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Corporate Governance: Practice in India and Role of Securities and Exchange Board of India

*1Dr. Manjulaben Gordhanbhai Patel

*1Department of Commerce and Accountancy, Shree Sahjanand Vanijya Mahavidyalaya (Affiliated to Gujarat University), Ambawadi, Ahmedabad, Gujarat, India.

Abstract

Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distributions of rights and responsibilities among different participants in the corporations, such as, the board, managers, shareholders and the others stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. Increasing reliance of the corporate sector on the capital sector on the capital market for their capital requirements of globalizations of Indian equity, etc. The first issue that needs attention in this context is to avoid over regulations Duplication in exercise of regulatory powers needs to be avoided. Presently, an identical issue, regulatory powers are being exercised both by the MCA & by SEBI (in regard to listed companies) in many respect, SEBI has conferred upon itself powers which are different from those available to the government under the companies Act. Likewise, certain requirement under the companies Act have not been incorporated in Clause 49. There is pressing need of coordination between MCA & SEBI in regards to matter relating to corporate governance and what is regulated by the companies Act should not be done again by the SEBI. SEBI should publish its annual report regarding corporate governance.

Keywords: Bond, shareholders, stakeholders, capital market

Introduction

Corporate governance is a system by which business corporations are managed, directed and controlled. 1t defines and confines the rights responsibilities of the constituents of the corporate like boards and shareholders and others stakeholders. 1t also lays down the rules and procedures managers making organizations more efficient by the use of institutional design and legislation.

"Corporate governance" is the current buzzword today as the entire sector unanimously acknowledges that effective corporate governance shall be indispensable for an effective and efficient capital market. Good governance practices are presumed to ensure prudence in financial operations, planning, and risk management, day-to-day business operations, internal monitoring and control to ensure safety and securities of the creditors ' and value maximizations for the providers of the risk finance. Good corporate governance is an important step in building market confidence and emerging more stable, long term international investment flows. A good governance system generates ideas through participations of all stakeholders and harmonizes different viewpoints while protecting interest of the minority stakeholders. 1n simple words corporate governance is an environment of trust, ethics, moral values and confidence, is synergic efforts of all the constituents of society, i. e. government general public professional and the corporate sector through the thrust to grow and flourish may contribute the god governance level.

Concept of Corporate Governance

Corporate governance is concerned with the establishment of system whereby the directors are entrusted with the responsibility and duties in relation to direction of company affairs. It is concerned with the morals, ethics, values, parameters, and its management. 1t is voluntary ethical code of business of companies. It deals with exercise of powers over the directions of the enterprise, the supervision of the execution action, acceptance of duty is accountable and regulation of the affairs of the company according to many international experts, corporate governance is interplay between companies, shareholders creditors, capital markets, financial sectors institutions and company law.

Definitions of Corporate Governance

1. "Corporate governance is a field in economies that investigates how to secure/motivate efficient management of corporations by the use of incentive mechanisms such as contracts, organizational designs and legislation. This is often limited to the question of improving financial performance for example, how the corporate owners can secure/motivate that the corporate managers will deliver a competitive rate of returns", www.encycogov.com, Mathiesen [2002] [34].
2. "Corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investments ". The Journal of Finance, Shleifer and Vishny [1997, page 737] [36].

*Corresponding Author: Dr. Manjulaben Gordhanbhai Patel

3. "Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distributions of rights and responsibilities among different participants in the corporations, such as, the board, managers, shareholders and the others stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structures through which the company objectives are set, and the means of attaining those objectives and monitoring performance, "OECD April 1999. OECD's definition is consistent with the one presented by Cadbury [1999, page 15] [32].
4. Corporate governance-which can be defined narrowly as the relationship of a company to its shareholders or, more broadly, as its relationship to society from an article in Financial Times [1997].
5. "Corporate Governance is about promoting corporate fairness, transparency and accountability "J. Wolfensohn, president of the word bank, as quoted by an article in Financial Times, June 21, 1999.
6. "Some commentators take too narrow a view, and say it (Corporate Governance) is the fancy term for the way in which directors and auditors handle their responsibilities towards shareholders. Others use the expressions as if it were synonymous with shareholders democracy. Corporate governance is a topic recently conceived, as yet ill-defined, and consequently blurred at the edges. corporate governance as a subject as an objective, or as a regime to be followed for the good of shareholders, employees, customers, bankers and indeed for the reputations and standing of our nation and its economy " MAW *et al*. (1994, page1) [35]
7. As far as the structure is concerned, corporate governance mainly consist of two elements:
   i) Long term relationship, which has to deal with checks and balances, incentives of managers and communications between management and investors.
   ii) Transactional relationship involving matters relating to disclosure and authority

