Corporate Governance at its Core: A comparative Study of India & South Korea

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Abstract:
The 20th century saw massive growth in management thought, management theories, management gurus, and management teaching but importance was not shown for Corporate Governance. Now in the 21st century it is the time of Corporate Governance which is predominant in the modern era of business. Various corporate scandals which not only fatal to the particular company but also create danger to the whole economy have also infused the much needed term corporate governance in the rule books of business. Various economies follow their own different regimes of corporate governance according to their culture, environment etc. Asia is a very diverse region in terms of levels of economic development, institutional regimes and business environment. We also aim to analyze such variations between the two countries viz India & the other being South Korea. So this paper presents a picture of Comparative analysis of Corporate Governance framework, practices, rules and regulations of the two powerful economies, India and South Korea.

Keywords: Corporate governance, Governance framework, India, South Korea

1. Research Methodology
The research is based on the information collected from various secondary sources. Articles published in various leading journals, books, official websites of regulatory bodies of India and South Korea and of other development organizations like OECD and online materials have been referred to in conducting the study.

2. What is Corporate Governance?
The definitions of Corporate Governance have never been uniform. The term has been defined by many scholars, researchers, academicians, writers, and organizational body; however some of the best definitions are as follows:

The father of corporate governance Sir Adrian Cadbury defines corporate governance as “the system in which companies are directed and controlled”.1

The OECD provides the most authoritative functional definition of corporate governance: “Corporate governance is the system by which business corporations are directed and controlled”. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company’s objectives are set along with the means of attaining these objectives as well as for monitoring performance”.2

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1 Report of the committee on the Financial Aspects of Corporate Governance, given by Sir Adrian Cadbury
2 Taken from Organisation for Economic Co-operation and Development
3. Various Committees formed time to time on Corporate Governance
There are various committees formed with a view to reforming the Corporate Governance in India since 1990s. Some of the recommendations of these committees are highlighted below.

3.1 Confederation of Indian Industries (CII) set up a task force in 1995 under Rahul Bajaj
In 1998, the CII released the code called “Desirable Corporate Governance”. It looked into various aspects of Corporate Governance and was first to criticize nominee directors and suggested dilution of government stake in companies.

3.2 SEBI had set up a Commission under Kumar Mangalam Birla
This committee covered issues relating to protection of investor interest, promotion of transparency, building international standards in terms of disclosure of information.

3.3 The Department of Corporate Affairs constituted Naresh Chandra Committee in 2002
The committee talks extensively about the statutory auditor-company relationship, rotation of statutory audit firms/partners, procedure for appointment of auditors and determination of audit fees, true and fair statement of financial affairs of companies.

3.4 SEBI appointed Narayan Murthy Committee in 2002
Its report mainly focuses on and makes mandatory recommendations regarding responsibilities of audit committee, quality of financial disclosure, requiring boards to assess and disclose business risks in the company’s annual reports.

3.5 CLAUSE 49 of the listing agreement
SEBI has set out corporate governance provisions that are intended to drive in a minimum standard of corporate governance among listed companies in India. This is issued as a part of the Listing Agreement that each listed company signs with the stock exchange under the title ‘Clause 49’. Like corporate governance standards in the United States and the United Kingdom, India’s corporate governance reforms followed a fiduciary and agency cost model. With a focus on the agency model of corporate governance, the Clause 49 reforms included detailed rules regarding the role and structure of the corporate board and internal controls. The Clause 49 reforms were phased in over several years, applying at first to larger entities and eventually to smaller listed companies.  

4. Voluntary Guidelines issued by Ministry of Corporate Affairs
Voluntary Guidelines on Corporate Governance were issued by the Ministry of Corporate Affairs in December 2009.

4.1 The Companies Act 2013
The new Companies Act has replaced the old Companies Act, 1956. Some of the salient features of the Act which make Corporate Governance practises more efficient are:

1. Democracy of Shareholders: The new Act has introduced new concept of class action suit with a view of making shareholders and other stakeholders more informed and knowledgeable about their rights

2. Supremacy of Shareholders: The Companies Act 2013 focus and provide major aspect on approvals from shareholders on various significant transactions. The Government has rightly reduced the need for the companies to seek approvals to managerial remuneration and the shareholders have been vested with the power to sanction the limit.

