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CORPORATE GOVERNANCE FOR EFFECTIVE SECURITY MARKET

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Corporate Governance for Effective Security Market

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Abstract – The Corporate Governance ensures the smooth and transparent functioning of the securities market. There are some norms which regulate the corporate governance of a particular company. The paper focuses to look at the evolution of these norms, its present status and the future and how conducive it will be adopt these rules as mandatory governance norms for the Indian Corporate World. It has been an argument against mandatory corporate governance norms, across the globe that not all well governed companies make profit and conversely not all bad governed companies sink either.

The scope of the paper shall be limited to Corporate Governance in India; however necessary references (in terms of evolution of these norms) to position in the United States of America and European Union shall be made wherever necessary.

The paper shall deal with the different legal obligations like listing agreements, company law etc. required to be followed which ensure effective security market. The paper shall also deal with the future possibilities and problems in the Indian market.

In the end, the paper shall also propose some suggestion and conclusion.

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INTRODUCTION

In this age of Globalisation, where economic motives precede over all virtues and traditions, protection of larger public interest from great corporate scandals has become matter of great importance. India has the largest number of listed companies in the world,[1] and therefore efficiency and well-being of the financial markets is critical for the economy in particular and the society as a whole. According to a report prepared by Pune-based India forensic Consultancy Services (ICS), at least 1,200 companies listed on domestic stock exchanges have forged their financial results. The figure included 20-25 firms on benchmark Sensex and Nifty indices. The study called *'Early Warning Signals of Corporate Frauds'* had alleged that such improper accounting included deferring revenue and inflating expenses.

The survey examined 4,867 companies listed on the BSE and 1,288 companies listed on the NSE.[2] With the Satyam Fraud unfolding the report does not seem improbable. In fact putting it in Mayur Joshi's (the founder of India forensic Consultancy Firm) words;

"*Satyam is just one component of all those companies which are indulging in such frauds. More than 73% of respondents in our report named Early Warning Signals of Corporate Frauds said companies*

[1] The total number of listed companies in India above 6000 combinely on Bombay Stock Exchange and National Stock Exchange, having a market capatalisation of US $ billion 1,163.9. Source: World Federtion of Exchanges. http://www.world-exchanges.org/member-exchanges Last visited on 2nd March, 2011

[2] 1200 listed companies forged accounts: Study, The Times of India, 23rd September, 2008. http://timesofindia.indiatimes.com/India_Business/1200_listed_companies_forged_accounts_Study/articleshow/3515467.cms Last visited on 2nd March, 2011

are indulging into financial statement frauds with the objective to beat the analysts' expectation."[3]

The present times are in need of standards of corporate governance more than ever for despite the dominance of organizational actors in contemporary social life, law is desperately short of doctrines, institutions, and regulatory techniques that adequately control corporate entities.[4] It has now become imperative to design and implement a dynamic mechanism of corporate governance, which protects the interests of relevant stakeholders without hindering the growth of enterprises because the corporate veil frequently deflects the penetration of legal values into and, indeed, the imposition of legal sanctions upon the corporate entity.[5] Adversarial-trained lawyers often facilitate avoidance and evasion of corporate liability through 'creative compliance' with legal requirements.[6] A commonly proffered solution to the problem of ensuring that legal values permeate the internal workings of the corporation is to require large institutions to regulate themselves in a way that is responsive to social concerns.

With a need for greater Foreign Direct Investment, the entry of transnational and multinationals to the country, a need for greater accountability and investor protection arose and the Corporate Governance norms became imperative for discerning securities market.

The first step taken in this regard was in 1996, when the Confederation of Indian Industries took a special initiative on Corporate Governance – the first institutional initiative in Indian industry. The objective was to develop and promote a code for Corporate Governance to be adopted and followed by Indian companies, be these in the Private Sector, the Public Sector, Banks or Financial Institutions, all of which are corporate entities.[7] The code however focused on listed companies for the simple reason that these are financed largely by public money (be it equity or debt) and, hence, need to follow codes and policies that make them more accountable and value oriented to their investing public. The preference was given to the shareholders and the creditors for instead of the employees, local communities, suppliers or ancillary units for the simple reason that;

Firstly corpus of Indian labor laws is strong enough to protect the interest of workers in the organised sector, and employees as well as trade unions are well aware of their legal rights. In contrast, there is very little in terms of the implementation of law and of corporate practices that protects the rights of creditors and shareholders.