Good Corporate Governance Implies

a) Optimal utilizations of resources for enhancing the value of the enterprise by effectively monitoring executive performance and
b) Ethical behaviour of the enterprise in honouring and protecting the rights of all stakeholders including the local community. Good corporate governance assumes much greater significance if we go through the implications of the following model of corporate growth.

Significance of Good Corporate Governance

- Good performance provides stability and growth to the enterprise
- Good Performance system demonstrated by adoption of good CŒPorate practices builds confidence
- Effective governance reduces perceived risks consequently reducing cost of capital
- In the knowledge driven economy excellence in soft skills like management will be the ultimate tool for corporate to leverage competitive advantages in the financial market
- Adoption of good corporate practices promotes stability and long term sustenance of stakeholders relationship
- A corporate citizen becomes an icon and enjoys a position of pride and,
- Potential stakeholders aspire to enter into relationship with enterprises whose governance credentials are exemplary.

Principles of Corporate Governance

Good corporate governance will include the following principles:

1. Review of operation: There should be review of operations of the company at a regular interval. It may include comparison of month/quarterly production and sales targets with actual, cash flow analysis etc.
2. Compliance with Statutory and Regulatory Requirement: The board should ensure compliance with various statutory and regulatory requirements. 1t may include clearance of statutory dues, Compliance with FEMA regulations, following suitable accounting policies and standards, etc.
3. Appointment of various Committees: There should be appointment of various committee to look after different matters. There can be following committee
   a) Audit Committee
   b) Grievance Committee
   c) Remuneration Committee and
   d) Investment committee, etc.
4. Contributions of Employees Union: employees or workers union can also contribute significantly to good corporate behaviour by promoting work culture. In this case inclusion of employees or workers representatives of the board, shareholders expect that investment decisions are judicious and do not suffer from any infirmities which affect shareholders interest.
5. Contribution of community development: Good corporate governance will help the community development of active participants. 1t adopts measure for pollution control. It adopts fair and ethical business practices. 1n India, the important committee is audit committed which is required by its code.

Literature Review

Transparency is an essential component of corporate governance and helps in appropriate valuation of the company (Bhattacharyya (2004) [37]. Appropriate and timely information helps to predict the future cash flows and the uncertainty related to these cash flows. Economic theory suggests that a commitment by a firm to increased levels of disclosure should lower the information asymmetry component of the firm's cost of capital (Leuz and Verrecchia (2000) [23]. Botosan (1997) [5] contend that financial disclosure has a 2-way effect on cost of equity. First, increase in disclosure increases liquidity and thereby reduces the transaction costs, this in turn reduces the cost of equity. Second, increase in disclosure reduces information risk which is priced in asset returns (Easley *et al* (2002) [13]. Most of the empirical research linking greater disclosure to lower cost of capital has been conducted on the United States stock markets. Stigler (1964) [29] studies the effect of Securities Exchange Actl, 1934, on the volatility of new stock issues. He documents that the volatility of the returns of new issues has reduced subsequent to the Act. Jarrell (1981) [22] confirms the results obtained by Stigler (1964) [29] with improved statistical techniques. Friend and Herman (1964) [14] view that lower volatility during the postSEC period has attracted more risk-averse investors and has increased the level of investment in the United States capital markets. On the contrary, Benston (1973) [2] does not find any impact of the Act on abnormal

returns and variability, subsequent to the applicability of the Act. Friend and Westerfield (1975) [15] defy the results obtained by Benston (1973) [2] by demonstrating that the result is due to wrong classification of firms. Majority of the empirical results related to this Act confirm that increased disclosure subsequent to the SEC Act is beneficial to the investors. The Securities Exchange Commission has made segment reporting mandatory for listed companies in United States starting from the year 1970. Collins (1975) [10] assesses the impact of segment reporting on stock market and finds that the portfolio of companies disclosing greater segmental information has earned higher abnormal returns than the group with less segmental information. Dhaliwal (1977) [12] finds that the experimental group, consisting of companies reporting the segment data for the first time, has experienced a lower standard deviation of its returns consequent to the applicability of the regulation. On the other hand, Horwitz and Kolodny (1977) [20] do not find any reduction either in risk or in abnormal returns subsequent to the regulation. However, Collins and Simonds (1979) [11] observe that the beta of the firms disclosing segment information has reduced during the posts regulation period.

