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Corporate Governance & its Significance in India

Rupal Arora*

ABSTRACT

In the contemporary discussion on Modern Corporation and its impact on the economy, society and nation, the focus has been shifted from “growth with only profitability” to “growth with sustainable development”, which includes the stakeholders. There is considerable debate on the corporation’s obligations to civil society in the western world. In the developing countries the debate is sporadic. And it is the first time that many B schools in the country are participating in the task of preparation of cases of corporate governance from various industry units focusing on the process and decision making content implicit in the introduction, implementation and evaluation of various facets of corporate governance. The issue of corporate governance has always been central to finance and economics not only in high profile developed countries but in developing countries too since its importance to economic development. The paper highlights the changes and reforms taken in corporate governance in the light of corporate frauds like Satyam, Enron etc which lit the fire of increasing corporate governance activities and increased responsibilities of directors to ensure good governance as good governance is good business.

Keywords: Clause 49, Companies act 2013, corporate frauds, CSR (corporate social responsibility), Transparency

Introduction: “What triggered the concept CORPORATE GOVERNANCE?”

The glimpse of term corporate governance can be seen since the creation of corporate form which created the possibility of conflict between investors and managers. So, it extends back to the formation of East India Company and Harts & Bay

Company. But it came into clear picture in late 1980s when a series of business scandals took place in the United Kingdom due to questionable corporate policies and unethical practices. Pension funds fraud by Robert Maxwell, Bankruptcy of Bank of Credit and Commerce International are examples of these scandals.

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These scandals were increasing alarmingly which led to setting up of Treadway Committee in USA in year 1987 and Cadbury Committee in UK in 1991. The Cadbury Committee formulated the codes of corporate governance and suggested the how to ensure it.

Investor protection Act of 2002 known as Sarbanes-Oxley (SOX) Act, 2002 was passed in U.S.A as a part of reform process in corporate governance to ensure protection to investors from corporate frauds.

While corporate practices of U.S came into lime light, it appeared that the problem was far more widespread. Parmalat in Italy and multinational newspaper group Hollinger revealed problems and issues in corporate governance. It was clear from the evidences that something was going wrong and faulty in the area of corporate governance.

The issue of corporate governance has always been central to finance and economics not only in high profile developed countries but in developing countries too since its importance to economic development. Serious efforts have been made after liberalization. Viz. Clause 49 of listing agreement by SEBI, which deals with corporate governance.

Corporate Governance defined...

Corporate means legally united into a body so as to act as an individual and

Governance means control or direction. If these two are put together it gives meaning that it brings together many different groups for the purpose of conducting business. Companies develop certain formal systems of Accountability Oversight and Control. With a main view to provide an opportunity for employees not to make unethical decisions and this is known as Corporate Governance. Corporate governance is how an organization is run, managed and controlled. It is the system or set of systems which ensure that the interests of shareholders have been given due care. It relates to the resolution processes to control and coordinate the interests of stakeholders and companies.

The Cadbury Committee (U.K) has defined corporate governance as **“the system by which companies are directed and controlled.**

It is about commitment to values, conducting the business in ethical ways, and using the powers in a responsible manner. It is the process of direction, supervision and accountability of corporations. It deals with the relationships of board of directors with the shareholders and other shareholders. It also deals with laws, rules, practices and procedures that help in taking improved and good managerial decisions.

Corporation Brings Different BUSINESS Together Groups	Managers	for conducting
	Employees	
	Suppliers	
	Customers	
	Investors	

Relationship between Corporation and Business

Perceptions of Corporate Governance

(Stakeholder model): This adopts a broader view of the purpose of business that includes satisfying concerns of other stakeholders/employees. This model focuses on relationships, not only between the company and its shareholders but also between the company and broad range of other stakeholders like employees, customers, suppliers.

(Shareholder model): Found in classic economic percepts (Maximization of wealth for investors and owners).

Elements of corporate Governance pertaining to ethical decision making

Role of Board of Directors (BODs) assumes legal responsibility for the firm's resources and decisions. Important Issues related are accountability, Transparency, and independence.

Executive compensation: Responsible for appointing and setting the compensation for top executive officers (CEOs) a controversial topic, executive pay may centre on the often disproportionate. Relationship

between highly paid executive and median employee wages in the Company.

The organizational ethical decision making does not rely strictly on the personal values and moral values of employees. Organizations have their own culture and if this is combined with the corporate governance mechanisms it may significantly influence business ethics. There is some theories act as determiners of nature of corporations: one is the private property of the stockholders who wants the business to be done in the corporate form and thus it becomes property rights theory. Another is corporation act as public institution sanctioned by the government for some social good. This is refers to as social institution theory.

