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INTERNATIONAL JOURNAL OF ADVANCED RESEARCH (IJAR)

Article DOI: 10.21474/IJAR01/13935
DOI URL: http://dx.doi.org/10.21474/IJAR01/13935

RESEARCH ARTICLE

CORPORATE GOVERNANCE THEORY AND MODEL : A CONCEPTUAL OBSERVATION

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Manuscript Info

Manuscript History
Received: 15 October 2021
Final Accepted: 18 November 2021
Published: December 2021

Key words:-
Corporate Governance, Theory, Model, Economy, Stakeholder, Independent Director

Abstract

This paper outlines the conceptual, contextual and disciplinary scope of the rapidly evolving topic of corporate governance. The aim of this paper is to make a study of different theories and models of corporate governance that have been used globally by analysing strengths and weaknesses for each one. This is to determine which one is the best theory and model and if it can be adopted to different economic systems. Corporate governance theory has tended to look to this theory to guide the decisions of the board of directors in curbing excessive executive power in the hands of management. While useful for this purpose, the Agency Theory provides limited guidance on corporate governance in real life situations which are far more complex. With the blurring of the roles of the principal and the agent, the currently prevalent governance framework, based on the Agency Theory has become self limiting and ineffective. Efforts to supplement the Agency Theory with alternative theoretical frameworks such as the Stakeholder Theory and the Stewardship Theory have, at times, tended to place the board of directors in conflict with their legal obligations to work in the interests of the shareholders. A governance model based on the concept of Trusteeship, while providing fresh insights, suffers from problems in implementation and remains a goal . These alternative frameworks have, therefore, not been of much practical use to the board members in helping them to decide what constitutes the "right" decision. We need new theoretical insights that will take us towards a comprehensive theory of governance. This paper seeks to highlight the various theoretical frameworks for corporate governance.

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Introduction:-

The directors of such (joint-stock) companies, however, being the managers rather of other people's money than of their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which the partners in a private co-partnery frequently watch over their own. Like the stewards of a rich man, they are apt to consider attention to small matters as not for their master's honor, and very easily give themselves a dispensation from having it. Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company.

— Adam Smith, quoted by Jensen and Meckling (1976).

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The term ‘Governance’ is derived from the Latin word ‘Gubernare’ which means to ‘steer’. In the context of companies,governance means direction and control of a company. Different experts have defined the term in their own ways, Corporate governance is the system by which companies are directed and controlled. It is the system of laws, rules and factors that control operations of the company. It means carrying the business as per the stakeholders’ desires. It is actually conducted by the board of Directors and the concerned committees for the company’s stakeholder’s benefit. It is all about balancing individual and societal goals, as well as, economic and social goals. The Relationship between the owners and the managers in an organization must be healthy and there should be no conflict between the both. The owners must see that the individual's actual performance is according to the standard performance. These dimensions of corporate governance should not be overlooked.

In modern corporations, the functions/ tasks of owners and managers should be clearly defined, rather than harmonised. It is determined through various ways to take effective strategic decisions and it gives ultimate authority and complete responsibility to the Board of Directors. In today’s market- oriented economy, globalization are significant factors to develop added value to the stakeholders.Corporate Governance ensures transparency and balanced economic development, so this also ensures that the interests of all shareholders (majority as well as minority shareholders) are safeguarded. It ensures that all shareholders fully exercise their rights and that the organization fully recognizes their rights. Corporate Governance encourages a trustworthy,moral, as well as ethical environment,fair and transparent system and accountable and democratic business conduct should be the paramount aim of modern management.

Corporate Governance is a broad term describing the processes, costumes, policies, laws and instructions that direct the organisations and corporations in the way they act, administer and control their operations. Corporate governance is a set of regulations and the corporate governance has traditionally specified the rules of business decision making that apply to the inked mechanisms of companies.This set of norms and laws has, first and foremost, served to shape the relations among board of directors, shareholders and managers as well as to resolve agency conflicts. Good corporate governance is the basis for our decision- making and control processes and companies responsible, value based management and monitoring focused on long term success, goal oriented and efficient cooperation between between our manasing and supervisory boards, respect for the interest of our shareholders and employees, transparency and responsibility in all our entrepreneurial decisions and an appropriate risk management system.

The Agency Theory led to the evolution of the anglo-saxon model of corporate governance that has become the basis for governance codes around the world including in India. Corporate governance theory has tended to look to this theory to guide the decisions of the board of directors in curbing excessive executive power in the hands of management. While useful for this purpose, the Agency Theory provides limited guidance on corporate governance in real life situations which are far more complex. With the blurring of the roles of the principal and the agent, the currently prevalent governance framework, based on the Agency Theory has become self limiting and ineffective. Efforts to supplement the Agency Theory with alternative theoretical frameworks such as the Stakeholder Theory and the Stewardship Theory have, at times, tended to place the board of directors in conflict with their legal obligations to work in the interests of the shareholders. A governance model such as Anglo-Saxon Model,German Model, Japanese Model and Indian Model are based on the concept of Trusteeship, while providing fresh insights, suffers from problems in implementation and remains a goal to aim for. These alternative frameworks have, therefore, not been of much practical use to the board members in helping them to decide what constitutes the “right” decision. We need new theoretical insights that will take us towards a comprehensive theory of governance. This paper seeks to focus on the various theoretical frameworks for corporate governance and a relationship of trust is constructed between company and its management.Investors protection is replaced by corporate governance in emerging markets of world and also India where investors are poorly protected.

