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A note on Corporate Governance in Public Sector Undertakings in India

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Abstract

This paper investigates the significance of corporate governance in the wake of recent developments in a global perspective. It also highlights the major corporate governance issues in public sector undertakings in India and their impact on accountability and performance compared to private sector. The various aspects like managerial autonomy, board structure, roles undertaken by non-executive directors and compliance with SEBI policies have been presented for which public sector undertakings need to develop well-defined strategies and strongly emphasize on planning and execution aspects.

Introduction

Today, in many industrialized nations, policy makers, economists, corporate executives and academicians are debating over the issues of corporate governance. The discussion focuses on the policy formulation and corporate structure by board of directors to improve executive behaviour and management oversight.¹

Corporate governance refers to the set of mechanisms that influence the decisions made by managers when there is a separation of management and control. The monitoring mechanisms can be board of directors, institutional shareholders and operation of the market for corporate control. Recently, global corporate governance debate has grown manifold with political, social, emotional and evolutionary forces fuelling the controversy.

For most of the company boards throughout the world, corporate governance is high on the agenda. Financial institutions like insurance companies and lending communities are emphasizing strongly on incorporating wider aspects of transparency in their financial statements in order to be more accountable to the investors. Many public enterprises in India also have thousands of retail investors as stakeholders in the company's overall performance along with the government. In order to deal with corporate governance norms, SEBI introduced Clause 49 of the listing agreement for public enterprises in the financial year 2000-01.²

¹In a paper on Value Maximization, Stakeholder Theory and the Corporate Objective Function by Michael C. Jensen, The Monitor Group and Harvard Business School, authors have focused on the high-stakes debate over corporate governance by various academicians as well as corporate executives.

²In a circular issued by SEBI on October 29, 2004, the deputy general manager of Division of Issues and Listing-II states the feature of various amendments made to the Clause 49 of SEBI listing agreement and a schedule of implementation that shall be applied to all the listed companies.

In 2003, certain recommendations were made by the Narayana Murthy Committee and revisions were made by SEBI in Clause 49. The changes were brought in categories like Whistle Blower Policy, independence of directors, performance analysis and training of non-executive directors, composition of board, compliance report and CEO/CFO certification. However, in this paper, we do not intend to discuss the impact of such amendments but the delinquency on the part of PSUs in terms of complying with the stated minimum requirements and the impact on the prospects of overall India Inc. when the ministry of corporate affairs is trying hard to attract investment and boost the economy.

Corporate governance: A prominent issue in global perspective

In the past two decades, corporate governance has emerged as a crucial issue in the wake of worldwide wave of privatization and a series of global corporate failures and scandals. In order to understand the relevance of corporate governance in public sector organizations, the historical roots of corporate governance and the rising importance are worth discussing in detail.

§ The world-wide privatization wave

The privatization wave started in the UK, which was responsible for 58% of OECD and 90% of European Community privatization proceeds in 1991. Since then, privatization has been an important phenomenon in Latin America, Western Europe, Asia and the former Soviet block.

With privatization, issues regarding ownership and control of newly privatized corporations also grew to a large extent. In certain countries, part of the agenda was to create "Shareholder Democracy" (Biais and Perotti, 2002) while other countries were more biased towards larger shareholders and their concerns. The rise of governance issues was the next step where the state assumed the new role of public shareholder in private corporations and led to the emergence of corporate governance practices worldwide. The protection of small shareholders was another significant aspect as stock markets gained importance and frequent public offerings were made diluting the ownership and control.

§ Mergers and takeovers

There was an era of massive M&As taking place as a consequence of globalisation and next came a hostile takeover wave first in USA in the 1980s and then in Europe in the 1990s (Becht, Bolton and Röell, 2005). These hostile takeovers counter-attacked the corporate policies and revolutionised the way regulation of domestic and international deals is carried out.

§ Deregulation and capital market integration

During the 1990s, a lot of integration activities started taking place in the global capital markets as the equity capital grew particularly in Eastern Europe, Asia and other emerging markets. This helped in rekindling the interest in regulation and governance issues (Khanna and Palepu, 2004).

§ Scandals and failures at major corporations

Many scandals and failures have started surfacing on a global platform. The reasons for most of them can be attributed to accounting irregularities through which firms started floating their earnings. Many of these failures get highlighted during downturns and recessions.

India: Historical roots of public sector

At the time of independence, India was left with high income disparities, poor infrastructure scenario and insufficient technological resources. There was an acute requirement for widespread development in fields like telecommunication, power, steel etc. and improvement in country's infrastructure. However, private sector was not encouraged to enter such fields since they required huge investment outlays with low and delayed returns. Since private sector had to part with its commercial interest, public sector came into being. However, with time the government proved inefficient in managing the public sector enterprises in various fields and de-licensing and deregulation eventually followed.

