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CHALLENGES IN CORPORATE GOVERNANCE PRACTICES AND REPORTING

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ABSTRACT

The concept of corporate governance grew in importance to protect the interests of the real owners of businesses from the clutches of the board who prioritize their own selfish interests. Many studies both at the national and international front have pointed out the challenges of good corporate governance and its reporting practices. This paper aims to highlight the current challenges in the practices of corporate governance and ascertain the gap in the areas of reporting. In this paper, the authors have undertaken content analysis to review a few relevant studies selected randomly that have been conducted post the high profile scams that shook the financial world. This resulted in an outpour of committees and their recommendations on good governance and reporting, which corporates have more or less imbibed. It was observed that although good corporate governance had a positive association with the firm's value, yet the companies were complacent about voluntary disclosure practices. Further, there was the prevalence of wide disparities across companies, and there was an absence of initiative for future modifications in reporting. The need for good corporate governance has wider dimensions extending to all stakeholders and many more areas of operations as per the Environmental Social and Governance model (ESG).

KEYWORDS: Corporate governance, Voluntary disclosures, Reporting challenges, Stakeholders.

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Challenges in Corporate Governance Practices and Reporting

"Wanna see how people really are? Wait till the money is involved……."

INTRODUCTION

Corporate governance took a leap into the limelight at the onset of the twenty-first century on account of globalization of the financial markets on the one hand and followed by a series of collapses of high-profile companies on the other viz Enron, Arthur Anderson, WorldCom, Maxwell, Parmalat, to name a few. The business world was aghast at the size of the unethical and illegal operations by such big business houses. Corporate governance (CG) in India got its jolt after the exposure of malpractices at Satyam on to a more recent IL&FS scam. All this has led to corporate governance becoming a major field of study within the legal and financial arena. However, the concern over the differences in the existing practices of corporate governance and the resulting disclosures in the developed countries is too small compared to the vast chasm in the case of developing economies.

The Anglo-Saxon model of corporate governance prevalent in the United States, Canada, Australia, and the United Kingdom features reliance on the capital market. In such models, the shareholders are exploited by the top management. In contrast, in countries like India, where the model is not applicable, small shareholders are at the mercy of dominant shareholders.Effective corporate governance gives a thrust to the development of efficient financial systems resulting in increased external financing by companies, thus leading to more significant investment, growth, and employment possibilities. It leads to effective resource allocation as a result of reduced cost of capital and higher returns on capital, implying enhanced firm valuation. Good corporate governance also generates both internal and external economies like improved labor relations and conserving the environment. Moreover, it has been observed that mutual funds prefer to invest in companies with a history of excellent corporate governance as compared to companies with not so good performance inCG (Mohanty 2003).

In the book 'A Board Culture of Corporate Governance,' Gabrielle Donovan defines corporate governance as "an internal system encompassing policies, processes, and people, which

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serve the needs of shareholders and other stakeholders, by directing and controlling management activities with good business…". In every country, a gamut of economic laws is created for the safety of the investors and creditors. But the actual effectiveness is dependent on the basic tenets of the law and its timely implementation. Worldwide laws of nations have been derived from the English, French, German, and Scandinavian laws.

The Indian law has its roots in the English common law system. Two of the most prominent indices used by researchers to assess the effectiveness of these laws in fulfilling the primary purpose for which they were created (i.e. protection of shareholder rights and creation of shareholder wealth) are 1) a *shareholder rights index (*ranging from 0 to 6) 0 being lowest. and 2) a *rule of law index (ranging* from 0 to 10), 0 being lowest) – to measure the adequate protection of shareholder rights in different countries. The previous index measures the degree to which the expressed law protects the shareholders while the latter measures the extent to which law is factually implemented. Interestingly, India has a shareholder rights index of 5, equivalent to that of other countries like USA, UK, Canada, Hong Kong, Pakistan, and South Africa which have their roots in English law, and can boast of an index higher as compared to other countries in the study for example France, Germany, Japan, and Switzerland. Despite this remarkable index, India fails to qualify as a strong candidate for good corporate governance.