Literature Review:-

Corporate Governance deals with how the suppliers of capital ensure that corporate managers make efficient use of that capital and provide investors with a return commensurate with the risk of the investment.(Berndt 2015). Corporate governance to enable business owners or business managers to have a strategic and transparent direction through the business. Shleifer and Vishny (1997) defines corporate governance as “the way in which suppliers of finance to corporations assume themselves of getting a return on their investment”. OECD in 1999 defined corporate governance as “ Corporate Governance is the system by which business corporations are directed and controlled”

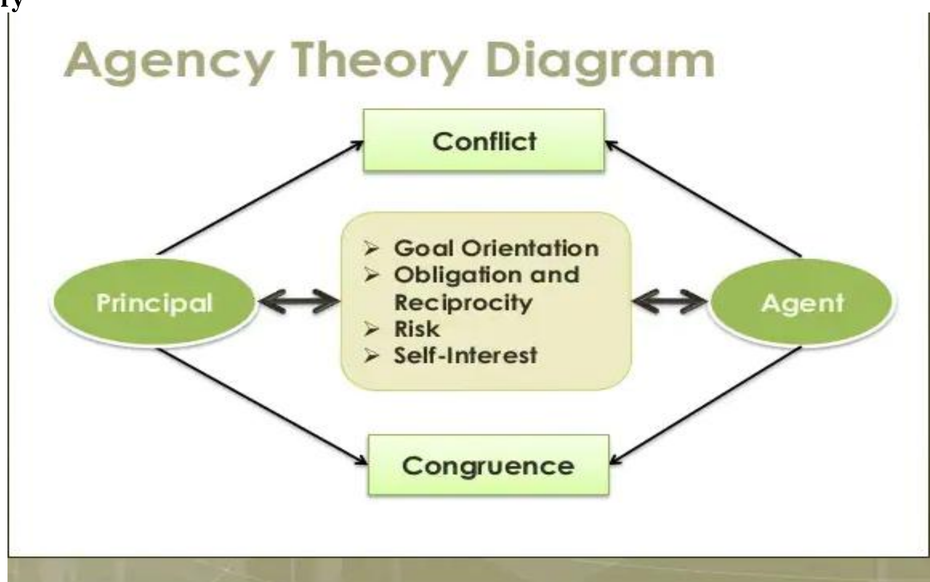
If we go back to the 19th century some of the big companies were owned and under the control of their founders. During this time, the original founders were able to accumulate enough assets with increasing profits from the business. However, owners realized that their resources were not enough to fund a steady increase. In most cases, they were able to raise additional capital in order not to weaken their ownership and control of the company. But there is a limit to the financial debt that the company can afford. To keep the competitive edge from economies of scale, there was a tremendous demand for the company's continued growth. That is why they demanded raising additional capital from the stock market. This would mean that their personal ownership diminished in relation to the company. Moreover, after they retired or died, the stakes were separated from their offspring. At the beginning of the 20th century, it was evident that large investors were fragmenting and disappearing over time. In other words, there was a reduction in ownership concentration. The highest standards of corporate governance are essential to business integrity.

Theories of corporate governance

Theories of corporate governance may be broadly categorized as:

1. Agency theory
2. Stewardship theory
3. Stakeholder theory

Agency Theory



The agency role of the directors refers to the governance function of the board of directors in serving the shareholders by ratifying the decisions made by the managers and monitoring the implementation of those decisions. This role has been examined in a large body of literature (Fama & Jensen, 1983; Baysinger & Butler, 1985; Lorsch & MacIver, 1989; Baysinger & Hoskisson, 1990; Daily & Dalton, 1994). Much of this research has examined board composition due to the importance of the monitoring and governance function of the board (Pearce & Zahra, 1992; Barnhart, Marr & Rosenstein, 1994; Daily & Dalton, 1994; Gales & Kesner, 1994; Bhagat & Black, 1998; Kiel & Nicholson, 2003;), because according to the perspective of agency theory the primary responsibility of the board of directors is towards the shareholders to ensure maximization of shareholder value. The focus of agency theory of the principal and agent relationship (for example shareholders and corporate managers) has created uncertainty due to various information asymmetries (Deegan, 2004). The separation of ownership from management can lead to managers of firms taking action that may not maximize shareholder wealth, due to their firm specific knowledge and expertise, which would benefit them and not the owners; hence a monitoring mechanism is designed to protect the shareholder interest (Jensen & Meckling, 1976). This emphasizes the role of accounting in reducing the agency cost in an organization, effectively through written contracts tied to the accounting systems as a crucial component of corporate governance structures, because if a manager is rewarded for their performance such as accounting profits, they will attempt to increase profits which will lead to an increase in bonus or remuneration through the selection of a particular accounting method that will increase profits.

Agency theory provides the fundamental theoretical base of corporate governance. The theory is based on the concept of separation of ownership and control. Shareholders as owners of the company decide the objectives of the company and appoint the managers as their agents to pursue their objectives. Thus, the managers, many times, are different from the shareholders. Such conflict in objectives is referred to as the 'agency problem' which may lead to self-interested action by the managers who are in control of the company. Managers of the firm have the managerial expertise and firm- specific knowledge. So, they are in the advantageous position over the owners. By this position the managers gain control over the firm. A conflict of goals thus occurs as managers pursue actions which benefit themselves. The managers use their control rights to pursue their personal goals even expropriate the funds through many forms. Some of these forms are:

1. Paying inflated transfer prices to the persons connected with them,
2. Engaging in insider trading,
3. Paying excessive compensation to themselves,
4. Investing in declining industries and so on.

The owners can not verify or it is difficult for them to verify the appropriateness of agents' behaviour. To resolve the conflict of interest, the theory has prescribed certain mechanisms to protect the interest of the owners of the firm:

1. Auditing system.
2. Various bonding assurances by the managers and contracts (written and unwritten) that such abuses do not take place.
3. Changes in the organisation system to limit the ability of managers to engage in the undesirable practices.

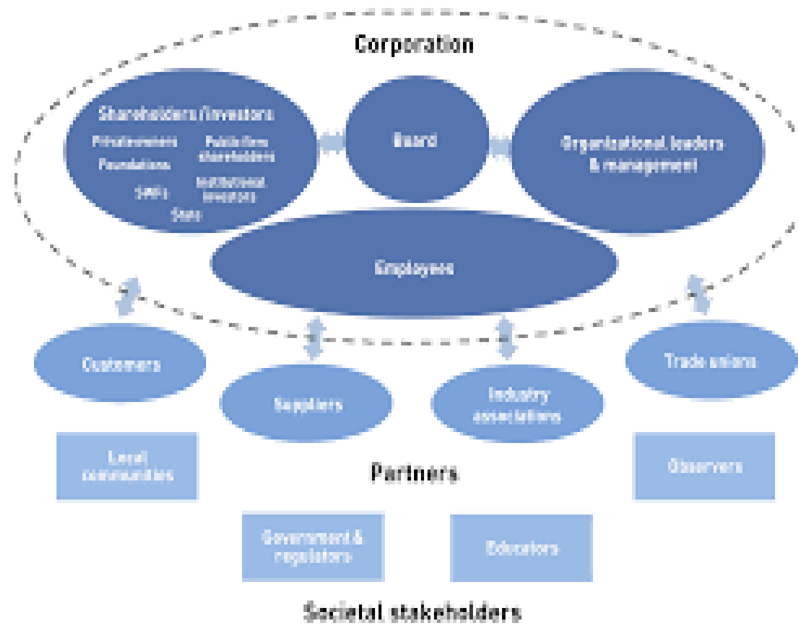
Propositions and assumptions of the theory