Nevertheless, public sector has transformed itself when it emerged least affected during the credit crisis phase. The market capitalisation of the listed PSUs also nearly doubled over the last four years signifying the success of disinvestment process.

Corporate Governance in Public Sector

Over the past few years, government has expressed strong desire to improve the transparency and accountability levels within PSUs. For all unlisted PSUs, the corporate governance norms meant for Central Public Sector Enterprises (CPSEs) were made mandatory. The government now wants to focus on their implementation in order to tackle key issues like PSUs failing to comply with clause 49 of SEBI listing agreement, autonomy of PSUs etc.

Issue 1: Current Standard of corporate governance in PSUs vis-à-vis private sector

Ideally PSUs should lead the way by setting in right policies for accountability and transparency in the corporate governance structure rather than following the private sector. To start with, Maharatna, Navratna and Miniratna PSUs should implement this by adopting the voluntary guidelines set by MCA.

Many agencies like Department of Public Enterprises, the Public Enterprises Selection Board, the Standing Conference of Public Enterprises and Central Vigilance Commission have been discussing the mechanisms for implementing reforms in corporate governance structures in PSUs.

Currently, it has been made mandatory for all CPSEs to follow the corporate governance guidelines formulated by Department of Public Enterprises.

Private sector has projected an ongoing quest to improve their policies and generally score over public sector in their functioning and disclosure norms. Moving ahead, government should also formulate well defined strategy for each PSU to ensure its efficient functioning and propose stringent corporate governance practices for the unlisted PSUs as well.

Issue 2: Balancing commercial and managerial autonomy

Well established theory says there is high positive correlation between autonomy and accountability. Same stands true for autonomy and enterprise performance as well. Indian government has granted various levels of autonomy to its public sector enterprises. However, the formal control by

government is highly extensive over various areas of activities of PSUs strangling their decision making, limiting their autonomy and hence, impairing their day-to-day performance.

Currently it is very important to delink managerial autonomy with board composition as according to present norms, autonomy granted to PSUs is directly dependent on the number of non-executive members present in their board of directors (Chattopadhyay, 2011). As PSUs are unable to fill up their vacancies of non-executive directors again due to government interference, these norms have resulted in a mockery of their autonomy.

Again, PSUs should be kept immune from political and bureaucratic involvement in matters of executive compensation, approval of projects and performance management systems barring matters of national interest.

Issue 3: PSU board structures and independent directors

The government should bring in norms to appoint competent professionals as board members who have a good understanding of the business and the sector. Large shareholders should also be allowed to nominate their representatives to Board (Selarka , 2005). Any political affiliation should be limited and board members' powers should be made independent of the executive management.

The non-executive directors on PSU boards play a vital role in its governance and designing strategic priorities and providing a risk oversight. Their selection is very crucial in these aspects and CMDs should be thoroughly consulted which currently doesn't happen.

The process can be initiated by PESC by short-listing eligible candidates from the private sector and PSU boards and CMDs contributing in board succession planning. These directors should also be adequately compensated at par with their private sector counterparts.

Issue 4: Ensuring compliance with the SEBI Listing Agreement

Many listed Navratna and Miniratna PSUs are lagging behind in complying with minimum requirements stated in Clause 49 of SEBI listing agreement. This directly hampers the future prospects of India Incorporated when the Ministry of Corporate Affairs is emphasizing strongly on the implementation of corporate governance guidelines. The corrective action can be to make proper disclosures within director's and corporate governance reports and ensuring accountability. Also implementation of corporate governance norms for CPSEs, both listed and unlisted, should be supervised consistently.

Issue 5: Government as the "Promoter"

The government needs to constantly monitor the performance of its Board of directors in cases where it acts as a promoter and a majority shareholder of the PSU. Without mitigating the independence and other powers of board of directors, it should clearly provide the strategic layout for tackling various issues (Chattopadhyay, 2011). According to the Organisation for Economic Cooperation and Development (OECD), the government should develop and issue an ownership policy that defines the overall objectives of state ownership, the state's role in corporate governance of state-owned enterprises and how this policy is likely to be implemented.

Conclusion:

Recent institutional failures in the global economic scenario generally rise from inappropriate policies or poor models of corporate governance. In India too, there is a continuous battle amongst stakeholders for value maximisation and increasing transparency and accountability. Definitely each public sector enterprise is unique and has its own set of strategically defined goals and way of functioning and hence, demands for a unique set of governance policies. However, certain corporate governance guiding principles need to be categorical in nature to be applicable over a wide range of public companies to provide a common performance evaluation parameter. This would entail providing autonomy to the public sector along with monitoring it. And ensuring managerial autonomy to the PSUs does not limit the role of the government, rather enhances it.

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