As per the Rule of law index, the other criterion, India, has a score of 4.17. Out of the 49 countries studied India stood at 41st position, having only lesser developed countries like Nigeria, Sri Lanka, Pakistan, Peru, Indonesia, and the Philippines behind, proving beyond doubt that laws in India, theoretically provide significant protection to shareholders but the implementation of the law is pathetic. Thus, we observe that differences in the enforcement of corporate governance in protecting shareholders' rights have created divergent degrees of financial and hence economic development in different countries.

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OBJECTIVES OF THE STUDY

1. To review the existing literature on corporate governance challenges:
    a. To highlight the current challenges of corporate governance practices.
    b. To assess the effectiveness of reporting under corporate governance.
    c. To analyze special concerns relating to corporate governance in the case of emerging economies.
2. To ascertain the gap in the areas of reporting and offer suggestions.

REVIEW OF EXISTING STUDIES

The study by Gupta, Nair, and Gogula, "Corporate governance reporting by Indian companies" (2003). The study involved content analysis to analyze reporting practices incorporate governance. The sample consisted of a total of thirty Indian companies listed on the Bombay Stock Exchange (BSE). The section pertaining to corporate governance in the annual reports was examined for two consecutive preceding years. Content analysis was used as a research tool to determine the extent of reporting. For the purpose of data analysis, least-square regression was applied. The results indicated wide differences in the reporting practices of the companies. Surprisingly, a few companies had total disregard of the mandatory requirements such as Clause 49 of the listing agreement. ``

The relationship studied in this paper was between voluntary disclosure of CG information by the companies and their capacity to raise capital in the capital market was analyzed by Collet and Hrasky in 2005 in their study, "Voluntary disclosure of corporate governance practices by listed Australian Companies. "The sample consisted of 299 companies listed on the Australian stock exchange for the year 1994, as this was the demarcating year after which the Australian stock exchanges required the companies to make disclosures about corporate governance practices. Connect-four databases were employed for identifying the annual reports of the companies. The study concluded that a meagre 10% of the companies disclosed voluntarily, and that the extent of disclosures differed across the companies. The regression analysis showed that voluntary disclosures of corporate governance practices had a positive association with the

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company's raising of equity capital, but no relation seemed to exist wrt raising debt capital. It was observed that the debt market was not so much impacted by a low degree of disclosures in corporate governance as much as the equity market due to inherent uncertainty and risk associated with the respective markets.

They emphatically portrayed that the CG has gained so much of importance that companies were likely to use this information for "Impression" management. They mentioned the relevance of "CG disclosures to be timely, clear, concise, precise and the substance over form principle." In their study, Economic impact of 'regulation on corporate governance: Evidence from India,' Bhattacharyya and Rao (2005) assessed whether adoption of Clause 49 by large business houses was able to predict low volatility and returns. In the paper, the authors have studied two time periods, the first timeperiod commencing from June, 1998 prior to the implementation of Clause 49. And second time period commencing from June 2001 subsequent to its implementation, the premise was that Clause 49 would enhance and better the quality of disclosures, thereby consequently increasing symmetry in information and consequently reducing share price variations. The study did not find significant results for price variation and whereas the results for returns were mixed.

The study "Determinants of voluntary disclosures in Kenyan companies' annual reports" by Barako et al. (2006) analyzed the extent of voluntary disclosure by the companies registered at the Nairobi Stock Exchange, beyond what was mandatorily required by law. The period of study was ten years, from 1992 to 2001. Due to the presence of longitudinal data, pooled Ordinary Least Squares (OLS) with Panel Corrected Standard Errors (PCSEs) was used. The focus of the study was to examine four broad categories of information in the annual reports, namely a) General and strategic, b) Financial, c) Forward-looking c) Social and board information. The purpose of the study was to ascertain how the voluntary disclosure of different types of information got impacted by corporate governance attributes, ownership patterns, and company characteristics. The study indicated that the factors mentioned above influenced the type and extent of voluntarily disclosed information, especially in the agriculture sector. Moreover, the audit committee had a positive impact on the extent of voluntary disclosure. In contrast, the percentage of non-executive directors on the board had a negative effect.

