AN OVERVIEW OF CORPORATE GOVERNANCE: INDIA AND CHINA

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Abstract

Corporate governance is a mechanism which helps in directing, controlling and managing the corporate organisation in an efficient manner. This structure of corporate governance may help the corporate organisations to avoid mismanagement, improve the access to the capital, and also to mitigate risk. Corporate governance also brings transparency and make the business organisation more accountable to its investors and other stakeholders. This may also help in the growth of the corporate, may led to new investments and build trust between the shareholders, directors and the managers of the company. Therefore, in this paper the author talks about the importance of corporate governance in the first part of the paper. The second part of the paper will discuss about the corporate governance structure in India as well as in china. The third part of the paper will talk about the role of independent director in the corporate organisation in India and china. In the last part of the paper the author shall talk about whether the independent director is helping in promoting the sense of good corporate governance in an organization.

INTRODUCTION

Corporations are usually large companies, with hundreds of employees and others, working within one single company. Therefore, there arises a need for a proper structure and order, which helps in better communication, and makes it easy to understand. This policy structure within the corporate organisation may be termed as corporate governance. Therefore, with the help of these set of rules and practices the corporate organisation may be governed, and the board of directors of a company can ensure fairness, accountability, and also maintain transparency in the relation to the company, its shareholders and other stakeholders like customers, employees, government and the community at large.

The corporate governance framework comprises of: -

1. Explicit and implicit contracts between the company and the shareholders for distribution of responsibilities, rights and rewards.
2. Procedures for reconciling the sometimes-conflicting interests of shareholders and the directors in accordance with their duties, roles and privileges and
3. Procedures for proper supervision, control, and information flow to serve as the system of checks and balances.

Therefore, corporate governance is a way by which there can be a proper distribution duties, responsibilities, rights and controls to those who actively participate in the working of the organisation including its directors, shareholders, various stakeholders, creditors and regulators.

GOAL OF CORPORATE GOVERNANCE

Corporate governance helps the corporate organisation to work efficiently, and run its day to day activity in a smooth manner. However, it is also important to understand the goals and principles of corporate governance. Few of the principles of corporate governance are as follows: -

i) Identifying the Roles of The Board of Directors- The board of directors are generally the head of any business organisation. There responsibilities are diverse. Therefore, corporate governance ensures that the board of directors are working for the betterment of the company, and has the level of commitment which is required to run the business in an efficient manner.

ii) Treating Shareholders Equally- Corporate governance allows and encourage the shareholders participation in the day to day activities of the company including the meeting. Therefore, corporate governance helps shareholders to exercise their rights for the efficient working of the company.

iii) Transparency- One of the most important principle of corporate governance is the concept of disclosure and transparency. These principles help in maintaining the transparency between various branches of the organisation, whereby helps maintaining the accountability. This also helps in building the trust between the corporation and the creditors and other investors.

iv) Interest of Stakeholders- Corporate governance also includes the best interest of the stakeholders as they are also an integral part of the corporation, even though they do not hold any shares in the organisation. Stakeholders generally include customers, investors, employees and others.

v) Ethical Behaviour- Corporate governances helps an organisation to follow the code of conduct and exhibit the ethical behaviour in the decision making process of the company.

IMPORTANCE OF CORPORATE GOVERNANCE

Since, corporate governance helps in determining the roles and responsibilities of every individual within the organisation, therefore it becomes easy to understand for an individual as to what exactly are they accountable for. For example, the board of directors are generally responsible for the management of the company, however, if there is any mismanagement in the company, then it can be termed as the fault on behalf of the directors. Thereby avoiding the situation where there is no way to know, who should be held responsible for any wrong doings of the corporate. Corporate governance also helps in various things which are as follows: -

i) Lowering Risk- Corporate governance helps in mitigating the amount of risk involved such as scandals, or fraud can be avoided whereby protecting company from any criminal liability. One of the main reason for this is that because of the structure of the corporate governance people in the organisation clearly know what exactly are they accountable for. Therefore, this will lead to a quick identification of the offender and this may not have a negative effect on the overall corporate organisation. Also, with the help of corporate governance everyone is held to a specific standard, and there exists an established hierarchy and the roles that every individual has in a corporate organisation. Therefore, it can be said that corporate governance is a form of self-policing.

