregular reporting to regulatory authorities has been the primary reason of corporate failure in Indian corporate world. In any organisation, some employees are well versed with the workplace, activities and are also aware of any kind of misconduct taking place. Sometimes, these people to become aware of the wrongful deeds of the corporates. However, they generally choose to exercise a studied silence due to the apprehended retaliation by the powerful lobby in the company itself. Whistle-blowers are also strong gatekeepers in the corporate setup. In this situation, boards must discuss in detail the issues flagged off by the whistle-blowers. Similarly, "A company might be in the habit of calling board meeting at very short notice or not sharing the agenda for such meetings well in advance. The intent behind such practice need to be looked into and rectified; the culture should be to rectify mistakes and not suppressing facts."¹⁰ Important cases like Kobe Steel and Volkswagen highlighted the deliberate misrepresentation of facts by these companies and whistle-blowers raised these issues to strengthen the power of corporate governance.

Independent directors (IDs) are also supposed to be more alert in these areas of concern. However, there is another development. According to guidelines issued by the SEBI and the Ministry of Corporate Affairs, at least once in a year, there should be a meeting of Independent Directors with whistleblowers, without the presence of any other executives. It should be used as an opportunity by the independent directors (IDs) to access about something which are unusual and are happening in the company. Directors are also empowered to seek necessary advice from any expert at any point of time.

Regulation 18 of the SEBI guidelines has made provisions for mandatory requirement for all listed companies to establish a vigil mechanism called "whistleblower policy" for internal stakeholders to inform or disclose their worries with regard to violation of compliance norms and ethical standards. Company must recognise the practice of highlighting or alarming some kind of unlawful, or wrongful activities which are taking place in the company.

Every company should adhere to a code of conduct and some commitment in operation of its business. These commitments include maintaining the higher standards of moral, legal, and ethical conduct required in business operation. "In order to have free, fair, and adequate information from internal stakeholders, companies are expected to protect them from any victimisation, harassment or discrimination."¹¹ Thus, companies should try to motivate internal stakeholders to express ill treatment meted out to them by a particular powerful lobby. Whistleblower protection must be given the highest priority to strengthen the corporate governance. It will also ensure that the corporates do not take discriminating decisions at the cost of other stakeholders. Moreover, companies are also expected to comply with existing regulatory provisions on moral, ethical, and legal framework.

According to provisions of existing regulatory framework, every listed company is required to establish a surveillance mechanism for internal stakeholders to report any fraud or misappropriation of funds in a systematic way. For this purpose, big companies have already formulated behavioural codes for their managers. Similarly, it is now make mandatory for every listed company to formulate whistleblower policy and make it available to the employees for further necessary actions. Listed companies are also expected to disclose all material information as per Regulation, 30 of the SEBI guidelines.

It has also been made mandatory by the Ministry of Corporate Affairs for all the listed companies to report all complaints of whistleblower to the auditor and the same shall be mentioned in the report published by the auditor. It will certainly improve and strengthen the practice of corporate governance. The most important objective of the whistleblowing policy is to maintain a balance between legal and ethical aspects and also forces the stakeholders to fulfil their social obligations.

In Indian scenario, whistleblowers have also raised some controversial scandals in some of leading companies. These companies are Heritage Food (India) Ltd, Wipro, Infosys, Tata Motors, Reliance Industries etc. In recent years these companies have already adopted the whistleblower policy to protect the identity of any employee who wishes to expose any kind of wrongdoing that might be happening in the company.

- **Shareholders Activism:** It is a mechanism by which a safety net is developed to protect shareholder interest from mismanagement of company. It deals with initiatives undertaken by shareholders to pursue the execute management in protecting their interests. "Activism is generally used in different from like having dialogue with managers, submitting shareholders

concern, proxy recommendation and legal issues etc. Shareholders activism enables the shareholder to demand necessary adjustments in policy framework of the company, composition of the board, managerial remuneration or financial performance."¹² In present scenario, shareholder activism is quite visible in Indian corporate sector. It will facilitate greater transparency, accountability, and better governance practices. "The company board should have positive influence on shareholders activism as it is expected to formulate and implement best practices and safety net to protect all stakeholders."¹³ Activist shareholders generally give red flag about the activities of companies by challenging their managerial decisions. It provides an additional safety net to protect the interest of different stakeholders. "They are also free to proposed necessary changes in the corporate strategies and also call for best corporate governance practices. It provides an opportunity to make the internal stakeholders accountable and aligned with objectives of different stakeholders." Shareholder activism creates several positive effects on the functioning of the company. These effects are as follows: (i) it improves corporate governance practices and disclosures and also accountability in the functioning of the corporates. In this way, shareholders can get an improved trust and confidence in corporate managers. (ii) it drives better corporate financial performance through better strategies, cost reduction or making the management team more effective and viable. (iii) it controls or mitigates the shareholders loss through risk aversion programme."¹⁴

Major examples of shareholder activism in India are as follows: Tata Sons–Cyrus Mistry Controversy, Infosys–NR Narayana Murthy Controversy, L&T–Mindtree Acquisition etc. All these examples have exposed the growing number of shareholders activity in India and its significant impact on corporate governance practices and decisional system of corporates. Thus, "encouragement of shareholders activities can ensure better corporate culture which ultimately create base for value addition by companies."¹⁵

The concepts of corporate governance and shareholder activism are getting more popularity in Indian scene. Regulatory authorities have made certain mandatory obligations by which companies are accountable for better corporate governance practices. In this way, it will create better corporate environment and protect the interest of minority shareholders.

Thus, corporate governance and institution of gatekeepers have been assigned more weightage in improving Indian corporate culture. The regulatory authorities have issued necessary guidelines to ensure better compliance. It has also ensured the protection of stakeholders interest. Now, Indian companies are adopting better disclosures and transparency which lead to improved corporate behavior and stakeholder engagement. Improved regulatory framework, growing shareholders participation and ensuring sustainability are some coveted areas which need to be inculcated in corporate behaviour. The growing clout of domestic financial institutions, have now forcing companies to go for better compliance. In changing scenario, if companies are unable to serve the purpose of stakeholders on priority basis, they will fail to win their support which is utmost important factor for growth. Coordinated efforts of institution of gatekeepers will enable the Indian corporates to implement better practices and solve shareholders issues. It will also ensure better caring, effective decisional framework and more dialogue with shareholders. Effective institutional gatekeeping process can help in achieving better participation of shareholders through improved transparency, accountability and developing professionalism in management.

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