1. The implicit assumption of the agency theory is that managerial behaviour is self-interested and that managers are inherently opportunists and take advantage of every opportunity that comes to maximize their personal welfare at the cost of the shareholders.
2. The focus of the theory is on identifying the governance mechanisms to limit the agent's self-serving behaviour and thus solving the agency problem.
3. The theory prescribes the role of an efficient capital market and labour market to control the self-serving behaviour of the managers.
4. The role of the board of directors is particularly emphasized by the theory to monitor the opportunism of managers and control the self-interested tendencies of the corporate management.
5. The theory assumes that an effective board comprises the majority of directors who are not managers in the company and are independent from the management. The interest of such directors referred as independent directors align with the shareholders.

Criticism of the agency theory

1. Over stress on shareholders: One of the most prominent limitations of the theory is over stress on shareholders' wealth maximization to the exclusion of other important stakeholders.
2. Not relevant for developing countries: The 'agency problem' is particularly acute in American and British cultures with dispersed ownership. It is less marketed in Germany, Japan and most other Asian countries owing to block holding by banks or business families. In developing countries the primary agency problem has historically been between majority and minority owners (and not between owners and managers).
3. Overstatement on self – interested qualities: The agency theory is also criticized for its over statement of the self- interested qualities of human beings. The behaviour of board managers is also likely to be shaped by their background, values, experience and tactical skills not merely on the basis of their being insiders or outsiders

Stewardship Theory



The fundamentals of stewardship theory are based on social psychology, which focuses on the behaviour of executives. The steward's behaviour is pro organizational and collectivists, and has higher utility than individualistic self-serving behavior and the steward's behavior will not depart from the interest of the organization because the steward seeks to attain the objectives of the organization (Davis, Schoorman & Donaldson 1997). According to Smallman (2004) where shareholder wealth is maximized, the steward's utilities are maximised too, because organisational success will serve most requirements and the stewards will have a clear mission. He also states that stewards balance tensions between different beneficiaries and other interest groups. Therefore stewardship theory is an argument put forward in firm performance that satisfies the requirements of the interested parties resulting in dynamic performance equilibrium for balanced governance. Stewardship theory sees a strong relationship between managers and the success of the firm, and therefore the stewards protect and maximise shareholder wealth through firm performance. A steward who improves performance successfully, satisfies most stakeholder groups in an organization, when these groups have interests that are well served by increasing organisational wealth (Davis, Schoorman & Donaldson 1997). When the position of the CEO and Chairman is held by a single person, the fate of the organization and the power to determine strategy is the responsibility of a single person. Thus the focus of stewardship theory is on structures that facilitate and empower rather than monitor and control (Davis, Schoorman & Donaldson 1997). Therefore stewardship theory takes a more relaxed view of the separation of the role of chairman and CEO, and supports appointment of a single person for the position of chairman and CEO and a majority of specialist executive directors rather than non-executive directors (Clarke 2004).

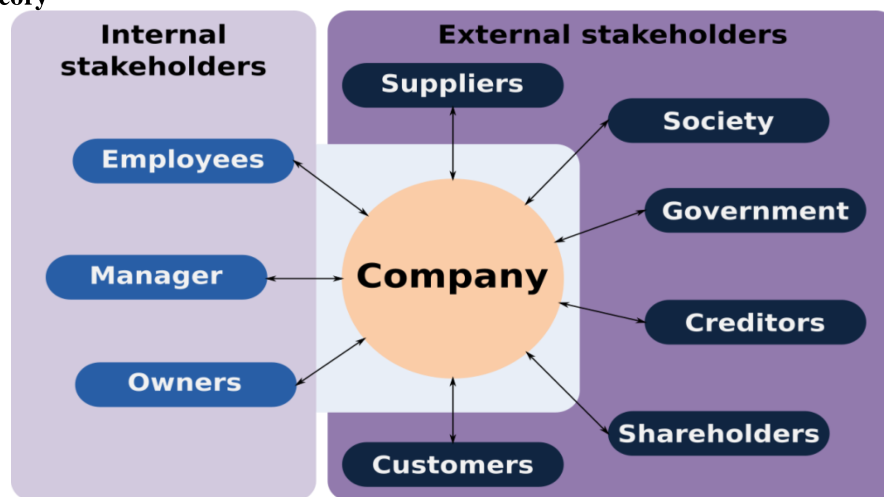
The stewardship theory of corporate governance is an alternative to the agency theory. It rules out the conflict of interest between managers and owners. The theory, propounded by Donaldson and Davis, argues that managers are trustworthy and not prone to misappropriate the funds of the investors. The managers attach significant value to their own personal reputation. The theory also referred to as 'trusteeship theory' regards business firms as a nexus of long established trust relationships. The large public corporation is viewed as a social institution, not the creation of a private contract.

Propositions and assumptions of the theory:

1. The theory argues that managers are not merely agents of the shareholders; they are good stewards of the company and work diligently to attain high levels of corporate profit and shareholders return. This is because their desire to maximise personal income is counterbalanced by 'a much larger range of human motives', including needs for achievements, responsibility, and recognition, as well as belief, respect for authority and motivation.

2. The primary mechanism to control managerial behaviour is the market for managers with strong personal reputation. Thus, the managers far from being an opportunistic shirker essentially want to do a good job, to be a good steward of the corporate agents' whose motives are aligned with the objectives of their principal.
3. The theory points out that the non-executive board of directors is an 'ineffective device'. The protagonists of the theory advocate giving high authority and discretion to CEOs who are viewed as stewards.
4. The focus of the theory is on structures that facilitate and empower the managers rather than the mechanisms to monitor and control them. The agency and stewardship theories contradict each other. However, certain commonalities between the two theories may be observed. Financial reporting, disclosure and auditing are important mechanisms to regulate managerial behaviour in both theories. While agency theory assumes that managerial behaviour is opportunistically directed towards personal gains, stewardship theories see the mechanism of control to confirm inherent trustworthiness of the managers.

