



CORPORATE GOVERNANCE IN INDIA: AN OVERVIEW

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ABSTRACT

While recent high-profile corporate governance failures in developed countries have brought the subject to media attention, the issue has always been central to finance and economics. The issue is particularly important for developing countries since it is central to financial and economic development. Recent research has established that financial development is largely dependent on investor protection in a country – de jure and de facto. With the legacy of the English legal system, India has one of the best corporate governance laws but poor implementation together with socialistic policies of the pre-reform era has affected corporate governance. Concentrated ownership of shares, pyramiding and tunneling of funds among group companies mark the Indian corporate landscape. Boards of directors have frequently been silent spectators with the DFI nominee directors unable or unwilling to carry out their monitoring functions. Since liberalization, however, serious efforts have been directed at overhauling the system with the SEBI instituting the Clause 49 of the Listing Agreements dealing with corporate governance. Corporate governance of Indian banks is also undergoing a process of change with a move towards more market-based governance.

Key words: corporate governance, development, enforcement, SEBI

INTRODUCTION:

“Corporate Governance is essentially about leadership; leadership for efficiency in order for companies to compete effectively in the global economy, and thereby create jobs; leadership for probity because investors require confidence and assurance that the management of a company will behave honestly and with integrity in regard to their shareholders and others; leadership with responsibility as companies are increasingly called upon to address legitimate social concerns relating to their activities; and , leadership that is both transparent and accountable because otherwise business leaders cannot be trusted and this will lead to the decline of companies and the ultimate demise of a country’s economy.”¹“Corporate governance is concerned with ways of bringing the interests of investors and manager into line and ensuring that firms are run for the benefit of investors”.²“Corporate governance includes ‘the structures, processes, cultures and systems that engender the successful operation of organizations’”.³The corporate governance ensures the accountability of certain individuals in an organisation through mechanisms that try to reduce or eliminate the principle-agent problem. It focuses on the economic efficiency, with a strong emphasis on shareholders’ welfare. The history of the development of India Corporate Laws has been marked by interesting contrast (Goswami, 2002). In terms of Corporate Laws and financial system, therefore, India emerged far better endowed than most other colonies. The 1956 Companies Act as well as other Laws governing the functioning of joint-stock companies and protecting the investors’ right built on this foundation.

The beginning of corporate developments in India were marked by the managing agency system that contributed to the birth of dispersed equity ownership but also gave rise to the practice of management enjoying control rights disproportionately greater than their stock ownership. The turn towards socialism in the decades after independence marked by the 1951 Industries (Development and Regulation) Act as well as the 1956 Industrial Policy Resolution put in place a regime and culture of licensing, protection and widespread red-tape that bred corruption and stilted the growth of the corporate sector.⁴ While the Companies Act provides clear instructions for maintaining and updating share registers, in reality minority shareholders have often suffered from irregularities in share transfers and registrations – deliberate or unintentional. Sometimes non-voting preferential shares have been used by promoters to channel funds and deprive minority shareholders of their dues. Minority shareholders have sometimes been defrauded by the management undertaking clandestine side deals with the acquirers in the relatively scarce event of corporate takeovers and mergers. Boards of directors have been largely ineffective in India in monitoring the actions of management. They are routinely packed with friends and allies of the promoters and managers, in flagrant violation of the spirit of corporate law. The nominee directors from the DFIs, who could

¹ Mervyn King, King Report on Corporate Governance for South Africa [King II Report] [Parktown, South Africa: Institute of Directors in Southern Africa, 2002] p.18

² F. Mayer (1997), ‘Corporate governance, competition, and performance’, In Enterprise and Community: New Directions in Corporate Governance, S. Deakin and A. Hughes (Eds), Blackwell Publishers: Oxford.

³ K. Keasey, S. Thompson and M. Wright (1997), ‘Introduction: The corporate governance problem - competing diagnoses and solutions,’ In K. Keasey, S. Thompson and M. Wright, Corporate Governance: Economic, Management, and Financial Issues. Oxford University Press: Oxford.