Corporate Governance is indispensable for India

It is rightly said that good corporate governance is good business. The following points highlight the importance of corporate governance:

1. The ownership structure has changed. Institutional investors have become the challenge for the management. Due to the threat that these FII's can takeover the companies ,today , India is taking initiatives for good governance in their companies so that the investor's confidence can be built up.

2. The duty now has been transferred to the directors who need to actively engage themselves in CSR activities as the interest of not only shareholders but other parties like creditors, lenders, customers are important.

3. Considerable growth in the empirical literature on corporate governance across accounting, economics, finance, management, and corporate strategy literatures.

4. Corporate Frauds like Enron, Harshad Mehta scam etc are the most important reason behind the increasing importance of corporate governance in India.

5. With globalization strong corporate governance is considered as a tool to measure investor protection nowadays.

It is easy to paint a gloomy picture as people celebrate another anniversary of independent India. Events during the past few weeks offer enough reasons to feel pessimistic about the future of this country. But do we simply worry over the clouds and ignore the silver linings. Despite weeks of high inflation our

economy continues to grow at a relatively rapid pace. The rains have picked up after a lull; a decent harvest should help food prices to decline. Democracy is in working order and Parliament had witnessed serious debate as MPs voted on a confidence motion even as opposition alleged that the government had literally bought its support. Corruption, is no less a problem in countries as different as Bangladesh and China. It's that we are free to complain publicly about it. However when the PM address every year, it replicate about the state of our national security. The country is now facing continuous low intensity of cold war. The enemies of the Indian state are of many ideological hues and some operate with covert financial and logistical assistance from other countries. Terrorism and cross border terrorism is on increase but is this due to failure on the part of successive governments.

But surely the near collapse of governance in much of the country has helped extremists Maoists in central India to insurgents in J & K and the north-east to thrive. Governance is perhaps the single most important issue that needs attention. It is not merely about building modern institutions. It is about ensuring that these institutions are accountable to the people, while they uphold the rule of law. That's possible only if the state clims down from

its commanding heights and revamps itself in the role of a facilitator and servant of the people instead of being seen only as a ruling authority. Respect rule of law is possible only when people see themselves as both masters and beneficiaries of state. It is time to restructure radically the state of governance and quality of relations between state and people.

Overview of Indian Corporate Governance

After the structural adjustment and New Economic policies the country has undergone significant reforms in corporate governance. Indian government faced crisis in 1991 and the remedial solution came out to be setting up of a regulatory authority SEBI (securities exchange Board of India) in 1992.

The need for capital was felt and there came the reforms in corporate governance. In 1998 the Confederation of Indian Industry (CII), an association of major Indian firms, issued a voluntary Corporate Governance Code. It pressed the government to make the central elements of the code mandatory for public firms, which is done by SEBI by adopting Clause 49. It was inserted in listing agreement in 2000.

Clause 49 has the codes relating to balanced board, transparency and disclosures, relationship with subsidiary companies CEO/CFO Certification etc.

An overview of the new clause 49 of the listing agreement (companies Act 2013)

Ensuring equitable treatment to all shareholders and recognizing the rights of all stakeholders in the company has become the key principle. Setting up an effective corporate governance frame work within the company and providing for timely and accurate disclosures is necessary to achieve it.

Greater powers have been given to directors in the matters related to corporate governance. It also extends some principles of corporate governance to material subsidiaries of listed companies.

Powers of the Audit Committee have been strengthened assigning it with various responsibilities to ensure corporate governance standards. Other changes include appointment of one woman director and strictly following the code of conduct.

A corporate governance disaster satyam –“lit the fire of increasing importance of the concept”

The Satyam episode posed a serious question “DO INDIA POSSESS REQUIRED GUIDELINES & ADEQUATE LAWS ON CORPORATE GOVERNANCE”

A big issue arose that the guidelines have been followed in true spirit and whether there was a proper monitoring system? Need was felt upon principle based

approach rather than standardized rule approach. The role of Independent Directors has again been brought under strict preview. The shareholders of a company place heavy reliance on the auditor's report, which shows the true and fair view of the accounts of a company. Utmost care and vigilance in their duties to ensure that there are no illegal or improper transactions is required. But still, Satyam scam has happened.