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3 Kaushik, S.V., Kamboj, R., Study on the State of Corporate Governance in India, Gatekeepers of Corporate Governance – Securities and Exchange Board of India (SEBI).
3. **Strengthening Women Contributions through Board**: The Act states appointment of at least one woman Director on the Board of the prescribed class of Companies.

4. **Corporate Social Responsibility**: The Act stipulates certain class of Companies to spend a certain amount of money every year on Corporate Social Responsibility.

5. **Prohibition on forward dealings and insider trading**: The Act prohibits directors and key managerial personnel from purchasing call and put options of shares of the company, its holding company and its subsidiary and associate companies as if such person is reasonably expected to have access to price-sensitive information.

6. **Electronic Mode**: The Act proposed E-Governance for various company processes like maintenance, inspection of documents and option of keeping books of accounts in electronic form, financial statements to be placed on company's website, etc.

7. **Independent Directors**: The Companies Act 2013 provides that all listed companies should have at least one-third of the Board as independent directors. No independent director shall hold office for more than two consecutive terms of five years.

8. **Duties of Director defined**: Under the Companies Act 1956, a director had fiduciary duties. However, the Companies Act 2013 has now defined the duties of a director.

9. **Rotation of Auditors**: The Companies Act 2013 provides for rotation of auditors and audit firms in case of publicly traded companies.

10. **Auditors performing Non-Audit Services**: The Companies Act 2013 prohibits Auditors from performing non-audit services to the company where they are auditor to ensure independence and accountability of auditor.

5. **Corporate Governance in South Korea**
The Korean CG is dominated by the chaebol which can be defined as “... a business group consisting of large companies that are owned and managed by family members or relatives in many diversified business areas” (Yoo and Lee, 1987). Indeed it has been estimated that the top 30 chaebol accounted for about 30% of the Korea's GNP manufacturing sector and for about 35% of Korea's total shipments in 1990 (Yoo Seong-Min). Further, in 1992, the top 30 chaebols equalled about 80% of Korea's GDP. Although there has been no separation of ownership and control in the chaebol through dispersion of equity ownership and control in the chaebol, they have been indirectly influenced by the government due to their significant holdings of debt finance, as Korean banks have traditionally been under government influence.

6. **Various time to time Amendments in the aspects of Corporate Governance in South Korea**
Following the 1997 financial crisis, corporate governance reforms initiated by Korean government. In the past, the internally appointed board members tended to act as rubber stamps and failed to monitor the actions of the controlling shareholders. However, speedy economic growth without proper functioning of corporate governance could increase the vulnerability of the economy to external shocks, as evidenced by the 1997 crisis. The reforms include board’s monitoring function, along with other measures such as increasing management/CEO accountability, protecting shareholder rights, and improving managerial transparency and information disclosure. Inspired by the Sarbanes-Oxley Act of 2002 in the US, introduction of outside director(s) was a major feature of the changes to board regulation. There were two major waves of reforms in relation to board structure in Korea. The first wave was largely aimed at establishing a foundation for the introduction of an outside director system. The second wave sought mainly to legalize the requirement for the improvement of corporate governance, including the outside director system. In February 1998, the Listing Act was amended to require all listed firms excluding the Korean Securities Dealers Automated Quotations (KOSDAQ) to appoint at least one outside director and to ensure that no less than a quarter of their

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board members were outside directors by the time of the firm’s annual general meeting in 1999. The second wave of reforms included amendments to the Securities and Exchange Law in March 2001 and December 2003. These revisions stipulate by law the 1998 Listing Act’s requirement for outside directors (Art. 54.5) for all listed firms on both the Korea Exchange and the KOSDAQ (except for some venture capital companies). These 2001 and 2003 amendments, based on the recommendations in the September 1999 Principles of Standard Corporate Governance and the Code of Best Practice of Corporate Governance, require:

(i) Large listed corporations to establish an Audit Committee and an Appointment Committee under the BOD comprised mainly of outside directors. A large firm is defined as a firm with an asset size of 2 trillion won (approximately 2 billion US$) or more;
(ii) The 2001 amendment also requires that no fewer than half the board members of large firms should be outside directors; and
(iii) The 2003 amendments stipulate that large firms listed on the Korea Exchange and KOSDAQ should have at least three outside directors and at least half the positions on the board should be filled by outside directors.5

After the Financial crises there was much need for the better practises of the Corporate Governance. A Committee on Corporate Governance was founded as a in March 1999 to develop a code of best practices for establishing proper corporate governance structure. The contents of the Code consist of five sections and recommendations: Preamble, Shareholders, Board of Directors, Audit Systems, Stakeholders, and Management Monitoring by the Market. This Code applied to listed companies and other public companies and was strongly advised for non-public enterprises to also follow the Code to the extent applicable.