Secondly there is much to recommend in law, procedures and practices to make companies more attuned to the needs of properly servicing debt and equity.

With this background, the Corporate Governance regime in India is more towards, legalizing the norms than leaving it to the ethical conscience of the company. The paper will further deal with feasibility of present and future proposed changes in the Corporate Governance Regime, the law, regulations and the listing agreement shall be the focal point of the paper.

"…Corporate Governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The corporate governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations, and society…"[8]

Sir Adrian Cadbury

NEED FOR CORPORATE GOVERNANCE NORMS

Corporate governance became important in Indian context because of the scams that occurred since liberalization from 1991, for e.g. The UTI scam, Ketan Parekh scam, Harshad Mehta scam & the latest & the biggest of them all the Satyam Fraud scam.

Further it is contested that in emerging market like India when investments take place investors want to verify that not only are the capital markets or the companies on which they have invested run competently but they also have good corporate governance.[9]

Another reason is that the legal & administrative environment in India provide excellent scope for corrupt practices in business.

[3] http://www.financialexpress.com/news/1-200-indian-cos-indulging-in-fraud-report-said-in-sept/408379/ Last visited on 5th March, 2011

[4] J. Coffee, *No soul to damn: no body to kick: An unscandalised inquiry into the problem of corporate punishment,* 79 Michigan Law Rev. 1981, p. 6.

[5] Christine Parker, *Compliance Professionalism and Regulatory Community: The Australian Trade Practices Regime*, Journal of Law and Society, Vol. 26, No. 2, 1999, pp. 215-239, p 216.

[6] D. McBarnet, *Legal creativity: Law, capital and legal avoidance,* in Lawyers in a Postmodern World: Translation and Transgression, (Eds.) M. Cain and C. Harrington (1994) 73

[7] *Desirable Corporate Governance: A Code*,

http://www.nfcgindia.org/desirable_corporate_governance_cii.pdf Last visited 5th March, 2011

[8] Sir Adrian Cadbury, *Global Corporate Governance Forum*, (2000)World Bank

[9] N. Vittal, *Issues in Corporate Governance in India* **,** Paper for publication in the 5th JRD Tata Memorial Lecture Series.

However it should be noted that the corporate governance problems in India is different from that in U.S. or U.K. The governance issue in U.S. or U.K. is that of disciplining the management while the problem in the Indian corporate sector is that of disciplining the dominant shareholder & protecting the minority shareholders.[10]

Good corporate-governance practices reduce this risk by ensuring transparency, accountability, and enforceability in the marketplace.[11] Moreover, well-governed firms likely will obtain capital more cheaply than firms that have poor corporate-governance practices because investors will require a smaller "risk premium" for investing in well-governed firms.[12]

While the presence of a good corporate-governance framework ensures neither stability nor success, it is widely believed that corporate governance can *"raise efficiency and growth,"* especially for countries that rely heavily on stock markets to raise capital. In fact, some contend that the *"Asian financial crisis gave developing countries ... a lesson on the importance of a sound corporate governance system."* [13] Thus, in an efficient capital market, investors will invest in firms with better corporate-governance frameworks because of the lower risks and the likelihood of higher returns.

"...Frequently, a man of great fortune, sometimes even a man of small fortune is willing to purchase a thousand pounds share in India stock merely for the influence which he expects to acquire by a vote in the court of proprietors. It gives him a share, though not in the plunder, yet in the appointment of the plunderers of India ... Provided he can enjoy this influence for a few years, and thereby provide for a certain number of his friends, he cares little about the dividend, or even the value of the stock upon which his vote is founded..."[14]

Adam Smith

CORPORATE GOVERNANCE IN INDIA

After discussing need of corporate governance, there are many factors that are responsible for ensuring corporate governance in India.

Clause 49 of the Listing Agreements

The SEBI implemented the recommendations of the *Birla Committee* through the enactment of Clause 49 of the Listing Agreements.[15] Clause 49 may well be viewed as a milestone in the evolution of corporate governance practices in India. It is similar in spirit and in scope to the *Sarbanes-Oxley* measures in the United States. The requirements of Clause 49 were applied in the first instance to the companies in the BSE 200 and S&P C&X NIFTY stock indices, and all newly listed companies, on March 31, 2001.