The Satyam Scam highlighted the need of following remedial steps:

1. Appointment and remuneration of auditors should not be left to the companies they audit, as the monetary benefit in terms of fees can easily influence them.
2. The auditors should also ensure that the audit is conducted in accordance with the Auditing and Assurance Standards (AAS) for the quality of audit.
3. Rotation of auditors.
4. Make independent directors truly independent with a finite tenure.
5. Healthy participation on the part of the partners by introducing partner's audit review.
6. Regulatory authorities like the SEBI and the CBL need to be pro-active in their approach and should monitor companies more aggressively.
7. Vigilance officers should be appointed and should be trained to check on frauds and any illegal acts.
8. The penalties and punishment should be substantial enough to have a strong effect on the individuals and the company.
9. Clause 49 of should provide wider powers to the audit committee and have penal provisions in case of failures.
10. Management should take into consideration shareholders opinion before making any unrelated diversification and should clearly explain the context and reason for the „unrelated,, diversification.

The Promises and Challenges of India's Corporate Governance Reforms

Significant efforts have been seen by various Indian Regulators since 1990s to achieve good corporate governance in Indian firms. Satyam scam also made government and industry actors into action. A strong need was felt in the reform process in corporate governance. Despite hard efforts the implementation process proved out to be a challenging task. It became more challenging due to various social, economic and political factors. In March 2010, the Indian Government announced that all Central Public Sector Enterprises (CPSEs), proportion of PSUs, will be required to comply with the corporate governance norms, some of which mirror those required by Clause 49.

Reforms in corporate governance (Companies Act 2013)

In August, India signed the Companies Act, 2013 into law, ushering in sweeping reforms to its corporate governance laws and practices. The Companies Act, 2013, has the potential to be a historic milestone, as it aims to bring the concept corporate governance more into limelight, simplify regulations, enhance the interests of minority investors and for the first time legislates the role of whistle-blowers.

Some of the changes are:

1. Companies will now be required to have independent directors of 33%, as well as a remuneration committee and a nomination committee (or combined as one) with a minimum independence level of 50%.
2. Nominee directors, having position on Indian boards of directors, will be prohibited from being considered as independent directors.
3. Directors will no longer be considered independent following ten consecutive years of board service. Directors are able to undertake a three-year “cooling off period” before acting again as an independent director.
4. Companies will also be required to have at least one female director, marking a outstanding and progressive step forward in promoting the role of women in Indian boardrooms.

5. Individual auditors will be limited to service of five consecutive years and audit firms will be limited to maximum service of ten consecutive years.

6. Prohibition on auditor’s other services in addition to main service. Other services includes (i) internal audits(ii); accounting and book keeping services; (iii) actuarial services; (iv) design and implementation of any financial information system; (v) investment advisory services; (vi) investment banking services; (vii) rendering of outsourced financial services; and (viii) management services

7. “Clawback” remuneration paid to executive directors. The ability for companies to recoup remuneration awarded on false or illegal pretenses has yet to take hold in Asia india would be the first market to adopt it.

“CORPORATE SOCIAL RESPONSIBILITY” a new wave in corporate governance

In the recent times there is distinct movement away from CSR as compliance and philanthropy to a strategy of social relevance. Corporations have an obligation to society as they influence environments, institutions and stakeholders. In fact they will earn and distribute money but that this has led to more problems. While they are earning money or wealth for that matter they will adopt some fair / unfair methods which do not conform to norms of social

behavior and standards governing trade and commerce. These should in fact be amenable for verification and accountability. Corporate leadership showcase high degree of dedication, due-diligence and commitment to adherence of core values of the business and aggrandize their managers to incorporate the same. It is the responsibility of top management of the company to articulate the principles of CSR and to ensure companywide programs for creating strategic groups within the organization. Thus there is need to send signals that CSR is not incompatible with profit, provided norms of transparency are introduced by the corporation and best practices are taken into account. Strategic social relevance is possible only when the third party costs are taken into account. Moreover long term sustainability of modern corporations gets strong foundation when the guiding principles of CSR are practiced.

Every company therefore, should evolve its own code of conduct within the broad spectrum set forth by the country experiences and best practices. A campaign to CSR becomes indispensable when it is founded by social consensus within the organizational hierarchy. Some research studies carried out by Financial experts show that investors in India are ready pay more money for participating in the prosperity of the companies and

enhancing shareholder value. The modern corporation can play vital role in providing useful feedback and new ideas to government for public policy formulation and for making CSR national program of action. There are newer demands for a movement from using CSR as brand building exercise so socially oriented actions which are influenced by the shrinking role of government demands for greater disclosure, increased customer interest growing investor pressures, competitive labor market and supplier relations. Corporate brands should reflect the underlying values of business and companies should develop brand equity programs around these values. When we link CSR with corporate governance we need to emphasize that the company will need to manage their intangibles. In fact the future modern corporations will also require better enforcement of various contracts and they can do so by relating operating aspects of business to brand building exercises.

