



Stock Exchanges and Corporate Governance in India: Challenges and the Way Forward

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ABSTRACT:

Stock exchanges become immensely important in corporate governance: they work as an intermediary between the company and the investor and try to enforce the regulatory framework that presumes transparency, accountability, and protection of shareholder's rights. Stock exchanges, earlier perceived only as trading platforms, saw an increase in the onus of their governance oversight with the evolution of financial markets. This article reviews the multidimensional role of stock exchanges in corporate governance. Specifically, the focus is on the regulatory role of a stock exchange: listing requirements, obligatory disclosure, and codes of corporate governance. It examines the way in which stock exchanges strengthen the accountability of the board, enhance financial transparency, and promote the efficiency of shareholder rights. This article goes further to discuss how technological advancement influences a stock exchange and, concurrently, corporate governance. The challenges faced by a stock exchange in enforcing standards of governance are put forward. The article concludes with the continuing need for evolution in governance practices that match emerging issues, including those dealing with ESG.

INTRODUCTION:

Corporate governance implies a mechanism or process by which companies are controlled and governed. Without a doubt, it provides a channel through which corporations can carry on their business with integrity, transparency, and accountability to the shareholders and other stakeholders. Stock exchanges are also part of such a corporate governance system as a regulated marketplace where securities are bought and sold. They not only act as a platform for raising capital but also as a locus of enforcement for standards of governance that build trust and ensure equity in financial markets¹.

This is reflected in how the stock exchanges have gradually evolved from no more than simple trading houses to complex regulatory bodies. In the wake of major corporate scandals and financial crises, such as the Enron case and Satyam, there has been a strong impetus towards improving governance standards. At the same time, stock exchanges have also entered the arena, putting in place strict listing requirements and codes related to corporate governance with a view to ensuring that listed companies conduct affairs with high standards and levels of transparency.

Stock exchanges are multifunctional in promoting corporate governance. They set listing requirements that companies should meet to be listed publicly, touching on elements that relate to the composition of the board, financial reporting, amongst others dealing with shareholders' rights. This means they institute a number of regulatory frameworks that enforce periodic disclosures and apply governance codes. For example, the New York Stock Exchange and the London Stock Exchange have come up with expanded versions of corporate governance standards that must be implemented by companies in order to sustain their listing status².

Apart from that, the protection of shareholder interest is also taken up by the stock exchanges through arrangements that offer opportunities for shareholder engagement and protection. They ensure that there is clear communication between companies and investors, and the shareholders are sufficiently informed about their rights. This is amply illustrated by the way SEBI has gone about laying out directives that make reporting more transparent and accountable in the case of companies listed on Indian stock exchanges.

The role of the stock exchanges in corporate governance has also been enhanced by the changes in technology. Electronic trading platforms, blockchain technology, among others, make their operations more efficient and transparent, hence giving greater breadth to the monitoring of corporate governance

¹ The Role of Stock Exchanges in Corporate Governance, Subin Abraham and M. Kannappan, Saveetha School of Law, Saveetha Institute of Medical and Technical Sciences, Saveetha University, International Journal of Pure and Applied Mathematics, available on <https://acadpubl.eu/hub/2018-119-17/1/89.pdf> last seen on 13/09/2024

² The Role of Stock Exchanges in Corporate Governance, Hans Christiansen, available on https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2384059

practices. Such technological advancement has reoriented the way financial transactions and shareholder communications flow, which gives added reason for better accountability and, therefore, better transparency in corporate governance.

MEANING OF STOCK EXCHANGE

A stock exchange is a controlled platform for exchanging securities, which includes stock, bonds, and derivatives. In the context of a financial system, it plays a vital role in maintaining a conduit through which companies can build capital and investors trade in such securities. It offers a platform wherein the feature of liquidity is made available, transparent transactions are made, and price discovery is organized.

KEY FUNCTIONS OF A STOCK EXCHANGE

1. Facilitates Trading:

The facilitation of efficient capital allocation is enabled because buyers are matched with their sellers, and there is orderly transfer of ownership. In such an efficient and organized atmosphere of stock exchange, the trades are executed at the prevalent fair market prices and at forces created by supply and demand dynamics.