These rules were applied to companies with a paid up capital of INR 100 million or with a net worth of INR 250 million at any time in the past five years on March 31, 2002, and to other listed companies with a paid up capital of over INR 30 million on March 31, 2003. The *Narayana Murthy Committee* worked on further refining the rules, and Clause 49 was amended accordingly in 2004.

The key mandatory features of Clause 49 regulations deal with the following:

(i) composition of the board of directors;

(ii) the composition and functioning of the audit committee;

(iii) governance and disclosures regarding subsidiary companies;

(iv) disclosures by the company;

(v) CEO/CFO certification of financial results;

(vi) Reporting on corporate governance as part of the annual report; and

(vii) Certification of compliance of a company with the provisions of Clause 49.

The composition and proper functioning of the board of directors emerges as the key area of focus for Clause 49. It stipulates that non-executive members should comprise at least half of a board of directors. It defines an "independent" director and requires that independent directors comprise at least half of a board of directors if the chairperson is an executive director and at least a third if the chairperson is a non-executive director. It also lays down rules

[10] J. Varma, *Corporate Governance in India : Disciplining the Dominant Shareholder*, (1997) IIMB Management Review [Oct- Dec. 1997 , 9 (4) , 5-18].

[11] Varun Bhat, *Corporate Governance in India: Past Present and Suggestions for Future,* (2007) Iova law Review, 129-157.

[12] William Lazonick and Mary O Sullivan, *Maximising shareholder Value: a new ideology for Corporate Governance,* (2000), Economy and Society, Vol. No. 9, 13-35

[13] *Ibid.*

[14] Adam Smith, Wealth of Nations (1776) , Book V, Chapter I, Part III, Article 1st

[15] Dilip Kumar Sen, *Clause 49 of the Listing Agreement on Corporate Governance.* http://www.icai.org/resource_file/10980dec04p806-811.pdf Last visited on 8th March, 2011

regarding compensation of board members, sets caps on committee memberships and chairmanships, lays down the minimum number and frequency of board meetings, and mandates certain disclosures for board members.[16]

Clause 49 pays special attention to the composition and functioning of the audit committee[17], requiring at least three members on it, with an independent chair and with two-thirds made up of independent directors--and having at least one "financially literate" person serving. The Clause spells out the role and powers of the audit committee and stipulates minimum number and frequency of and the quorum at the committee meetings.

The areas where Clause 49 stipulates specific corporate disclosures are: (i) related party transactions;[18] (ii) accounting treatment;[19] (iii) risk management procedures;[20] (iv) proceeds from various kinds of share issues; (v) remuneration of directors; (vi) a Management Discussion and Analysis section in the annual report discussing general business conditions and outlook; and (vii) background and committee memberships of new directors as well as presentations to analysts. In addition, a board committee with a non-executive chair is required to address shareholder/investor grievances. Finally, it is mandated that the process of share transfer (that had been a long-standing problem in India) be expedited by delegating authority to an officer or committee or to the registrar and share transfer agents.

Company Law

The primary protection to minority shareholders is laid down in the company's law. Some of these provisions are the regulatory equivalent of an atom bomb - they are drastic remedies suitable only for the gravest cases of misgovernance. Company law provides that a company can be wound up if the Court is of the opinion that it is just and equitable to do so.[21] This is, of course, the ultimate resort for a shareholder to enforce his ownership rights. Rather than let the value of his shareholding be frittered away by the enrichment of the dominant shareholder, he approaches the court to wind up the company and give him his share of the assets of the company. In most realistic situations, this is hardly a meaningful remedy as the break-up value of a company when it is wound up is far less than its value as a "going concern." It is well known that winding up and other bankruptcy procedures usually lead only to the enrichment of the lawyers and other intermediaries involved.