This paper, "Status of Corporate Governance Research on India: An exploratory study" by Srinivasan & Srinivasan (2012), focuses on the research status of corporate governance in India over a decade commencing from year 2000 both in Indian and international publications. Several online databases were used in the study, including the EBSCO integrated search engine. The sample included 140 research works done internationally that concentrated on India or comprised samples from India. Further, 42 articles were identified from 20 reputed Indian academic journals. Both the authors reviewed the abstracts of the research papers and followed thematic analysis of the content. Adequate care was taken to ensure the consistent classification of themes.

According to the study, there has been a steady growth of research on corporate governance in India, especially after the corporate scandals, yet it lacks empirical work. In the study, the articles were categorized on the basis of themes such as composition of board, CSR & Ethics in business, disclosure, protection of investors mechanisms, origin and models of governance, structure of ownership, performance, regulatory reforms, etc. Out of these, the five areas that topped the list were performance, corporate social responsibility, governance origins and model, disclosure, regulatory mechanisms, and reforms in that order. The study found that 76% of the researches were empirical, while 24% were descriptive. In India, the subject of CG in India is finding an increasing presence in international journals, and the same goes for the domestic front.

On analyzing the sample, the following were the conclusions a) The broad themes discussed under corporate governance relate to disclosures, both mandatory and voluntary, disclosures from the banking industry, disclosure in CSR, greater transparency, and protection of investors rights. b) Good governance and performance in terms of market returns have a positive relation. c) Composition of board directors (independent directors), board size contributed positively to the firm's value. d) In regard to CSR and business ethics, most of the papers reviewed in the publications in India were conceptual in nature (52%), discussing merely policies and regulations. In comparison, the papers in the international journals were largely (73%) empirical-based. e) Many laws have been introduced pertaining to corporate governance, and some significant changes have been incorporated in the Listing Agreements of stock exchanges. f) They observed the need for rigorous methodological design in the papers published in Indian journals.

The paper by Rajesh K Pillania, "Corporate Governance in India: Study of the Top 100

Firms" (2012), focuses on the Indian scenario of practices in corporate governance. It has the following divisions: the introduction, research methodology, findings and discussions, and conclusions. The study aims to answer five pertinent questions. a) How vigilant companies are regarding practices in CG? b) Manner of doing it? c) Purpose of doing it? d) To assess its impact on performance? e) Proposal for the future? For the purpose of the study, data was gathered from the annual reports and company websites covered in the sample. The companies were shortlisted from the Prowess database of the Center for Monitoring Indian Economy (CMIE). These were companies traded on India's major stock exchanges and range from industrial to banking, financial, and other allied services. The study's findings were as follows; - 1) All of the companies adopted CG practices in some manner, except for 1. 2) Disclosures were selective, keeping the company's interests in mind. Some more observations were like the government banks do not have the remuneration committee. While some sectors do not adequately disclose about the board's composition. 3) The primary purpose of adopting the CG measures in the private companies is the shareholder's interest, building reputation, and getting a competitive advantage while in government organizations, especially in the banking sector, to comply with the rules. 4) It was found that CG practices have had a significant impact on building brand image and bringing ethics and order in the companies. 5) It was also observed that none of the 99 companies had any future plans to change their corporate governance practices shortly.

