CHAPTER- VII

CONCLUSION AND SUGGESTIONS

The term “Corporate Governance” is gaining momentum in today’s business and corporate world. The changes in the corporate structure were because of lack of management’s responsibility not only towards shareholders, but also towards society at large.\(^1\) In recent times a corporation is considered a social institution, interacting with the society in many ways and affecting its individuals. The major concern of all conscious citizens i.e. shareholders, employees, creditors, customers and government should be to govern this institution in a rational manner\(^2\). Besides, corporate governance is mostly related with the systems and processes that undertake to enhance shareholder’s investment and help the preservation of all public listed companies.

Chapter I highlights the research design, importance and various manifestations of corporate governance with special emphasis on corporate governance in India. The legal framework relating to corporate governance has been analysed.

The corporate governance system also involves the entire network of formal and informal relations and interactions between the board, management, shareholders, auditors, and other interested parties. These relations and interactions determine how a company is controlled and how risks and returns from corporate activities are determined.\(^3\) In short, ‘Corporate governance’ is the system by which company is directed, administered and controlled through a set of corporate processes, customs, policies and law. It is a congregation of various stakeholders, namely, customers, employees, investors, vendor partners, government and society. The term ‘Corporate governance’ denotes the entire process by which corporations are managed and controlled. It is the set of processes, customs, policies, laws and institutions by which corporation are

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\(^1\) Indrajit Dube, *Corporate Governance* 4 (Lexis Nexis Butterworths Wadhwa, New Delhi, 2009).
tors+responsibility.pdf) (Visited on November 13, 2013).
\(^3\) Ibid.
directed, administered and controlled. It also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance of the company are determined. It involves regulatory and market mechanism, and the roles and relationships between a company’s management, its board, its shareholders and other stakeholders.\(^4\)

Although instituting corporate governance is clearly very beneficial for firms and countries, the rapid pace of globalization has made the need more urgent which requires that the firms and national governments make some fundamental changes. Companies must change the way they operate, while national governments must establish and maintain the appropriate institutional framework. What corporate governance is all about in larger terms is how a structure can be set up that allows for a considerable amount of freedom within the rule of law.\(^5\)

Public attention through high profile corporate scandals and collapses has forced governments, regulators and boards of corporations to carefully reconsider fundamental issues of corporate governance as essential for public economic interest. In addition, the volatility and instability experienced in emerging markets in recent times has drawn attention to the implications of corrupt practices and maladministration in national and international financial systems and on public expenditure. Good corporate governance practices are now becoming a necessity for every country and business enterprise, and are no longer restricted to the activities of public-listed corporations in advanced industrial economies.\(^6\)

It is clearly evident that inefficient management practices led to several financial crisis and business collapses around the world. These business failures forced the business world to think and stress upon the significance of sound concept of corporate management practices. The issue sighted serious consideration among the various professional bodies and makers of laws and regulations at international level and they considered the quality of corporate governance practices equally significant for decision making. Recently it was noticed that global investors have realized the significance of corporate

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governance practices on the financial performance of companies and also realized that the issue of corporate governance bears more importance while adopting investment decisions. It is also true that the investors are ready to pay higher premiums for companies having sound corporate governance practices. There are various advantages which can be reaped by companies of any nation through sound corporate governance framework. An effective and sound corporate governance policy in practice helps the companies to raise cheaper fund at low cost of capital, enhances financial soundness and liquidity position, provides capabilities to overcome and prevent any financial collapses and also improves the standing in the capital market. It also helps in improving country’s image and reputation by prevention of outflow of funds and increase in foreign capital flow. It also leads to efficient allocation of resources, increases the competitive power and strengthens the capital market and finally increases the chances of higher prosperity by preventing and reducing the occurrence of any financial crisis.

Various significant studies of corporate governance have been undertaken and still being conducted to realize the importance and role of corporate governance in the current changing business scenario. The studies to a large extent have stated that their does not exist any single model of corporate governance which can be adopted uniformly in all the countries due the political, economic, legal and cultural and custom differences. Hence, there is an utmost need of a model to be developed which can be compatible to each country based on the principles of transparency, equality, accountability and responsibility which may be widely accepted for international corporate governance. The term equality can be defined as equal treatment of stakeholders by the management to prevent any possible conflict as regard to their interest. Transparency can be expressed as providing all material financial and non-financial information within a reasonable time at low cost which should be accurate, reliable and valid for their decision making process. On the other hand accountability may be defined as laying down powers to the board so that the board of directors may be made answerable towards the company as a corporate entity and the stakeholders. Responsibility can be associated with compliance to all rules & regulations drafted under articles and in the operation & audit process. Thus to establish the corporate governance
framework, various organizations viz; World Bank, Organization for Economic Cooperation and Development and Global Corporate Governance Forum were assigned the task to discuss the issue. Thus, a large number of countries in the developed and developing economy were in the process for reviewing and restructuring their legislation and some of them even came out with new laws & regulations.