Company law also provides for another remedy if the minority shareholders can show that the company's affairs are being conducted in a manner prejudicial to the interests of the company or its shareholders to such an extent as to make it just and equitable to wind it up. Instead of approaching the Court, they can approach the Company Law Tribunal. The Company Law Tribunal which is a quasi-judicial body can make suitable orders if it is satisfied that it is just and equitable to wind up the company on these grounds, but that such winding up would unfairly prejudice the members. In particular, the Tribunal may regulate the conduct of the company's affairs in future, order the buyout of the minority shareholders by the other shareholders or by the company itself, set aside or modify certain contracts entered into by the company, or appoint a receiver. The Tribunal could also provide for some directors of the company to be appointed by the Central Government, or by proportional representation. The Tribunal normally entertains such complaints only from a group of shareholders who are at least one hundred in number or constitute 10% of the shareholders by number or by value.[22]

Another safeguard in the company law is the requirement that certain major decisions have to be approved by a special majority of 75% or 90% of the shareholders by value. This may not be an effective safeguard where the dominant shareholders hold a large majority of the shares so that they need to get the approval of only a small chunk of minority

[16] Clause 49 of the Listing Agreement: I Board of Directors (B)-Non executive director's compensation and disclosures.

[17] Clause 49 of the Listing Agreement: II Audit Committee

[18] **Clause 49 of the Listing Agreement: IV Disclosure (A) Basis of related party transactions** (i) A statement in summary form of transactions with related parties in the ordinary course of business shall be placed periodically before the audit committee. (ii) Details of m aterial individual transactions with related parties which are not in the normal course of business shall be placed before the audit committee. (iii) Details of material individual transactions with related parties or others, which are not on an arm's length basis should be placed before the audit committee, together with Management's justification for the same.

[19] *Ibid.* **(B) Disclosure of Accounting Treatment**

Where in the preparation of financial statements, a treatment different from that prescribed in an Accounting Standard has been followed, the fact shall be disclosed in the financial statements, together with the management's explanation as to why it believes such alternative treatment is more representative of the true and fair view of the underlying business transaction in the Corporate Governance Report.

[20] Ibid. **(C) Board Disclosures – Risk management**

The company shall lay down procedures to inform Board members about the risk assessment and minimization procedures. These procedures shall be periodically reviewed to ensure that executive management controls risk through means of a properly defined framework.

[21] **Section 433(f) of the Companies Act, 1956** provides that a Company may be wound up by the tribunal when the tribunal is of the opinion that it is just and equitable to wound up the company.

[22] **Section 402 of the Companies Act, 1956. Power of tribunal on application under section 397 and 398.** Without prejudice to the generality of the powers of the [1][Tribunal] under section 397 or 398, any order under either section may provide for- (a) The regulation of the conduct of the company's affairs in future; (b) The purchase of the shares or interests of any members of the company by other members thereof or by the company; (c) In the case of a purchase of its shares by the company as aforesaid, the consequent reduction of its share capital.

shareholders to reach the 75% level. However, the recent amendments in Indian Companies Law provides that a listed company may have one director elected by small shareholders. The appointment of small shareholders' director is not mandatory, which again acts as a constraint. Company law provides for regular accounting information to be supplied to the shareholders along with a report by the auditors.[23] Disclosure does not by itself provide the means to block the dominant shareholders, but it is a prerequisite for the minority shareholders to be able to exercise any of the other means available to them. Disclosure is also a vital element in the ability of the capital market to exercise its discipline on the issuers of capital.

Securities Law

Historically, most matters relating to the rights of shareholders were governed by the company law. Over the last few decades, in many countries, the responsibility for protection of investors has shifted to the securities law and the securities regulators at least in case of large listed companies. In India, the Securities and Exchange Board of India (SEBI) was set up as a statutory authority in 1992, and has taken a number of initiatives in the area of investor protection.

Information Disclosure

As discussed above, the company law itself mandates certain standards of information disclosure both in prospectuses and in annual accounts. SEBI has added substantially to these requirements in an attempt to make these documents more meaningful. Some of these disclosures are important in the context of dealing with the dominant shareholder. One of the most valuable is the information on the performance of other companies in the same group, particularly those companies which have accessed the capital markets in the recent past. This information enables investors to make a judgment about the past conduct of the dominant shareholder and factor that into any future dealings with him.

Promoters' Contribution and Lock In

Another aspect of the SEBI regulations is that in most public issues, the promoters (typically the dominant shareholders) are required to take a minimum stake of about 20% in the capital of the company and to retain these shares for a minimum lock-in period of about three years.[24]

Pricing Of Preferential Share Allotments

Another area in which SEBI has intervened to tackle the dominant shareholder is the pricing rule that it has imposed on preferential allotments. Company law itself provides that new issue of shares must be rights issues to existing shareholders unless the shareholders in general meeting allow the company to issue shares to the general public or to other parties.[25] In 1994, SEBI issued new guidelines on preferential allotment that prohibited preferential allotments at a price lower than the average market price during the last six months. It is now replaced by the SEBI (ICDR) Regulation, 2009.[26]

This regulatory intervention illustrates very nicely the problems that the regulator faces in dealing with governance abuses by the dominant shareholder. There are many situations where it may be in the interests of the company as a whole (and not just the dominant shareholders) to issue equity at below the six monthly average prices.

