



Importance of corporate governance for investor protection in India

Kshetrimayum Rosita Devi

LLM Student, Amity Law School, Amity University, Haryana, India

Abstract

The corporate governance has a significant role on account of investor protection and promotes the investor in the market sector. The need for corporate governance to work effective and efficient for investor protection has arisen due to cheating and fraud. Therefore, this paper describes the corporate governance, concept and definition of corporate governance, principles and characters of corporate governance, and mechanism as general and particularly illustrates the Securities and Exchange Board of India (SEBI) with two scams. This paper is developed based on the theory of corporate governance such as research papers that available to the public domain.

Keywords: security, investor protection, corporate governance, mechanism for investor

1. Introduction

Industrialization and modernization is influencing the economic development in developing and developed nations. In the same tract of development due to globalization and this point of time, investor started to invest capital in the market sector^[1]. In this situation of earlier time, fraud and cheating was common in the developed and developing nations. In the earlier, the system and mechanism for investor protection was weak to control and manage. For example, SEBI is regulatory body for investor protection^[2]. Its principles were enshrined in the Clause 49 of the listing agreement. SEBI had set up a Commission under Kumar Manlagam Birla, whose report came up in 2000 covering issues such as protection of investor interest, promotion of transparency, building international standards in terms of disclosure of information. This clause was amended as per recommendations of the Naresh Chandra Committee (2002) and Narayana Murthy Committee (2002)^[3]. It is important for healthy growth of financial in market sector. In fact, cheats and fraud is still very common in the developing nation particularly in India. So, good corporate governance plays very important roles for security market. Strong investor protection is being essential character for healthy growth of financial market that encourages security prices, efficient investment, and better access to external finance^[4]. If the system of investor protection is weak to control and regulate the system would like to have negative impact such as distort investment decision and lowers company value, cheat and fraud etc^[5].

Good corporate governance is to set up proper structure to regulate property in safe guard the investor. In system of corporate governance - transparency, equity, accountability and participation are some keys characters of good corporate governance in order to regulate in well manner for sustainable of financial sector in market^[6]. Work in ethical manner and clear vision of corporate governance is required to run a business smoothly in effective and efficient^[7].

2. Concept and definition of corporate governance

Due to economic growth, many investors come out to invest in the market and take up share and as market flow in streamline. More investor is start investing in the market share and in the meantime, fraud and malpractice and misuse of money in the market had been occurred. Hence, the concept of evolution of investor protections comes into being and started to establish to protect investor^[8]. Consequently, corporate governance has been set up to control the legal measure to protect the investor in order to growth economic and it also has roles to protect investor by setting up certain regulatory framework for the protection of investor. To fulfill all this need proper corporate governance is necessary which will help the company in controlling and operating for full functioning of these companies^[9]. The aim of this corporate governance is to give a required regulatory framework for effective accountability to the stakeholders. Corporate governance can be defined as regulatory agencies for the investor protection in such a way that agency is to set up proper governance in the interest of

¹ Mabruka Muspah Elkhatali and Javed Qadri, (2015): A Study of SEBI as Regulatory Authority in Indian Capital Market: an Empirical Analysis, Journal of Economic and Finance, Vol. 3 (III), pp, 08-09

² G Sabarinathan, (2010): SEBI's Regulation of the Indian Security Market: A Critical Review of the Major Development, SAGE, Vol. 35 (4), pp, 13-26

³ SEBI, (2000): Corporate Governance of Security and Exchange Board of India, Security and Exchange Board of India, Feb, 2000, Mumbai

⁴ D S Rawat, (2015): Current Fraud Trend in the Financial Sector, ASSOCHAM,

⁵ Chien Chi Chu, Sang Bing Tsai, Yinghui Chen, Xiyang Li, Yuming Zhai, Quan Chen, Zeng Jing , Zeng Zi Ju and Bin Li., (2017): An Empirical

Study on the Relationship between Investor Protection, Government Behavior and Financial Development, MDPI, pp. 3-14

⁶ Ruchi Kulkani and Balasundram Maniam, (2014): Corporate Governance – Indian Perspective, Vol. 5 (4), pp, 364-368

⁷ Aghogho Odibo, (2016): Corporate Governance Research, Research Gate, pp, 1-10

⁸ Shaik Abdl Majeed Pasha, R Vamsi Krishna and V Hemantha Gopi Kiran., (2012): A Study on Role of SEBI in Indian Capital Market: An Empirical Analysis, International Journal of Multidisciplinary Research, Vol. 2 (3), pp, 396-413

