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CORPORATE GOVERNANCE

Poor governance in the government and low prosecution rates are encouraging companies to give preference to personal benefits

Set Systems Right, Industry will Follow

One of the key issues that affect the conduct of business in India and its related governance is the dominance of the owner, who uses his near-absolute ownership or control to derive private benefits from such control. In case of private enterprises, usually banks, lenders, government, community and minority shareholders are the ones who pay the price of such asymmetry of ownership. The impact of dominance of ownership on governance applies not just to promoter- and family-owned companies; it extends to all types of ownership models.

Indian government, as a majority owner of PSEs, often dictates decisions that may not always be linked to business and commercial interests of the PSE or minority shareholders and other stakeholders like bankers, etc. The relevant administrative ministry often take decisions for a PSE 'in national interest', a term that is not clearly defined. This ambiguity was exposed in good measure in recent issues concerning coal companies where 'national interest', 'minister's interest' or 'minister's party interest' seemed to flow from one into another.

MNCs in India are perceived to have a better record in implementing governance norms; however, it is the writ of the parent MNC that holds sway, even if it is at variance with the interest of minority shareholders in India. This was particularly evident in decisions involving delisting of Indian subsidiaries, such as HP's attempt to merge HP Digital Global Soft with HP India subsidiary at a distressed valuation or Luxottica delisting Rayban Sun Optics by bringing down the stock price.

Promoters of family-owned firms are often maligned due to the significant influence they have on the company and control over all resources even if they do not own majority shares. A classic example was the case of Ramalinga Raju, the promoter of Satyam Computer who held less than 5% shares when the accounting fraud was discovered, yet had total control on the affairs of the company.

Another risk associated with dominance is when promoters pledge shares for loans. Lenders require a collateral corresponding to the value of loan that is discharged by pledging shares, which, in turn, fluctuates in value. A company's management often resorts to manufacturing financial results that can maintain the share price at the desired levels because a fall in share prices would mean that promoters need to pledge more shares to maintain the margin and risk losing their holdings in the company. Many studies show that there is a positive correlation between pledging of shares and manipulation of financial results.

> Ramalinga Raju, the promoter with just 5% ownership, had total control over Satyam

To balance the detrimental effects of such dominance, there is clamour for more transparency and need for information from companies. But will this really solve the problem when dominance is known to lead to manipulation of information? For instance, 10 out of 35 accounting standards, as in January 2012, have flexibility of accounting treatment and provide increased discretionary power to management that helps them manage or manipulate results.

The oversight ecosystem is steeped in opacity and arbitrariness, and this is particularly in evidence in enforcement processes such as Sebi's appeals process, which oversees the capital markets, a barometer of the Indian economy. The fines that are charged to defaulters are so paltry compared to the value of abuse that it almost makes it profitable to break the law. Low prosecution, accountability and conviction rates in India for white-collar crimes hardly cause deterrence for persons in power to derive unjust benefits from their control.

Manipulation of information due to dominance and control also extends to the political sphere — in the context of reporting at the country level, often data and results of evaluation of effectiveness of public policies are criticised for the lack of rigour and robustness. Likewise, ownership dominance is reflected in the spate of financial scandals, whether in CWG, 2G or Coalgate, which have arisen from primarily allocating public resources for private use and benefits by people in power and control in the government. This is similar to a situation of owners of a company unjustly enriching themselves through a web of transactions with related parties and, due to a lack of accountability, scandals involving corruption of people in public office and those in control of companies tumble out with alarming regularity.

Governance of corporates and the country are inextricably linked and embedded with each other and cannot be seen in isolation. Corporate governance cannot flourish when the systems of governance in a country falter.

EXPERT VIEW
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