Historical Perspective of Corporate Governance

Watergate scandal in the United States led to the development of the foreign and corrupt practices Act of 1977 in USA that contained specific provisions regarding the establishment, maintenance and review of systems of interval control. Two year after Water gate scandal, in 1979 the Securities and Exchange Commission of USA's proposed for mandatory reporting on internal financial controls

In 1985, following a series of high profile business failure in the USA, the most notable one of which being the savings and loan collapse, the tread way commission was formed. Its primary role was to identify the main causes of misrepresentation in financial reports and to recommend ways of reducing incidence thereof. The tread way report published in 1987 highlighted the need for a proper control environment, independent Audit Committees and an objective internal Audit function. 1t called for published reports on the effectiveness of internal control. 1t also requested the sponsoring organization to develop an integrated set of internal control criteria to enable companies to improve their controls.

Accordingly COSO (committee of sponsoring organization) was born. The report produced by it in 19982 stipulated a control framework, which has been endorsed and refined in the four subsequent U. K report Cadbury, Rutteman, Hemple and Turnbull. While development in the U. K., a spate of scandals and collapses in that country in the late 1980's and early 1990's led shareholders and banks to recognize that the then existing legislation and self-regulations were not working. Companies such as Polly peck, British & common wealth, BCCI and Robert Maxwell's Mirror Group News International in U. K. were all victims of the boom to bust decade of the 1980's several companies, which saw explosive growth in earning, ended the decade in a memorably disastrous manner. Such spectacular corporate failures arose primarily out of poorly managed business practices.

The modern trend of developing corporate governance guidelines and codes of best practice began in the early 1990's in the U. K. the U. S. and Canada in response to problems in the corporate performance of leading companies the perceived lack of effective board oversight that contributed to those performance problems and pressure for change from institutional investors. The Cadbury report in the U. K., the General Motors Board and the dey report in Canada have each proved influential source for other guidelines and code efforts. 0ver the past decade, governance guidelines and code have issued from Stock Exchanges, Corporation, Institutional Investors and associations of directors and corporate managers.

Corporate Governance in Indian Context

India is traditional country having historical background going way back to many countries. 1t has its own culture and values system. It has its own legends and similarly own management practices Indian Economy is very old and its craft and artistic products were well known world over. It is a fact that before the British ruled in India, India was known exporter of many goods to the other countries and always had a favorable balance of payment. The present day the corporate sector in India is governed by the Indian management practices and corporate governance is a blend of provisions provided by various laws, government directives and Indian social traditions.

The performance of the Indian corporate sector in relation to corporate governance is only mediocre. In India the corporate panorama is dominated more by family controlled business, rather than professional management. Companies are formed with, some nominal contributed by promoters and major contribution by Fls, followed by individual shareholders. Although theoretically as per the companies Act, 1956, the management of the companies is vested with the members of the board of directors in the annual general meeting on the basis of majority votes polled in the meeting but the practically the individual shareholders are ineffective in influencing the management due to their indifference national spread of shareholders populations, locations of registered office, meeting venue in remote places and so on. As a result, the substantial proportions of the shareholders are not present in the meeting to exercise their rights. 1n this process the votes polled by the opponents. Hence, despite having lesser number of shares with them, they have final say in any proposal introduced in AGM.

In India, the question of corporate governance has come up mainly in the wake of economic liberalization and deregulation of industry and business ethos and stricter compliance with the law of the land. In the context of the unique situation in India where the financial institutions holds substantial stakes in companies, the accountability of the directors including non-executives and nominees has come into sharp focus.