⁹ Humera Khan, (2011): A Literature Review of Corporate Governance, International Conference on E-Business, Management and Economics IPEDR, Vol. 25, (2011) IACSIT Press, Singapore

investors to have better quality in the market. It is relation of all stakeholders such investor, members within company and manages in a better way in order to effective and efficient in all activities ^[10]. It will be providing proper structure with clear objectives set up by itself in order to attaining those objectives and monitoring performance are determined. Good corporate governance means by which corporate governing is managing the business process in the interest of investor, other partnership of all actors to deliver the effective and efficient benefit among all who are involves in it ^[11].

Corporate Governance has gained momentum across the world due to corporate failures, unethical business practices and insufficient disclosure etc. Effective Corporate Governance depends upon two factors. Transparency in the business operations and the second are the legal and regulatory framework created by the Government. There is a gap between percept and practice of Corporate Governance. The topic of Corporate Governance has gained prominence since the 1980's and more so after the code of corporate governance issued by the Cadbury committee. In line with the Cadbury committee, the Kumara-Mangalam Birla Committee has also issued a code of corporate governance for companies in India. According to the Kumara Mangalam Birla Committee- Corporate governance is the system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies. The shareholders 'role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place. The responsibilities of the board include setting the company's strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship. The board's actions are subject to laws, regulations and the shareholders in general meeting". The governance structure of a country protects the investors from expropriation by managers and large shareholders. In different jurisdictions, rules protecting investors come from different sources, including company, security, bankruptcy, takeover, and competition laws, and also from stock exchange regulations and accounting standards ^[12]. It is integrated process to participate of all stakeholders for economic growth and at same for social welfare. The main objectives are: (a) Protecting the interest of the stakeholder and enhancing the value of shareholder by developing the performance and their accountability, (b) Creating an environment as such the thrust wordiness and improving the confidentially among those companies having competing and conflicting interest; and (c) strengthening the investor confidence which is done for the company to bring higher growth and profits ^[13].

¹⁰ Padmini Srinivasan, (2011): Status of Corporate Governance Research on India: An Exploratory Study, Indian Institute of Management, Bangalore, Working Paper 334,

¹¹ Priyanka Aggarwal, (2013): Impact of Corporate Governance on Corporate Financial Performance, Journal of Business and Management, Vol. 13 (3), pp, 01-05

¹² Amita Rani, (2018): Role of SEBI in Promoting Corporate Governance: A Conceptual Paper, International Journal of Engineering Technology Science and Research, Vol. 5 (2), pp, 167-173

¹³ Keerthevasan and V Arya R, (2018): Roles of SEBI Corporate Governance, International Journal of Pure Applied Mathematics, Vol. 120 (5), pp, 217-228

3. Principles of corporate governance

The corporate governance needs the principles such as Transparency in Dealing and Disclosures (TDD), Disciplines in Operations (DO), Rights and Equitable Treatment of Shareholders (RETS) Interests of Others Stakeholders (IOS), and Roles and Responsibilities of the Board (RRB). The first TDD is one principle that organization should clarify and make publicly known the roles and responsibilities of board and management to provide stakeholders with a level of accountability. They should also implement procedures to independently verify and safeguard the integrity of the company's financial reporting. Disclosure of material matters concerning the organization should be timely and balanced to ensure that all investors have access to clear, factual information. The second principle (DO) that Operational discipline asks for quality approval at every stage of predictor services. It refers to the effective and optimum application of the technology available at times. Integration and co-ordination in the entire system is but the prime requirement for the operational efficiency. The third principle (RETS) is that Organizations should respect the rights of shareholders and help shareholder to exercise those rights. They can help shareholders exercise their rights by openly and effectively communicating information and by encouraging shareholders to participate in general meetings. The Four principle is that Organizations should recognize that they have legal, contractual, social, and market driven obligations to non-shareholder stakeholders, including employees, investors, creditors, suppliers, local communities, customers, and policy makers. And last principle is that the board needs sufficient relevant skills and understanding to review and challenge management performance. It also needs adequate size and appropriate levels of independence and commitment ^[14]. For ensuring the basis for effective corporate governance, it should develop the guidelines of company's rule and regulation. There should be fair market and transparency while running the mechanism of corporate governance by fully utilizing resources. The right and equitable treatment of shareholders and key ownership functions to the shareholder in particular companies while investing equity in market is a basic fundamental ^[15].