ii) Public Acceptance- Since, the company acts in a transparent manner due to the existence of corporate governance, it is widely accepted by the public. Also, as the corporate is under full disclosure, and takes full responsibility of its actions, there is a higher level of trust amongst the general public. Moreover, since the corporate governance is in place in a corporate, it reduces the risk of any scam. Whereby increasing public confidence in that particular company. The important reason as to why the corporation undertakes corporate governance is to maintain a public image.

CORPORATE GOVERNANCE IN INDIA

The concept of corporate governance gained importance, when India got liberalized during the period of 1990s, this was brought into existence by Confederation of Indian Industry (CII), and this measure was voluntary adopted by the companies earlier. It gained a mandatory status in the year 2000 under clause 49 of Listing Agreement. This made it compulsory for all the companies listed on the stock exchange to abide by this rule of corporate governance. Moreover, in the year 2009, the ministry of Corporate Affairs, provided with few guidelines with respect to corporate governance which addresses corporate governance issues. However, the public companies were only required to follow these guidelines, and disclosure standards, enumerated in the companies Act 1956, India had fiscal crisis in 1991, which led to the enactment of a series of reforms aimed at general economic liberalization. The Securities and Exchange Board of India (SEBI) was formed in 1992, and it worked as India's securities market regulator. During mid-1990s, the Indian economy was growing gradually, and Indian firms thereby required equity capital to expand their companies, so that it could enter into the market spaces created by liberalization. Therefore, the ever-increasing need for equity capital led to corporate governance reform and many major corporate governance initiatives were launched in India since the mid- 1990s. Also in the year 2009, the ministry of Corporate Affairs, provided with few guidelines with respect to corporate governance which addresses corporate governance issues.

Since, the Indian, model of corporate governance is largely based on the western model of corporate governance, however, there exists a primary difference in enforcement of corporate governance in India and other west economies. The agency gap in the western economies is between the management and the dispersed shareholders, i.e. the conflict of interest between the management and the shareholders, thereby the corporate governance mechanism is the western economies are aimed at reducing the gap between the shareholders and the management. Whereas, in India there is a dominant shareholder who monopolizes the majority of the company’s recourse, i.e. there exists the concentrated form of shareholders unlike the western economy. Therefore, the major agency gap exists between the majority shareholders and the other stakeholders.

Secondly, the corporate governance model in the western economy broadly focuses on the board of directors and their various committees, independent directors and the other management. Whereas, in India the board works under the shareholders, and the will of majority shareholders exists, unlike, in other western economies.

Therefore, in India, the most corporate governance issues arise due to conflict between the majority and minority shareholders. This applies to almost all form of Indian companies with majority who is a dominant shareholder for example Public Sector Unit (PSUs) the government as the majority shareholder, multinational companies where the parent company is the majority shareholder and private sector family-owned companies and business groups, family members being the majority shareholders.

A new Companies Bill, was introduced in the year 2011 to revise the Companies Act 1956, this bill included various provisions for improving the corporate governance in Indian companies. The corporate reforms mainly included improving the board oversight process, independence of board, and introduction of independent directors. However, the major challenges to corporate governance in India are

Power of the dominant shareholder(s), Lack of incentives for companies to implement corporate governance, Underdeveloped external monitoring Systems, Shortage of real independent directors, therefore, India needs and deserves a well-designed policy framework that takes into account all these concerns while being aligned to global developments.

INDEPENDENT DIRECTORS IN INDIA

The Companies Act of 1956, did not directly talked about the concept of independent director and no such provision existed for the compulsory appointment of the Independent Director.

