Corporate governance: A paradigm shift needed

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A great deal has been written about corporate governance in India since the turn of the millennium, when the nation's economy was gaining prominence on the world stage. It became a buzzword in boardrooms and the echelons of management, and the government established committees, several of whose recommendations were adopted.

Listed companies got their first formal regulatory framework for corporate governance in February 2000 – clause 49 of the listing agreement. This was followed by further legislative initiatives pertaining to audit committees, audit reports, codes of conduct, directorships and director compensation, financial disclosures, independent directors, related party transactions and risk management.

Over many years the government has endeavoured to establish checks and balances in this area, as well as stringent penal provisions for violations. The regulatory regime in India is covered under the Companies Act, 1956; the Securities and Exchange Board of India Act, 1992; the Securities Contracts (Regulation) Act, 1956 (which was enacted to check speculation in securities); and the Depositories Act, 1996. The common objective of these pieces of legislation is to protect the interests of investors in the capital markets, and to maintain standards of corporate governance.

Yet none of these statutes, systems or "best practice" standards of leading corporations could prevent Satyam from becoming an infamous name at the start of 2009, just when the world economy was reeling from the effects of an unprecedented crisis. Quickly labelled a watershed in the history of India Inc, the Satyam scandal prompted a new debate on the question: What really is needed to fix corporate governance in India? Amid salvage efforts surrounding the damaged company, and the reactions, recriminations and retaliations being aired through the media, a few key points emerge.

Companies must ensure that their systems, processes and documentation of financial reporting and disclosure compliance are stringent and rigorous. The requirements of the law are not sufficient; global best practices need to be considered, adopted and integrated.

Listed companies need to validate the accuracy and integrity of their financial management. Companies must establish procedures for meeting their reporting obligations, and undertake internal and external evaluations of the effectiveness of their controls over the established financial processes.

The Securities and Exchange Board of India (SEBI) must step up its monitoring and enforcement in key compliance areas, to ensure that the corporate malfeasance seen in the case of Satyam is not repeated. Independent directors need to be far more involved than is usual at present. They should develop and demonstrate real awareness of the company's businesses and strategies.

SEBI must ensure that only companies that have demonstrated effective and strong corporate governance structures are permitted to be listed. India's most influential rating agency, CRISIL, graded 29 initial public offerings made in February. Its results showed that 50% were by companies with weak, faulty corporate governance structures, 25% were "average" in this regard, while 15% were above average. Only 10% were "robust".

Improved corporate governance does not begin and end with a company. Shareholders also play an important role. Shareholder activism is needed – at the very least, in the form of questions about a company's governance at its meetings, and by recourse to regulators, be it the Company Law Board or the Registrar of Companies.

A fundamental factor – and the hallmark of a good standard of corporate governance – is that a company's board needs to be both independent and of good quality. Most importantly, independent directors need to be truly independent of the promoters, capable of articulating their views candidly and able to control promoters' propensity for related party transactions. For company boards to be able to attract this good talent, it is vital that independent directors receive protection under the law.

In the wake of Satyam, a seven-member core group was created by the Institute of Company Secretaries of India (ICSI), and charged with making further recommendations within six months to the Ministry of Company Affairs regarding methods and measures to strengthen corporate governance. While it is difficult to anticipate the extent of changes the ICSI core group will recommend, the group is likely to focus on enhancement of disclosure and transparency norms by companies, and the introduction of an evaluation system for company boards and independent directors.

Satyam has given India Inc, law makers, regulators, the judiciary and accounting professionals cause for introspection, prompting re-examination of internal practices and much thought about how standards of corporate governance can be raised.

Regulation and enforcement in this area is a challenge to legislative bodies around the world; one that requires a change in stagnant thought patterns and beliefs if there is to be meaningful improvement, and if further scandals are to be prevented.

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