Role of SEBI in Corporate Governance

The 1999. SEBI, It constituted as the custodian as 18 member of investors' committee, interests, chaired did by not the log young behind and on forward, May) looking industrialist, Mr. Kumar Mangalam Birla (a C. A himself), on corporate governance mainly with a view to protecting the investors' interest. The committee made twenty-five recommendations, nineteen of them mandatory in the sense that these were enforceable. The listed companies were obliged to comply with these on account of the contractual obligation arising out of the listing agreement with stock exchanges. The mandatory recommendations of the Kumar Mangalam Committee the constitution of Audit committee and Remuneration committee in all listed companies, appointment of one or more independent Directors in them, recognition of the leadership role of the chairman of a company, enforcement of

Accounting standards, the obligation to make more disclosure in annual financial report, effective use of the power and influence of institutional shareholders, and so on. The committee also recommended a few provisions, which are non-mandatory. Let us see these recommendations in brief: The Board of a company should have an optimum combination of executives and non-executives Directors with less than 50% of the board comprising the non-executive directors.

The board of a company should set-up a qualified and an independent Audit Committee.

The Audit Committee should have minimum three members, all being nonexecutives Directors, with the majority being independent, and with at least Apa one directors having financial and accounting knowledge. reco The chairman of the Audit committee should be independent Directors. reco The board of directors is a combination of executive directors and non-executive directors.

The non-executive directors comprise of promoters directors and independent directors are those who apart from receiving directors remuneration, do not have any material pecuniary relationship or transactions with the company, its promoters, its management or its subsidiaries that in the judgement of the board may affect their independence judgement. The chairman Of the Audit Committee should be present at Annual General Meeting to answer shareholders-queries.

The Audit Committee discharge various roles such as reviewing any change in accounting policies and practices, compliances with accounting standards; compliance with stock exchange and legal requirement concerning financial statements, the adequacy of internal control system; the company's financial and risk management policies, etc.

The Board meeting should be held at least four times a year,

A director should not be a member in more than ten committees or act as the chairman of more than five committees, across all companies in which he is a Director. This is done to ensure that the members of the Board give due importance and commitment of the meeting of the Board and its committees. The Management must make disclosure to the Board relating to all material, financial and commercial transactions, where they have personal interest. In case of the appointment of a new Director or re-appointment of a director, the shareholders must be provided with a brief resume of the Director, his expertise and the names of companies in which the person also holds Directorship and the membership of the committee of the Board.

A Board committee should be formed to look into the redressal of shareholders complaints like transfer of shares, non-receipt of balance sheet, dividend, etc. there should be a separate section on corporate governance in the annual report of the companies with a detailed compliance report.

Apart from these, the Kumar Mangalam Committee also made some recommendations that are non-mandatory in nature. Some of the non-mandatory recommendations are that:

i) The Board should setup a Remuneration committee to determine the company's policy on specific remuneration packages for executive directors.
ii) Half-yearly declaration of financial performance including summary of the significant events in the last six months should be sent each shareholders.
iii) Non-executive chairman should be entitled to maintain a chairman's office at the company's expense. This will enable him to discharge the responsibility effectively.

It will be interesting to note that the Kumar Mangalam Committee while drafting its recommendations was faced with the dilemma of statutory v/s voluntary compliance. The desirable code of corporate governance which was drafted by Cll and was voluntary in nature did not produce the expected improvement in the corporate governance. It is in this context that the Kumar Mangalam co felt that under the Indian conditions a statutory rather than a voluntary code be far more purposive and meaningful. This led the committee felt the some recommendations are absolutely essential for the framework of corporate governance and virtually from its code, while other could be considered desirable. Besides, some of the recommendations need change of statute such companies Act for their enforcement. Faced with this difficulty the settled for two classes of recommendations.

SEBI has given effect to the Kumar Mangalam Committee's recommendations by a directions to all the stock exchanges to amend their listing agreement with various companies in accordance with the mandatory part of the recommendations with its list of recommendations, the SEBI Clearly addresses the rights responsibilities and obligation of the different groups of stakeholders in the company. Although these changes are being implemented, one needs to consider that in many cases the most important stakeholders of an Indian company is likely to be the owner himself. The owner usually controls management and typically member of the family are involved in the day to day supervision of the company. Even though the company may be listed on the stock exchange, shares are mostly held within the family. The Board of Directors may be comprised of family members and close friends of the family.

Regulators have the most crucial role in improving corporate governance. They are in fact external pressure points. Although compliance with the regulatory requirements is an ideal situation, it is not enough ensuring good corporate governance. But more important are the internal pressure such as peer pressure and market pressure to reach the standards higher than the minima prescribed by the regulatory prescriptions and maximizing voluntary codes to ensure excellence in corporate governance.