With a view to match the existing need the Committee was re-constituted. The Committee presented the revised code in 2003 which has attempted to harmonize the Code with the global standards and realities in the South Korean context.

9. Comparison of Corporate Governance of India and South Korea
There are as many different system of Corporate Governance as there are countries in the world (Solomon). Asia has a diverse range of economic, legal, and political systems. A noteworthy feature of many Asian companies is the presence of large business houses in which shareholding pattern is concentrated, some shareholders hold the large share of a company. India has one of the best Corporate Governance legal structures but poor implementation has affected corporate governance in the country. Even among large companies, shareholdings remain relatively concentrated with “promoters” and family business groups continuing to dominate the corporate sector. The corporate governance landscape has been changing very fast over the past decade; particularly with the enactment of Sarbanes-Oxley type measures in Clause 49 of the listing agreements, Voluntary Guidelines by Ministry of Corporate Affairs and legal changes like newly added Companies Act 2013 which emphasis on Good Governance practices. We are also seeing the rise of companies like INFOSYS that are free from the influence of a dominant family or group, and make the individual shareholder their central governance focus.

The Korean corporate sector has traditionally been characterized by family ownership; family management style; and control; and authoritarian management style; a broad range of business activities involving vertical and horizontal relationship and close integration with the Korean

5 Min, B., East Asia Forum Economics, Politics and Public Policy in East Asia and the Pacific.
Following the 1997-98 Asian financial crisis, South Korea made significant progress in reforming its financial institutions and capital markets. In addition, the Korean government took steps to strengthen its competitiveness, enacting measures to boost foreign investment incentives, allow non-Koreans to own land and real property, welcoming foreign investors to participate in the local economy, promoting labor flexibility and tightening the financial industry. Laws and regulations based on the Anglo American corporate governance model were introduced to increase corporate transparency and accountability and to align directors’ and shareholders’ interest, increased the levels of financial reporting and allowed minority shareholders to commence actions against the board.\textsuperscript{7}

The following tabular comparison of Corporate Governance of India and South Korea throw the lights on the major differences, issues and the regulating practices prevailing in these two Asian Giants.

<table>
<thead>
<tr>
<th>Basis of Comparison</th>
<th>India</th>
<th>South Korea</th>
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<tbody>
<tr>
<td><strong>1. The Company law</strong></td>
<td>The Companies Act 1956 replaced by The Companies Act 2013 having 29 Chapters, 470 Clauses and 7 Schedules</td>
<td>The Commercial Act 1963 having 5 parts and 998 articles in which part 3 is related to Company</td>
</tr>
</tbody>
</table>
| **2. The major laws and regulations that form the Corporate Governance framework and impact practices** | - The Companies Act 2013  
- The Securities and Exchange Board of India Act, 1992  
- Clause 49 of the Listing Agreement entered by listed companies with Stock Exchange  
- Institute of Chartered Accountants act 1949  
- Institute of Company Secretary Act, 1980  
- Banking Regulations Act, 1949 | - Commercial act 1963  
- The Securities & Exchange Act  
- The Stock Market Listing Regulation  
- The Stock Market Disclosure Regulations  
- The Regulation on Securities Issuance and Disclosure |
| **3. Major Organizations that Promote Improvement of Corporate Governance** | - Ministry of Corporate affairs  
- Securities of Exchange Board of India  
- Reserve Bank of India  
- Indian Chartered Accountants Institute  
- Institute of Companies Secretaries of India  
- National Foundation of Corporate Governance | - Ministry of Strategy and Finance(MOSF)  
- Financial Services Commission  
- Financial Supervisory Service  
- Fair Trade Commission  
- Korea Exchange  
- Securities Policy Division, Financial Policy Bureau, MOFE |
- Report of the Kumar Mangalam Birla Committee on Corporate governance February 2000  
- Draft Report of the Kumar Mangalam Committee on Corporate Governance September 1999  
- Code of Best Practices for Corporate Governance September 1999 |


