

Corporate governance in India from the internal stakeholder's perspective

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Abstract

The underlying aim of the research paper is to evaluate the internal stakeholders' perceptions of the current corporate governance regime in India. In order to analyze the internal stakeholder's perception towards current corporate governance regime, regulations and issues, a structured questionnaire has been prepared covering various aspects of corporate governance like components and performance implications of corporate governance in India, major issues in corporate governance, corporate governance strategies and practices, key players etc.

The majority of the respondents perceive that there is a need to make the internal and external corporate governance better, enhance the standards of accounting, audit and disclosures, prohibit or check related party transactions, improve relation between board and management, publicize corporate governance ratings of companies, strengthen stock exchanges to ensure transparency, improve access to new capital etc.

The findings of the study has contributed to the future development of corporate governance regulations in India. It will aid regulators, policy makers, stock exchanges and think tanks to rethink their priorities and develop rules to incorporate best practices on corporate governance.

Keywords: Corporate governance, Corporate governance practices, Regulatory framework, Listing agreement, Securities markets.

Introduction

If Indian securities market is a model for others, it is natural that it leads in the area of corporate governance. The initiatives for improvement in corporate governance regime are coming mainly from three sources namely, Market, Regulator and Legislature. While the legislative initiative is directed towards bringing about amendments to the basic law – India's Companies Act - to include certain fundamental provisions related to corporate governance, other dynamic aspects of corporate governance such as disclosures, accounting standards, etc., the regulatory initiatives include bringing about amendments to the Listing Agreement.

While the corporate governance is expected to enhance the interests and fulfil the aspirations of all stakeholders, it does not necessarily happen always. The obligations towards the contractual stakeholders such as customers, employees, vendors, creditors and the society get precedence over the interests of the shareholders. The Corporate governance framework must be such that wealth created is evenly distributed across all classes of stakeholders.

Since 2000, despite many initiatives and resultant changes, it is generally felt that corporate governance is about abiding by the rules and laws i.e it is practically followed merely in letter and not in spirit. In the light of the above, it is important to assess the perception of various stakeholders regarding the present corporate governance regime.

Literature Review

In the early twentieth century it was seen that companies were focusing only on shareholder wealth maximization and other stakeholders were ignored (Bhasa 2003). This line of thought led to the stakeholder theory that

states corporations must attempt to maximize stakeholders' interests instead of just focusing on shareholders' benefits.

The concept of Stakeholder theory is ascribed to R. Edward Freeman (1984) whose original theory was that managers have a moral obligation to consider and appropriately balance the interests of all stakeholders. Goodpaster (1991) built on the work of Freeman (1984) and divides stakeholder theory into three approaches of strategic, multi-fiduciary and synthesis. The strategic approach to stakeholder theory views stakeholders instrumentally. The multi-fiduciary approach views the firm as having a fiduciary responsibility to all stakeholders, not just shareholders. The synthesis approach combines elements of both i.e the corporation has a moral and ethical duty to stakeholders, but the fiduciary responsibility remains solely to shareholders.

Evan and Freeman (1993) stated, "A stakeholder theory of the firm must redefine the purpose of the firm...the very purpose of the firm is...to serve as a vehicle for coordinating stakeholder interests." Schneider (2002) posits that stakeholder theory extends the concept of ownership of the firm beyond that of the traditional legal or economic owners of the firm, who become a stakeholder by contribution of capital or other means that results in equity ownership.

Primary stakeholders are vital to a corporation's success and secondary stakeholders are less influential. While stakeholder theory began as an alternative to shareholder value theory, it has diverged along two paths: normative and instrumental. The normative stakeholder path continues in the tradition of a view of the firm in relationship to its various stakeholders with no stakeholder having pre-eminence. The instrumental path, however, attempts to connect stakeholder management to wealth creation. In doing so, instrumental stakeholder theory

becomes a subset of shareholder value theory (Jennings, 2002).

Firms generally approximate to total stakeholder maximization under constraints defined by other stakeholder interests. With stronger regulation, pressure from different stakeholder groups, and more emphasis on corporate social responsibility, the decision area where the company can simultaneously maximize stakeholder-owners' returns and other stakeholders' interests will be protected (Mygind, 2009).

Research Methodology

On the basis of the literature review and the objective laid down for the study, a structured questionnaire has been prepared to gauge the perception of employees on various aspects of corporate governance like components and performance implications of corporate governance in India, current status, major issues in corporate governance, corporate governance strategies and practices, key players of corporate governance etc.

The corporate governance assessment instrument consisting of 54 items on a five point Likert scale. The primary data has been gathered through electronic correspondence i.e. LinkedIn and other professional networks. The respondents are the employees between the age group of 26-45. The data from 420 respondents has been collected and the tool used for data analysis is Exploratory Factor Analysis (EFA).

Major Findings

This exploratory study investigated the internal stakeholder's perception on corporate governance regime in India and identified nine important factors which are as follows:

1. Regulations
2. External players
3. Way ahead
4. Components
5. Hindrances
6. Internal players
7. Impacts
8. Role of stock exchanges
9. Social factors

Using the Kaizer-Meyer-Olkin's criterion, nine factors with minimum factor loading of 0.586 were extracted and 10 statements did not fall in any of the factors (eigen values less than 1). Internal consistency and Reliability of the scale has been tested using the Cronbach's Alpha. The value of Cronbach Alpha turned out to be 0.680. The KMO measure of sampling adequacy is 0.8 which is higher than 0.6 benchmark value, and Bartlett test for sphericity is significant with P value less than 5%. The grouping of items in the extracted factors together with factor loadings, eigen values and the percentage of variance explained is shown in table 1.1 below:

Table 1.1: Grouping of factors

Grouping of Factors	Factor loading	% of variance explained	Eigen value
Factor One Regulations		11.904	6.428
The standard of CG in India is comparable to that of Asian countries	.797		
The existing CG regulations are adequate to ensure good CG in India	.792		
CG will improve corporate social responsibility	.761		
The existing CG regulations are effectively implemented by most India firms	.740		
Most listed companies in India could have done more to strengthen CG	.596		
The standard of CG in India is comparable to that of a developed country	.589		
The stock exchanges should have introduced more rigorous CG rules	.500		
Factor Two External Players		8.745	4.722
The Judiciary	.759		
Reserve Bank of India	.747		
Civil activists (such as Investors association, minority shareholder etc.)	.738		
The Institute of Chartered Accountants of India	.736		
Other professional institutions (NISM, MCA, IICA)	.717		
Outside directors (Non- executive and independent directors)	.715		
Securities and Exchange Board of India	.487		
Factor Three Way ahead		8.272	4.467
Enhancing the standards of accounting, audit and disclosures	.837		
Making the external corporate governance mechanism work better (E.G. Enact specific regulations, monitoring, facilitating hostile acquisitions etc.)	.757		
Prohibiting or tightly controlling some types of related party transactions (E.g. lending to directors, cross guarantees of repayment etc.)	.686		
Improving ineffective connectivity between board and management	.562		
Making the internal corporate governance mechanism work better. (E.G.	.523		

Effective board function, active shareholder participation etc.)			
Conducting and publicizing corporate governance rating of companies	.516		
Factor Four Components		5.742	3.101
Financial reporting framework of the country	.780		
Ownership structure of the companies	.772		
Corporate culture and practices	.664		
Companies internal management regulations, policies and procedures	.611		
Code of best practices of corporate governance	.527		
Factor Five Hindrances			
Inadequate protection of minority shareholders' rights	.767	4.665	2.519
Insider trading	.760		
Lack of integrity and ethics among top management	.643		
Drain off of funds through associate or subsidiary companies	.603		
Conflicts of interest of directors	.473		
Lack of transparency in financial reporting	.415		
Factor Six Internal Aspects			
Lack of proper balance between executive and non-executive directors in the board	.731	4.336	2.341
Independent directors do not exercise true independence in decision making	.713		
Lack of transparency about directors' remuneration	.658		
Reducing ownership concentration (E.g. tighter control on cross shareholding and pyramids ownership structure etc.)	.437		
Factor Seven Impacts			
Reduce shares price volatility	.717	3.448	1.862
Reduce political or regulatory intervention	.691		
Increase market value of shares	.661		
Factor Eight Role of stock exchanges			
Improve access to new capital	.762	3.158	1.705
Improve ability to generate equity capital	.732		
Stock exchanges- NSE-BSE play an important role in strengthening corporate governance	.468		
Factor Nine Social factors			
Culture and value system of the society	.745	2.734	1.476
Improve financial performance	.715		
Relationship among core stakeholders	.450		

With regard to the regulations of corporate governance, the majority of respondents indicate that Indian corporate governance is comparable to that of Asian countries and other developed countries. Further, the existing regulations are appropriate to improve corporate governance & corporate social responsibility and are being implemented by most of the listed companies and there is no need for more rigorous CG rules.

The external players in CG framework in the order of importance are Judiciary, Reserve Bank of India, Civil activists, the Institute of Chartered Accountants of India, Other professional institutions, independent directors, Securities and Exchange Board of India. The respondents believe that there is a need to make the internal and external corporate governance better, enhance the standards of accounting, audit and disclosures, prohibit or check related party transactions, improve relation between board and management and conduct and publicize corporate governance ratings of companies.

Another important aspect identified was the components of corporate governance which include financial reporting framework, ownership structure, corporate culture and practices, internal management regulations, policies and procedures. A group of items namely- inadequate protection of minority shareholders rights, insider trading, lack of integrity and ethics among top management, drain off of funds through associate or subsidiary companies, Conflicts of interest of directors, Lack of transparency in financial reporting are perceived as hindrances in the CG framework. On the impact of corporate governance, the respondents agreed on good governance leading to reducing share price volatility, reducing political or regulatory intervention and increasing market value of shares.

The survey found that the respondents strongly feel that role of stock exchanges in another important aspect in strengthening CG framework. Intervention by stock exchanges ensuring transparency would lead to improved access to new capital, improved ability of companies to

generate equity capital. Corporate governance regime would improve society by enforcing culture and value system and improving relationship among core stakeholders.

Conclusion

It is extremely important for corporates to develop, ensure and follow a corporate governance regime for the benefit of all its stakeholders. At the same times it is important for all stakeholders to participate and help the business organisations in doing so. The present study attempts to understand the perception of employees with respect to the present corporate governance regime in order to provide a direction to develop, ensure and follow a corporate governance regime for the benefit of all its stakeholders.

The findings of the study will contribute to the future development of corporate governance regime in India. The findings will help the regulators, policy makers, stock exchanges and think tanks to rethink their priorities and develop rules or codes of best practices on corporate governance that would respond to the ever increasing need for good governance. This is a study of employees perception of corporate governance regime in India so the findings do not apply to other countries and the perception of other stakeholder groups should also be considered in the future research.

Limitations & Future Scope

The empirical base is limited and the use of primary data has its own set of shortcomings. The empirical findings of this study must be further verified and extended to other stakeholders within the corporate governance framework. The data used in this study covers only middle-aged professionals across the spectrum, a follow up study on point of view of regulatory agencies, investors, shareholders, chief finance officers etc. would be an interesting validation of findings.

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