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EVOLUTION OF CORPORATE GOVERNANCE IN INDIA – ISSUES AND CHALLENGES

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ABSTRACT

The topic has recently received media attention due to high-profile corporate governance failures in wealthy nations, but finance and economics have long prioritized it. The issue is especially crucial for emerging nations as it is so important for financial and economic growth. According to recent studies, both de jure and de facto investor protection in a nation are crucial for its financial prosperity. India has some of the greatest corporate governance regulations because of the legacy of the English legal system, but poor implementation and the socialist policies of the pre-reform era have had an impact on corporate governance. Pyramiding, finance tunnels, and concentrated ownership of shares are characteristic features of the Indian business environment. Boards of directors have repeatedly watched in silence as the DFI-nominated directors failed or refused to perform their oversight duties. However, significant efforts have been made to restructure the system after liberalization. As an example, the SEBI implemented Clause 49 of the Listing Agreements, which deals with corporate governance. With a drive towards more market-based governance, the corporate governance of Indian banks is also experiencing reform.

Keywords: Corporate Governance, India, Finance, Listing Agreements, Joint-stock company

INTRODUCTION

After a series of high-profile corporations went out of business, the topic of corporate governance exploded into the spotlight of the world of business. The energy and telecom behemoths Enron and WorldCom, both situated in Houston, Texas, startled the business community with the scope and duration of their unethical and criminal activities. Even

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worse, they appeared to be just the proverbial "tip of the iceberg" of peril. While business practices in US firms were criticised, it seemed that the issue was much more pervasive. From the international newspaper business Hollinger Inc. to the large and reputable Parmalat in Italy, substantial and ingrained issues with corporate governance have been found.

Even the prestigious New York Stock Exchange was forced to fire Dick Grasso as a director after widespread criticism of his high remuneration. It was obvious that there was a problem with corporate governance on a global scale. Of course, corporate governance has long been a hot topic for research in the realm of finance. The issue has been extensively studied by financial researchers for at least a quarter of a century,[3] and Adam Smith, the founder of modern economics, was the first to identify it more than 200 years ago. There have been arguments over whether the German and Japanese bank-based models of corporate governance are superior to the Anglo-Saxon market model. The disparity between corporate governance rules and practices in these industrialised nations as a whole and those in the developing world, however, is much wider than the disparities in corporate governance quality in these nations.[4] However, the differences in corporate governance quality between these industrialised countries and those in the developing world are far smaller than the differences in corporate governance regulations and practices.

Long before the latest wave of corporate scandals in developed economies made news, corporate governance was a major problem in emerging nations. Economic development and company governance are inextricably connected. Whether they are primarily market-based, or bank-based, robust financial systems are developed because of effective corporate governance systems, and this has an indubitably good impact on economic growth and poverty reduction.[5]

Causation operates through several channels. A company's ability to acquire external financing is improved by effective corporate governance, which increases investment, growth, and employment. In countries with the highest adoption and enforcement rates of creditor rights, the share of private credit in GDP is more than twice as large as it is in nations with the lowest adoption and enforcement rates.[6] In terms of equity financing, the ratio of stock market capitalization to GDP is almost four times higher in the nations with the highest adoption and enforcement of shareholder rights than it is in the nations with the lowest adoption and enforcement. Additionally, weak corporate governance impedes the establishment and growth of new businesses.

Additionally, good corporate governance decreases the cost of capital by lowering risk and increasing business valuation, which boosts real investments once again.[7] The "control premium" (the transaction price of shares in block transfers signalling control transfer less the market share price) varies by a factor of 8 depending on which country has the highest level of equity rights protection.[8]

Better resource management and allocation are ensured by effective corporate governance procedures, increasing return on capital. In comparison to nations with the least protection for equity rights, the return on assets (ROA) is around twice as high in nations with the highest

3. Starting from the seminal "agency problem" paper of Jensen and Mackling (1976).
4. See Shleifer and Vishny (1997).
5. See Claessens (2003)
6. See La Porta et al (1997)
7. La Porta et al (2000)
8. Dyck and Zingales (2000)

level of protection.[9] The likelihood of a national financial crisis can be considerably decreased by good company governance. The effectiveness of corporate governance and currency depreciation are strongly inversely correlated.[10] Indeed, the Asian Crisis of 1997 is thought to have been primarily caused by a lack of corporate governance standards and poor transparency. Such financial crises have significant negative economic and social effects and can delay a nation's progress for several years.

