

Corporate Governance and Public Sector Units in India: A Review

Chandrani Chattopadhyay¹

Ph.D. student, Department of Sociology, School of Social Sciences, University of Hyderabad, India

Abstract. As market forces increasingly replace government controls, corporate governance is fast gaining prominence in business circles. Corporate governance is concerned with the way in which corporate entities are governed, as distinct from the way in which businesses within those companies are managed. The public sector units with important social responsibilities to fulfill other than make profits also come under the scanner because they use the taxpayers' money for their operations. The paper tries to explore the corporate governance problems of Indian public sector units. The paper is a theoretical review. PSUs in India constitutes a large part of business entities, but is often being criticized of inefficiency and improper governance. The paper makes an attempt to understand the reasons behind the failure to uphold proper governance of the PSUs in India. Few structural problems which hinder the proper functioning of corporate governance in public sector units of India are their conflicting objectives, excessive government interference, lack of managerial and commercial autonomy and lack of truly independent directors. Although Indian public sector units have certain unique characteristics, but it should work on the impediments' of corporate governance so that it could be removed and an accountable and transparent corporate governance structure can prevail.

Keywords: PSU, Corporate Governance, India

1. Introduction

Corporate Governance as a concept is fast rising as a decisive conceptual tool to control, contain and also facilitate corporate operations across the world. In these days of globalization, dominated by the flows of global capital, corporate governance is a means of assuring investors both individual and institutional shareholders that the corporation does not intend to misuse their money in their operations. The structures of corporate governance ensure that the corporate entities do not engage in fraud and continue to grow and make profits. The public sector utilities with important social responsibilities to fulfill other than make profits also come under the scanner because they use the taxpayers' money for their operations. The non-government organizations use donor moneys for their non-profit programmes and are answerable to the donors for proper and befitting use of funds.

Corporate governance is high on the agenda of company Boards worldwide. As institutional investments from financial institutions such as lending institutions, insurance companies and pension funds are growing; investors have been increasingly demanding transparency in company accounts, fair treatments and periodic updates about the company's performance. Corporate governance, however, does not mean protecting the interests of investors alone; it aims at achieving fairness and transparency in transactions with all the stakeholders including customers, employees, investors, vendors, government and the society at large. Corporate governance seeks to build confidence and trust of the stakeholders by observing fairness and transparency in all company affairs. Shareholders, in the technical sense, are the owners of a company but

¹ Tel.: (+91) 9866276315; (+91) 9945076612
E-mail address: moumitab30@gmail.com; trishna2k@gmail.com

they mostly regard themselves as investors. As shareholders are residual claimants, in well performing capital and financial markets, whatever maximize shareholder value should maximize corporate security and best satisfy the claims of creditors, employees and society at large. Moreover, there exist well defined laws to protect the interest of employees and creditors. Therefore, corporate governance regulations in India promote the rights of shareholders; while at the same time ensure the interests of other stakeholders are also simultaneously protected.

2. Historical Roots of Public Sector

The public sector in India emerged out of a mandate where the state was supposed to lay a strong industrial base in the economy. At the time of Independence, India was a poor country with high income inequalities, low growth in income and savings, very poor infrastructure facilities and inadequate technological resources. The economy was largely dominated by subsistence farming, hunger and unemployment. India needed vast industrialization to be able to produce goods of mass consumption and several other basic and key goods that were needed as inputs for manufacturing. India also needed to develop infrastructure like power, telecommunications, railways and steel. There was also a strong need to produce defense equipments and other heavy goods like automobiles, railway coaches that were imported. Thus, a strategy of laying an industrial base, rapid industrialization even in the backward regions of the country and a need for import substitution led to the setting up of a vast empire of public sector enterprises.

The reason why government had to be in business rather than encourage the private sector enterprises to grow was because such large scale industrialization often needed huge investment outlays with low returns. The private sector neither had the resources at its disposal nor could be asked to make such sacrifices of its commercial interest. Hence, the central public sector came into being. The public sector mainly dominates in mining and mineral extraction, manufacturing of metals and other basic goods such as fertilizers, seeds, chemicals and heavy machinery. In the services, public sector dominates in agricultural trading, railways, airlines, telecommunication, financial services, tourism and consultancies.