4. Mechanism of corporate governance for investor protection

The corporate governance is the policies and procedures a company implements to control and protect the interest of internal and external business stakeholders. It also represents the proper framework of the policies and guidelines for each individual in the business. In the larger organization are adapted to use corporate governance mechanism to manage their business because of their complexity ^[16]. For effective corporate governance is essential to run a business in order to meet its strategic goals. A corporate governance structure combines controls,

¹⁴ Shobha C and Kalaivani K N., (2014): The Role of Corporate Governance Practice in Selected Indian Financial Institutions, International Journal of Business and Administration Research Review, Vol. 1 (5), pp, 99-103

¹⁵ Latin America Development Bank, (2012): White Paper the Importance of Corporate Governance in State Owned Enterprises, Latin America Development Bank,

¹⁶ Osmond Vitez, (2017): Types of Corporate Governance Mechanisms, bizfluent

policies and guidelines that drive the organization to move toward its objectives. There are three types of corporate governance mechanism – (a) Internal mechanism, (b) external mechanism and (c) Independent Audit ^[17]. The description of various constituents of internal and external corporate governance mechanism is in the table 1.

Industry (CII) and the Securities and Exchange Board of India (SEBI) ^[18]. The composition of SEBI management is mention in given below as per the Securities and Exchange Board of India Act, 1992 [As amended by the Securities Laws (Amendment) Act, 2014].

- a. The Board shall consist of the following members, namely: (a) a Chairman; (b) two members from amongst the officials of the Ministry of the Central Government dealing with Finance and administration of the Companies Act, 1956 (1 of 1956); (c) one member from amongst the officials of the Reserve Bank, (d) five other members of whom at least three shall be the whole-time members, to be appointed by the Central Government.
- b. The general superintendence, direction and management of the affairs of the Board shall vest in a Board of members, which may exercise all powers and do all acts and things which may be exercised or done by the Board.
- c. Save as otherwise determined by regulations, the Chairman shall also have powers of general superintendence and direction of the affairs of the Board and may also exercise all powers and do all acts and things which may be exercised or done by that Board.
- d. The Chairman and members referred to in clauses (a) and (d) of sub-section (1) shall be appointed by the Central Government and the members referred to in clauses (b) and (c) of that sub-section shall be nominated by the Central Government and the Reserve Bank respectively.
- e. The Chairman and the other members referred to in clauses (a) and (d) of sub-section (1) shall be persons of ability, integrity and standing who have shown capacity in dealing with problems relating to securities market or have special knowledge or experience of law, finance, economics, accountancy, administration or in any other discipline which, in the opinion of the Central Government, shall be useful to the Board¹⁹.

6. Scam under SEBI

Harshad Mehta scam: In the early 1990s, Harshad Mehta, a stockbroker acting as an intermediary, started playing malpractice in the Bombay Stock Exchange, he used to raise funds from the banks and illegally invest them in the stocks listed in the Bombay Stock Exchange (BSE). Therefore, during that time the Sensex moved upwards at a fast pace

and reached 4500 points in no time. In order to make quick money huge number of investor started to invest money in the stock market with the motive to make a good earning. Harshad Mehta diverted an estimated amount of around five thousand crore rupees from Indian banking sector to the Bombay Stock Exchange during the period from April 1991 to May 1992. The Indian stock market crashed consequently after this fraud revealed^[20].

Nirav Modi scam: The latest and the largest banking fraud in the history of Indian markets, Nirav Modi defrauded PNB (Punjab National Bank), second largest public sector bank more than 11,300 crores. Billionaire jeweler Nirav Modi pulled this scam by acquiring fraudulent LOUs (Letters of Undertaking) from one of PNB's branches in Mumbai. These LOUs were eventually used for overseas credit from other Indian lenders. PNB's core banking system was bypassed such that payment notes were raised to overseas branches of other Indian banks (Allahabad Bank, Axis Bank, and Union Bank of India to name a few). This was carried out by using the international financial communication system, SWIFT. After years of mastering this trade and using LOUs, PNB in March 2018, informed the exchanges, SEBI and CBI that it had detected some fraudulent and unauthorized transactions in one of its branches. This was done to benefit only a few selected account holders. Based on transactions, other banks were involved too as they had paid these account holders money abroad. As soon as the amount was disclosed, the whole market turned bearish and PNB shares saw its worst hit. The sad part to the story is that the guilty, Nirav Modi and Mehul Choksi fled the country before the scam came to light. They still not have been brought back to India^[21].