Finally, effective corporate governance may improve social and labour relations, as well as external economies like environmental preservation. It can also lower legal costs and eliminate misunderstandings among various stakeholders.

The main concerns in corporate governance include ensuring that the managers act on behalf of the owners of the company—the stockholders—and pass on the profits to them. The joint-stock company type of organisation survives on limited liability and distributed ownership, yet these characteristics ultimately result in the distance and ineffective managerial oversight by the actual owners of the company. Managers may not operate in the shareholders' best interests because they have direct authority over the company. These possible issues with corporate governance are pervasive. The Indian financial sector is also characterised by a predominance of family enterprises, a history of managing agency systems, a relatively underdeveloped equity market that is susceptible to manipulation, inadequate analyst activity, and a typically high level of corruption. Because of all these characteristics, corporate governance is a crucial topic in India.

1. Central Issues in Corporate Governance

In theory, the joint-stock corporation form of business has the following basic power structure. The actual proprietors of the corporation are the many shareholders who contribute to its capital. They choose a Board of Directors to oversee the company's operations on their behalf. The Board then appoints a group of managers to oversee the day-to-day operations of the business and provide regular reports to the Board. To maximise shareholder wealth, managers act as the shareholders' agents. Even if this power structure were to hold in practice, it would be difficult for the Board to adequately oversee management. The fundamental problem is the terms of the agreement between shareholder representatives and management, which direct the former on how to use the money they received from the former. The primary difficulty stems from the fact that these contracts are inevitably "incomplete". The Board cannot provide management with comprehensive guidance on the preferred course of action in every conceivable business situation.[11] Countless scenarios could arise. As a result, no agreement between shareholders' representatives and management can be drafted that lays out the proper path of action in every eventuality and allows for the management to be held accountable for breaking the agreement if it chooses to take a different course of action in the given situation. Due to the "incomplete contracts" condition, either the management or the financiers must have some "residual powers" over the company's funds. These remaining powers must belong to management because the former lacks the knowledge and motivation to run the company in the conditions not covered by the contract. A significant portion of the topic of corporate governance is the effective limits to these powers.

The truth is far more convoluted and skewed in management's favour. In reality, managers have immense authority in joint-stock corporations, and the common shareholder has very little control over how the company spends his or her

9. Claessens (2003)
10. Claessens (2003)
11. Shleifer and Vishny (1997)

money. The management (the CEO in an American context, or the Managing Director in a British-style organisation) has less accountability in firms with widely dispersed ownership. The majority of shareholders frequently provide their "proxies" to management because they do not want to attend general meetings where the board of directors is elected or replaced. Even individuals present at the meeting find it challenging to influence the choice of directors because only management is permitted to put out a slate of candidates for vote. The CEO usually fills the board with friends and allies who hardly ever have opposing views. Frequently, the CEO also serves as the board of director's chairman. As a result, the Board's oversight function is frequently seriously undermined, and management, who controls the company, may be able to use corporate funds to serve its interests rather than that of the shareholders.

The inefficiency of the Anglo-Saxon corporate structure, where actual monitoring is anticipated to come from financial markets, and the ineffectiveness of the Board of Directors' lack of overseeing management actions is particularly evident. The fundamental assumption is that shareholders who are unhappy with a particular management would simply sell their firm stock. The company would become a takeover target because this would lower the share price. The purchasing business would fire the current management when the transaction occurs. Therefore, rather than shareholder action, the threat of a takeover is what is supposed to keep management honest and alert.

Other than outright theft, common management practices that could be sub-optimal or against the interests of the shareholders include excessive executive compensation, transfer pricing (doing business with privately held companies at prices below market rates to syphon off funds), managerial entrenchment (managers resisting being replaced by superior management), and inefficient use of free cash flows. The company's retained earnings are used by managers in this final clause. This money is frequently wasted on dubious empire-building projects and acquisitions in the absence of successful investment alternatives, even if returning them to the owners would be the best use for them.