Stakeholder theory



This theory centres on the issues concerning the stakeholders in an institution. It stipulates that a corporate entity invariably seeks to provide a balance between the interests of its diverse stakeholders in order to ensure that each interest constituency receives some degree of satisfaction (Abrams, 1951). However, there is an argument that the theory is narrow (Coleman, 2008: 4) because it identifies the shareholders as the only interest group of a corporate entity. However, the stakeholder theory is better in explaining the role of corporate governance than the agency theory by highlighting different constituents of a firm (Coleman, 2008: 4). With an original view of the firm the shareholder is the only one recognized by business law in most countries because they are the owners of the companies. In view of this, the firm has a fiduciary duty to maximize their returns and put their needs first. In more recent business models, the institution converts the inputs of investors, employees, and suppliers into forms that are saleable to customers, hence returns back to its shareholders. This model addresses the needs of investors, employers, suppliers and customers. Pertaining to the scenario above, stakeholder theory argues that the parties involved should include governmental bodies, political groups, trade associations, trade unions, communities, associated corporations, prospective employees and the general public. In some scenarios competitors and prospective clients can be regarded as stakeholders to help improve business efficiency in the marketplace. Stakeholder theory has become more prominent because many researchers have recognized that the activities of a corporate entity impact on the external environment requiring accountability of the organization to a wider audience than simply its shareholders. For instance, McDonald and Puxty (1979) proposed that companies are no longer the instrument of shareholders alone but exist within society and, therefore, have responsibilities to that society. One must however point out that large recognition of this fact has rather been a recent phenomenon. Indeed, it has been realized that economic value is created by people who voluntarily come together and cooperate to improve everyone's position (Freeman et. al., 2004). Jensen (2001) critiques the Stakeholder theory for assuming a single-valued objective (gains that accrue to a firm's constituency). The argument of Jensen (2001) suggests that the performance of a firm is not and should not be measured only by gains to its stakeholders. Other key issues such as flow of information from senior management to lower ranks, interpersonal relations, working environment, etc. are all critical issues that should be considered. Some of these other issues provided a platform for other arguments. An

extension of the theory called an enlightened stakeholder theory was proposed. However, problems relating to empirical testing of the extension have limited its relevance (Sanda et. al., 2005)

Stakeholder theory adopts a broader approach and lays emphasis on the fact that corporations must take Into account wider interest of the society while running the businesses. The essential premise of the theory is that a company has relationships with many constituent groups that affect and are affected by its decisions. The constituent groups are referred to as the 'stakeholders'. Firms must respond to the expectations of these diverse stakeholders to achieve long-term value maximisation.

Arguments of the stakeholder theory

1. The arguments of the theory are based on 'social contract' theory wherein organisations are seen as accountable to all their stakeholders because organisations use resources of the society and enjoy special privileges from society.
2. The purpose of the firm is seen to create value for its stakeholders by converting their stake into goods and services. The theory, thus, considers firm as an input-output model by adding all interest groups-employees, customers, dealers, government, and the society at large-to the corporate mix.

Criticism of the theory

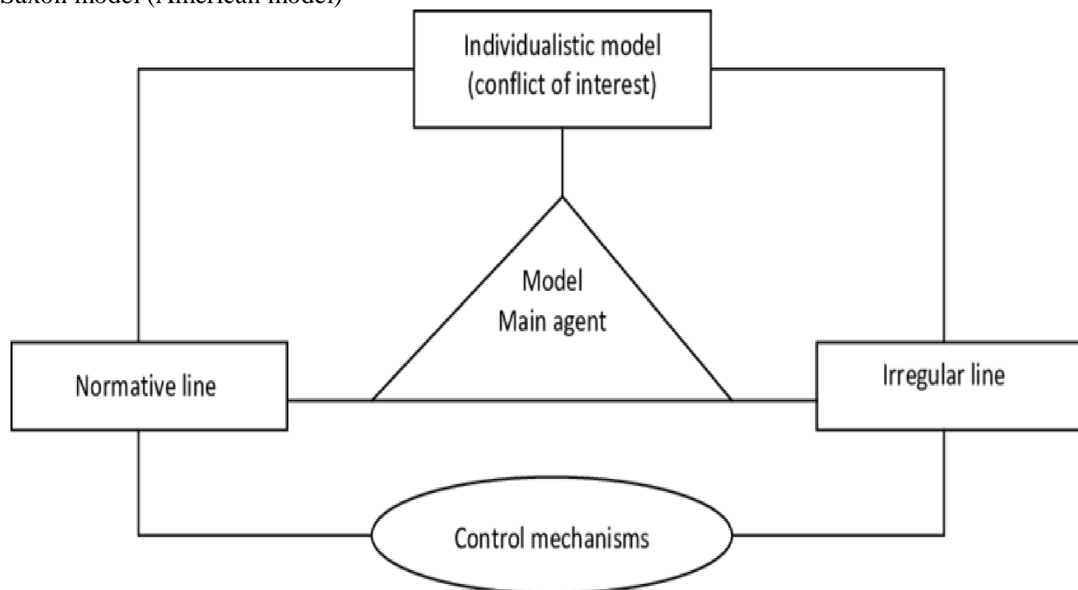
1. The major problem with the stakeholder theory is defining the concept of stakeholder'. What constitutes a genuine stakeholder? Taking a broader perspective, 'stakeholder' includes all groups or individuals who can affect or are affected by the organisation, that is all those who have a stake in an organisation.
2. Stenberg in her paper published in 1997 put forth strong arguments against the stakeholder theory saying that the theory is both misguided and mistaken. She argues that the theory is incompatible with business and with good corporate governance as the key concept in the corporate governance is accountability.
3. The stakeholder theory undermines private property by denying owners the right to determine how their property will be used. It also denies the duty which the agents owe to the principals. The managers owe shareholders a 'judiciary duty' which is not generally granted to any other stakeholders.