One thing is clear from this movement and that the outcomes of CSR are improved financial performances, increased customer loyalty, higher competency to attract and retain labor force – reduced regulatory oversight, workforce diversity, product safety and decreased liability – employee volunteer programs and greater use of renewable resources.

The CSR assumes pivotal significance in the modern world, for sustainable development. More business establishments, corporations in the corporate horizon exert considerable influence on the economy, polity and society of nation. The world over increasingly, as there is an evidence of extraordinary economic power exercised by the mega corporations and their impact being more severe in the case of developing nations. Umpteen developing countries in the world opted for democratic framework, and the issues of economic and social governance became important, for instance sensitive issues like human rights, labor norms, health and education, poverty, among others.

Further the academics and public policy makers are also thinking on CSR with significance as the perceived many developing countries viewing the concept of CSR as era of full of opportunities for Public Private Partnerships (PPP). Because they knew neither the Public nor the Private sector can deal effectively the magnitude or threshold of hurdles that come in the social sector development. At the same time the government on its own cannot get involved any further in several sectors simultaneously as they did in the last four decades in many countries.

One of the Herculean tasks for modern governments in the developing countries is to create and nurture durable framework of institutions who will translate public policies into deliverables. India needs strong institutional framework for meeting multiple objectives of economic growth and development. Another task is commitment of the top management of the public enterprises and corporate sector to move away from mere philanthropy to corporate social action. Thus there is need for training and development of large pool of voluntary sector personnel and cooperatives so that they can get substantively involved.

COMPANIES ACT 2013: A SIGNIFICANT STEP FOR CSR

The 2013 Act has introduced several provisions as compared to Companies Act 1956 which would change the way Indian corporate do business and one of such provisions is spending on Corporate Social Responsibility (CSR) activities. CSR, which was been considered as a voluntary contribution by corporate has now been included in law. Section 135 has been introduced.

Section 135 of the 2013 Act states that Every company having net worth of 500 crore or more, or turnover of 1000 crore or more or a net profit of 5 crore or more during a year shall be required to formulate a CSR policy to ensure that

every year atleast 2 % of its average net profits during three immediately preceding financial years shall be spent on CSR activities. "Average net profit" shall be calculated in accordance with the provisions of section 198 of the 2013 Act.

The committee would comprise of three or more directors, out of which at least one director shall be an independent directors..

The role of committee is to 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; to recommend the amount of expenditure to be incurred on the activities referred to above; to monitor the Corporate Social Responsibility Policy of the company from time to time. . As per sub-section (5) of section 115 of the Act the CSR projects or programs or activities undertaken in India only shall amount to CSR expenditure. The Board of Directors of the company shall, after taking into account the recommendations of CSR Committee, approve the CSR Policy for the company and disclose contents of such policy in its report and the same shall be displayed on the company's website, if any, as per the particulars specified in the Annexure.

In case of failure to do so, the company shall report the necessary reasons for not spending the same in their Board's report.

CSR activities includes

- Promotion of education
- promoting gender equality and empowering women setting up homes for women
- Eradicating extreme hunger and poverty
- reducing child mortality and improving maternal health
- ensuring environmental sustainability
- combating human immunodeficiency virus
- Employment enhancing vocational skills
- Social business projects
- Contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government or the State Governments for socio-economic development and relief and funds for the welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women; and
- Such other matters as may be prescribed

In determining CSR activities to be undertaken, preference would need to be given to local areas and the areas of company's operation. In accordance with section 135 of the Act the CSR projects or programs or activities that benefit only the employees of the company and their families shall not be considered in CSR activities. Recently as per budget 2014 the development of slum areas is also included in CSR activities.

Conclusion

With the increasing speed of corporate frauds and scandals the concept of corporate governance is gaining more importance these days. A large number of standards and reforms have been introduced around the globe viz. The Sarbanes-Oxley legislation in the USA, the Cadbury Committee recommendations for European companies and the OECD principles of corporate governance are some. The reform processes have not only been seen in developed countries but in developing countries too. India has been no exception to the rule. Several committees and groups have looked into this issue. Development of norms and guidelines are an important first step in a serious effort to improve corporate governance. The bigger challenge in India, however, lies in the proper implementation of those rules Companies act 2013 changes have been considered as a new wave in corporate governance.

Increasing corporate governance have been felt among various companies as it affects the firm performance as well as build the investor trust and confidence.

In spite of the challenges faced in India for the implementation in true form and spirit, the future of corporate governance in India would be better than the past and will ensure greater investor protection and confidence in companies.

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