Maintaining professional management in check is merely one of the challenges in corporate governance, yet it's possibly the most crucial. Corporate governance primarily focuses on the successful protection of creditors' and investors' interests, which can be jeopardised in a variety of other ways. Family enterprises and corporate organisations, for instance, are widespread in many nations, including India. These include various family business conglomerates in India, such as Barlas and Ambani, as well as Keiretsus in Japan and Chaebols in Korea. It is challenging for outsiders to track the financial reality of individual companies within these behemoths due to the interlocking and "pyramiding" of corporate control within these conglomerates. Additionally, these enterprises frequently have managerial power in the hands of a small number of individuals, typically a family, who either hold the majority interest in the company or maintain control with the help of other block holders like financial institutions. Even when they possess most of the shares, their interests need not align with those of the other, minority shareholders. By "tunnelling" business profits or capital to other corporate companies within the group, this frequently results in the expropriation of minority shareholder value. Such infringements on the rights of minority shareholders are likewise a significant problem for corporate governance.

Aligning the interests of management and shareholders is one strategy to address the issue of corporate governance. This endeavour is reflected in the recent increase in stock- and option-related pay for top managers in businesses all around the world. The fact that family company oligarchies are typically led by a family member is a more conventional embodiment of this concept. However, managerial equity ownership has intriguing consequences for business value. Firm value is observed to increase for a while (until managerial ownership (as a percentage of total shares) reaches

about 5% for Fortune 500 companies), then fall for a while (when the owner is in the 5% - 25% range, again for Fortune 500 companies), before it starts to rise again.[12] The reason for the fall in the intermediate range is because, in that range, managers possess enough to guarantee their jobs no matter what and can also find ways to increase their income through non-shareholder-friendly corporate fund uses.

2. Legal Environment, ownership Patterns and Corporate Governance

To establish an efficient corporate governance structure and safeguard investors' and creditors' rights, a nation's legal system is essential. The two key components of the legal environment are the protection provided by the laws (de jure protection) and the degree of actual law enforcement (de facto protection). In identifying the type of corporate governance in the country in issue, both factors are crucial.

Recent studies have argued that the protection provided to creditors and shareholders,[13] outside financiers of enterprises, is how the relationship between a nation's legal system and the foundation of its financial and economic architecture occurs. The four distinct legal systems—English common law, French civil law, German civil law, and Scandinavian civil law—are the foundations of the legal systems in the majority of nations. English common law serves as the foundation for the legal system of India. To assess how effectively shareholder rights are protected in the various countries under study, researchers employed two indices: a shareholder rights index with a scale from 0 (lowest) to 6 (highest) and a rule of law index with a scale from 0 (lowest) to 10. The first index measures how much the written legislation protected shareholders, whereas the second measures how much the law is upheld.

The Scandinavian-origin countries come in second place with an average score of 3, followed by the English common law countries with an average score of 4 (out of a maximum possible score of 6), and the French and German-origin countries in last place with an average score of 2.33 each. Therefore, the legal systems of English origin offer the best protection for shareholder interests. India, for instance, has the highest shareholder rights index of the 42 nations included in the study, with a score of 5, making it equal to the United States, United Kingdom, Canada, Hong Kong, Pakistan, and South Africa (all of which have English-origin laws). It also outperforms all other nations in the study, including France, Germany, Japan, and Switzerland.

Another topic is the Rule of Law Index. The Scandinavian-origin nation's top the list with an average score of 10 (the highest attainable), followed by the German-, English-, and French-origin nations (8.68, 6.46, and 6.05, respectively). This measure often yields very high ratings for advanced nations and low values for underdeveloped nations. India, for example, is ranked 41st out of 49 countries evaluated with a score of 4.17, just ahead of Nigeria, Sri Lanka, Pakistan, Zimbabwe, Colombia, Indonesia, Peru, and the Philippines. On paper, Indian law gives shareholders a lot of protection, but in practice, its implementation and enforcement are woefully inadequate.