Therefore, there arose the need for mandatory appointment of the independent directors under the framework of corporate governance in the functioning of the company. Therefore, the new Companies Act 2013, incorporated the role of Independent directors within the Act and makes the role of such independent directors different from the role of other executive director. Hence, under the new Act Independent Director is entrusted with several roles, duties and liability for the good governance of the company.

The most important aspect of the Independent Director's role is to protect the interest of the minority shareholders, and ensure that there exists no dominance of the majority shareholder on the board of directors. Further, the Companies Act 2013, categorically defines the manner of selection of the Independent Directors, their duties, roles and liabilities. The key role of the Independent Director in a company are to increase the governance standard, risk management and improving corporate credibility. The most important reason as to why the concept of independent director was introduced was to enable the board of directors to take an unbiased decision, and also to maintain checks and balance in the decision taken by the majority shareholders and the management. Thereby bringing credibility and accountability in the board procedures. Therefore, the introduction of the concept of Independent Directors, was to make them act as the trustees of the good corporate governance.

The Companies Act, 2013 has defined the term 'Independent Director' u/s 2(47) which says that 'Independent Director' means an Independent Director as referred to in sub-section (5) of section 149.

Section 149 of the Companies Act, 2013, states the appointment and qualification of Independent Director on the board of the Company. Also, the Act mandates one third of the board of the directors to be comprising of the independent directors.

The Act, 2013 has described the manner or procedure for selection of Independent Director's under Section 150. This section says that selection of an Independent Director shall be done from a Data Bank maintained by anybody, institute or association, as may be notified by the Central Government, containing names, addresses and qualifications of persons who are eligible and willing to act as Independent Director. It also says that the appointment of an Independent Director shall be approved by the company in general meeting and the explanatory statement indicating the justification behind appointing such person, attached with the notice of general meeting.

The specific guidelines of the duties, roles and function is provided under Schedule IV of the 2013, Act. Some of the functions of the Independent Director are as follows: - Analyzing the performance of the board and the management, safeguarding the interest of the minority shareholders, harmonizing and mediating in situation of conflict between the shareholders and the directors. Independent Directors are also required to be updated with the day to day activities of the company, to actively participate in the committees of the board in which they are the head or the member, and also to regularly attend the board meeting of the company

The Act, 2013, restricts and limits the liability of Independent Director's to the matters which are directly relatable to them. Section 149 (12) limits the liability of an ID "only in respect of acts of omission or commission by a company which had occurred with his knowledge, attributable through board processes, and with his consent or connivance or where he had not acted diligently".

Therefore, having independent director on board was one of the important step for a good corporate governance in India. The Act, 2013 has bestowed various power on Independent Director's to ensure that the management & affairs of a company is being run fairly and smoothly, the Act also provides Independent Directors to vote in the meeting of the board of director, thereby, giving them a say in the management of the company. But, at the same time, greater accountability has also been placed upon them to avoid any wrong doing by them. Therefore, the concept of Independent director strengthens the corporate governance in the corporate organisation in India.

CORPORATE GOVERNANCE IN CHINA

The concept of corporate governance came into limelight since late 1970s. The development of the concept of corporate governance was considered as an important component with respect to the restructuring of the SOEs. However, before such economic reforms, majority of the Chinese industries were state owned, this made the SOEs the major economic contributors as they were required to fulfil the production plans as provided by the government. However, the opening up of Chinese capital market ultimately enhanced the development of corporate governance in China.

The opening up of Chinese market led to the change in many of its economic aspects, out of which corporate governance being one of the most important corporate reform. The corporate governance model regulated majorly business organisation. There are mainly two types of companies in China namely i) state-owned enterprises (SOEs) and ii) publicly held companies (PHCs).

Corporate governance is divided in two categories namely internal and external governance. Internal governance included the regulations pertaining to the boards of directors, ownership and control, and managerial mechanisms, the external governance was with regards to the external market and governmental policies and regulations.

Also, in order to make the reform of Corporate Governance work properly the Chinese Government introduced a set of laws to lay the foundation. The reforms included SOE Law, Company Law, and Securities Law. These reforms made it mandatory for the corporation to have a governing body comprising of the shareholders, the board of directors and the board of supervisors.