In addition to the above, the public sector has played an important role in the achievement of constitutional goals like reducing concentration of economic power in private hands, increasing public control over the national economy, creating a socialistic pattern of society, etc. With all its linkages the public sector has made solid contributions to national self-reliance.

3. Changes in Public Sector

Almost all over the world, public sector was being dismantled on the grounds that government run businesses were less efficient and since they were not always run on the profit motive, they caused a huge drain of the tax payers, money. India experienced a severe resource crunch and went to the IMF for aid. IMF demanded to restructure its economy. The policy of the progressive dissolution of the public sector was thus adopted.

Industries were delicensed and deregulated even the private sector could enter areas like airlines, mining etc. that were hitherto reserved for the public sector. The private sector could now raise their investments and increase their capacities and liberally invite foreign capital. The monopoly of public sector thus eroded. The public sector was asked to operate like any other economic agent in a competitive market situation. In pursuit of profits, the public sector would look after its commercial interests ahead of its social duties.

4. Features of Indian PSUs

First, several of the public enterprises in India are publicly listed and actively traded with thousands of individual investors owning shares alongside the government. Secondly, government ownership of assets dominates both in the manufacturing and in the banking sector. Thirdly, the market capitalization of the public enterprises as a proportion of total market capitalization is probably among the highest in the world. Just as in the case of private enterprises that do not have well diversified ownership, public enterprises may also have issues of ownership and control. In both cases, the structure and practice of monitoring, control,

and superintendence appear to go beyond the typical corporate governance mechanisms, to direct control over management.

5. Difficulties in Arriving at Structure of Governance in India's Public Sector

There are several quantitative studies done to measure the efficiency of public sector units compared to private companies. Joshi and Little (1994) have attempted to estimate the real rates of return to investment in the public and private sectors. Bhaya (1990) based his findings on the time series data from 1981-82 to 1985-86 published annually for the public and private sector by the survey of industries. He used three indicators of efficiency (managerial efficiency – things that can be controlled by managers). They are money, workforce and material. On the basis of the evidence available over the period 1981-82 and 1985-86, Bhaya concluded that barring the burden of the fixed capital over which the public sector management has no control and despite higher wages and administered prices over which the management has no control, efficiency in public sector is in no way inferior to the private sector. Jha and Sahni (1992) use Annual Survey of Industries data for the years 1960-61 to 1982-83 for our industries: cement, cotton textiles, electricity, and iron and steel in another study. The latter two industries, they claim are primarily in the public sector while the first two are owned predominantly by private interests. The authors have no evidence of allocative inefficiencies in general and each of them is relatively as efficient as one another. Sharma and Sinha (1995) have used Cobb- Douglas production function to study productive efficiency (or Economic efficiency), which combines both technical and allocative efficiencies for the cement industry in India. Majumdar (1995) evaluated relative performance difference between the government owned, joint sector and private sectors of Indian industry. Kaur (1998) compared TFPI of 15 public and 15 private enterprises from diverse sectors, viz., aluminium, steel, fertilizers, engineering, drugs and chemicals and consumer goods. Naib (2002) compared efficiency of 26 enterprises (13 public and 13 private) for a 12 year period from 1988-89 to 1999-2000. The results indicated that both public and private firms experienced modest positive average annual growth rate during this period.

The Central Vigilance Commission, the Public Enterprises Selection Board, the Department of Public Enterprises, the Standing Conference of Public Enterprises as well as a few other agencies have been debating the need for the reform of corporate governance mechanisms in respect to the public enterprises. But there are certain difficulties in arriving at a structure of governance in PSUs. The objective of this paper is to do a qualitative analysis of the problems in arriving at a structure of governance in public sector units of India.

5.1. Objective Function

After economic liberalization, the goal of the public enterprises have changed and become more complex. There are many kinds of goals of the public sector social development, income redistribution, making profits in order to sustain itself and also ensuring services, at costs that are affordable, for a large section of the population. Now the problem is a company cannot have two objectives that are conflicting in nature. The company will have to focus on either of the two objectives, because in many situations, the board of directors will find it impossible to balance these two objectives. Moreover, multiplicity of objectives dilutes the management's accountability.