One situation where compromises may be desirable on price is when the company is making a private placement of equity to large investors in an arms' length transaction. The private placement may be to avoid the costs of a public issue or because the company does not satisfy the entry norms for a public issue. It is well known that a company making a large additional issue of equity (whether by public issue or by private placement) has to price its equity significantly below the ruling market price. Many

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[23] Section 210 of the Companies Act, 1956 requires the Board of Directors to lay before the Shareholders the annual profit and loss account in the Annual General Meeting. Further Section 217 provides for disclosures to be made by the Board of Directors in the Board Report. The provision also provides for a penalty in case of contravention of the same.

[24] **SEBI (DIP) Guidelines, 2000. 13.3 Non-transferability of financial instruments :**13.3.1 (a) The instruments allotted on a preferential basis to the promoter / promoter group as defined in Chapter VI in Clause [6.4.2 (m)] of these guidelines, shall be subject to lock-in of 3 years from the date of their allotment. (b) In any case, not more than 20% of the total capital of the company, including capital brought in by way of preferential issue, shall be subject to lock-in of three years from the date of allotment. (c) In addition to the requirements for lock in of instruments allotted on preferential basis to promoters/ promoter group as per clause 13.3.1 (a) and (b), the instruments allotted on preferential basis to any person including promoters/promoters group shall be locked-in for a period of one year from the date of their allotment except for such allotments on preferential basis which involve swap of equity shares/ securities convertible into equity shares at a later date, for acquisition.(d) The lock-in on shares acquired by conversion of the convertible instrument/exercise of warrants, shall be reduced to the extent the convertible instrument warrants have already been locked-in. Please note that the DIP Guidelines are now replaced with the SEBI (ICDR) Regulations, 2009 which provides for the following:- **Lock-in of specified securities held by promoters.**

[25] Section 81 of the Companies Act, 1956 deals with the preemptory right of the existing shareholders to buy the shares of the company, in cases of further issue of capital of the company.

[26] Regulation 76 provides for pricing of equity shares in case of preferential allotment.

public issues for example are typically made at discounts of 15-20% to the ruling market price. The prohibition on making preferential issues at a discount would effectively rule out such private placements altogether.

At the same time for reasons of size or otherwise, a public issue may be infeasible. The regulatory intervention on preferential allotment may thus have the wholly unintended consequence of denying the company access to the capital market completely. Again, one can think of modifications in the regulations that would exempt arms' length transactions defined in some suitable way, but no such definition can be wholly satisfactory.

In short, this example shows very well how regulatory interventions designed to discipline the dominant shareholder always run the risk of attempting to micro-manage the affairs of the company. This is a dilemma that simply will not go away.

Insider Trading and Takeover Regulations

Securities regulators around the world have framed various regulations to deal with the problem of insider trading. The existence of regulations does not necessarily mean that they are enforced.[27] However, in the United States and the United Kingdom there have been a large number of well publicized and successful actions against insider trading.

These allegations of insider trading have been difficult to prove in most instances as the promoters can act through numerous friends, relatives and other fronts.

The take-over regulations in India require that a slice of this cake be shared with other shareholders. The acquirer of a controlling block of shares must make an open offer to the public for 20% of the issued share capital of the target company at a price not below what he paid of the controlling block. Of course, if more than 20% of the shareholders want to sell at that price, the acquirer is bound to accept only 20% on a pro-rata basis functioning market for corporate control, he can expect to get a premium over the market.[28]

ROLE OF STOCK EXCHANGES IN CORPORATE GOVERNANCE

India currently has two major stock exchanges--the National Stock Exchange, established in 1994, and the Bombay Stock Exchange (BSE), the oldest stock exchange in Asia, established in 1875. Until 1992 the BSE was a monopoly, marked with inefficiencies, high costs of intermediation, and manipulative practices, so external market users often found themselves disadvantaged.