2. Price Discovery:

It helps in the price discovery of the market through continuous trading. This is where the security price determination depends upon the judgments of different investors regarding the valuation of a company, based upon the reported financial performance and general prevailing market conditions.

3. Regulatory and Oversight Arrangements:

The stock exchanges ensure rules and regulations with a view to maintaining integrity in the market and safeguarding investors. They set requirements for the listing of a company, including standards on financial reporting, corporate governance, and disclosure. This supervisory mechanism prevents frauds and elemental injustices from occurring³.

4. Capital Formation:

Stock exchanges also provide a platform for companies to issue new shares as a source of capital formation. In this process, companies obtain funds for expansion, research, and development, while investors get opportunities to share in the growth and profits of these respective companies.

5. Transparency and Disclosure: Listed companies are to disclose relevant financial and operational information periodically. It is this transparency that shall enable investors to make informed decisions based on correct and updated information about the companies they invest in.

MAJOR STOCK EXCHANGES

1. New York Stock Exchange:

NYSE, headquartered in New York City, is the largest and one of the most renowned stock exchanges worldwide. The NYSE allows for trading in a range of securities from equities to derivatives.⁴

2. London Stock Exchange:

The London-based LSE is among the leading stock exchanges in the world with a global reputation for internationality and for the variety of securities listed on it. It hence plays a vital role in the global financial markets.

3. National Stock Exchange of India:

The NSE is among the leading exchanges in India. It enjoys wide recognition for the first completely automated electronic trading system and other 'firsts' in terms of market innovations. It provides a trading facility for equities, debt instruments, and derivatives.

³ Corporate Governance in Emerging Markets: A Survey by Stijn Claessens and Burcin Yurtoglu, available at:

https://dlwqtxts1xzle7.cloudfront.net/49018125/Corporate_Governance_in_Emerging_Markets_A_Survey-libre.pdf?1474483081=&response-content-disposition=inline%3B+filename%3DCorporate_Governance_in_Emerging_Markets.pdf&Expires=1726252074&Signature=EdAgxBMTzaSH45hiPrV-1zC639nt6OHwywkuXVhP3jpa22tVILQFcYU3n96336iW6b~O8phZH~mW8w7Ssye0-Mlu08Fb-qjI5AsQ3t8WvL2OBSf6pfiWj7THerAHUOaYeQr8xZOXyqWO1oQlyng2GOxw4U1c96fDXRh~0Jd4hpysQhD5dg3sZ0XFClBGO3W5Xgzj7lw74ZgWGZgA4DP39TN3gQ2IMT-Y1mEyLST6sFNtlkO3psAEQ-NVQrTMZ3WH9VpxFln5TnMnQYO669-m7q~YJZyaRQM4lQQ3zG-319epPud-0A2hxoAPHErxCl1yWcScpzFtTi7yhj3L957yw_&Key-Pair-Id=APKAJLOHF5GGSLRBV4ZA, last seen on 12/09/2024

⁴ The Indian Express, available at: <https://indianexpress.com/article/trending/top-10-listing/top-10-largest-global-stock-exchanges-in-2024-indias-nse-rank-9485985/>

4. Bombay Stock Exchange:

This is one of the oldest stock exchanges in Asia and India, initiated in 1875. This provides a platform for trading mainly in equity shares, bonds, and other securities derivations. It is also famous for its broad market index known as Sensex, which reflects the performance of the top 30 companies listed on this exchange.

MEANING OF CORPORATE GOVERNANCE:

Corporate governance is the system of laws, practices, and processes through which a company is directed and controlled. It involves the means by which shareholders, stakeholders, and the management interact with a view to ensuring accountability, fairness, and transparency in the operation of a company. The main elements flowing from this definition of corporate governance cover aspects such as the structure and functioning of the board, executive remuneration, shareholder protection, and transparency of accounts.

Effective corporate governance tends to align the interests of shareholders, management, and employees and protect against abuses and conflicts of interest. It is also concerned with providing clear policies and procedures concerning the manner in which decisions are taken and how its performance is measured and reported to the outside world. Good corporate governance will enhance a company's reputation and facilitate investor confidence, therefore making a vital contribution to its long-term success and sustainability.