The different countries' approaches to financial and economic development have taken entirely diverse paths because of these variations in the protection of shareholders' rights. The English-origin systems produce the most businesses per capita (an average of 35.45 companies per million people as opposed to 27.26 for Scandinavian-origin countries, 16.79 for German-origin countries, and 10.00 for French-origin countries). Additionally, they excel in attracting outside funding. In comparison to the average ratios for German, Scandinavian, and French-origin countries of 0.46, 0.30, and

12. Morck et al (1988)
13. See the path-breaking set of papers, La Porta et al (1997-2002)

0.21 respectively, the stock market capitalization held by minority shareholders—i.e., shareholders other than the three largest shareholders in each company—to the GNP of a country averages a remarkable 0.60. India ranks among the lowest English-speaking nations in terms of the number of businesses per million residents, but it is greater than many French-speaking nations including Germany. India has a score of 0.31 for the external capital to GNP ratio, placing it in the top half of the sample.

The execution of laws rather than the laws themselves is the main distinction between the legal systems of developed and developing nations. When defining events like CEO turnover and fostering the development of security markets by banning insider trading, enforcement of the law is far more significant than the quality of the regulations now in place.[14] Entrepreneurs and managers find it challenging to communicate their commitment to potential investors in a setting where property rights and contracts are weakly enforced, which results in a lack of external finance and ownership concentration. The growth of new businesses and small and medium-sized organisations (SMEs) is severely harmed by this. Many of the traditional corporate governance practices, including the market for corporate controls, board activity, proxy battles, and executive remuneration, become ineffective under such circumstances. The most significant corporate governance mechanism is large block-holding, with some possible roles for shareholder agitation, bank oversight, employee oversight, and societal control.

Aside from the universal aspects of corporate governance, Asian economies have some characteristics in common that have an impact on the region's corporate governance practices. Most Asian nations are characterised by concentrated stock ownership and a preponderance of family-controlled businesses, despite the significant differences in their economic and politico-legal environments. State-controlled enterprises also make up a significant portion of the corporate sector in many of these nations. Asian countries have placed a high priority on corporate governance issues, especially considering the Asian crisis, which is said to have been exacerbated in part by a lack of openness and subpar corporate governance in East Asian nations.[15]

Evidence of pyramiding and family control of businesses has been found in Asian nations, primarily East Asia, though this characteristic is also common in India. Even in 2002, promoters held an average of 48.1%[16] of the shares in all Indian enterprises. This, it is thought, is a result of the legal system's failure to adequately safeguard property rights. In nations where the legal protection of property rights is generally lax, concentrated ownership and family control are crucial. The popularity of family-owned firms, organisational arrangements that lower transaction costs and asymmetric information problems are also a result of lax property rights. These ownership patterns are also influenced by underdeveloped foreign financial markets. It is difficult to predict how this management-concentrated ownership would affect Asian nations. In several East Asian nations, the company value improves with the greatest owner's stake but decreases when the largest owner's management authority over his equity stake increases,[17] which is like the consequences for US corporations. In Taiwan, family-run businesses with less family control outperform those with more control.[18]

14. See Berglof and Claessens (2004)
15. See Claessens and Fan (2003) for a survey of the literature on corporate governance in Asia.
16. Topalova (2004)
17. Claessens et al (2002)
18. Yeh et al (2001)

The type and scope of "tunnelling" of finances among Indian business groupings have also been studied recently.[19] Indian corporate organisations tunnelled a sizable sum of money up the ownership pyramid throughout the 1990s, robbing the minority shareholders of businesses at the lowest levels of the pyramid of their just rewards.

There aren't many empirical studies on the effects of ownership by other (non-family) groups in Asia. Some Asian nations, particularly China and India, place a strong emphasis on the state. In general, it is believed that state-controlled enterprises have less effective corporate governance practices. Numerous studies demonstrate that state-owned Chinese businesses perform less well in accounting. With state ownership, entrenchment's nonlinear consequences are also present.[20] In emerging economies, institutional investors play a crucial certification role, although there is scant evidence of their effectiveness in Asian corporate governance. Performance in India[21] is not significantly impacted by institutional ownership of equity, such as through mutual funds. On the other side, ownership by other groups including directors, foreigners, and lending institutions seems to enhance performance. Foreign ownership only improves performance in post-liberalization India if foreign investors make up the majority of shareholders.[22]

