

**Financial Accounting**  
**Prof. Varadraj Bapat**  
**Department of School of Management**  
**Indian Institute of Technology, Bombay**

**Lecture - 20**  
**Corporate Governance: Global Models**

Namaste. In the last session we had discussed Corporate Governance, the structure, the need for governance and what will happen if there is a lack of governance. I hope you have understood remembered it, I had also asked you to check in your annual report who are the directors of your company; I hope you have done this also look at the AGM notice that is Annual General Meeting there will be some information about board meetings as well. So, that was about the basics of governance.


Today we look at the global models, although the corporate governance principles are global in nature different give things are given emphasis in different parts of world. So, today's discussion will be on that and as we have seen last time ethics is very important part of governance which is very much there in Indian culture. So, we will discuss about the same.

(Refer Slide Time: 01:40)



**ANGLO-US MODEL**

- The chief executive plays an important role.
- Capital markets are quite active.
- Short-term action pervasive.
- There exists a fairly active market for corporate takeover and control.
- If the company is poorly managed it is exposed to takeover threats.

Now, by far the most popular model is Anglo-US model one which evolved in US or in UK mainly in English speaking countries, it has spread all over the world because major MNCs from there operate everywhere in the world and many of the regulator have

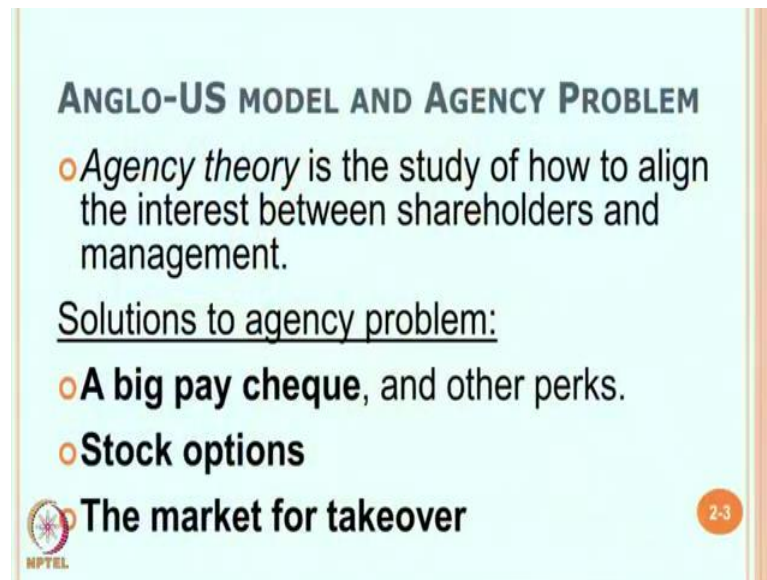
adopted this model. Now, here CEO plays pivotal role, so chief executive officer is one who is looking after the operations is also responsible for reporting to the board is also responsible for reporting to the shareholders. Now, the capital markets are very active in US especially, so if CEO performance declines it has a impact on the stock market performance of the company, the stock prices typically drop and that is a control mechanism on the CEO functioning.

Now, the short term actions are very important because the appointment of CEO itself is for 2 years, 3 years or sometimes even 1 year. So, the profit in that year many times in that quarter plays a very important role because you know stock markets are very sensitive. The profits or the performance will have immediate impact on the stock prices not even at the end of the quarter, it happens every minute.

So, the positive side or negative side in the short term becomes very important, it is very much necessary in the model that there should be active market for corporate takeovers. So, if the management team is not doing well the stock prices will fall that will bring in bad name to the company, but it does not have immediate effect on the controlling group. Because if they have reasonably high number of shares they can continue to be in charge of the company, but because of the falling prices the company becomes a prey for somebody wanting to takeover.

So, other groups may take over the company and the current management gets exposed because of takeover threat that is how the Anglo US model operates, that a negative performance is penalized by reduction in prices. And. if the negative performance continuous for a longer time the whole company will be taken over by somebody else.

(Refer Slide Time: 04:37)




**ANGLO-US MODEL AND AGENCY PROBLEM**

- *Agency theory* is the study of how to align the interest between shareholders and management.