HOW STOCK EXCHANGES ARE LINKED WITH CORPORATE GOVERNANCE:

Stock exchanges also play a very critical role in the promotion and enforcement of corporate governance practices. A stock exchange offers a formal framework where listed companies are bound to maintain certain standards of governance through regulatory compliances. Here's how the relationship between stock exchanges goes with corporate governance⁵:

1. Listing Requirements:

Stock exchanges set the requirements for listing to be traded on a stock exchange. Many of these requirements will relate to governance, such as the structure and composition of the board, including the number of independent directors, and other committee requirements, such as audit and compensation. In setting the standards, the stock exchanges make sure that the accountability and transparency at the companies listed on their exchanges are of a high quality standard.

2. Corporate Governance Codes:

Most stock exchanges have drawn up codes of corporate governance or best practice guidelines for listed companies. Typically these address such matters as the composition of the board, executive remuneration, risk management and shareholder rights. For example, the London Stock Exchange Corporate Governance Code guides the governance of UK-listed companies towards high standards of conduct and a proper degree of accountability.

3. Disclosure and Transparency:

The principle of disclosure and transparency demands that the stock exchanges request the listed companies to disclose the financial and operational results periodically. This is utterly important because such transparency helps in informed investment by investors. The regulator of the stock exchanges in India, the Securities and Exchange Board of India, implements such requirements so as to ensure that the investors have access to correct and timely information of the companies they invest in.

4. Regulatory Oversight:

Similarly, the stock exchanges' role is to monitor and enforce strict standards for governance. For enforcing good governance standards, there are powers granted to the Stock Exchanges to trigger disciplinary actions against companies which fail to comply with good governance requirements through fines or delisting. Regulatory oversight integrity financial markets maintain protection for investors.

5. Protection for Shareholders:

Stock exchanges have machinery that protects the rights of shareholders and introduces efficient shareholder involvement. They ensure that companies maintain practices that permit shareholders to vote on vital matters like board elections and major corporate decisions. In this manner, the protection helps to avoid abuses and an appearance of conflict of interest in aligning interests of the management with those of the shareholders⁶.

EVOLUTION OF STOCK EXCHANGES AND CORPORATE GOVERNANCE IN INDIA:

1. Early Development

⁵ Securities and Exchange Board of India (SEBI), SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015

⁶ Securities and Exchange Board of India (SEBI), SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015

The history of stock exchanges in India began during the late 19th century. The Bombay Stock Exchange was established in 1875 and was the oldest stock exchange in Asia. The BSE started operating as an area where the stock brokers used to gather and trade in the shares informally, but over time it got organized⁷.

2. Post-Independence Era

After the Independence of India in the year 1947, financial markets started to witness a number of changes. The Securities Contracts (Regulation) Act, 1956, was enacted for regulating transactions in securities and for the registration and regulation of stock exchanges. This act laid the foundation for a more organized and controlled stock market in India.

3. Liberalization and Technological Advancements

The Indian stock market reached its turning point with the decade of economic liberalization in the 1990s. This was followed by the constitution of the National Stock Exchange of India in 1992, with the introduction of electronic trading and modernizing the trading infrastructure. In comparison with the old open outcry system of the BSE, the electronic trading system of the NSE proved more efficient and effective for better market transparency.

4. Recent Developments

Over the last few years, both BSE and NSE have continued to evolve by integrating advanced trading technologies and development of their offering range. Furthermore, efforts to establish a derivatives market, commodity trading, and mutual fund trading platform have also been extended to advance India's infrastructure relating to stock markets.

EVOLUTION OF CORPORATE GOVERNANCE IN INDIA:

1. Initial Framework

In India, corporate governance was relatively at a low level in the early years of independence. In those days, much importance was not given to governance standards and all concentration was focused on economic growth and industrialization. However this scenario totally changed after some cases of corporate scandals and financial crises took place in late 1990s and early years of 2000.