⁴ Chakrabarti, Rajesh. Corporate Governance in India – Evolution and Challenges

and should have played a particularly important role, have usually been incompetent or unwilling to step up to the act. Consequently, the boards of directors have largely functioned as rubber stamps of the management. For most of the post-Independence era the Indian equity markets were not liquid or sophisticated enough to exert effective control over the companies. Listing requirements of exchanges enforced some transparency, but non-compliance was neither rare nor acted upon. All in all therefore, minority shareholders and creditors in India remained effectively unprotected in spite of a plethora of laws in the books.

OBJECTIVES OF CORPORATE GOVERNANCE:

The development of corporate governance concept is naturally and essentially related to the “objectives of corporate governance”.⁵ Good governance is integral to the very existence of a company. It inspires and strengthens investor’s confidence by ensuring company’s commitment to higher growth and profits. It seeks to achieve following objectives: i. That a properly structured Board capable of taking independent and objective decisions is in place at the helm of affairs; ii. That the Board is balanced as regards the representation of adequate number of nonexecutive and independent directors who will take care of the interests and wellbeing of all the stakeholders; iii. That the Board adopts transparent procedures and practices and arrives at decisions on the strength of adequate information; iv. That the Board has an effective machinery to sub-serve the concerns of stakeholders; v. That the Board keeps the shareholders informed of relevant developments impacting the company; vi. That the Board effectively and regularly monitors the functioning of the management team; and vii. That the Board remains in effective control of the affairs of the company at all times. The overall endeavour of the Board should be to take the organisation forward, to maximise long-term value and shareholders’ wealth.”

DEVELOPMENTS IN INDIA:

On account of the interest generated by Cadbury Committee Report and also in the wake of Government initiatives to respond to corporate developments world over, the following major developments have taken place:

- i. The Confederation of Indian Industries (CII), the Associated Chambers of Commerce and Industry and the Securities and Exchange Board of India constituted committees to recommend initiatives in corporate governance. The CII, in 1996, took a special initiative on corporate governance. It was the first institutional initiative in Indian industry. The objective being to develop a code for corporate governance to be adopted by the Indian companies (private sector, the public sector, banks and financial institutions which are corporate entities), a code by CII carrying the title “Desirable Corporate Governance” was released.
- ii. The SEBI appointed committee, known as the Kumar Mangalam Birla Committee’s recommendations led to the addition of Clause 49 in the Listing Agreement. Compliance of provisions of Clause 49 was largely made mandatory by listed companies. The committee recommended that there

⁵ Corporate Governance Reporting (Model formats) by ICSI 2003.

should be a separate section on corporate governance in the Annual Report of companies. This section was required to detail the steps taken to comply with the recommendations of the committee and thus inform the shareholders of specific initiatives taken to ensure corporate governance. The committee accorded recognition to the three vital aspects of corporate governance, namely accountability, transparency and equality of treatment for all stakeholders.