Models of corporate governance

In global corporate governance practice, due to the dissimilarities of the structure of corporate governance, the different countries follow diverse models. Though all models of corporate governance are practiced, in reality, they are different in nature due to their national, socio-economic, cultural, and religious perspectives. For example, Shleifer and Vishny (1997) designed a corporate governance structure based on the principles of investors" legitimate security and proprietorship concentration. The ultimate problem of corporate governance structure among the scholars regarding the traditions and practices which are mostly different in the mechanism of ownership control and management decision-making process (Marshall, 1920; Berle and Means, 1932; Smith, 1993; Keasey et al., 1997). Corporate governance codes, rules, and regulations were restructured with a view to managing and controlling the companies after the numerous corporate governance scandals (Bank of Credit and Commerce International"s web fraud, and deception, the Collapse of Baring and Policy Peck and the Enron Scandals of United States) into the banks transactions and countries (Kay and Silberston, 1995). Besides, Lewis (1999) studies six diverse models of corporate governance such as the Anglo-Saxon model, the Germanic model, the Japanese model, the Latin model, the Confucian model, and the Islamic model. European countries and a few other countries follow the European model of corporate governance. Moreover, some nations i.e. France, China, and India, have their own distinct models of corporate governance. The specific model of corporate governance of a country is narrated in its own code but the roots are like a shareholder model (Anglo-Saxon model) or stakeholder model (Continual European Model) or best of both models namely hybrid model. A precise overview of each model is described onwards.

1. Anglo- Saxon model
2. German model
3. Japanese model
4. Indian model

Anglo-Saxon model (American model)



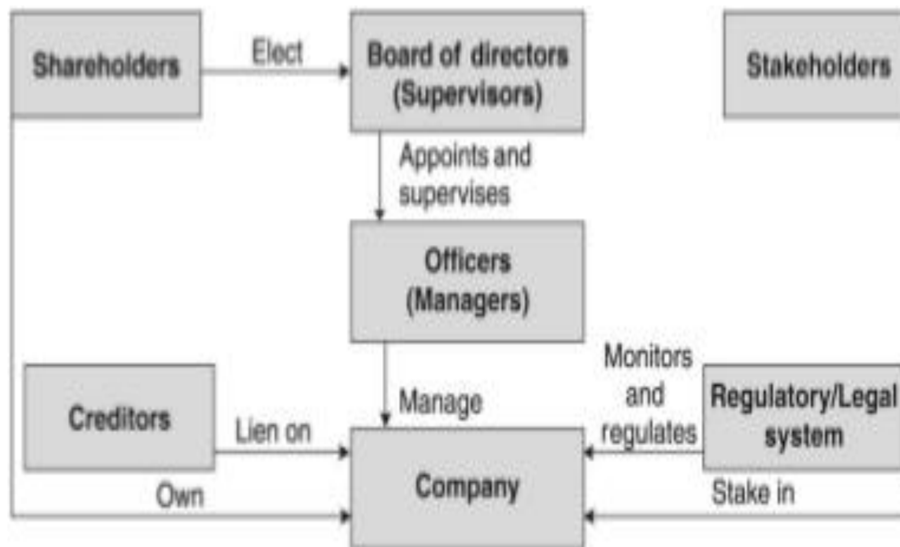
The Anglo-Saxon model is characterized by the dominance in the company of independent persons and individual shareholders. The manager is responsible to the Board of Directors and shareholders, the latter being especially interested in profitable activities and receiving dividends. It ensures the mobility of investments and their placement from the inefficient to the developed areas, but it however feels a lack of strategic development. In the U.S., financial markets activities dominate the allocation of ownership and control rights into organizations. Legislation always appeared hostile to concentration, especially in the banking industry, but in the recent years there have been new regulations developed, more forced by the new economic trends: the increasing influence of boards, investors are increasingly demanding and cautious and managers give more importance to key business issues. Enterprises are required to disclose more information compared to those Japanese or German. On financial markets (NASDAQ) smaller companies are also present, even if some are still in growth and development. Corporate governance was encouraged by the work of various associations which have introduced a motion to support the shareholders, such as National Association of Investors Corporation (founded in 1951) which advises on investments on the stock exchange and National Council of Individual Investors, which protects interests of the shareholders in front of regulatory authorities. Mainly are considering transparency and access to information, strengthening the relationship between regulators and shareholders, and promoting business ethics.

The corporate governance system of the U.S.A., U.K Canada, Australia and other Commonwealth countries including India (to a larger extent) is broadly categorised as the Anglo-Saxon Model.

Features of Anglo-Saxon model

1. Well Developed stock market: The model is based on market capitalism. It is characterised by a well-developed stock market with substantial degree of liquidity and depth. The financial market plays a dominant role in the USA and the UK as a major source of funds for investment and as a disciplinary mechanism to resolve the agency problem.
2. Ownership pattern: The striking feature of the Anglo-Saxon model is the structure of ownership pattern. The shareholders of a typical Anglo-Saxon firm are widely dispersed. Owing to widely dispersed share ownership, shareholders' influence on management is weak.
3. Unitary board of directors: The board of directors in the Anglo-Saxon model is unitary which gives primacy to shareholders interest. The directors are appointed by the shareholders by exercising their voting rights based on proportionate holding of the paid up equity share capital in the company.
4. Influence of trade unions: influence of trade unions is much less in the Anglo-Saxon model as compared with the European model of Germany. The Anglo-American countries have a low and declining rate of unionization as the model does not allow for labour to participate in strategic management decisions. The Anglo-Saxon model can be described graphically as under:

German model



The Continental European model is characterized by a high concentration of capital. Shareholders have common interests with the organization and participate in its management and control. Managers are responsible to a wider group of stakeholders, besides shareholders, such as unions, business partners, etc. It can be said that in Italy, the idea of cooperation dates back to ancient Rome, from the time of Emperor Trajan. At that time they had institutions ``collegia artificum" similar to the contemporary, which were legal entities for various types of trade. The members of "collegia artificum" enjoyed tax benefits and other reliefs. They were inspired by the example of Greek society and the goal was to assist entrepreneurs. Italian corporatism saw two levels: the Catholic and fascist. Catholic-inspired corporatism appeared in 1891 and has grown to the early-twentieth century. Representative is the name of Giuseppe Toniolo, economist and sociologist, who has always promoted solidarity, rejecting individualism and liberal doctrines. Fascist corporatism developed during the years 1920-1940, and its general principles were set out in the Charter of Labour in 1927 and were institutionalized with the advent of new corporations, bringing together different categories of entrepreneurs and workers. 1939 was the crucial step by establishing Chamber fascia. Its abolition coincided with the removal procedure. The 1980s brought into attention a new concept, later debated by Italian literature: neo corporatism. Currently, market and companies management regulation is prevalent in a less receptive environment and exposed to adverse conditions. Socio-economic reality generated some different structures of distribution and control management, each specific to the reference market and with special characteristics. Ownership and control of listed companies are significantly concentrated, shareholders having the opportunity of intervention in the management process. In the German system of governance, the enterprise is seen as the combination of various interest groups aimed to coordinate the national interest objectives. From a historical point of view, German banks have played an important role in corporate decisions. Only one of four companies in Germany is entitled to public transactions, thus most companies seek financial assistance from banks. A great importance is given to the protection of creditors, even to the point where a bank might dominate a firm. Unlike the U.S., German banks may hold only actions of their own clients. This ensures the depositary voting rights to control the decisions and votes in a company. In Germany, the corporate governance system is a dual one, aiming at the same time a national policy to provide employees access to information and participation in various activities of the enterprise and industrial democracy.