Solutions to agency problem:

- **A big pay cheque**, and other perks.
- **Stock options**

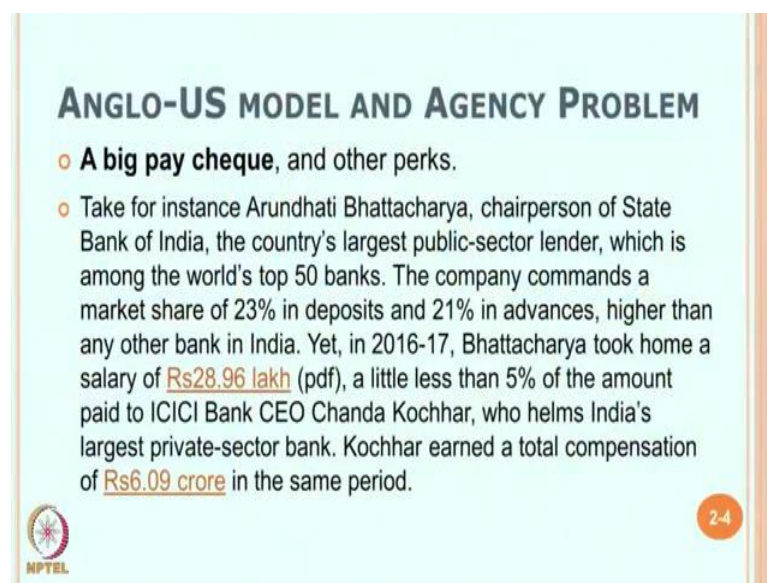
 **The market for takeover** 2-3

Now, there is a agency theory which is very important for understand this model. This is a study of how to align the interest between shareholders and management these are considered to be the most important stakeholders and you can go in there is a lot of research which has happened in agency theory. Now, the major solutions given are in the form of big pay cheque.

So, CEO is given substantially high salary a very high salary and also lot of perks. Now, the idea is that keeps CEO on toe. If the performance falls the person will lose out on sizeable financial benefit that keeps person motivated, not only the CEO it is also true for senior management team they are also given other benefits in the form of stock options I hope you know stock options. So, they are issued lot of shares often free of cost or at a discounted price which are converted after some days. So, they have an incentive that if they are performing well the prices of the company will the stock of the company will be high. Since they are getting stock at a negligible price they would be able to make a lot of money.



And, the third is a market for takeover which we already seen that in case of bad performance fall in the prices company becoming a easy target for take over and of course, the new group will kick off the current team. So, that becomes a it is a carrot and threat of carrot of a big pay cheque threat because a poor performance will mean loss of job and loss of control on the company.

(Refer Slide Time: 06:45)



**ANGLO-US MODEL AND AGENCY PROBLEM**

- A big pay cheque, and other perks.
- Take for instance Arundhati Bhattacharya, chairperson of State Bank of India, the country's largest public-sector lender, which is among the world's top 50 banks. The company commands a market share of 23% in deposits and 21% in advances, higher than any other bank in India. Yet, in 2016-17, Bhattacharya took home a salary of Rs28.96 lakh (pdf), a little less than 5% of the amount paid to ICICI Bank CEO Chanda Kochhar, who helms India's largest private-sector bank. Kochhar earned a total compensation of Rs6.09 crore in the same period.

Now, here is an example of how big the pay cheque is this was a recent news a may be one year old news item we know the largest bank in India is state bank of India at that time that is in year 16 -17 it was headed by Arundhati Bhattacharya. Now, Arundhati is managing a bank as big as SBI which has a market share of 23 percent in deposit and 21 percent in advance.


So, you can imagine how big the state bank is in if you look at the Indian banking industry, her salary was 28 lakhs per annum which is even less than 5 percent of salary of ICICI bank CEO at that time Chanda Kochhar was CEO of ICICI Bank her compensation was 6 crores versus compensation for Arundhati is only 28 lakhs. I am just trying to bring the difference is SBI is a PSU under the public sector the salary is 28 lakhs even for the chairman and MD and for CEO in private sector it is 6 crore. This is not including other perks which the CEO of private sector banks get, this is not only for ICICI I have shown you the salaries of other private sector banks.