Ruth V. Aguilera, Kurt A. Desender (2012), in their paper 'Challenges in the Measuring of Comparative Corporate Governance: A Review of the Main Indices' explain Corporate Governance as a set of rights of stakeholders in a firm and the governance mechanisms which ensure mutual respect for rights of/by all stakeholders. They express an urgent need to look into the aspects of corporate governance in the global scene. Therefore, comparative models of corporate governance need to be studied and strengthened by incorporating the heterogeneity of situations prevailing across the globe. The increasing amount of importance is being attached to corporate governance, which has resulted in the development of specific Corporate Governance indices. Aguilera and Desender discuss the various indices, some academic and others commercial, to be used to benefit the investors. The academic index is further subdivided into two types: the Antidirector rights index, which uses components like a) shareholder voting (voting by

mail, power to call an EGM, etc.), b) Protection of minority rights (which includes minority representation on the board, provision for rights shares, etc.). The second academic index is the governance index (G-index) which consists of 24 anti-takeover provisions and shareholder rights.
Many (for example, Daines, Gow & Larcker, 2010) feel that commercial indices are better than academic indices since they use more sophisticated techniques like quantitative algorithms; thus, they are based on expertise that theoretical indices lack. Also, they are commercially successful, which suggests their utility. Commercial indices prepared and used by institutions like the Corporate Governance Quotient, Governance Metrics International, Standards & Poor’s Corporate Governance Scores, etc., use attributes like board accountability structure, financial disclosure and internal controls, social responsibility, and executive compensation. They use public data, press releases as well as documents filed with the SEC. Shareholder activism which is also becoming prominent (as in the case of Calpers), uses their own criteria for determining the governance in companies.
The authors conclude that there is a) corporate governance and firm performance do not seem to have any direct relationship, although an indirect relationship may exist b) The causal relationship may also be inverse i.e., firm performance affecting corporate governance. c) corporate governance indices can’t capture the quality of governance. This is since indices measure very different corporate governance attributes, and many implicit assumptions sacrifice the construct validity. Also, elements worldwide vary; what is expected in Anglo-American Corporate Governance systems may not be present elsewhere. So, at best Corporate Governance indices may be helpful for intra country/ industry analysis, and a one-size-fits-all approach is not desirable; instead, an index should capture the diversity of governance mechanisms.

In their research paper ‘Corporate Governance: Issues, Opportunities, and Challenges,’ Shamsuddin M Nadaf, Dr. B S Navi (2017) undertook a descriptive study based on secondary data. Good corporate governance enhances shareholders’ wealth in the long term and positively affects its reputation. The high-profile scams and scandals would not have occurred but for bad governance. The codes of corporate governance issued in various countries are different depending on their social and economic culture. These codes come from stock exchanges, corporations, institutional investors and follow broad guidelines issued by international organizations. Though the corporate governance framework adopted by the UK and USA, which follow the Anglo Saxon model, is different from Germany and Japan who have a two-tiered board, the principles of corporate governance remain fundamentally the same, i.e., enhancing shareholder value, the need for independent directors, etc. Corporate governance challenges evolved from traditional issues like a corporate strategy to more modern ones like crisis management and shareholder activism. In the Indian context, it was seen that CEO and other principal shareholders primarily looked after their own interests, and benefit to other shareholders was only consequential. Also, directors neither updated their knowledge nor participated actively in board meetings; they were more like yes men. Thus, what is needed is that directors act more ethically, be well informed, should oversee succession planning, should ensure a good system of internal control, financial reporting, etc. The authors contend that modern corporate governance is based on integrity, transparency, responsibility & accountability, which directors are expected to observe to ensure long-term wealth creation for the shareholders and sustainability. The study concludes that good governance is not only to create wealth for the shareholders alone but also for society and the other stakeholders; only then can a company succeed in the global business scenario.