\textsuperscript{7} Transplanting The Anglo American Corporate Governance Model Into Asian Countries: Prospects And Practicality.
| 5. Types of Companies | • public company  
• private company  
• One Person Company (private company)  
   A company formed under above three may be either:  
   - a company limited by shares; or  
   - a company limited by guarantee; or  
   - An unlimited company.  
• Partnership companies  
• limited partnership companies  
• stock companies  
• Limited liability companies. |
|---|---|
| 6. Ownership Structure | Concentrated family ownership in large conglomerates.  
Highly concentrated ownership in Chaebols. |
| 7. Independent Directors | (a) a minimum number of three directors in the case of a public company, two directors in the case of a private company, and one director in the case of a One Person Company; and  
(b) a maximum of fifteen directors:  
Provided that a company may appoint more than fifteen directors after passing a special resolution.  
Provided further that such class or classes of companies as may be prescribed shall have at least one woman director.  
The number of outside directors should be a minimum of two, so that the Board is able to maintain practical independence.  
Particularly, in the case of large listed corporations, it is recommended that half of its directors be composed of outside directors (minimum of three outside directors).  
However, a large listed controlled company of which more than 50% of the voting power is held by an individual, a group or another company (refers to a company of which more than 50% of voting power is held by individuals or a group.), does not need to have a majority of its board composed of outside directors. |
| 8. Woman contribution through Board room | The Companies Act 2013 has clearly specified that at least one woman director in prescribed class of companies.  
No rule regarding representation of woman in Board room. |
| 9. Managerial Remuneration | The total managerial remuneration payable by a public company, to its directors, including managing director and whole-time director, and its manager in respect of any financial year shall not exceed eleven per cent of the net profits of the company for that financial year.  
Except that the remuneration of the directors shall not be deducted from the gross profits:  
Further the remuneration payable to directors who are neither managing directors nor whole-time directors shall not exceed—  
(a) one per cent of the net profits of the company, if there is a managing or whole-time director or manager;  
(b) three per cent of the net profits in any other case.  
If the amount of remuneration to be received by directors has not been determined by the articles of incorporation, it shall be determined by a resolution at a general shareholders' meeting.  
(So, not specifically mentioned in codes or their commercial act) |
| 10. Voting Rights | a) on a show of hands, every member present in person shall have one vote; and  
b) on a poll, the voting rights of members shall be in proportion to his share in the paid-up equity share capital of the  
(a) Each bondholder shall have one vote for each minimum face amount of the bonds.  
(b) The holder of bearer bond certificates may not exercise his voting rights unless he has deposited his bond certificates at least |
A member may exercise his vote at a meeting by electronic means in accordance to prescribed section and shall vote only once.

(a) In the case of joint holders, the vote of the senior who tenders a vote, whether in person or by proxy, shall be accepted to the exclusion of the votes of the other joint holders.

A member of unsound mind, or in respect of whom an order has been made by any court having jurisdiction in lunacy, may vote, whether on a show of hands or on a poll, by his committee or other legal guardian.

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1. **Democracy of shareholders**

The Companies Act 2013 has introduced new concept of Class Action Suit with a view of making shareholders and other stakeholders, more informed and knowledgeable about their rights.

While South Korea was having this rule under Korea's 2005 Securities Class Action Act. In which minority shareholders are able to file class action suits for manipulation of share prices, false disclosure of information, and accounting malpractice. However, in large part due to rather stringent and complex procedural requirements, only one class-action suit has been filed since the law came into effect.

2. **Audit Committee**

The Board of Directors of every listed company and such other class or classes of companies, as may be prescribed, shall constitute an Audit Committee.

The Audit Committee shall consist of a minimum of three directors with independent directors forming a majority. Every Audit Committee shall act in accordance with the terms of reference specified in writing by the Board which shall, inter alia, include,—

- the recommendation for appointment, remuneration and terms of appointment of auditors of the company; review and monitor the auditor’s independence and performance, and effectiveness of audit process;
- examination of the financial statement and the auditors’ report thereon; approval or any subsequent modification of transactions of the company with related parties; scrutiny of inter-corporate loans and investments; valuation of undertakings or assets of the company, wherever it is necessary; evaluation of internal financial controls and risk management systems; monitoring the end use of funds raised through public offers and related matters.