A corporation is a congregation of various stakeholders, namely customers, employees, investors, vendor partners, government and society. In such situation and in the changed scenario of Indian corporation, as also a corporation elsewhere should be fair and transparent to its stakeholders in all its transactions. This has become imperative in today's globalized business world where corporations need to access global pools of capital, need to attract and retain the best human capital from various parts of the world. Unless a corporation embraces and demonstrates such type of ethical conduct, it will not be able to succeed.

Corporations need to recognize that their growth requires the cooperation of all the stakeholders; and such cooperation is enhanced by the corporations adhering to the best Corporate Governance practices. In this regard, the management needs to act as trustees of the shareholders at large and prevent asymmetry of benefits between various sections of shareholders, especially between the owner-managers and the rest of the shareholders.

The Indian Companies Act, 2013, is significantly changing the way companies are governed. It has made sweeping changes in the corporate governance system of the country and indicates the intention of the government to move from control and command regime to placing the onus on those entrusted with the governance of the company. Indian companies have a long way to go before adhering to the best governance practices. The Act, amongst other things, focuses on good corporate governance practices by increasing the roles and responsibilities of the Board, protecting shareholders’ interest, bringing in a disclosure based regime and built in deterrence through self- regulation.

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7 Supra Note 1.
The genesis of the corporate governance lies in the business scams and failures in India and around the world. From time to time several committees have been appointed and each of the reports recommended some code of practice targeted towards avoiding similar incidences in future. A primary goal of prevailing corporation laws is to promote honest and efficient markets and informed investment decisions through full and fair disclosure. Transparency in financial reporting plays a pivotal role in making our markets the most resilient and efficient in the world. It enables investors, creditors and the market to evaluate an entity thereby helps investors make better decisions and, naturally, increases confidence in the fairness of the market.

“Joint-stock company” is one of the greatest inventions of mankind. It is this very invention which is playing a major role in eroding the geographical boundaries of nations across the globe. As the mankind is making strides with the help of this invention, care is also being taken that these organisations fulfil their objectives in the best possible manner. Today the corporate organizations have grown into huge sizes, characterised by separation between control and ownership, their internal organisational problems and their external relation to the society, have acquired new dimensions, not envisaged in the early era of the corporations. Corporations today affect the average citizen’s life both directly and indirectly, in many ways- he may be its shareholder, employee, supplier, dealer, customer and even if none of these, his life may still be affected by what the corporation does, e. g. by the pollution that its plant may create and by the company’s impact on the general economy. Thus major concern of both developed and developing countries is proper governance of the modern companies.

The recent past has seen a marked enthusiasm and interest in the subject of corporate governance. There is common consensus that Indian companies need to

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8 Dr. Onkar Nath Dutta, “Corporate Governance-Codes and Ethics”, 33 Growth 10(2006).
10 Yogesh Upadhyay and Shive Kumar Singh, “Corporate Governance: Role of Corporate Laws” 3 Pranjana, (2000).
become more transparent and accountable to its shareholders. Corporate Governance is a voluntary ethical code of business of companies. Philosophical traditions in West and East may be reviewed to know the bed rock of ethical standards. A business should benefit from the business like a honey bee which suckles honey from the flower without affecting its charm and beauty reflecting wisdom from Vedas.\(^\text{12}\)

The western thought on the other hand views ethics from the angle of sectoral interests. Values system is an important factor and plays a significant role, in successful management of a business. The very essence of corporate governance is based upon principles of transparency, accountability, fairness and responsibility. Their application is universal in nature. The concept may be complex but the principles are essentially simple and straightforward stimulating a fine fusion of legislative and ethical frame work.\(^\text{13}\)