"Recent years have shown a spurt in international studies on Challenges in Corporate governance in emerging economies (Al-Malkawi, Pillai & Bhatti, 2014; Allen, 2005; Berglöf & Claessens, 2006; Black, Gledson de Carvalho, Khanna, Kim & Yurtoglu, 2014; Claessens & Fan, 2002; Claessens & Yortuglu, 2013; Crittenden & Crittenden, 2012; Fan, Wei & Xu, 2011)".(Seth Armitage, Wenxuan Hou, and Subrata Sarkar, 2017).These authors in their paper 'Corporate Governance Challenges in Emerging Economies', cite the problems of developing countries that are unique to them. The basic nature of governance problems in emerging economies is different from those of developed economies. The underlying conditions of business differ, which are influenced by political solid and weak social & legal systems and institutions. While developed countries are characterized by diffused ownership, emerging economies have concentrated ownership, dominant business houses, and substantial related-party dealings. Governance mechanisms constitute both internal and external mechanisms, but the weights attributed to the variables differ considerably in the developing and developed world. While board monitoring and executive compensation feature primarily in developed economies, the participation of financial institutions, controlling family members, and the state are of prime importance in developing countries. Though corporate governance proponents advocate use of international accepted best practices, country-specific institutions have a huge role to play. What is needed in developing countries is the development and strengthening of institutions, which will result in changes in ownership holdings in developing economies. The aspects like 'independence' of independent directors, auditors, and the audit committee and the board's involvement in strategic issues are more important than the structure and composition of the board itself. The role of the nomination committee thus becomes more relevant. Another area of research for emerging economies is the nature and extent of related party transactions. The role of public enforcement through legal & institutional activism also needs further research. A corporate governance index consisting of inhouse and outside governance mechanisms would be a positive step in the direction of measurement of CG. CSR has not been given its due importance in developing economies, also its impact on social capital and long-term sustainability are issues that need to be researched.

A. Veeramaniand & R P Ngulai Rong (2018), in their paper on "Corporate Governance in India: The Changing of Corporate Board System," claim that though the corporate governance mechanism in India is becoming very well aligned with the Anglo Saxon model and the recent regulatory changes made have strengthened it, there is still a need for proper implementation at the ground level, and an effective mechanism for board evaluation must be in place. The authors discuss and compare the three latest regulatory frameworks given for corporate governance viz, The Companies Act 2013, SEBI (LODR) Regulations, 2015 and the most recent and stringent recommendations provided by the Kotak Committee (2017). All these regulations look after board independence and gender diversity on the board. The Kotak Committee has recommended an increase in the minimum number of directors on the board, raising the number of independent directors and various committees of the board, and insists on the woman director to be an independent one. They also define independent directors as more stringent by adding a rigorous condition in the current definition of independent directors. As per their recommendation "if Mr Z is an executive director on Co. X and is also an independent director on Co. Y, then no non-independent director of Co. Y can be an independent director on the board of Co. X" (Kotak

Committee, 2017). The authors suggest that the regulatory framework of corporate governance is entirely aligned with international standards; what is now required is a system of board evaluation that can bring about good corporate governance in spirit.

Rajesh Chakrabarti and Mandar Kagade (2018) studied the topic "Corporate Governance: Evolution and Challenges in the New Companies Act. In their work, they analyze the impact of the reforms in the field of corporate governance due to the introduction of the Indian Companies Act 2013. The areas discussed range from board of directors (BOD), mergers and acquisitions (M&A), provisions of auditors, class action suits, and tribunals and other regulatory bodies. Modifications relating to limit, composition, powers, duties, liability, remuneration, gender, and independence of directors have been made to strengthen CG.

The provisions relating to the appointment of auditors have been made stringent, further their role in the event of frauds has been tightened. In the context of mergers and acquisitions, the law has been simplified and made stringent at the same time. The various regulatory bodies like National Company Law Tribunal (NCLT), National Company Law, Appellate Tribunal (NCLAT), National Financial Regulatory Authority (NFRA), and Serious Fraud Investigation Office (SFIO) have been made operational for administration of companies act, to adjudicate on appeals made, to regulate matters of accounting and auditing and to look into frauds. Further, the shareholders have been empowered with the initiation of class action suits. According to them, these changes have made corporate governance in tune to the challenges of the financial world, faced by the modern-day businesses.

ANALYSIS AND INTERPRETATIONS

- Studies indicate the debt market was not so much impacted by a low degree of disclosures in corporate governance as much as the equity market due to inherent uncertainty and risk associated with the respective markets.
- It has been observed that corporate governance attributes, ownership patterns, and company characteristics were the determining factors for disclosures in corporate governance made voluntarily.