(Refer Slide Time: 08:16)

**ANGLO-US MODEL AND AGENCY PROBLEM**

○ **A big pay cheque, and perks**

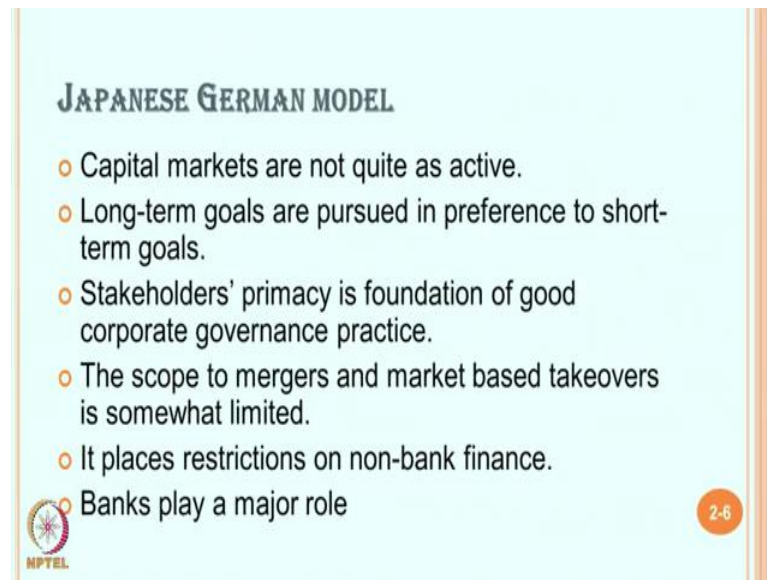
Name	Bank	2016	2017	2018
Aditya Puri	HDFC	Rs 9.73 crore	Rs10 crore	Rs9.64 crore
Chanda Kochhar	ICICI	4.79	6.09	–
Shikha Sharma	AXIS	3.73	4.06	4.02
Rana Kapoor	YES Bank	5.67	6.87	5.52
Uday Kotak	Kotak Mahindra	2.70	2.63	2.92

 NPTEL

So, Aditya Puri who is incharge of or CEO of HDFC Bank we can see the salary for 2016 was 9.3 then 10 crore now 9.67 crore. Remember this is excluding the perks, this is the cash salary for Chanda Kochhar it was 4.79, then 6 and now you know that she is held up in a fraud, so she has been removed. In Shikha Sharma who heads Axis bank it is 3.73 4 crore 4 crore for Rana Kapoor Yes Bank again something like 5 to 6 crore for Uday Kotak for Kotak Mahindra bank it is about 3 crore.

So, do you feel now wanting to join the bank as CEO that is true for CEOs of many private companies and this is mainly because of US model where the top management team gets a very high salary are you getting this was just as an example. Now, there is also Japanese and German model keep in mind that these are advanced countries, but the capital markets are not as active as in US.

(Refer Slide Time: 09:33)



**JAPANESE GERMAN MODEL**

- Capital markets are not quite as active.
- Long-term goals are pursued in preference to short-term goals.
- Stakeholders' primacy is foundation of good corporate governance practice.
- The scope to mergers and market based takeovers is somewhat limited.
- It places restrictions on non-bank finance.
- Banks play a major role

NPTEL

2-6

So, the market control as envisaged in a US model or Anglo US model is not very active. Now, here instead of short term goals long term goals are given more importance and shareholders have a more dominating roll, the chances of mergers and takeovers are relatively less because there is no active market and regulators have more control they do not encourage takeovers that easily.

There is a restriction on non banking finance, so banks play a very major role in Japanese and German companies even their corporate governance because banks are major stakeholders there would be a lot of control of banks or the important institutions on the functioning instead of market control its more of a bank dominated economy ok.

Now, we will go to Chinese model we know that for last ten fifteen years China is lot in news and china has acquired major market share in various types of commodities lot of production or manufacturing activity has shifted to China.

(Refer Slide Time: 11:09)



*CHINA MODEL*

- In the case of China, the focus of industrial policy reform is deregulating the state owned enterprises.
- Partly privatised companies are trading in the stock market. And the standards of corporate governance have started emerging.
- In China, we have evidence of the practice of two-tier boards. It's truly an insider dominated system.
- Also primarily, it is the domination of the state and the partly be the enterprises. There is an issue of minority shareholders still being unprotected.