2. Kumar Mangalam Birla Committee

The turning point for corporate governance in India came with the formation of the Kumar Mangalam Birla Committee in 1999. Its report, which has come to be called the "Report of the Committee on Corporate Governance," recommended a set of far-reaching reforms in board independence and disclosure. Its recommendations were factored into the listing agreements of stock exchanges and subsequently into the Companies Act, 2013⁸.

3. Companies Act, 2013

The Companies Act, 2013, was a complete makeover of the then-existing corporate governance laws in India. It introduced tight corporate governance laws: the mandatory appointment of independent directors, audit and nomination committees, and disclosure requirements, among other provisions. The Act aims at encouraging greater transparency, accountability, and protection for shareholders.

4. Role of SEBI

There has been active participation by the Securities and Exchange Board of India in the matters relating to corporate governance. The SEBI further introduced the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, which update and consolidate disclosure and governance requirements for listed companies. The guidelines with SEBI deal with various issues, such as corporate governance codes, insider trading, and enforcement mechanisms.

5. Recent Trends

On this count, the recent past has been replete with shrill emphasis on integrating Environmental, Social, and Governance considerations into practice amongst companies. SEBI has framed rules mandating listed entities to prepare and publish BRSR, which is a reflection of the larger thrust for sustainable and ethical businesses.

IMPACT OF TECHNOLOGY ON STOCK EXCHANGES AND CORPORATE GOVERNANCE:

The impact of technology upon stock exchanges and corporate governance is immense and multi-dimensional in nature, a reflection of the sea change the financial world has witnessed. Technology has brought about changes in the ways and means of working of the stock exchange, which has in turn brought about many changes in the way corporate governance works. These advances have heightened the efficiency and transparency with which stock exchanges

⁷ History and Milestones, BSE, available at: https://www.bseindia.com/static/about/History_Milestones.html

⁸ Corporate governance in India: A systematic review and synthesis for future research Faozi A. Almaqtari, Hamood Mohd. Al-Hattami, Khalid M. E. Al-Nuzaili and Mohammed A. Al-Bukhrani, Researchgate, available at: https://www.researchgate.net/publication/343765849_Corporate_governance_in_India_A_systematic_review_and_synthesis_for_future_research

function and are reshaping the dynamics of corporate governance itself. Rationale behind this includes easier access to critical information by shareholders, facilitation of securities trading at unparalleled speeds, and the ability to exercise governance rights in a far more effective manner⁹.

Examples include the use of blockchain technology as a new approach to facilitate better transparency in shareholder voting. By using the underlying technology behind blockchain technology, there is an unchangeable and transparent record of the vote; hence, decisions on behalf of the shareholders can be considerably better realized with a lower chance of fraud and manipulation. This increases investors' trust in addition to participating more in corporate governance. In the same vein, the electronic trading platform has democratized access to financial markets by enabling small retail investors to participate in an active and equitable manner. Such new access leverages the capacity of their shareholders to engage in governance mechanisms effectively, whereby they can vote with ease now on critical issues or attend virtual annual meetings and connect with the management over digital channels.

CHALLENGES OF STOCK EXCHANGES IN CORPORATE GOVERNANCE

1. Insufficient Disclosure and Transparency:

A lot of companies still do not disclose correctly and at the right time, though it is actually required under various regulations. Incomplete or misleading financial information defeats the investors' informed decision-making and impairs corporate governance frameworks.

2. Compliance Gaps:

While stock exchanges stipulate requirements on corporate governance, stringent adherence to such stipulations remains an issue. Some companies find ways of bypassing the set standards on governance, and the regulators might not have the machinery or mechanisms to ensure total and full compliance with regulations¹⁰.

3. Related Party Transactions and Conflict of Interest

Related-party transactions between a company and its directors or affiliates are commonly faced with governance issues like conflicts of interest, which are still rampant. Their decision-makers might also repeatedly serve personal interests rather than the best interests of their shareholders.

4. Insider Trading:

Insider trading is a major governance issue. Laws are strict, yet it is hard to detect and prove; this further erodes trust in stock exchanges and corporate governance mechanisms.