7. Investor Protection in India under SEBI

Securities Exchange Board of India (SEBI) is regulatory body established in the year of 12th April, 1992 in accordance with the provision of Security Exchange Board of India Act 1991 for investor protection in India as it formulates to monitor the working for the stock exchange^[22]. It is compulsory for promoting the development and regulates security market. It measures to improve the investor protection through proper regulating guideline of the company. Under SEBI law, it tries to improve corporate governance and regulate the company through framework of the 34 securities market^[23]. Several efforts with a view to evaluate the adequacy of existing corporate governance practices is done by SEBI in the country and further improve these practices. Organizational framework for investor protection is the Ministry of Corporate Affairs (MCA), the Confederation of Indian

¹⁷ Julie Davoren, (2019): Three Types of Corporate Governance Mechanisms, Small Business Chron

¹⁸ Mabruka Muspah Elkhatali and Javed Qadri., (2015): A Study on Role of SEBI as a Regulatory Authority in Indian Capital Market: an Empirical Analysis, Journal of Economics and Finance, Vol. 3 (33), pp. 08-09

¹⁹ SEBI, (2014): Securities and Exchange Board of India Amendment Act, Securities and Exchange Board of India, Delhi

²⁰ Ananda Das Gupta, (2010): Meththa Scam-Bussiness Ethic Report, Indian Institute of Management, Kozhikode, pp. 1-12

²¹ Prabhat Patnaik, (2018): The Nirav Moodi Scandal, Macro Scam, February 20, 2018

²² SEBI, (2018), Annual Report, Securities Exchange Board of India, Delhi

²³ Shaik Abudl Majeed Pasha, R Vamsi Krishna and V. Hemantha Gopi Kiran., (2012): A Study on Role of SEBI Indian Capital Market: An Empirical Analysis, International Journal of Multidisciplinary Research, Vol. 2 (3), pp. 396-413

Table 1: Corporate Governance Mechanism

Constituent Parameters	Description
Internal Corporate Governance Mechanism	
The Board of Director	Board of the Directors is the main peoples of the firm and for the few companies they are the backbones of the business. They have more authorities and responsibilities of the business firm and they keep track on monitoring and controlling all activities of the management in order to maintain the business performance on the track as well as safeguard the interest of stakeholders
Board Committees	Board committees are the additional part of the board of directors. They are involved in those activities which are assigned by the board of members to them. According to the nature of business, board committees are regulated by the laws and regulations issued by the company. It totally depends on the country's laws and regulations whether the creation of these types of committees should be mandatory for the firm or not.
Financial Statements and Auditors	Financial statements are the information which contains the company data and transactions. Every company needs to present their financial reports on the quarterly and annual basis and get them checked with the auditors. The real picture presented by the auditors reveals the true financial picture of the firm which further becomes the information for the parties involved with the firm either directly or indirectly. On the basis of these financial statements, stakeholders create their statements of action towards the firm. In case they found the reports in positive track, they make up their mind to invest in those firms, on the other side if the stakeholders find the report in the negative side, it will further hamper their trust level in favour of the firms
Ownership Structure	This is another means of controlling the management part of the company. This way a business can maintain its best monitoring and controlling system for the better performance of all the functioning of the business firm.
Stock-Based Compensation	To eradicate the principle and agent costs issue, the best solution is to provide shareholders interest on time and proper compensation to the employees. Stock-based compensation helps the shareholders in motivating the internal managers for achieving the long terms objectives of the company.
External Corporate Governance Mechanism	
The Financial Market	Stock market plays a significant role in firm's ups and downs. There is a direct relation between the market value of the firm and the efficiency of the managers. In case if the shareholders start selling the shares of the company due to somehow reason and if the process is going on in large number further then naturally the market value of the firm starts declining. This way the company who is losing its market value may become the target of acquisition with the help of other big company. Due to the threat of acquisition, the management of the firm can adopt the negative actions like adopting agency costs policy or any other strategy in order to safeguard their business.
The Market of Goods and Services	Competition is another factor which leads the business firm. If the society does not like the products and services offered by a business firm then it becomes natural that their business starts declining and further it may lead to a reduction in the profits ratio of the business firm. Thus company needs to adopt timely researchers and survey in order to tap the resources in accordance with the market requirements
The Labour Market for Managers	In controlling process, human capital is the concept which can be sometimes controlled and sometimes not. If the managers are highly conservative and strict to their employees than the labour market can go in against with the business and may harm the resources of the firm in order to fulfill their demands. This process needs a proper selection of competent manager (who controls the lower class employees) should be done in order to create a proper balance of coordination between the managers and the employees.