NPTEL

2-7

Now, in china it is a dominance of government companies now the companies which are partly privatized they have got tradings stocks and there are also standards of governance, but in many cases there is a dual board and it's truly insider company insider dominated system.

So, for day to day operations there will be one board there will be one senior board consisting of government party leaders etcetera who have the final say in the decision making. So, it is a dominance of a state and the minority shareholders rights are not protected they do not have much rights and such that is a Chinese model.




(Refer Slide Time: 11:48)



### CORPORATE GOVERNANCE IN INDIA

- Ethical foundations for governance was very well developed from Vedic period (1 lakh+ years old)
- Governance norms /mechanism developed from prehistoric era.
- Rigvedic hymns, Upanishads – provide norms
- In the third century B.C. Kautilya (Chanakya) wrote his celebrated treatise on Statecraft – *Arthashastra* or Law of Economics.
- History records Pataliputra, the Capital of Mauryan Empire as a city "astonishingly well organized and administered according to best principles of Governance."



Now, we look at the corporate governance model in India, here by India in ancient India because the current model which is being practiced is mostly Anglo US model. But, from a very long time in the history we have got a model with a ethical foundation we know that Vedic period is perhaps more than 1 lakh years old and lot of ethical foundations or moral foundations have been laid down.

So, even in prehistoric times we do observe certain government related norms and mechanisms from various Rigvedic hymns or in Upanishads various norms for regulation are provided for more well documented norm if we go to Kautilya's Arthshastra a detailed treatise has been written about statecraft. So, though the name is Arthshastra actually it is about governance. So, lot of governance principle not only for government even for corporates or businesses have been laid down.

Now, if you look at the history records of Pataliputra which was the capital of Mauryan Empire we have very well administered city and there were properly laid down principles of governance.



(Refer Slide Time: 13:29)



## CORPORATE GOVERNANCE IN INDIA


Kautilya further elaborates on fourfold *dharmas* (duties) of a King/ Leader as:

1. *Raksha* – Protection
2. *Vridddhi* – Enhancement
3. *Palana* – Maintenance
4. *Yogakshema* – Safeguard

2-9

Now, four important principles which are known as fourfold duties or dharma's for the king or any other leader even for corporate leader. One is Raksha or protection, second is Vridddhi it is enhancement not just growth also enhancement, Palana having a maintenance and Yogakshema which is safeguard having controls.

(Refer Slide Time: 13:44)



## SALIENT IDEAS AND THOUGHTS ON PRINCIPALS OF GOVERNANCE AS REVEALED BY OUR ANCIENT SCRIPTURES

- **Atmano Mokshartham, Jagat hitaya cha:** All work is an opportunity for doing good to the world and thus gaining materially and spiritually in our lives
- **Atmana Vindyate Viryam:** Strength and inspiration for excelling in work comes from the Divine, God within, through prayer, spiritual readings and unselfish work.
- **Tesham sukhm tesham shanti shaswati:** Infinite happiness and infinite peace come to them who see the Divine in all beings.
- **Yogah karmashu Kaushalam, Samatvam yoga uchyate:** He who works with calm and even mind achieves the most.
- **Yadishi bhavana yasya siddhi bhavati tadrishi:** As we think, so we succeed, so we become. Attention to means ensures the end.
- **Parasparam bhavayantah shreyah param bhavapsyathah:** By mutual cooperation, respect and fellow feeling, all of us enjoy the highest good both material and spiritual.

2-10

So, there were fourfold duties for the leaders there are various salient ideas or thoughts which are there in the ancient scriptures which are very much relevant to governance. So, I have tried to list a few of them.

The first one is Atmano Mokshartham, Jagat hitaya cha, so all work is an opportunity for doing good for the world Jagat hitaya cha for the good of the world and gaining both materially and spiritually. So, materially because you will get reward in this world you will also get reward in the form of Moksha or in other world that is a basic principle of life.