It is desirable that the Board of listed corporations, government-invested institutions and financial institutions establish an audit committee as a board committee. A corporation, which has established an audit committee, should not employ auditors. The audit committee shall consist of not less than three directors: Provided, That persons falling under any of the following subparagraphs shall not exceed 1/3 of the total members of the committee—

- Any director or employee in the active service of the company or any person who was a director or employee thereof within the period of two years before the date of appointment as a member of the committee;
- In case the largest shareholder of the company is an individual, the individual himself, his spouse, his lineal ascendants or descendants;
- In case the largest shareholder is a corporation, any director, auditor or employee of the corporation;
- Spouse of any director of the company, his lineal ascendants or descendants;
- Any director, auditor or employee in the service of the parent or a subsidiary company with—
  - which the company is affiliated;
  - Any director, auditor or employee of a corporation which has an important interest.
Corporate Social Responsibility

The Companies Act 2013 has introduced the idea of CSR to the forefront and through its disclose-or-explain mandate, is promoting greater transparency and disclosure. Companies Act’ 2013 requires companies having net worth of at least Rs 500 crore or having minimum turnover of Rs1,000 crore or those with at least net profit of Rs 5 crore to spend at least 2% of their three-year average annual net profit towards CSR activities. There is no penalty for not spending such an amount, but explanation for non compliance is sought in the Board’s Report.

To defend themselves in the short term from intense political pressure, therefore, businesses have boosted their CSR budgets with funds previously allocated to political donations.

FKI has established a CSR committee responsible for monitoring member companies’ economic responsibility, legal responsibility, moral responsibility and social responsibility. It also now put considerable effort into reporting on the CSR activities of Korean corporations.

Comparison of India and South Korea according to Asian corporate governance association

<table>
<thead>
<tr>
<th>Country</th>
<th>India</th>
<th>South Korea</th>
</tr>
</thead>
<tbody>
<tr>
<td>Over all Rank</td>
<td>7th Rank in ASIA</td>
<td>8th Rank in ASIA</td>
</tr>
<tr>
<td>Corporate governance watch market scores in total</td>
<td>51</td>
<td>49</td>
</tr>
<tr>
<td>Corporate governance rules and practices</td>
<td>49</td>
<td>43</td>
</tr>
<tr>
<td>Enforcement</td>
<td>42</td>
<td>39</td>
</tr>
<tr>
<td>Political and regularity</td>
<td>56</td>
<td>56</td>
</tr>
<tr>
<td>IGAAP</td>
<td>63</td>
<td>75</td>
</tr>
<tr>
<td>Corporate governance culture</td>
<td>43</td>
<td>34</td>
</tr>
</tbody>
</table>


10. Conclusion

The term Corporate Governance has gained importance in last one or two decades in the economic policy of every country. Corporate scandals have also infused much contribution to the evolution of the new theories and practices of Corporate Governance. Now its existence is greatly felt in organization, the business organizations which have followed good corporate governance practices have found their share of success like Infosys in India and Samsung in South Korea. There are many differences between corporate Governance of India and South Korea but there are similarities too. Both the countries are following Anglo-American model of Corporate Governance, the ownership structure is also not much different, where in India there is concentrated ownership pattern and in South Korea also the ownership pattern is highly concentrated in chaebols and both the countries follow unitary structural board. India is a developing country with lower middle income category while South Korea got the status of a developed economy with high income category. With the introduction of at least one woman in the board, India is strengthening woman contribution in corporate world whereas there is no such rule in South Korea. Companies Act 2013 also emphasised on whistle blowing mechanism and for mandatory provisions of Corporate Social responsibility. In the case of Corporate Governance both the economies are going head to head, according to Asian Corporate Governance Association, India is on 7th rank whereas South Korea is on 8th rank.

Although India is noted for bureaucracy and corruption, its corporations are making progress in the area of corporate governance. The market provides incentives to improve and to compete in practically every area of economic activity, including the realm of corporate governance. Those who do not clean up their act will be left behind as corporations in other countries improve their corporate governance practices.9

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9 Ibid