Recently, Indian companies have realized the need for ethical behaviour and as end to corrupt government practices. In 1995, the Federation of Indian Chambers Of Commerce and Industry (FICCI) issued a ten-point declaration of "Norms and business Ethics" for Indian companies to follow. The basic purpose is to high standards of business practices through self-regulation. It was an important step in the development of Indian business because it was the first time that the subject of ethical behaviour was linked to mission statement and core values of companies. These days investors are becoming more responsive to the significance of disclosure because of this a new debate is gaining ground. It is a mandatory disclosure vs. Voluntary disclosure issue. Mandatory disclosure are made according with the relevant regulatory framework. Thus, in India mandatory disclosures are as required by the companies Act, 1956, the mandatory accounting standards and the listing agreements with the stock exchange, voluntary disclosures are made over and over and above.

The code of corporate governance, which was drafted by Cll and was voluntary in nature, did not produce expected improvement in corporate governance. It is in this context Kumar Mangalam Birla Committee felt that under the Indian conditions a statutory rather than a voluntary code would be far more purposive and meaningful. This led the committee to decide between mandatory and non-mandatory provisions.

The committee felt that some of the recommendations are absolutely essentials for the framework of corporate governance and virtually from its core, while often could be considered as desirable. Besides, some of the recommendations need change of statute, such as the companies Act or their enforcement. Faced with this difficulty the committee settled for two classes of recommendations. The imperative for corporate governance lies not merely in drafting the code of corporate governance, but in practicing it.
Under the SEBI Act, 1932, SEBI has extensive powers to issue directions to market participants on a wide range of subjective, many of which relate to corporate governance some such regulation include : SEBI (Substantial Acquisition of shares & takeover) Regulations, 1997 : the SEBI (Prohibition of insider trading) regulations, 1992 : SEBI (Disclosures and investors protection) Guidelines, 2000; SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to securities market) Regulation, 2003, etc.
Clause 49 of the listing Agreement was formally introduced by amending the listing agreement in January 2000 based on the recommendations of the Kumar Mangalam Birla committee report. Further amendments were made to this basic framework by SEBI on the basis of Naresh Chandra Committee Report (2002) & the Narayan Murthy Committee report (2003) clause 49 was amended by SEBI in October 2004 and was scheduled to come into force on 31/03/2005. Subsequently, SEBI, vide circular No. SEB1/CFD/DIL/CG/l/2005/29/3 dated 29/03/2005, extended the date to 31/12/2005 by which companies should be in total compliance with the revised clause 49. In January 2006. SEB1 issued another circular No. CED/DIL/CG/1/2006/13/1/13/1/2006 again amending clause 49 of the listing agreement. At this point it would be useful to list out at one place the previous actions taken by SEBI as a regulator in the context of corporate governance. SEBI & MCA have initiated various measures to ensure good governance by companies. The issue of transparency is corporate reporting has become utmost significant mainly because of the establishment of SEBI. With wide powers for monitoring and regulating the capital market and protecting the investors' interest.

Conclusions and Suggestions

Increasing reliance of the corporate sector on the capital sector on the capital market for their capital requirements of globalizations of Indian equity, etc.
The first issue that needs attention in this context is to avoid over regulations Duplication in exercise of regulatory powers needs to be avoided. Presently, an identical issue, regulatory powers are being exercised both by the MCA & by SEBI (in regard to listed companies) in many respect, SEBI has conferred upon itself powers which are different from those available to the government under the companies Act. Likewise, certain requirement under the companies Act have not been incorporated in Clause 49. There is pressing need of coordination between MCA & SEBI in regards to matter relating to corporate governance and what is regulated by the companies Act should not be done again by the SEBI. SEBI should publish its annual report regarding corporate governance. This could be on the lines on which the MCA publishes its annual report, which are placed on the Table of both the Houses of the parliament. Enormous efforts put in the context of corporate Governance should be usefully utilized. The report regarding corporate governance published in the annual report of the listed companies and those emanating from the multiple certificates prescribed by the SEBI in some case must be having valued information in regard to the strengths and the weakness notices concerning corporate governance. There should be highlighted in the annual report of the SEBI so that corporate world may be benefitted by following the good practices mentioned and avoid the lapses highlighted in their future working.

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