Then Atmana Vindyate Viryam, Atmana means self. So strength and inspiration for excellence in work comes from within, so divine or lord is within. So, it is not based on rewards from outside you will see in the western or in the Anglo US model its mostly the back pay cheque or some threat, but here from within Vindyate Viryam means from within you feel like doing good or doing selfish work that is the driving principle.

Tesham sukhm tesham shanti shaswati I hope you understand sukhm refers to happiness, shanti refers to peace, shaswati means infinite; infinite happiness and peace is possible from the taking care of others or all well beings because if we only try to get happiness keeping others unhappy that would not be a shaswati sukhm because at some other point of time we get hit. So, here the message is that for shaswat sukh or for infinite happiness we have to take care of others also. Now, Yogah karmashu Kaushalam or Samatvam yoga uchyate these are two definitions of yoga that, he who works with calm and even mind achieves the most.

So, Kaushalya or the efficiency of karma depends on how much calm we are if we are able to work without getting distracted then we can perform very good our level of achieving will be very high Yadishi bhavana yasya siddhi bhavati tadrishi, bhavana means feelings whatever feelings you keep same way you get. So, if you have bad feelings for others you get bad things, but if you keep good feelings for others you get good feel good things back. So, for achieving better performance or for having a fair corporate governance people in charge need to have fair and good feelings not just outcome even the means are important.

Parasparam bhavayantah shreyah param bhavapsyathah, so here parasparam bhavayantah parasparam means mutual cooperation has been given very much of importance it is not just a feeling of competition western model mostly emphasizes on competition one who is the best will be made CEO. So, managers would essentially fight with each other

because they want to prove that they are better than others, but in Indian model lot of emphasizes has been given for mutual cooperation.

So, nowadays world is slowly moving towards team spirit that as a team we need to perform better because if company has to be good then as a team we need to be good. So, that particular thing comes from this principle like that we can have lot of principles have, but I have just tried to list a few of them. Now, these are basic values of Indian principles of governance.

(Refer Slide Time: 18:21)

**BASIC VALUES OF INDIAN PRINCIPALS OF GOVERNANCE**

- Human being has immense potential, energy and talents for perfection.
- Holistic approach indicating unity between the individual self and the universe.
- Subtle, intangible subject and gross tangible objects are equally important. One must develop one's Third Eye, *Jnana Chakru*, the Eye of Wisdom, Vision, Insight and Foresight. Inner resources are much more powerful than outer resources. Divine virtues are inner resources. Capital, materials and plant & machinery are outer resources.
- Co-operation is a powerful instrument for team work and success in any enterprise involving collective work.

 2-11

Human beings are given lot of importance because an individual has a immense potential, energy and talent for perfection there is no limitation for how well the human being can achieve. There is a holistic approach because unity of individual and universe is a starting point in the Indian concept. So, it is not a fight if we try to disturb others we also get disturbed that is a holistic approach this is useful within the team also and between the corporates and other entities or stakeholders as well.

Now, the subtle and intangible subjects are extremely important as much as tangible objects now if you look at the balance sheets of the companies all over the world say 100 years before that tangible assets were most important. Now a days the intangible assets are becoming more important because, of the knowledge society actually our ancient scriptures or Shasta's had emphasized it thousands of or perhaps lakhs of year before that one needs to develop third eye or gyaanachakshu one needs to develop wisdom the inner

resources are as much important perhaps more important like than outer resources. Outer resources are in the form of capital or land of plant and machinery, but to use them effectively you need inner resources if you have got inner talent the outer resources can be raised.

And the last point which we already discussed is about cooperation, that cooperation is a powerful instrument for teamwork and the success of any team or any enterprise very much depends on the collective work that does not mean individual achievement is not important. But, it should be supported by teamwork then one can perform consistently for a long period of time are you getting. So, these are the important principles we have tried to compare various global models, we have a US model or Anglo US model which emphasizes on CEOs role lot of perks and salary is to CEO.

The second is German or Japanese model which is more of a bank based, the third is Chinese model which is more straight driven, the fourth one which we discuss is a Indian model which is more of ethics and moral driven that it is not a regulator from outside, but it is from within you feel that you should perform in a fair manner. So, emphasis on self regulation nowadays the world is slowly coming to understand importance of these concepts like self regulation or team spirit or having the need of fairness within and so on.

So, with this will stop here. Namaste.