In Asian nations, hostile takeovers are almost non-existent. In most Asian nations, the premium for control is large and in Korea,[23] it can reach up to 10% of the share price. Although becoming more common, professional participation and external and minority representation on boards are still uncommon in Asian businesses. Corporate governance isn't completely ineffectual in Asia, though. CEOs are more likely to leave their positions when corporate performance is lower in many Asian nations, including India.[24]

The weak link in India's legal and corporate governance framework continues to be the execution of corporate laws. The OECD's corporate governance rules are examined on a country-by-country basis in the World Bank's Reports on the Observance of Standards and Rules (ROSC). The ROSC noted that while India substantially adhered to or respected most of the principles in its 2004 report on India,[25] there were still certain areas where India might improve. One such area is the participation of nominated directors from financial institutions in overseeing and monitoring management. Additionally, there is a need to strengthen the enforcement of several laws and rules, including those governing insider trading, stock listings on major exchanges, and how to deal with violations of the Companies Act, which forms the basis of India's corporate governance framework. Unresolved concerns with jurisdiction and the SEBI's authority are the cause of some of the troubles. A case of the brazen theft of investors' money with companies disappearing overnight serves as an extreme example. The Department of Company Affairs and SEBI's collaborative efforts to identify the offenders have generally failed. Although the resolution rate for complaints regarding the transfer of shares and the non-receipt of dividends was an excellent 95%, there were still more than 135,000 complaints outstanding with the SEBI. To support the development of the corporate governance mechanism in the nation, there is therefore a lot of room for improvement on the enforcement side of the Indian legal system.

19. Bertrand et al (2002)
20. Tian (2001)
21. Sarkar and Sarkar (2000)
22. Chhibber and Majumdar (1999)
23. Bae et al (2002)
24. Gibson (forthcoming) and Das and Ghosh (2004)
25. World Bank (2004)

3. Corporate Governance in India – a background

There have been many intriguing contrasts throughout the history of the evolution of Indian corporate laws. When India gained independence, it took over one of the world's poorest economies, but it also had one of the world's largest manufacturing sectors, four active stock markets (predating the Tokyo Stock Exchange), a well-developed equity culture, if only among the urban wealthy, and a banking system with sophisticated lending standards and recovery procedures.[26] India, therefore, came out far better off than most other colonies in terms of company legislation and the financial system. On this foundation, the 1956 Corporations Act and other legislation governing the operation of joint-stock corporations and safeguarding the rights of investors were constructed.

The managing agency system, which helped to create distributed equity ownership but also gave rise to the practice of managers holding control privileges disproportionately bigger than their stock ownership, marked the beginning of corporate developments in India. The 1951 Industries (Development and Regulation) Act and the 1956 Industrial Policy Resolution, which were markers of the shift towards socialism in the decades following independence, established a system and culture of licencing, protection, and extensive red tape that fostered corruption and stifled the expansion of the corporate sector. The subsequent decades saw a steady deterioration of the situation, with corruption, nepotism, and inefficiency emerging as the defining characteristics of the Indian business sector. Exorbitant tax rates prompted innovative accounting techniques and complex remuneration arrangements as a means of evading the law.

The three all-India development finance institutions (DFIs), the Industrial Finance Corporation of India, Industrial Development Bank of India, and Industrial Credit and Investment Corporation of India, along with the state financial corporations, became the primary sources of long-term credit to businesses in the absence of a developed stock market. They held sizable stakes in the businesses they lent money to, together with the government-owned mutual fund Unit Trust of India, and frequently had representatives on their boards of directors. The corporate governance system was similar to the bank-based German model in this regard, where these institutions had a significant impact on keeping their clients on the correct track. Unfortunately, they were judged on how much they lent rather than how well they lent it, and as a result, they were not motivated to properly evaluate credit or follow up with and monitor clients. Their chosen directors frequently acted as proxies for the current administration. With their assistance, business owners in India might have management control with relatively little of their equity investment. Because their investment was typically recovered quickly, borrowers had little motivation to continue operating their businesses or making loan payments. They frequently stole money from the business with impunity, all the while having DFI nominee directors sitting on their boards as mute bystanders.