The government should formulate well defined strategy for each PSU and establish the objective function based on that strategy. Clarity and transparency in communicating the objective function to all stakeholders is essential to protect the interest of non-government investors and to ensure effective functioning of the enterprise. The board of directors should use the objective function as the guide post in managing the resources of the firm.

The government should review and if necessary, revise the objective function to meet structural changes in the socio-economic environment or changes in national priorities. However, frequent revisions should be avoided. Frequent revision would confuse the stakeholders and will undermine the credibility of the government. Similarly, the government should not set multiple objectives for a particular PSU. In short, the

vision and mission statement of a PSU should be framed by the government, and that should clearly reflect the objective function established for the particular PSU. The board of directors should adopt the same.

5.2. Managerial and Commercial Autonomy

There is a positive and high correlation between autonomy and accountability, and autonomy and performance. Various committees and commissions set up to make in-depth studies on the public sector have recommended autonomy. Though various governments have accepted autonomy, it continues to elude PSUs. The question of accountability imposed by the ministries is oppressive; there being little evidence of the often stressed need to dilute and rationalize accountability of PSUs. While formal control by the government, as per provisions of law or the Memoranda and Articles of Association, is very extensive covering almost all areas of activities of enterprises, the informal control which consumes productive time of PSU managements, inhibits their decision making, a mockery of their autonomy and impairing their performance. If public sector reforms have to become a reality, accountability not only of PSU managements but also for bureaucracy and ministers should be defined including its content, limits, mechanics and benchmarks.

Public enterprises function directly under the control of the government, even when they do not form departments in the government, there is far too much of interference in the working of the public sector enterprises. There is thus a question of autonomy of the public sector enterprise that is crucial for good performance and decision making. PSUs should be kept immune from political and bureaucratic interference. It is now well established that political and bureaucratic interference affects the performance of an enterprise adversely. Therefore, the government should control and monitor PSUs without interfering in their day-to-day management. The government should act as an informed and responsible promoter and majority shareholder of PSUs. The government policy to provide managerial and commercial autonomy to PSUs, operating in a competitive environment is much needed.

5.3. Board of Directors and Independent Directors

Performance of any enterprise depends to a very large extent on the capability and value system of the top management. To perform, however, he/she must have the freedom to put his/her intellect, experience, knowledge, values and ethics to optimum use. Nominating unqualified and unsuitable persons as top management of PSUs by vested interests affects their performance.

In most cases, the Board of the public sector enterprises have bureaucrats as members; and this does not qualify as independent directors. The lack of “independence” for the independent directors constrains the independence of the Board and the autonomy of the public sector. The government should appoint professionals having competence and understanding of business as board members. It may be a good idea to invite other large shareholders to nominate their representatives to the Board. An independent director in a PSU board should not only be independent of the executive management, he/she should also be independent of the government and the political parties in power. Therefore, the government should avoid appointing individuals political affiliation to the Board of directors of a PSU as an independent director.

The government, as the promoter of a PSU and as a majority shareholder, should closely monitor the performance of the enterprise and the performance of its Board of directors. The government should enforce control and monitoring through government officials, who are members of the Board of directors. They should clearly communicate the government strategy and government views on various issues in the Board meeting without impeding the independence and authority of other directors.

5.4. Role of Investigating Agencies

Effective and quick decision-making involves an element of risk which may mean occasional losses. The ultimate career decision of PSU executives seems to lie with officials of investigating agencies and not with Board of management. It would be desirable to create a cadre of ombudsmen for PSUs making it imperative to refer any charges against executives to them before any disciplinary action is contemplated.

5.5. Other Issues

The corporate pay structure is designed more towards attaining social equality and sometimes may not reward good performance. In other words, there is little connection between performance and pay in the public sector. This might reduce employee initiatives in the organization. Since pay and performance are not always related, there is no adequate structure in corporate governance for the monitoring of organizational performance.

Though there are also instances of fraud in the public enterprises, yet the disclosures of the non-financial aspects in these units are not transparent. Most public sector units do not have systematic risk-taking techniques. In fact there is a positive risk aversion in the public sector. The general risk aversion of the public sector Boards also make them less effective and they cannot make as much profit as they could have.

An important factor in the performance of PSUs is ethics, morality and qualifications of political decision makers. The corrupt nexus between politicians and bureaucrats in financial deals of PSUs, under public scrutiny has damaged the image of many PSUs.