The Corporate Governance now required the shareholders to meet at least once every year to vote on the

company's development strategy, investment plan and other day to day working of the company. On the other hand, the board of directors were required to execute such decision made at the shareholders meeting and also to minimise the costs arising due to the separation of ownership and management.

The board of supervisors was created to supervise directors and senior managers to make sure that they fulfil their responsibilities.

However, in 2001 and 2004, the authority issued the "Code of Corporate Governance for Listed Companies in China" and the "Provisional Code of Corporate Governance for Security Companies". These two Codes added many features of corporate governance that exist in some of the major economies of the world.

The Board of the company -

The Chinese listed companies have adopted the two-tier board structure i.e. the board of directors and the board of supervisor with the logic that the supervisory board will supervise the decision made by the board of directors and maintain a check and balance over them. However, the board of supervisors has been unable to play the monitoring role in Chinese companies simply because the supervisory board has no significant powers to monitor the daily business operations and appoint senior management members.

Ownership and Control: State and Institutional Ownership-

In China, the majority shareholders are institutions and the state rather than individuals, and the majority of publicly traded companies are state-controlled. Prior studies have shown that the relationship between state ownership and firm performance, and concluded that the performance of the company is negatively related to the level of direct state ownership. Therefore, If the state controls the company, the board generally comprises of the politicians and state-controlling owners. Therefore, the likelihood of finding a director representing minority shareholders is very small. This is the reason as to why the independent directors needs to be appointed in the board of directors to maintain checks and balances in the internal governance of the company.

INDEPENDENT DIRECTORS IN CHINA

The concept of Independent Directors in china was introduced around 1997. These Directors were supposed to be the members of the board of directors who had no material relationship with the company. However, there were no specific guidelines provided with respect to the functions and the powers of such Independent Directors. In the year 2001 the Chinese Securities and Regulation Commission provided with the principles for corporate governance, which was model from the OCDE principles on corporate governance. This guideline required the board of directors to contain at least one third of independent directors in all listed companies.

As stated earlier, one of the most important problems in Chinese corporate houses in the dominance of the large shareholders, thereby leading to the problems of insider control. Hence, making it difficult for the shareholders to supervise the management efficiently. Therefore, the concept of Independent Directors was introduced with the hope that it will represent the interest of the minority shareholders. The problem indented to solved with the introduction of the independent directors was to address the abuse of the dominant shareholder at the expense of the minority shareholders.

However, the problem seems to be still existing even after having independent directors on board because it is the majority shareholder who get to choose the independent director, therefore, making it easier to assume that the directors actually representing the interest of the minority shareholders would ever be elected unless the basic method of selecting the independent director is changed.

Hence, it can be said that existing set of independent directors are powerless to protect the interest of the minority shareholders, as they themselves are a minority on the board who are nominated by the majority shareholders, thereby failing in their duty to provide protection to the minority shareholders.

On August 16, 2001, the CSRC issued its "Guidance Opinion on the Establishment of an Independent Director System in Listed Companies" (Independent Director Opinion). Basic Requirement of Independent Directors

The basic rule of the Independent Director Opinion is set forth in Sec. 1(3): listed companies are to revise their articles of association to provide for independent directors. At least one of these should be an

Accounting professional. Listed companies were required to have at least two independent directors by June 30, 2002, and such directors were to constitute at least one third of the board by June 30, 2003

CSRC also provides for the qualification of independent directors some of which are

" (1)be qualified to serve as a director pursuant to the Company Law and other regulations; (2) possess the independence required by the Opinion itself (3) possess basic knowledge relevant to the operations of the listed company, and be familiar with relevant laws and administrative rules and regulations; (4) possess at least five years' work experience in law, economics, or other fields necessary for the proper exercise of his functions as independent director; and (5) possess other qualifications stipulated in the company's articles of association." CSRC later in a circulation also stated that independent directors must also undergo a training course organized by the CSRC in conjunction with Tsinghua University.

