Corporate Governance in Stock Exchanges and PSUs

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The concept of corporate governance came to the forefront after the Cadbury Report of the 1990s .It is aimed at promoting the interests of all the stakeholders in a balanced manner. The Sarbanes Oxley Act of the U S Congress later clearly spelt out the role of the various parties in corporate management. The essence of corporate governance is honesty, integrity and trust. that seeks to promote the interest of the stakeholders.

OECD in its "Principles of good corporate governance" has identified some common elements of good corporate governance. The main requisite is that the majority of directors should come from outside the company and have no business or personal ties to the company, its promoters or its management. This would imply that functional, shareholder and promoter directors should be in a minority in the Board. This requisite is not met in public sector companies and banks where the reverse is true with outside directors being in a minority. Even in the private sector, except in a few professionally managed companies, this condition is not met.

The other conditions are that the boards should protect the rights of shareholders including minority shareholders, should provide timely and accurate disclosure of the company's financial condition and performance and effectively monitor the management. Boards themselves should be accountable to the company and the shareholders.

These conditions are considered to be met by the quarterly publication of financial results and annual reports.. With new accounting standards being introduced in line with international practice, the quality of disclosure has no doubt improved in recent years. However even where audit committees have been set up, the audit committee reports as recommended by the Cadbury Committee are still not brought before the shareholders. These reports and suggestions and their acceptance and compliance by the management should be placed at the AGMs for discussion by the minority shareholders.

Historically, minority shareholders have not had any say in the affairs of their companies. They are unable to attend AGMs as the cost of travel and stay for attending these meetings deters them and may even exceed the value of their shares. The availability of proxies has not worked. A suggestion was made by the author over 8 years ago that postal ballot should be introduced so that minority shareholders can vote on important resolutions and express their confidence or lack of it in the managements. The companies were obviously not in favour of this. After a long delay, the recent amendments to the Companies Act have taken a half hearted step by giving the option of postal ballot. This needs to be made compulsory at least for Special Resolutions and certain other important resolutions so that minority shareholders have an opportunity of expressing their views about the quality of corporate governance and exercising their voting rights on resolutions proposed by the management..

The institutional investors have become proactive all over the world, but still not in India. Indian mutual funds have to play a more proactive role in bringing about better corporate governance in the companies in which they invest. Compared to the small investors, they have the professional expertise and the means to play this role more effectively and thereby protect the small investor also

Another significant fact that should motivate these institutional investors is that globally, over 80 per cent of investors feel that they would pay more for the shares of a well governed company as compared to a poorly governed company even if their financial performances are similar at any given point of time

The recent decision of SEBI to ensure that at least 25 per cent shares are held by the public will help in promoting shareholder participation and democracy.

Stock Exchanges

In a stock exchange, there are several stakeholders. These include investors, brokers, companies listed at the exchange and regulatory bodies on one hand and auditors, board of directors, management and employees of the exchange on the other.

Corporate governance should primarily aim to protect the interests of the investors against fraud, misrepresentation of facts, fair dealing, market manipulation and to provide full information and transparency.

With increasing globalization of the activities of the stock exchanges of different countries, the complexities of harmonizing the activities of the various players has been recognized. Bodies like the IOSCO have a major role to play in this.

The investors have a choice of several types of transactions like the vanilla type of cash for delivery, the derivatives like futures and options, stock lending through the intermediates like brokers etc. Rules of the exchange provide for the parties to behave in good faith in the performance under the broker-client contracts. When the investor deals with a broker, he does so under a contract approved by the exchange.

In the cash for delivery transaction, when the investor places a buy order, the price at which the broker purchases the scrip should be directly linked to the time of the transaction. In a fluctuating market, the broker should get the best price for the investor. He should not buy at a lower price and report higher price. Similarly, in a sell order, he should get the best price for the client. It is the duty of the exchange to oversee the broker's conduct.

The broker should strictly follow the KYC procedures. He should also ensure orderly completion of transactions and avoid disputes of delayed payment by or to the investor.

The exchange has an obligation ensure the observance of contractual conditions between the client and the broker. When dispute resolution arises, the arbitration mechanism should act promptly and fairly and the award should be enforced speedily.

The role of the exchange in the capital market is very important. The composition of the exchange's governing board has undergone a change in recent years and is not entirely constituted of brokers even in the BSE. On the other hand, brokers of NSE for long have been demanding a place in its governing board. Shares in the exchanges are held by different groups and the impact on the investor by different exchanges holding shares in other sister exchanges needs to be examined. For example, the impact or benefit of the holding by the Singapore Stock Exchange in NSE and BSE has not yet been fully appreciated. Investor participation in the management of stock exchanges will improve the performance of exchanges.

The conflict of interest situations that arise in the exchange-broker-management relationship needs to be avoided by the supervisory role of the regulatory bodies. One of the basic objectives of ensuring good corporate governance is to avoid conflict of interest. For companies, Clause 49 of the Listing Agreement lays down the broad guidelines. Many companies have set up independent audit committees to go into transactions to ensure that there is no conflict of interest, The recent case of Satyam brings out the need for all the players to perform as per the corporate governance rules. The exchanges too need to adopt these corporate governance guidelines.

There should be audit committees, with independent members, at stock exchanges which should be supervised by the regulator ,to ensure good corporate governance. There should also be a rotation of auditors. ICAI has recently recommended that there should be rotation of auditors every 5 or 6 years. This should be followed in the case of stock exchanges also.

PSUs

Corporate governance in the public sector continues to be opaque and generally below expected standards. It should be pointed out that as a result of piecemeal disinvestments from 1991 onwards, the government shareholding in some of the blue-chip companies has come down significantly to between 52 and 66 percent. The non-government shareholders with 48 to 33 percent shares have virtually no say in the management and do not even find a place on the boards of these companies. If, as pointed out earlier, share values in companies with good corporate governance go up, the share values of blue chip PSUs go up when they go out of the government control. This shows the negative perception of the investors towards the companies under government control.

By merely bringing down government shareholding below 51 percent and widely dispersing the rest of the shares, they will technically go out of the public sector but the fact is that these would still be under the control of the government, being the single largest shareholder, but without any checks and balances.