- The annual reports of the companies containing reporting on corporate governance demonstrated wide variations in their practices.
- Despite the presence of clause 49 in the listing agreement of Indian Stock Exchanges, share price volatility continued to exist, indicating either existence of inefficient markets or inauthentic disclosures that are merely compliance-driven.
- Good governance, Composition of board of directors (independent directors), board size all contributed positively to the firm's value.
- In regard to CSR and Ethics, most of the research papers in the reviewed Indian publications were conceptual in nature (52%), discussing merely policies and regulations. The papers in the international journals were largely (73%) empirical-based, signaling the need for rigorous methodological design in the papers, especially in Indian journals.
- Disclosures are selective, keeping in mind the company's interests; for instance, the government banks did not have the remuneration committee. In some sectors like the metals and minerals sector, companies did not adequately disclose about the board's composition.
- The primary purpose of CG varies depending on the type and nature of the organization, whether private or public sector. The purpose of adopting the corporate governance measures in the private sector is the shareholder's interest, building reputation, and getting a competitive advantage while in government organizations (especially in the banking sector) in compliance with the rules.
- Most companies were complacent about the prevalent CG practices and did not intend to change their practices in corporate governance.
- To measure corporate governance, both academic and commercial indices are being used worldwide. Still, there is no direct relationship between corporate governance and firm performance, although there may exist an indirect connection. The causal relationship may also be inverse i.e., firm performance affecting corporate governance.
- CG indices cannot always capture the quality of governance.
- The culture of today's businesses incorporates not only the profit of shareholders but the entire stakeholder community.

- The chairman's report should incorporate the chair's personal views on good governance and board activities that are generally lacking. According to them, the board reports broadly about its committees, while what is required is how and on what issues the board spends in greater detail.
- Evaluation of the board and its performance is an area requiring attention, especially in the Indian context.
- The essential nature of governance problems in emerging economies is different from those of developed economies. The underlying conditions of business differ, which are influenced by political solid and weak social & legal systems and institutions. While developed countries are characterized by diffused ownership, emerging economies have concentrated ownership, dominant business houses, and substantial numbers of related party dealings.

SUMMARY AND CONCLUSIONS

The primary issue in corporate governance is to prioritize the returns of the owners of the company, i.e., the stockholders. It is the managers that hold the reins of the business and may not necessarily be beneficial to the rest of the shareholder community. A case in point is the decision of the New York Stock Exchange to remove Dick Grasso, the director, over allegations of excessive pay package and $188.5 million golden parachute. It is widely observed that shareholders are mere spectators in the game with little power in selecting directors. At the same time, the CEO backed by the board composed of his acquaintances (family and friends) wields real passion, which is often used in promoting selfish interests. These universal problems of corporate governance could lead to disaster in the company. A company with dissatisfied shareholders becomes an easy target for takeover attempts as the equity owners with grievances would try to dispose of their shares. The acquiring company would naturally weed out inefficient management. Thus, it is the post takeover ambiguity that prompts the management to perform with a sense of accountability and transparency. It is not very surprising that researchers, once again, are pondering over the objectives of modern corporations, with profit not being merely the sole objective. In addition to maximizing the returns to the owners, corporate social responsibility (e.g., Protecting environmental degradation, development of rural areas, etc.) was the center of attention. Of late, the scope of CSR activities has widened, and a new concept Environmental, Social and Governance (ESG) Framework, has risen, adding more items to the existing list, e.g., human rights, gender diversity, etc.Several changes in the recent Companies Act have added credibility to the existing CG provisions and mechanisms. Observations point to corporate governance practices having a significant impact on building a company's brand image and bringing ethics and order in the companies. The other prominent questions that emerge for further research are board composition, board competence, well-informed directors with diverse skill sets, progressive succession planning, reporting time horizon, risk management. All of these recent developments point to the possibility of further research in the future.

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