Source: Nidhi Sharma, 2017

8. Conclusion

The corporate governance is essential and significant roles for investor in order to protect in the securities and promote the economic development in the market sector. It is required to have strong corporate governance with best principles and mechanism for interest of investor, particularly SEBI exists in India. Its primary mandate of SEBI according to its preamble is describe the basic functions of the SEBI as "to protect the interests of investors in securities and to promote the development of, and to regulate the securities market for matters connected therewith or incidental thereto.

9. References

1. Aghogho Odibo. Corporate Governance Research, Research Gate, 2016, 1-10
2. Amita Rani. Role of SEBI in Promoting Corporate Governance: A Conceptual Paper, International Journal of Engineering Technology Science and Research. 2018; 5(2):167-173
3. Ananda Das Gupta. Meththa Scam-Business Ethic Report, Indian Institute of Management, Kozhikode, 2010, 1-12.
4. Chien Chi Chu, Sang Bing Tsai, Yinghui Chen, Xiyang Li, Yuming Zhai, Quan Chen, et al. An Empirical Study on the Relationship between Investor Protection, Government Behavior and Financial Development, MDPI, 2017, 3-14.
5. Rawat DS. Current Fraud Trend in the Financial Sector, ASSOCHAM, 2015.
6. Sabarinathan G. SEBI's Regulation of the Indian Security Market: A Critical Review of the Major Development, SAGE. 2010; 35(4):13-26.
7. Humera Khan. A Literature Review of Corporate Governance, International Conference on E-Business, Management and Economics IPEDR, IACSIT Press, Singapore, 2011, 25.
8. Julie Davoren. Three Types of Corporate Governance Mechanisms, Small Business Chron, 2019.
9. Keerthevasan V, Arya R. Roles of SEBI Corporate Governance, International Journal of Pure Applied Mathematics. 2018; 120(5):217-228.
10. Latin America Development Bank. White Paper the Importance of Corporate Governance in State Owned Enterprises, Latin America Development Bank, 2012.
11. Mabruka Muspah Elkhtali, Javed Qadri. A Study on Role of SEBI as a Regulatory Authority in Indian Capital Market: an Empirical Analysis, Journal of

- Economics and Finance. 2015; 3(3):08-09.
12. Nidhi Sharma. Corporate Governance Mechanisms in India, International Journal of Advance Research and Development. 2017; 2(5):132-137.
 13. Osmond Vitez. Types of Corporate Governance Mechanisms, bizfluent, 2017.
 14. Padmini Srinivasan. Status of Corporate Governance Research on India: An Exploratory Study, Indian Institute of Management, Bangalore, Working Paper, 2011, 334.
 15. Prabhat Patnaik. The Nirav Moodi Scandal, Macro Scam, 2018.
 16. Priyanka Aggarwal. Impact of Corporate Governance on Corporate Financial Performance, Journal of Business and Management. 2013; 13(3):01-05.
 17. Ruchi Kulkani, Balasundram Maniam. Corporate Governance – Indian Perspective. 2014; 5(4):364-368.
 18. SEBI. Corporate Governance of Security and Exchange Board of India, Security and Exchange Board of India, Mumbai, 2000.
 19. SEBI. Securities and Exchange Board of India Amendment Act, Securities and Exchange Board of India, Delhi, 2014.
 20. SEBI. Annual Report, Securities Exchange Board of India, Delhi, 2018.
 21. Shaik Abdl Majeed Pasha, Vamsi Krishna R, Hemantha Gopi Kiran V. A Study on Role of SEBI in Indian Capital Market: An Empirical Analysis, International Journal of Multidisciplinary Research. 2012; 2(3):396-413
 22. Shobha C, Kalaivani KN. The Role of Corporate Governance Practice in Selected Indian Financial Institutions, International Journal of Business and Administration Research Review. 2014; 1(5):99-103.