The National Securities Clearing Corporation is the legal counter-party to net obligations of each brokerage firm, and thereby eliminates counter-party risk and the possibility of payments crises. It follows a rigorous 'risk containment' framework involving collateral and intra–day monitoring. The NSCC, duly assisted by the National Securities Depository, has an excellent record of reliable settlement schedules since its inception in the mid-1990s. The number of trades is an important indicator of the extent of investor interest and participation in equities and equity trading, and provides important incentives for improving corporate governance practices in India.

Corporate Governance as an Ethical Practice

Corporate governance is such a burning issue for regulators that it is often forgotten that the capital market by itself exercises considerable discipline over the dominant shareholder.

Minority investors may rarely attend shareholder meetings where the dice are loaded against them, but they are continuously voting with their wallets. They can vote with their wallets in the primary market by refusing to subscribe to any fresh issues by the company. They can also sell their shares in the secondary market thereby depressing the share price. A cash rich company with no foreseeable need for additional funds can be relatively unconcerned about this kind of action by minority shareholders. Even in this case, however, the dominant shareholder (unless he holds a clear 51%) faces the risk of being ousted in a take-over battle.

A depressed share price makes the company an attractive take-over target. A well-functioning market for corporate control makes this threat more real. The most powerful impact of voting with the wallet is on companies with large growth opportunities that have a constant need to approach the capital market for additional funds.

For these companies, shareholder disenchantment can be very expensive. In fact, in equilibrium, the price at which such companies can raise funds from the public will reflect the true worth of the business less the present value of all privileges that the market expects the dominant shareholder to extract in future. If these market expectations are fulfilled, the minority shareholders have little cause for complaint since they end up getting what they paid for. The market may be fooled once or twice, but pretty soon they can form a fair idea of the nature of the dominant shareholders and what they are likely to do. It is quite common for investors in India to value a scrip using a standard

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[27] M.E. King, Chairman, *Report on Insider Trading,* (1997)

[28] SEBI (Substantial Acquistion of Shares and Takeovers) Regulation, 1997. Regulation 21(1) The public offer made by the acquirer to the shareholders of the target company shall be for a minimum twenty per cent of the voting capital of the company:] However, the recently concluded Report of the Takeover Regulation Advisory Committee, has suggested an Open offer of 100 per cent, so that every shareholder has a right to exit the company. Available at http://www.sebi.gov.in/commreport/tracreport.pdf. Last visited on 11th March, 2011.

financial model (like the price-earnings model, dividend discount model or discounted cash flow model) and then to subtract a "management discount" of 15% or 20% depending on the particular management group involved. This management discount reflects the present value of all future losses to the minority shareholder from governance abuses by the dominant shareholder.

This impact is further strengthened when the minority shareholders are large institutions (both domestic and foreign) who, in a sense, act as the gatekeepers to the capital market. When they vote with their wallets and their pens, they have an even more profound effect on the ability of the companies to tap the capital markets. Indian companies that opened their doors to foreign investors have seen this power of the minority shareholder in very stark terms. These investors can perhaps be fooled once as easily as any other intelligent investor, but the next time around, the company finds that its ability to tap the international markets with an offering of Global Depository Receipts (GDRs) or other instrument has practically vanished. In the mid-90s, company after company in India has woken up in this manner to the power that minority shareholders enjoy when they also double up as gatekeepers to the capital market.

The role of gatekeepers is quite crucial when a company accesses the capital market infrequently. When a company comes to the market for the first time, there is no track record on the basis of which the market can assess the damage that the dominant shareholder is likely to do. In well-developed capital markets, large investment banks perform the gatekeeping function of making a judgment about the company and its management. The investment bank definitely is no stranger to the capital markets, and it has a reputation to defend because it needs to come back to the market again and again. The privileged relationship that the investment bank, particularly the lead manager has with the issuer enables it to make a better assessment about the corporate governance of the company involved. This judgment is reflected in its pricing decisions.[29]

What makes capital market discipline so much more attractive than regulatory intervention is that unlike the regulator, the market is very good at micro level judgments and decisions. In fact the market is taking micro decisions all the time. It is its success in doing so that makes it such an efficient allocator of capital. Unlike the regulator, the market is not bound by broad rules and can exercise business judgment. It therefore makes sense for the regulator to pass on as much of the burden of ensuring corporate governance to the markets as possible. The regulator can then concentrate on making the markets more efficient at performing this function. Similar views have been expressed about corporate governance problems even in the United State,[30] but they apply with far greater force to the Indian context.