Moreover, CSRC also provides with the guidelines which might disqualify a person form being an independent directors "(1) a person who holds a position in the listed company or its subordinate affiliates as well as the direct relatives of, and those with important social connections to, the former; (2) a person, or the direct relative of a person, who directly or indirectly holds at least 1% of the company's stock or is among the top ten shareholders of the company; (3) a person, or the direct relative of a person, who is employed by an entity that directly or indirectly holds at least 5% of the company's stock or is among the top five non-natural person shareholders of the company; (4) a person about whom any of the above conditions have been met within the last year; (5) a person who supplies accounting, legal, consulting, or other similar services to the company or its subordinate affiliates; (6) any other person specified in the company's articles of association; and (7) any other person specified by the CSRC."

The CSRC also provides independent directors with various powers, one of which is that the independent directors should comprise of half of the board of the nomination, compensation and the audit committee. However, on the other hand CSRC fails to make it mandatory to establish such committee, thereby leaving it at the option of the entire board.

Moreover, they cannot exercise the powers given to the independent directors in their individual capacity i.e. consent by all the independent directors as a body. Also, the important transaction does not require the approval of the independent directors; it only required the independent directors to express their views on it. Hence, giving no such powers at the hands of the independent directors as they can merely object but cannot stop the transaction from taking place.

This shows that the independent directors opinion is a mere guiding opinion, which is not strictly mandatory. Therefore, even if the listed companies have adopted the concept of independent directors there exists no sanction on failing to comply with such regulations.

The CSRC only provides that the company failing to adopt this mechanism would be publicly criticized. Thereby it can be said that the regulations and policies do not specify numbers or the specific powers of the independent directors.

INDEPENDENT DIRECTORS IN INDIA AND CHINA: AN OVERWIEW

India and china are two great nation civilizations. However, it differs with respect to economic and political structures, its internal organization etc. These common facts provide an interesting and rich platform for consideration of popular or contested corporate governance and corporate governance reform percepts.

Corporate governance model in China can be seen as a control based model as the controlling shareholder, is responsible for employing the governance mechanism of all the listed companies thereby effecting the corporate governance. Also, as stated above china has enacted various laws, rules and regulations to implement the governance model in the companies.

On the other hand, the Indian model of corporate governance can be said to be a 'hybrid' of the insider and outsider model, as the small shareholders also participate in the governance model, the Indian governance model also include the institutional investors. Therefore, it can be said that the corporate governance model in India is much like the Anglo-Saxon Model than that of China.

The Indian model of corporate governance is moving faster towards adopting the Anglo-Saxon Model as compared to china. The main reason for this is that the Indian economy is more privatized, and the state ownership or the governmental control is reduced significantly. Whereas, In China most of the listed companies are either state owned or state controlled.

There exists one similarity between both India and China is that the companies in both the economies have been historically controlled by either a business family or by a state entity. Thereby exhibiting a concentrated form of ownership. Therefore, creating a similar agency problem between the majority shareholders and the minority shareholders to be dealt by the corporate governance model.

However, one of the most important legal reforms in both the Asian economies is in the field of corporate governance. The policy makers in both the countries are trying to place responsibilities on independent directors so that the companies can demonstrate corporate governance.

Today, the concept of an “independent director”, although a new concept, has provided major progress in recent corporate governance development in China and India.

OECD’s principles of corporate governance specify some attributes of independent directors, which are as follows: -

Attribute 1: Independence

There are two components of independence i.e. having a strict criterion for independence, and having more number of independent directors on the board. The criteria laid down in India and China for Independence of directors are highly criticized for lack of clarity.

The Chinese independent directors’ Guidelines, s 3(4), require only a one-year “cooling-off” period before a former executive or a potential ex-shareholder of the company can become an independent director, compared with the three-year cooling-off period adopted in India. Therefore, in such cases it has been argued that a one year cooling off period is no sufficient for the person to be appointed as an independent director of the that company.