This unspeakably familiar process typically persisted until the company's net worth was destroyed. This stage would follow a period of loan default for the company, but it would be at this point that the 1985 Sick Industrial Companies Act (SICA), which governs India's bankruptcy reorganization system, would deem the company "sick" and refer it to the Board for Industrial and Financial Reconstruction (BIFR). A firm receives immediate protection from creditors' claims for at least four years as soon as it registers with the BIFR. The average time it took BIFR to decide was well over two years between 1987 and 1992; since then, the wait has almost doubled. There are very few corporations that have successfully navigated the BIFR, and even for those that had to be liquidated, the legal process typically takes more than 10 years, by which point the company's assets are essentially

26. This section draws heavily from the history of Indian corporate governance in Goswami (2002).

worthless. Therefore, in India, the protection of creditors' rights has only been on paper. Given this circumstance, it should come as no surprise that banks, loaded with depositor money, frequently choose to lend exclusively to reputable businesses and keep their money in government securities.

Although India's financial disclosure laws have historically lagged behind those in the USA and other developed nations, they have historically been better than those in most Asian nations.

Non-compliance with disclosure requirements and even legally incompliant auditor reports are punished with meager fines and barely any punitive action. The Indian Institute of Chartered Accountants is not known for acting against negligent auditors.

Even though the Companies Act gives clear directions for maintaining and updating share registers, minority shareholders frequently suffer as a result of purposeful or unintentional anomalies in share transactions and registrations. Promoters have occasionally utilised non-voting preferential shares as a financial conduit and a way to avoid paying minority shareholders their dues. In the very infrequent instance of company takeovers and mergers, management has occasionally cheated minority shareholders by engaging in covert side agreements with the acquirers.

In India, boards of directors have largely failed to effectively oversee management's operations. They are frequently jam-packed with the friends and supporters of the managers and promoters, which is blatantly against the letter of corporation law. The DFI nominee directors, who could and should have played a particularly crucial role, have typically been incapable of performing their duties or unwilling to do so. As a result, the boards of directors have primarily served as management's apologists.

The Indian equity markets were not liquid or developed enough to effectively control the corporations during most of the post-Independence era. Exchange listing rules imposed some transparency; however, non-compliance was neither uncommon nor dealt with. Overall, despite the existence of numerous rules, minority shareholders and creditors in India continued to be essentially unprotected.

5. Changes since liberalization

Since liberalisation, there have been significant changes in the laws and rules governing corporate governance as well as in people's awareness of it. The creation of the Securities and Exchange Board of India (SEBI) in 1992 and its subsequent gradual empowerment may be the most significant single development around corporate governance and investor protection in India. It was first created to control and monitor stock trading, but it has since played a significant role in developing the nation's fundamental standards for business conduct. However, a string of crises in the early 1990s—the Harshad Mehta stock market scandal of 1992, followed by instances where companies gave preferential shares to their promoters at steep discounts and instances where companies just vanished with investor money—were largely responsible for igniting concerns about corporate governance in India.[27]

There have been various studies into how to improve corporate governance in India because of corporate scandals, as well as opening up to the forces of competition and globalisation. The CII Code for Desirable Corporate Governance, created by a committee led by Rahul Bajaj, was one of the first such initiatives. In 1996, the committee was established, and its code was delivered in April 1998. Later, SEBI established two committees to investigate the topic of corporate governance: the first, led by Kumar Mangalam Birla, delivered its report in early 2000, while the second, led by Narayana Murthy, delivered its findings three years later.

27. Goswami (2002)

6. Corporate Governance of Banks

No industry needs good corporate governance more than the banking and finance sector. Due to the crucial position that banks play in a developing nation's financial and economic system, a bank failure brought on by unethical or inept management actions threatens not just the shareholders but also the general public's ability to deposit money and the health of the economy. The degree of secrecy in how banks operate and the larger role of governmental and regulatory bodies in their operations are the two key characteristics that distinguish banks from other types of businesses.[28]

Between "insiders" in management and "outsiders" in owners and creditors, there are significant information asymmetries because of banking's opaqueness. The fundamental nature of the company makes it incredibly simple and alluring for management to change banks' risk profiles and steal money. Therefore, it is far more challenging for the owners to adequately oversee how the bank management is operating. The interest of depositors in following bank management activities is further diminished by the existence of explicit or implicit deposit insurance.