5. Board Independence

Independent boards are considered a strong foundation for good governance. Yet, most companies are failing at the task of creating truly independent boards with independent directors connected to the management due to which oversight is not effective.

6. Corporate Scandals and Frauds:

High-profile scandals regarding corporate practices in famous places like India, say about Satyam, exposed governance weaknesses and financial losses for investors. Such scandals damage the reputation of the stock exchanges and destroy the confidence reposed in them to exercise regulation over companies.

7. Poor Enforcement Structure:

There are regulatory frameworks. However, there is a weakness in their enforcement. If there is a violation of governance standards, there is delay in redressing it. Punitive actions are slow or inadequate and that's why the deterrence for companies which are not abiding by these norms is also weak.

8. Shareholder Activism:

While better shareholder activism can contribute to good corporate governance, it is generally insufficient in most countries, including India. Normally, institutional investors are not able to make a sufficiently strong impact on companies to ensure good corporate governance in their ownership.

WAY FORWARD

1. Strengthen Disclosure Norms:

Regulatory bodies should enforce better compliance with disclosure norms, and companies should develop a culture of transparency. The use of mandatory audits as well as real-time reporting, using technologies such as blockchain could enhance transparency.

⁹Impact of Technology on Stock Market, Sonal Kumar Singh, Quest Journals Journal of Research in Business and Management, <https://www.questjournals.org/jrbm/papers/vol12-issue4/1204264279.pdf>, last seen on 12/09/2024

¹⁰ The Role of Stock Exchanges in Corporate Governance, Subin Abraham and M. Kannappan, Saveetha School of Law, Saveetha Institute of Medical and Technical Sciences, Saveetha University, International Journal of Pure and Applied Mathematics, available on <https://acadpubl.eu/hub/2018-119-17/1/89.pdf> last seen on 13/09/2024

While SEBI and stock exchanges have a role to play in bringing these companies into the enforcement net, there is still much scope for further strengthening their mechanisms. Regular audits, surprise inspections, and use of technology for tracking corporate activities are some ways to move toward that end¹¹.

2. Promotion of Independent Boards:

That no less than half of the membership of the boards of listed companies be independent is indeed a good stipulation. Stock exchanges should go one step further in laying down more stringent rules regarding the appointment and functioning of independent directors. Independent directors should be genuinely independent and actively engaged in the decision-making process.

3. Encouragement of Long-term Approaches:

Companies need to be incentivized so that their focus shifts from short-term financial results to long-term strategic goals. Long-term performance incentives, including those affecting structures of executive compensation, could help achieve good corporate governance.

4. Combating Insider Trading:

For better detection and prevention of insider trading, stock exchanges and regulators should be investing in advanced technologies such as AI and data analytics. Severe penalties for violations could act as a deterrent¹².

5. Improving Shareholder Rights and Activism:

Encourage Greater involvement by institutional investors in governance. Good corporate citizenship requires not only better informational access but also mechanisms that enable or allow participation by shareholders in decision-making—quite a strengthening of their rights.

6. ESG Principles Adoption:

Companies should be made to integrate the application of ESG principles into the corporate governance framework. Stock exchanges may make it mandatory for listed companies to publish sustainability reports and ESG factors as part of better responsible governance.

7. Speedier and More Effective Enforcement:

Establish more effective enforcement mechanisms that can resolve cases of governance issues much quicker. Speeding up cases concerning corporate fraud or governance failure would ensure greater investor confidence in the stock market.

8. Awareness and Education:

Stock exchanges and regulators should promote investor education and awareness about corporate governance practices. Informed investors might prove to be an effective force for accountability in the event of governance failures.

CASE LAWS:

1. Sahara India Real Estate Corporation Limited & Ors. v. Securities and Exchange Board of India (SEBI) & Anr., (2012) 10 SCC 603

Facts: This case related to Sahara India, which raised funds from the public by issuing optionally fully convertible debentures in violation of SEBI regulations. SEBI initiated legal action against Sahara on grounds of non-issue of prospectus and failure to obtain listing, as mandated for a public offer¹³.