The Indian legal system provided a loose legal definition of “independent directors” in the initial version of Clause 49. However, 2004 revision, provided a stricter definition. However, there still exists some controversy with respect to Clause 49, s III(IV), states that “nominee directors appointed by an institution which has invested in or lent to the company shall be deemed to be independent directors”. These kinds of independent directors are highly criticized in India as the researchers argue that such kind of directors show minimal interest in the working of the company, thereby very unlikely to perform

Since, both the economies have a concentrated form of shareholding, the majority shareholders are seen to dominate the selection of the independent directors. Thereby, making the idea of independence a myth in practice.

Attribute 2: Expertise

Since, the concepts of Independent directors are relatively new in both India and China, both the countries face lack of candidates who are qualified to become an Independent Directors.

Therefore, in both the countries generally appoint university professors, government officials to be Independent directors, or the controlling shareholders appoints the independent directors who has a little interest in the governance.

Therefore, the independent directors lack the required expertise or the qualification.

Therefore, it can be said that the both the countries are suffering from the severe shortage of qualified Independent Directors with the required expertise.

Attribute 3: Motivation

“the remuneration of a non-executive director should be sufficient to attract and fairly compensate high quality individuals”.

The independent directors generally do not depend on the director’s fee for their living. Therefore, in order to attract well-qualified directors there is a need to fair and reasonable remuneration for the independent directors to motivate them to perform.

The compensation of independent directors mostly includes: a fixed fee and compensation such as stock options or superannuation contributions. Therefore, studies suggest that both in India and China the insufficient compensation is the most important obstacles which directly affect the performance of the independent directors

In China, companies often pay independent directors an annual fee with no other form of compensation. Thereby causing lack of incentive to perform. Also, it can be seen that it is unusual in Chinese firms to grant stock options, and so is the case in India. It is very uncommon for independent directors in India to receive stock options, which are only provided by few large corporations. However, Indian regulators to have taken an interventionist approach in setting limits on the amount of director compensation.

Attribute 4: Commitment balance

Independent directors should have sufficient time and energy to perform their duty toward the company with the required amount of diligence. Since, the concept of multiple directorships is prevalent in both India and china as there is a shortage of qualified candidates. Therefore, it can be deduced that due to the shortage of candidates the qualified candidates attract multiple directorship. These directors are seen to have experience, network and knowledge, which may be beneficial for the growth of the company. Also, these directors may have incentive to work as they have their reputation to maintain as a decision-making expert. However, these independent directors are generally over worked or over committed due to multiple directorship thereby not be able to perform effectively in their monitoring roles.

Therefore, it can be said that both India and China faces the issue of shortage of independent directors thereby making the available independent directors overworked or over committed.

CONCLUSION

Indian boards have more independent directors than the board of directors in China. The average number of independent directors on Indian boards is five, representing 53% board membership, whereas there are four on Chinese boards, accounting for 33%. With respect to the expertise of the independent directors it can be seen that china has higher number of experts on board which is 52% as compared to Indian board, which amounts to 34%, there exists 10% and 3% of independent directors with core business knowledge in china and India respectively. However, there still exists a shortage of independent directors with required expertise both in India and China.

The compensation of independent directors is almost similar independent director remuneration in China = $12,931; independent director remuneration in India = $11,973.

However, the maximum compensation level of Chinese independent directors is almost twice that of their Indian counterparts. This may be a result of the difference in the GDP of both the economies. Also, study shows that the independent directors in India hold more multiple directorships as compared to Chinese counterparts. On average, an Indian independent director sits on four boards, compared with two boards for a Chinese independent director. However, the average maximum number of boards served by Indian independent directors is 15, which is nearly twice that of China.

Through this comparison it can be said that there exists only few minute distinction between India and China with regards to Independent Directors. Since, both the economies have different legal system i.e. china has a civil law legal system whereas India has a common law system. However, both the economies lack in providing the strict guidelines with respect to the qualification of the independent directors and the appointment mechanism.