"…Corporate governance is about "the whole set" of legal, cultural, and institutional arrangements that determine what public corporations can do, who controls them, how that control is exercised, and how the risks and return from the activities they undertake are allocated..."[31]

Margaret Blair

CONCLUSION

The hypothesis *"Corporate Governance Norms should be adopted as basic ethical practice on part of the companies and not as mandatory legal requirement, good governance norms cannot be enforced it can only be imbibed"* stands proved.

Corporate governance emerged on the scene as a result of the liberalisation policy initiated in 1992. It has been an argument against the corporate governance norms that not all well governed companies do well in market and neither the reverse of that happens. Hence the real threat to maximising shareholder returns centrally risk management and policy decisions taken by the Board instead of responsibility and accountability. A responsible and honest decision need not always be a discerning decision; however one can also not do away with requirements of fair play and accountable behaviour in the name of profit. Hence what is required today is a moderate regulatory regime with strong ethical code of conduct for the key players in the governance of a company.

Secondly governance norms should be principle based, as they are subjective criteria depending on the convenience of a company to comply with the same. A detail based regime do a lot of harm to functioning of the structure and be an unnecessary requirement for w in India do not really face stifle

29 *See* Jayant Rama Verma, *Corporate Governance in India: Disciplining Dominant Shareholders in India,* (1997) http://www.iimahd.ernet.in/~jrvarma/papers/iimbr9-4.pdf Last visited on 15th March, 2011.

30 J Pound**,** *The fight for good governance*, (1993) Harvard Business Review, January-

February, 76-83

31 Maragret Blair, Professor of Law, Vanderbilt University Law School, available at

http://www.corpgov.net/library/library.html Last visited on 15th March, 2011.

between BoD and Shareholders for power as is the case in the US of A or United Kingdom.

Thirdly, with heavy inflow of foreign direct investment need for investor protection arose. In terms of policy the Indian legal system provides one of the highest levels of investor protection in the world, the reality is different with slow, over-burdened courts and significant corruption.

In addition, despite the corporate governance shortcomings, the Indian economy and its financial markets have started attaining impressive growth rates in recent years, and display an exceptionally high level of optimism. The reason is that India is now clearly and strongly committed to sustaining and rapidly furthering the major economic reforms and the liberalization started in the early nineties. Specifically, the *Securities and Exchanges Board of India* established as a part of these reforms, has a rigorous regulatory regime to ensure fairness, transparency and good practice, and the *National Stock Exchange of India*, also established as part of the reforms, functions efficiently and transparently to now trade among the highest number of trades in the world, just behind NASDAQ and NYSE. The traditional *Bombay Stock Exchange* has also reformed effectively.

Further, the corporate governance landscape in the country has been changing very fast over the past decade, particularly with the enactment of Sarbanes-Oxley type measures in Clause 49 of the listing agreements, and legal changes to improve the enforceability of creditor's rights.

The problem in the Indian corporate sector (be it the public sector, the multinationals or the Indian private sector) is that of disciplining the dominant shareholder and protecting the minority shareholders. A board which is accountable to the owners would only be one which is accountable to the dominant shareholder; it would not make the governance problem any easier to solve. Clearly, the problem of corporate governance abuses by the dominant shareholder can be solved only by forces outside the company itself. This paper has discussed the role of two such forces – the regulator (the company law administration as well as the securities regulator) and the capital market.

Corporate governance abuses perpetrated by a dominant shareholder pose a difficult regulatory dilemma in that regulatory intervention would often imply a micro-management of routine business decisions. The regulator is forced to confine him to broad proscriptions which leave little room for discretionary action. Many corporate governance problems are ill suited to this style of regulation.

The capital market on the other hand lacks the coercive power of the regulator. What it has however is the ability to make business judgments and to distinguish between what is in the best interests of the company as a whole as against what is merely in the best interests of the dominant shareholders. The only effective sanction that the market can impose against an offender is to restrict his ability to raise money from the market once again. Denial of market access is a very powerful sanction except where the company is cash rich and has little future needs for funds.

In short, the key to better corporate governance in India today lies in a more efficient and vibrant capital market.

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