Ruling: The Supreme Court of India passed a final order, which pronounced Sahara guilty of infringing on the regulatory norms laid by SEBI. The court ordered Sahara to refund the entire amount it had garnered from investors along with interest and, in effect, underlined that companies raising funds from the public must be transparent and accountable and function within the full ambit of SEBI regulations.

Impact: This case highlighted the regulatory role of SEBI in enforcing standards on corporate governance in public fund raising and interest of investors. The judgment went to reinforce adherence to norms of disclosure and listing as provided for in the stock exchanges and the regulations of SEBI.

2. Tata Consultancy Services Ltd. v. Cyrus Investments Pvt. Ltd. & Ors., (2021) 9 SCC 225

Facts: The case involved the removal of Cyrus Mistry from the position of chairman in Tata Sons Ltd. and various disputes that were raised on the aspects of corporate governance practices, particularly on boardroom-related decisions, the rights of minority shareholders, and the role of independent directors¹⁴.

¹¹ The Role of Stock Exchanges in Corporate Governance, Subin Abraham and M. Kannappan, Saveetha School of Law, Saveetha Institute of Medical and Technical Sciences, Saveetha University, International Journal of Pure and Applied Mathematics, available on <https://acadpubl.eu/hub/2018-119-17/1/89.pdf> last seen on 13/09/2024

¹² THE LEGAL AND INSTITUTIONAL PRECONDITIONS FOR STRONG SECURITIES MARKETS Bernard S. Black, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=182169

¹³ Sahara India Real Estate Corporation Limited & Ors. v. Securities and Exchange Board of India (SEBI) & Anr., (2012) 10 SCC 603

¹⁴ Tata Consultancy Services Ltd. v. Cyrus Investments Pvt. Ltd. & Ors., (2021) 9 SCC 225

Decision: The Supreme Court maintained the removal of Cyrus Mistry and ruled in favor of Tata Sons. In this regard, it said there was no proof of oppression or mismanagement, as claimed on behalf of Mistry, while continuing to impress the need for transparent governance practices to protect minority shareholders.

Impact: This case brought out the increasing requirement of better corporate governance in the decisions of the boardroom and protection of minority shareholders, and strengthened the responsibility of companies listed on stock exchanges to ensure good governance practices in their internal operations.

3. SEBI v. Pyramid Saimira Theatre Limited, (2019) SCC OnLine SEBI 39

Facts: The SEBI has taken action against the Pyramid Saimira Theatre Limited for the fraud regarding corporates and manipulation of books of accounts. The case involved a fraudulent letter, which inflated the stock price of the company artificially, influencing the investor's decisions¹⁵.

Ruling: It also ordered that the company's promoters be debarred from accessing the securities market for several years and imposed penalties. The regulator also highlighted the responsibility of the company for ensuring compliance with the requirements of disclosure and maintaining ethical standards of corporate governance.

Impact: The case showed the power of SEBI and the trading powers in issues related to corporate fraud and breakdowns in corporate governance. It marked the need for proper financial reporting and investor confidence in a company whose shares are traded publicly.

CONCLUSION:

However, the role of stock exchanges in corporate governance is also very important in inducing transparency, accountability, and investor protection in the corporate sector. The BSE, NSE, and SEBI in terms of regulatory authority have played an important role in defining the standards for governance and enforcement of these standards. However, challenges such as lack of proper disclosure and insider trading, enforcement gaps, and weak mechanisms of enforcement detract from the effective implementation of governance frameworks.

These call for a multiple intervention strategy characterized by tougher oversight, espousal of independent boards, encouragement of long-term corporate policies, and utilization of technology to enhance transparency and catch governance lapses. Greater implications include the strengthening of shareholder rights, encouragement of institutional investor activism, and the embedding of ESG principles in corporate governance structures.

Therefore, strong governance frameworks must be followed by strict enforcement and a focus on sustainability in the long term to ensure that the Indian corporate governance system is set to conform with the best practices of the world. This would help the challenges for stock exchanges continue further on platforms for promoting ethical business practices and sustainable business practices of companies, investor trust enhancement, and subsequent growth of the economy.

¹⁵SEBI v. Pyramid Saimira Theatre Limited, (2019) SCC OnLine SEBI 39