The German model, also known as the 'Continental Europe' model, is prevalent in Germanic countries such as Germany, Switzerland, Austria, and Netherlands. This model is based on the 'Stakeholder' theory of corporate Governance.

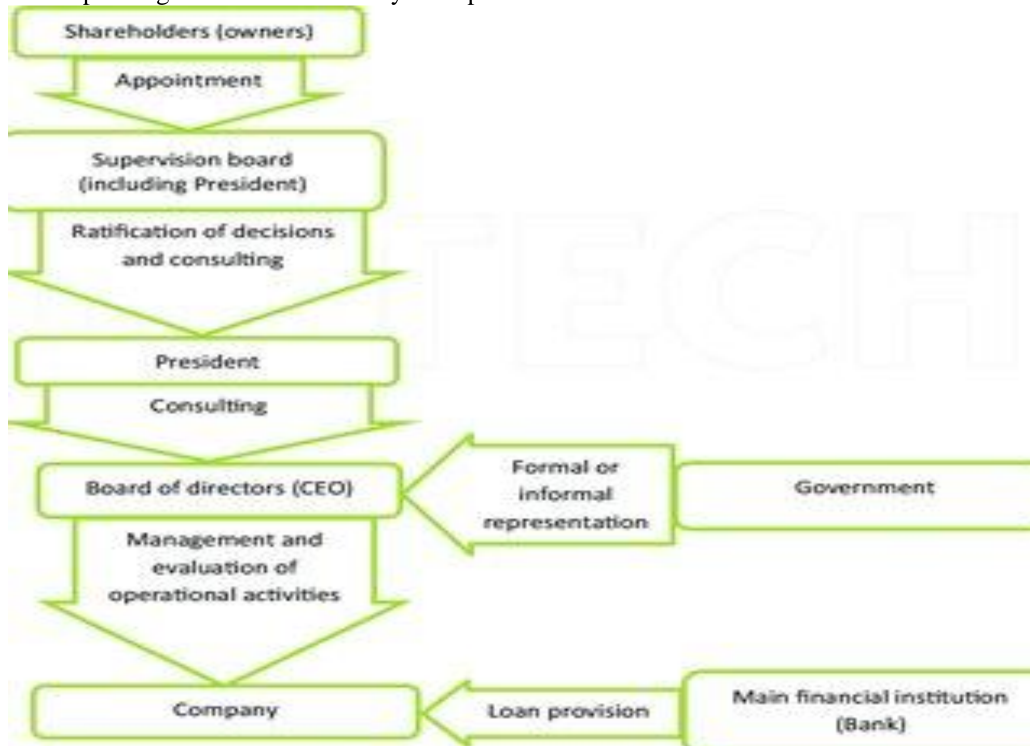
Features of German model

Comparatively less developed financial markets, closely held large block holding of shares, inter-firm cross shareholding, dominant role of banks, and employees representation in the two-tier boards of directors are the striking features of the corporate governance system in large parts of the Continental Europe.

1. Dual-Board system:- A key feature of the German model is the dual-board system. All public limited companies (AG) and private Manager limited companies (GmbH) with more than 500 employees have a supervisory board and an executive board.
2. Participation of employees: - Another striking feature of the German model is participation of employees at the level of board of directors. One third to one half (depending on size of the company in terms of number of employees) of the directors on the supervisory board consists of full time employees and they are elected by the employees.
3. Prominent Role of Banks: The German model is based on the prominent role of banks. It is common for the universal banks in Germany,Austria and Switzerland (such as Deutsche Bank, Dresdner Bank) to act as suppliers of bank loans and equity capital.
4. Large block-holding of shares: - Most German companies have large controlling block holders of shares. It is reported that more than half of the listed German firms have an owner holding more than 50 percent of the equity. The concentration of control is reported even higher in unlisted firms.
5. Less developed stock market: - German model is characterised by an illiquid and less developed stock market. The role of the market in the exercise of corporate control is insignificant owing to the structure and concentration of shareholding in Germanic countries. The three organs of corporate governance in German model: the supervisory board, the executive board and the shareholders can be described as follows:

Japanese model

The Japanese corporate governance model may be depicted as follows:



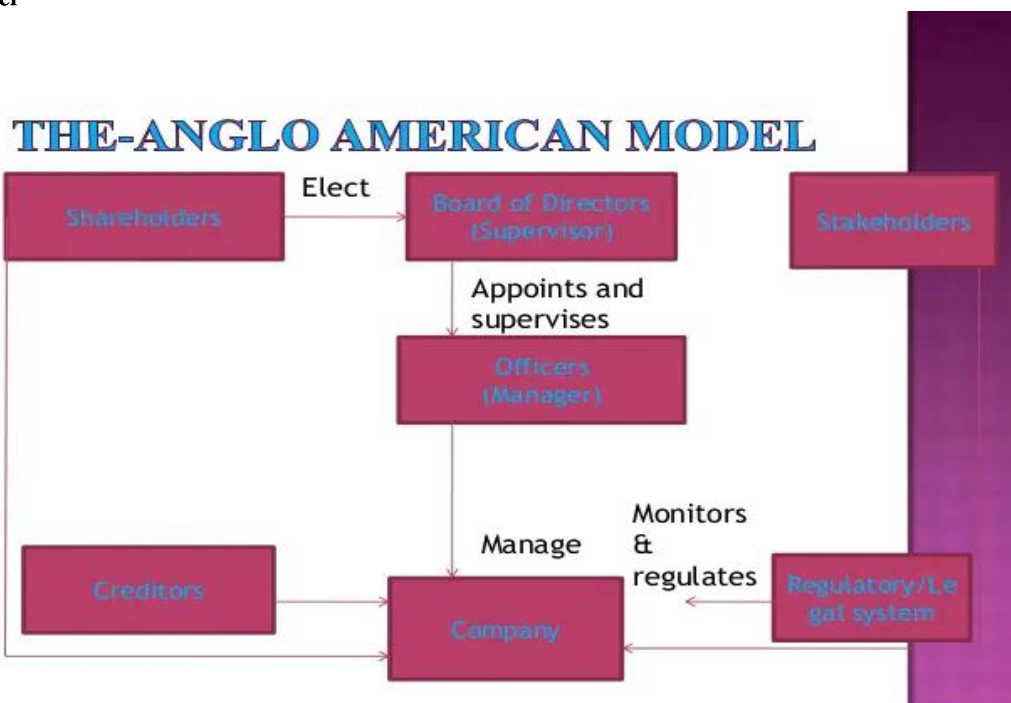
The Japanese model brings, as a new, the holding concept, which designates industrial groups consisting of companies with common interests and similar strategies. The managers' responsibility manifests itself in relations with shareholders and keiretsu (a network of loyal suppliers and customers). Keiretsu represents a complex pattern of cooperation and also competition relationships, characterized by the adoption of defensive tactics in hostile takeovers, reducing the degree of opportunism of parties involved and keeping long term business relationships. Most Japanese companies are affiliated with this group of trading partners. The characteristic pattern of governance is dominated by two types of legal relationships: one of co-determination between shareholders and unions, customers, suppliers, creditors, government and another ratio between administrators and those stakeholders, including managers. The necessity of the model results from the fact that the activity of a company should not be upset by the relations between all these people, relationships that generate risks. Management decisions pursue improving the income and power of an enterprise, in particular by specific corporate governance practices, although

sometimes the shareholders control on the management can be hampered. Therefore, the Japanese model (similar to the German one) is based on internal control; it does not focus on the influence of strong capital markets, but on the existence of those strategic shareholders such as banks. As in Germany, major shareholders are actively involved in the management process, to stimulate economic efficiency and to penalize its absence. It also aims to harmonize the interests of social partners and employees of the entityAt present, Japan's system is focused on transactional networks and not enough on individuals. Relations between keiretsu and a stable banking system is generally based on strong management and sometimes even isolated. There are two favourable factors: the first refers to passivity of shareholders and second is the predominance of internal directors.

The Japanese model of prevention in Japan is also referred to as the 'relationship model'.
Features of Japanese model:

1. Small dominant groups: - The Japanese model comprises a small number of dominant groups such as Mitsubishi, Mitsui, and Sumitomo called Keiretsu. Most of these groups are diversified and vertically integrated by cross- Shareholdings and relationships with a number of small businesses.
2. Dominant role of the government; - In the Japanese model, the government plays an important role of supervision and control over the corporate activities. Retired government officers are placed on the boards of the companies.
3. Role of banks: - The main source of funds of Japanese companies is mostly banks and other financial institutions which provide debts as well as equity capital by a consortium led by a major bank called 'main bank'. The banks are linked through Keiretsu as most banks are affiliates of Keiretsu.
4. Participation of employees: - Board membership in Japanese firms is frequently offered as a reward to long-serving, committed employees. Nearly 90 per cent of the directors are senior managers or former company employees. This ensures participation of employees in the governance of the companies and extracts long term commitment to the firm.
5. Unitary board of directors: - The structure of the board of directors in the Japanese model is the traditional unitary board where important decisions need action by the entire board. On the face of it, the structure resembles the U.S. companies.
6. Contingency model: Banks and financial institutions do not exercise any direct power over a company as long as the company is run successfully in terms of growth and market share. However, where There are signs of poor performance and governance becomes suspect, the main bank intervenes effectively by reviewing the investment plans and assumes the role of oversight over the management.

Indian Model



The Indian model of corporate governance is a hybrid of Anglo-American and family-based models. Its distinctive features are as under:

Resemblance with the Anglo-American model

The model of corporate governance in India resembles to a large extent the Anglo-American model. The Indian Companies Act,2013 (earlier Companies Act,1956) is a substantive law for corporate business in India which provides a legal framework for regulating the corporate activities including governance and administration of companies, rights of shareholders and creditors, disclosures of information relevant for stakeholders etc. The Indian Companies Act closely parallels the Anglo- American model wherein a single –tier board's role is conceived to be that of governance leaving day-to-day operations of the company to the executive management. In the wake of the liberalisation and globalisation process as part of the structural adjustment programme unleashed in India in 1991, the key tenets of the Anglo-American model of corporate governance were adopted. The Indian Companies Act, 1956 which was already in line largely with the basic Anglo-American model was revamped (by making amendments) to reduce its complexity and bureaucratic interference.

The Capital Issues Control Act, 1947 was scrapped removing the control of the government over the issue of securities. The securities and exchange board of India (SEBI) was set up in 1992 as an independent market regulator to bring in a new regime of greater disclosure and transparency. The gradual empowerment of the SEBI since then has played a crucial role in establishing the basic rules of corporate governance in the country.

Family Domination

The tradition of family dominance is entrenched in the Indian corporate governance system. Nearly one third of the publicly listed companies in India are promoted, controlled and managed by the 'business families' at present. The structure of ownership pattern in the corporate sector is strikingly different from the Anglo-American model. Many large private sector companies are being controlled by the business houses on the strength of their majority shareholding in the companies which have been promoted by the families. The present Indian model can best be described as a hybrid of Anglo-American and family-based models.

No separation of ownership and control

In this model, the separation of ownership and control does not exist as the controlling families directly participate in day-to-day operations of the companies. Controlling families appoint their family members or close associates as the CEO or the MD. The boards are usually staffed with family members. Outsiders may be involved in the boards more to meet the regulatory requirement or to add ornament value to the boards. The duties of directors are stipulated in the laws but often given low priority. With reforms underway, independent directors have been introduced to the family dominated boards. However, the role of independent directors has not taken a desired shape.

Role of banks and financial institutions

Banks and other financial institutions provide finance to the companies but do not exercise much control over the firms. Although in some cases, financial institutions and banks appoint their nominees on the boards of invested companies, such nominees directors more often are passive participants in board processes. The financial institutions vote with their feet instead of monitoring the assisted companies. Most family-owned companies have low free float.