Memorandum of Understanding (MoU) basically covers annual plan/budget for the enterprises. Meetings are held with task forces to analyze the annual results points are allocated to the enterprises based on performance. Task force comprise of retired public/private sector senior executives and bureaucrats, it is the opinion of most of these members that these are futile exercises. All types of irrelevant questions and data are asked by the task force members based on half knowledge of the enterprise. Assessment of the enterprise by members of the task force who have no accountability does result in demoralization of the managers. There are well established norms for assessing the performance and competence of the managers. There is no need for an intermediary. Task Forces do not have the power to influence the efficiency of the ministries.

6. Conclusion

Experience from across the world and especially from the developed countries of the west has shown us that there can be no single model of corporate governance. Each company has its own peculiar balance of interests and power among its stakeholders and hence, the outcome depends much on how the powers among the contending parties are exercised and influenced. Thus, ideally the actual norms and procedures of corporate governance should be generated internally from within an organization. However, the guiding principles of corporate governance would have to be universal, especially in these days of globalization. This is not to overlook the fact that most legal structures of countries and institutions during the present times are geared to serve the interests of global capital. It is, therefore, also up to the individual countries to balance their own local needs and sovereignty in the face of sweeping globalization. Corporate governance rules, thus, face a set of dilemmas of balancing the individual needs of some common principles guiding the diverse particulars. The rules must also balance out among local need at the national level and the global needs of international capital.

While we admit that there can be no set of rules to completely eliminate the undesirable effects of bad corporate governance, we must also admit that there should be some semblance of institutionalization and normalization of corporate governance. There is thus a need for company Boards to increasingly adopt formal governance structures, well defined criteria to evaluate Board performance such as ratings, articulate clear decision making structures and also scientific methods to arbitrate power battles among the stakeholders like executives, management, shareholders and the society at large. The Boards need to develop informed and scientific risk management systems in order to be able to assess the company's strategic decisions. In an overall manner we may conclude that the issues of corporate governance of the public sector in India revolve around autonomy and the monitoring of that autonomy. The autonomy of the public sector paradoxically does not reduce the role of the government, rather increases it. The role of the government however changes from a supervisor and prime decision maker to that of a custodian of resources.

7. Acknowledgements

I would like to extend my heart-felt gratitude to Mr. Kaushik Kumar Bar who provided constant support during the compilation of this paper.

8. References

- [1] Geeta, Gouri. Public enterprise disinvestment and corporate governance: A conceptual framework. *ASCI Journal of Management*. March 1998, Vol (1&2).
- [2] Jha, R. and B.S. Sahni . ‘Measures of Efficiency in Private and Public Sector Industries: The Case of India’, *Annals of Public and Cooperative Economics*, 63(3):489-495, 1992
- [3] Reddy, Y. R. K. Corporate Challenges for Public Enterprises in India. *Corporate Governance Journal*, September 2004, Vol- 4.Issue no. 9.
- [4] [Reddy, Y. R. K. Corporate Governance and Public Enterprises: from heuristics to an action in the Indian context. *ASCI Journal of Management*. March 1998. Vol- 27 (1&2).
- [5] Sharma, R.C. and N. Sinha. “Frontier System and Estimation of Productive Efficiency in Intra- Industrial Private and Public Firms”, *The Journal of Institute of Public Enterprise*, XVIII (1-2): 27-35, 1995.
- [6] Aggarwal, M.D. & Mathur, B.L., *Public Enterprises in India*, Ramesh Book Depot, Jaipur, 1986.
- [7] Aggarwal, R.C., *State Enterprises in India*, Chaitanya Publishing House, Allahabad, 1961.
- [8] Banerji, *Handbook of Information on Public Enterprises*, 1970
- [9] Bhattachary K. Ashish, “Corporate Governance in Indian Public Sector Enterprises – Some Issues,” *Indian Journal of Public Enterprises*, Vol.16, No.29, Dec. 2000, pp. 1-7.
- [10] Bhaya, H.: ‘Management Efficiency in the Private and Public Sectors in India’ in J. Heath (ed.), *Public Enterprise at the Crossroads*, London: Routledge, 1990.