- iii. The Department of Company Affairs (DCA) appointed a study group on 15.5.2000 under the Chairmanship of the then Secretary DCA to suggest ways and means of achieving corporate governance. The study group appointed a task force. The study group recommended the setting up of an independent, autonomous centre for corporate excellence with a view to accord accreditation and promote policy research and studies, training and education and awards etc., in the field of corporate excellence through improved corporate governance. It favoured greater shareholders' participation, formal recognition of corporate social responsibility, non-executive directors being charged with strategic and oversight responsibilities, minimisation of interest–conflict potential, and also suggested application of corporate governance principles to public sector.
- iv. The Department of Company Affairs also constituted on August 21, 2002 a high level committee, popularly known as Naresh Chandra Committee, to examine various corporate governance issues and to recommend changes in the diverse areas such as the statutory auditor-company relationship, rotation of statutory auditors, procedure for appointment and determination of audit fees, restrictions if necessary on non-audit fees, independence of auditing functions, ensuring presentation of 'true and fair' statement of the financial affairs of companies, certification of financial statements and accounts, regulation of oversight functionaries, setting up an independent regulator and the role of independent directors. The committee has made very significant recommendations for changes inter alia, in the Companies Act.
- v. Yet another major development includes the constitution of a committee by SEBI under the Chairmanship of Shri N.R. Narayana Murthy, for reviewing the implementation of corporate governance code by listed companies. The mandatory recommendations of the committee on various matters are detailed in the Annexure.
- vi. The Department of Company Affairs also has set up a proactive standing company law advisory committee to advise on issues like inspection of corporates for wrong doings, role of independent directors and auditors and their liability, suggesting steps to enhance imposition of penalties. A High powered Central Coordination and Monitoring Committee (CCMC) co-chaired by Secretary DCA and Chairman SEBI was also set up to monitor action against vanishing companies and unscrupulous promoters, who misused funds raised from public.

SEBI has also undertaken a project for development of a comprehensive instrument by a reputed rating agency for rating the good corporate governance practices of listed companies.

ENFORCEMENT OF CORPORATE GOVERNANCE IN INDIA:

1) The Companies Act Companies in our country are regulated by the Companies Act, 2013, as amended up to date. The companies Act is one of the biggest legislation in India. The arms of the Act are quite long and touch every aspect of a company's insistence. But to ensure corporate governance, the Act confers legal rights to shareholders to i. Vote on every resolution placed before an annual general meeting; ii. To elect directors who are responsible for specifying objectives and laying down policies; iii. Determine remuneration of directors and the CEO; iv. Removal of directors and v. Take active part in the annual general meetings.

2) The Securities and Exchange Board of India (SEBI) The primary securities law in our country is the SEBI Act. Since its setting up in 1992, the board has taken a number of initiatives towards investor protection. One such initiative is to mandate information disclosure both in prospectus and in annual accounts. While the companies Act itself mandates certain standards of information disclosure, SEBI Act has added substantially to these requirements in an attempt to make these documents more meaningful. The main objective of SEBI regulation is shareholder value maximization by putting corporate governance structures in place and through the reduction of information asymmetry between the managers and the investors of the company. Jensen (2000) also argues in favour of shareholder wealth maximization as the main objective function of any company.

3) The Reserve Bank of India (RBI) The RBI, established in 1935, is the central bank of India and is entrusted with monetary stability, currency management and supervision of the financial and payments systems. Its functions and focus have evolved in response to India's changing economic environment. It acts as the banker to the state and national governments, the lender of last resort and the controller of the country's money supply and foreign exchange. The RBI supervises the operations of all banks and NBFCs in the country. It is responsible for monetary policy, setting benchmark interest rates, managing the treasury operations (both borrowings and redemption) for the government and as custodian and controller of the foreign exchange reserves.

4) Criminal Actions Under The Indian Penal Code The Indian Penal Code (IPC) provides a number of provisions under which governance related matters can be addressed. These include criminal breach of trust (section 406) and cheating (section 420).⁶ Although these provisions do not target core governance concerns, they are sometimes used to address these concerns (Khanna & Mathew, 2010). However conviction rates are not terribly high (a concern found in many areas of the IPC and related criminal provisions) and hence the deterrent effect of these provisions is likely to be attenuated (Debroy & Singh, 2009; Khanna 2010). Nonetheless the power to arrest is ubiquitous even if convictions are not. This particular equilibrium (easy

⁶ For details, see *Tristar Consultants v. Vcustomer Services*, AIR 2007 Delhi 157; *Nanalal Zaver v. Bombay Life Assurance*, AIR 1950 SC 172

arrest and difficult convictions) is troubling on multiple levels and is a matter that needs to be addressed before criminal laws can be used effectively in this area (Khanna 2010a; Khanna & Mathew 2010).