Family monitoring

The family –based model of corporate governance fills the market mechanism monitoring gaps. The family provides effective control over the companies. The family business is less driven by the short term outlook. It also creates wealth for the family to be handed down to the next generation.

Challenge: The bigger challenge in the Indian model is to incorporate sound corporate governance practices and to manage the companies by the professional managers in view of complexities of modern business.

corporate governance has gained importance in recent years

'Corporate governance' has been a long standing issue ever since corporate entities were conceived, characterized by separation of ownership and control. The issue of separation was recognized way back in the eighteen century by Adam Smith in his seminal work Wealth of Nation: 'the directors of such companies, however, being managers of

others peoples' money than of their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which the partners in a private company frequently watch over their own.' Separation of management and ownership became more focused in the early twentieth century with the rise of many public companies in the United States and United Kingdom. Berle and Means (1932) drew attention to the issue in their book. The Modern Corporation and Private Property. The pioneering work of Berle and Means led to the development of corporate governance not only as a concept but also a plethora of research on the subject. Although the phrase "corporate governance" came into vogue much later in 1978. Now corporate governance is finding acceptance with the policy makers all around the globe as an indispensable component of resilient and vibrant capital markets.

Changing Ownership Structure

In the recent year the ownership structure of the company has changed a lot. Public financial institutions, Mutual funds, etc. Are the single largest shareholder in most of the large companies. So they have effective control on the management of the companies. They force the management to use corporate governance. That is, they put pressure on the management to become more efficient, transparent, accountable etc. They also ask the management to make consumer friendly policies. To protect all social groups and protect the environment, the changing ownership structure has resulted in corporate governance.

Forces of globalization and privatization

The forces of globalization and privatization unleashed a cult of equity investment around the world. The capital needs of companies are no longer met domestically and this has led to internationalisation of world capital markets. A large number of companies from both developed and developing economies trot the globe to peddle their securities. In such a competitive scenario it is important not only to win but also to retain the confidence of the investors. The significance of good corporate governance in attracting investors has gained recognition, albeit slowly. Empirical research which examined the mechanism(s) of corporate governance and related that with the firm performance has led to an increasing recognition that good governance practices enhance the performance of the company and boosts up the investors' confidence. Studies have revealed that markets and investors take note of well governed companies and reward them with higher valuation. IN fact, the McKInsey Survey (2002) covering companies from emerging markets such as India, Malaysia and South Korea etc. found that companies that adopted good corporate governance practices enjoyed higher market valuation and investors were willing to reward them with a premium which was as high as 28 per cent per share. International institutions such as the World Ban and the OECD have strongly advocated the adoption of corporate governance practices to promote economic growth.

Corporate Collapses and Scams

The governance of companies (or corporate governance) came to the forefront in the wake of a series of corporate collapses taking place around the globe. The Failure of giant companies- Enron, WorldCom, Tyco, Xerox in the USA , Maxwell Publishing, BCCI Bank, Poly Peck, Rolls Royce in the UK, HIH Insurance in Australia, Parmalat in Italy, and most recently Satyam in India, shattered the confidence of investors and mounted massive financial losses to the shareholders and other stakeholders. The striking feature of all these cases was dishonest CEOs and other senior managers perpetuated their frauds keeping the boards at bay. These promoted re-examination of effectiveness of boards given that the board is central to the formulation and implementation of corporate strategy and responsible for oversight over the executives.

The Financial Crisis of 2008

The financial crisis of 2008 has renewed focus on corporate governance, once again. The crisis promoted by the securitization of subprime mortgages in the US had a chain effect owing to globalization and it led to the collapse of banks and other financial institutions around the world. The financial crisis can be to an important extent attributed to failure and weaknesses in corporate governance arrangements. Excessive risk taking promoted by the greediness of the management of the companies to show fabulous financial results, and lack of foresightedness of the boards culminated in unfolding the inevitable burst of global financial meltdown. In many cases the risk management system failed due to inadequacies in corporate governance procedures. Company disclosures about foreseeable risk factors and about the system in place for monitoring and managing risk had many weaknesses. Information about risk exposures in a number of cases did not reach the board and even senior levels of Management.

Future Research

My study, being conceptual in nature,examines in- depth and analyzes the Theory and different Models of corporate governance. It refers to ethical business conduct as well as commitment to values.It aims at bringing fairness, transparency, accountability and employment of democratic and open process. More empirical research will in fact be necessary to refine and further elaborate findings in the area of good corporate governance.

The study is an eye opener for the researchers who have ample interest in the significance of the theory and models.It should seek to operationalize the elements identified in the theory and model and test the direction of linkages among elements and focus on building a robust model and theory can be easily incorporated into practice. This paper will offer them the leads towards the better understanding of the key variables of the emerging and increasingly crucial area of modern management.

Conclusion:-

Corporate governance in India has undergone a paradigm shift by gradually becoming more conscience driven due to interests of customers, employees, vendors and regulators. Corporate governance is about promoting fairness, transparency and accountability; by controlling and managing a company in such a way that helps in mitigating the cost in aligning the interests of various interested parties viz. shareholders, stakeholders, management, board of directors, suppliers of finance, creditors, employees, clients, government and other parties with whom the firm conduct its business; by using incentive mechanisms such as contracts, organisational designs and legislations; to increase company's performance and achieve sustainable shareholder value.

Good governance is still difficult to measure, organizations carrying out such assessments need more representative criteria so that entities must notify their management processes in an efficient manner. The implemented model essentially depends on the firm's theory of voluntary or mandatory approach, but also on the boundaries between markets, entrepreneurs and civil society. The literature cannot provide yet a general method which to base on a comparative study, because the measurement techniques of social responsibility performance are not rigorously founded. Managers focus on the economic activity of producing goods and services and forget that their organisation's true nature is that of a community of humans . The Theory and Model proposed in this paper compels a dipper look within the firm, within the environment and between the firm and its environment encapsulating law, labour markets, product markets and capital markets. The challenges lies in sifting corporate governance from a regulatory approach that 'limit' actions, to an environment of 'self- regulation and adherence to personal ethical standards that that actually requires'pro- active action'.The time has come to articulated by - Philips (2006) where " corporate managers are seeking not just more corporate governance words but a reason for taking this philosophy into day to day management."

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