Prudent banking practices and rigorous central bank oversight of commercial bank operations are crucial for the efficient operation of the banking sector, in part because of these factors. On the other hand, governmental oversight of banks increases the risk of corruption and the diversion of loans for political ends, which may, in the long term, endanger both the economy's overall health and the financial stability of the bank.

The changes have signalled a change in the main paradigm of corporate governance in Indian banks from direct government control intervention to market forces.[29] With the granting of licences to new private banks, competition has been boosted, and the management of the bank has been given more authority and freedom to control both pricing and credit policies. The RBI has switched from a style of direct meddling to one of governance by prudential principles, even allowing debate among banks about the suitability of laws. Government efforts to increase openness and liquidity in markets for government securities and other asset markets have been accompanied by developments that have strengthened market institutions.

Along with this market orientation of governance controls in banking, stricter transparency standards and a focus on regular RBI surveillance have been put in place. Since 1994, the "CAMELS" (Capital adequacy, Asset quality, Management, Earnings, Liquidity and Systems and controls) strategy has been used by the Board for Financial Supervision (BFS) to examine and oversee banks. Since 1995, audit committees in banks have been required.

Another important aspect of the changes has been the increased independence of public sector banks. The emphasis is on boards being more frequently chosen than "appointed from above" as nominee directors, both from the government and RBIs, are being phased out. With the hope that the boards will have the power and expertise to effectively manage the banks within the broad prudential requirements established by the RBI, there is an increasing emphasis on increased professional representation on bank boards. Rules prohibiting lending to businesses that have one or more bank directors on their boards are being relaxed or eliminated, allowing banks to engage in "related party" transactions. It is becoming more and more obvious that choosing executive directors need expert guidance.

Concentrated ownership is still a common trait of old private banks, which restricts opportunities for professional competence and creates a risk of credit misallocation. Regulators should focus their attention on cooperative banks and NBFCs'

28. Levine (2003)
29. Reddy (2002) summarizes the reforms-era policies for corporate governance in Indian banks.

corporate governance. Rural cooperative banks are usually managed as fiefdoms by politically influential families with little professional involvement and a significant amount of loans going to family companies. The "new" private banks are thought to have better and more skilled corporate governance mechanisms in place. The recent failure of the Global Trust Bank, however, has severely refuted that assumption and provoked thoughtful discussion on the subject.

CONCLUSION

Numerous corporate governance norms and standards have emerged globally because of the recent wave of corporate crises and the ensuing interest in corporate governance. The best-known of these is perhaps the OECD's corporate governance standards, the Cadbury Committee's recommendations for European businesses, and the Sarbanes-Oxley law in the USA. However, developing nations are also not behind. Recent surveys have found that there are well over a hundred different codes and norms, and that number is rapidly growing.[30] There hasn't been an exception made by India. This problem has been studied by several committees and groups, and it unquestionably merits all the attention that can be given to it.

India's thought on the subject has steadily crystallised into the creation of standards for publicly traded corporations during the past few years. Private companies make up the great bulk of corporate entities in India, hence the issue they face is still mostly unresolved. Due to the common lack of separation between ownership and control, the agency problem is probably less severe there. However, minority shareholder exploitation may frequently be a significant problem.

An important first step in a genuine endeavour to enhance corporate governance is the creation of norms and rules. The proper execution of those regulations on a local level, however, presents a significant issue in India. The activities of management of the nation's top corporations increasingly seem to be influenced primarily by external forces like analysts and stock markets, particularly overseas markets for companies issuing GDRs. However, their impact is limited to a select group of the best (if not the biggest) businesses. To guarantee proper corporate governance in the typical Indian company, more needs to be done.

In a system beset by pervasive corruption, even the most prudent norms can be duped. Nevertheless, the future of corporate governance in India promises to be noticeably better than in the past, as industry organisations and chambers of commerce actively fight for an enhanced corporate governance framework.

30. Gregory (2000) and (2001)