Mains Practice Question

Practice

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Q. What is Corporate Governance? What are the ethical issues with Corporate Governance in India? Suggest measures to improve Corporate Governance in India. (250 words)

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Approach

- Describe corporate governance.
- Enlist the ethical issues with Corporate Governance in India.
- Suggest measures to improve Corporate Governance in India.
- Give a conclusion by underlining the significance of corporate governance.

Introduction

Corporate governance essentially involves balancing the interests of a company's many stakeholders, such as shareholders, senior management executives, customers, suppliers, financiers, the government, and the community.

Body

Ethical issues with Corporate Governance in India

- **Conflict of Interest:** The challenge of managers potentially enriching themselves at the cost of shareholders e.g. recent case of former ICICI bank head Chanda Kochar approved a loan to Videocon for a quid pro quo deal for her husband.
- **Weak Board**: Lack of diversity of experience and background represents a major area of weakness for these boards. There have been questions about the board performing in the larger interests of the shareholders. In the case of IL&FS, not a single red flag was raised by any board member.

- **Separation of ownership and management:** In case of family-run companies, the separation of ownership and management remains a key challenge in majority of companies including some of India’s top ones.
- **Independent directors:** Independent directors are partisan and are not able to check promoters unethical practices.
- **Executive Compensation:** Executive compensation is a contentious issue especially when subject to shareholder’s accountability. Executive compensation needs to stand the test of stakeholders' scrutiny.

Suggestions to improve Corporate Governance in India

- Implement the recommendations of Uday Kotak Panel, such as:
    - Minimum 6 directors to be on board of listed entities; every listed entity to have at least 1 independent woman director
    - More transparency on appointment of independent directors and should play a more active role on the boards.
    - Audit Committee must review use of loans/adv/investment by holding co in arm over Rs 100 crore.
- **Diverse boards are better boards:** In this context, ‘diverse’ is all-encompassing, including gender, ethnicity, skills and experience.
- **Robust risk management policies:** Adoption of effective and robust risk management policies for better decision making as it develops a deeper insight into the risk-reward trade-offs that all Corporations face.
- **Effective governance infrastructure:** Policies and procedures which guide ethical behaviour should form the base of any organizational behaviour. Ensure separation of the line of responsibility between board and management.
- **Evaluation of the Board’s performance:** The Board should consider addressing weaknesses uncovered in board evaluations, enhancing their governance processes.
- **Communication:** Facilitating shareholder communication with the board is key. There is a need to provide a contact person with whom shareholders may discuss any issue.

Conclusion

In a growing economy like India corporate governance is critical for attracting investment both from domestic and international sources.