OECD PRINCIPLES ON CORPORATE GOVERNANCE⁷: OECD, in its endeavour to improve the governance practices, had published its revised principles on Corporate Governance in 2002. The OECD Principles of Corporate Governance have since become an international benchmark for policy makers, investors, corporations and other stakeholders worldwide. They have advanced the corporate governance agenda and provided specific guidance for legislative and regulatory initiatives in both member and non-member countries. The Financial Stability Forum has designated the Principles as one of the 12 key standards for sound financial systems. OECD Principles on Corporate Governance are as follows:

- i. Principle I: Ensuring the Basis for an Effective Corporate Governance Framework The corporate governance framework a) should promote transparent and efficient markets, b) be consistent with the rule of law and c) clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities
 - ii. Principle II: The Rights of Shareholders and Key Ownership Functions protected and facilitated a) protect and facilitate the exercise of shareholders' rights
 - iii. Principle III: The Equitable Treatment of Shareholders a) Should ensure the equitable treatment of all shareholders, b) opportunity to obtain effective redress for violation of their rights
 - iv. Principle IV: The Role of Stakeholders in Corporate Governance- recognized a) should recognise the rights of stakeholders, b) encourage co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of enterprises
 - v. Principle V: Disclosure and Transparency a) Timely and accurate disclosure is made on all material matters including the financial situation, performance, ownership, and governance of the company.
 - vi. Principle VI: The Responsibilities of the Board-Monitoring Management and Accountability to Shareholders a) should ensure the strategic guidance of the company, b) the effective monitoring of management by the board, and c) the board's accountability to the company and the shareholders
- Indian Corporate Governance Framework is in compliance with the Corporate Governance principles of OECD. OECD steering committee on corporate governance reviews the principles and its compliance by member and non-member countries by conducting regular thematic peer review of member and non-member countries.

VOLUNTARY GUIDELINES ISSUED BY MINISTRY OF CORPORATE AFFAIRS⁸ Voluntary Guidelines on Corporate Governance were issued by the Ministry of Corporate Affairs in December 2009. Few guidelines are worth mentioning.

⁷ Principles of Corporate Governance : A report by OECD Task Force on Corporate Governance. (1999)

⁸ Report of the CII Taskforce on Corporate Governance Chaired by Mr. Naresh Chandra (November 2009)

1. Board of Directors A. Appointment of Directors i. Companies should issue formal letters of appointment to Non-Executive Directors (NEDs) and Independent Directors as is done by them while appointing employees and Executive Directors. Such a formal letter should form a part of the disclosure to shareholders at the time of the ratification of his/her appointment or re-appointment to the Board. ii. The offices of chairman of the board and chief executive officer should be separate. iii. The companies may have a Nomination Committee comprised of a majority of Independent Directors, including its Chairman. A separate section in the Annual Report should outline the guidelines being followed by the Nomination Committee and the role and work done by it during the year under consideration.
- ii. The companies should also provide for adequate safeguards against victimization of employees who avail of the mechanism, and also allow direct access to the Audit Committee Chairperson in exceptional cases.

RECENT POLICY TAKEN BY SEBI⁹ The introspection that followed the Satyam episode has resulted in some major changes in Indian corporate governance regime. Some of the recent steps taken in this regard are as follows:

1. Disclosure of pledged shares: It is made mandatory on the part of promoters (including promoter group) to disclose the details of pledge of shares held by them in listed entities promoted by them. Further, it was decided to make such disclosures both event-based and periodic.
2. Peer review: In the light of developments with respect to Satyam SEBI carried out a peer review exercise of the working papers (relating to financial statements of listed entities) of auditors in respect of the companies constituting the NSE – Nifty 50, the BSE Sensex and some listed companies outside the Sensex and Nifty chosen on a random basis.
3. Disclosures regarding agreements with the media companies: In order to ensure public dissemination of details of agreements entered into by corporates with media companies, the listed entities are required to disclose details of such agreements on their websites and also notify the stock exchange of the same for public dissemination.
4. Maintenance of website: In order to ensure/enhance public dissemination of all basic information about the listed entity, listed entities are mandated to maintain a functional website that contains certain basic information about them, duly updated for all statutory filings, including agreements entered into with media companies, if any.
5. Compulsory dematerialization of Promoter holdings: In order to improve transparency in the dealings of shares by promoters including pledge / usage as collateral, it is decided that the securities of companies shall be traded in the normal segment of the exchange if and only if, the company has achieved 100% of promoter's and promoter group's shareholding in dematerialized form. In all cases, wherein the

⁹ Securities and Exchange Board of India (2002) Report on SEBI Committee on Corporate Governance (under the chairmanship of Shri N R Narayanamurthy)

companies do not satisfy the above criteria, the trading in securities of such companies shall take place in trade for trade segment;

6. Peer reviewed Auditor: It has been decided that in respect of all listed entities, limited review/statutory audit reports submitted to the concerned stock exchanges shall be given only by those auditors who have subjected themselves to the peer review process of ICAI and who hold a valid certificate issued by the 'Peer Review Board' of the said Institute;

7. Approval of appointment of 'CFO' by the Audit Committee: In order to ensure that the CFO has adequate accounting and financial management expertise to review and certify the financial statements, it is mandated that the appointment of the CFO shall be approved by the Audit Committee before finalization of the same by the management. The Audit Committee, while approving the appointment, shall assess the qualifications, experience & background etc. of the candidate

8. Disclosure of voting results: In order to ensure wider dissemination of information regarding voting patterns which gives a better picture of how the meetings are conducted and how the different categories of investors have voted on a resolution, listed entities are required to disclose the voting results/ patterns on their websites and to the exchanges within 48 hours from the conclusion of the concerned shareholders' meeting.

9. Enabling shareholders to electronically cast their vote: In order to enable wider participation of shareholders in important proposals, listed companies are mandated to enable e-voting facility also to their shareholders, in respect of those businesses which are transacted through postal ballot by the listed companies.

10. Manner of dealing audit reports filed by listed entities: SEBI board has approved a mechanism to process qualified annual audit reports filed by the listed entities with stock exchanges and Annual Audit Reports where accounting irregularities have been pointed out by Financial Reporting Review Board of the Institute of Chartered Accountants.

CONCLUSION: With the recent spate of corporate scandals and the subsequent interest in corporate governance, a plethora of corporate governance norms and standards have sprouted around the globe. The Sarbanes-Oxley legislation in the USA, the Cadbury Committee recommendations for European companies and the OECD principles of corporate governance are perhaps the best known among these. But developing countries have not fallen behind either. Well over a hundred different codes and norms have been identified in recent surveys and their number is steadily increasing.

India has been no exception to the rule. Several committees and groups have looked into this issue that undoubtedly deserves all the attention it can get. In the last few years the thinking on the topic in India has gradually crystallized into the development of norms for listed companies. The problem for private companies, that form a vast majority of Indian corporate entities, remains largely unaddressed. The agency problem is likely to be less marked there as ownership and control are generally not separated.

Minority shareholder exploitation, however, can very well be an important issue in many cases. Development of norms and guidelines are an important first step in a serious effort to improve corporate governance. The bigger challenge in India, however, lies in the proper implementation of those rules at the ground level. More and more it appears that outside agencies like analysts and stock markets (particularly foreign markets for companies making GDR issues) have the most influence on the actions of managers in the leading companies of the country. But their influence is restricted to the few top (albeit largest) companies. More needs to be done to ensure adequate corporate governance in the average Indian company. Even the most prudent norms can be hoodwinked in a system plagued with widespread corruption. Nevertheless, with industry organizations and chambers of commerce themselves pushing for an improved corporate governance system, the future of corporate governance in India promises to be distinctly better than the past.