The concept of “corporate governance” is multi faceted and involves lot of dimensions. Therefore, it covers several principles such as rights and equitable treatment of shareholders, interest of stakeholders, role and responsibility of board, integrity and ethical behaviour, and disclosure and transparency. By the adoption of such principles the corporate business is expected to operate to insure good governance.\(^\text{14}\)

Firstly, the organization should respect rights of shareholders and help shareholders to exercise those rights. They can help shareholders exercise their rights by communicating information openly and effectively and by encouraging shareholders to participate in general meetings. Secondly, organization should recognize that they have legal, contractual, social, and market driven obligation of non-shareholder stakeholders, including employees, investors, creditors, suppliers, local communities, customers, and policy makers.\(^\text{15}\)

In addition, the board needs to possess sufficient relevant skills and understanding to receive and challenge management performance. It also needs adequate size

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\(^\text{12}\) S.B. Mathur, “Corporate Governance-Concept and Issues”, Charted Secretary, (1997).

\(^\text{13}\) These words have been extracted from one of the speech of Sir Adrian Cadbury delivered in India during his visit in Year 2000.


\(^\text{15}\) \textit{Ibid.}
and appropriate levels of independence & commitment. Besides this, integrity should be a fundamental requirement in choosing corporate officers and board members. Organizations should develop a code of conduct for their directors and executives that promotes ethical and responsible decision making. And finally, organization should clarify and make publicly known the roles and responsibilities of board and management to provide stakeholders with a level based on accountability. They should also implement procedures to independently verify and safeguard the integrity of the company’s financial reporting. Disclosure of material matters concerning the organization should be timely and balanced ensuring that all investors have access to clear and factual information. All these principles are universal in application and try their level best to provide comprehensive coverage along with complete protection.

**Chapter II** sheds light on the various scams around the world and constitution of various committees which led to the development of corporate governance.

The failure of HIH Insurance Limited, Harris Scarfe Limited, Enron Inc., Xerox Corporation and WorldCom Inc. etc are the examples of the extent to which directors, senior management or even auditors may have failed to pay due regard to proper corporate governance practices. Conflicts of interest seem to have prevailed over the proper and independent consideration of relevant issues to the detriment of the company, the shareholders and other interested stakeholders. In India, the initiative on corporate governance was not a result of any major corporate scandal, like Enron, World Com, etc. It started as a self-regulatory move from the industry rather than the rule of law. The management is believed to be a trustee of shareholder’s capital and business is a trustee of all resources, including the environment. As trustees the primary goal of management is to protect the interest of the owners and also, not to exploit resources for short term profits. The need for Corporate Governance has become highlighted by the scams brought high almost as an annual feature ever since the liberalization of the economy in 1991, To cite a few Harshad Metha, ketan Parikh scam, UTI scam, the vanishing company scam, the Bhansali scam and so on. There is a need to learn lessons from the countries like USA and UK where companies are exposed to lot of hardships.
and failures due to misgovernance and unethical business practices. In the Indian corporate scenario, it has become imperative to induct good global standards so that the scope for scams is minimized. The most important development in the field of Corporate Governance and Investor protection in India has been the establishment of the Securities and Exchange Board of India in 1992 and its gradual empowerment since then. It was established primarily to regulate and monitor stock trading; it has played a crucial role in establishing the basic minimum ground rules of corporate governance in the country. Concerns about corporate governance in India were, however, largely triggered off by a spate of crises in the early 1990’s as already noted. This concerns about Corporate Governance stemming from the several corporate scandals, coupled with a perceived need to open up to the forces of competition and globalization, gave rise to several investigations into ways to fix the Corporate Governance situation in India. In the beginning of the last century, though the academia attempted to shape the concept of corporate governance, but the corporate governance as a business practice was adopted only two decades back. Corporate governance as a method of business practice was examined several times by different expert business committees across several jurisdictions. The committees attempted to describe and provide the meaning of and define corporate governance based on the social, economic and political culture of the state. Some of them did not give any definition of corporate governance, whereas others described the attributes of corporate governance.  

One of the first such endeavors was the confederation of Indian Industry (CII) code for Desirable Corporate Governance, developed by a committee chaired by Rahul Bajaj, this committee was formed in 1996 and submitted its code in April 1998. Later the Securities and Exchange Board of India (SEBI) constituted two committees to look into the issue of Corporate Governance. The first was chaired by Kumar Mangalam Birla, which submitted its report in 2000, and the second by Narayana Murthy, which submitted its report three years later. These two committees have been Instrumental in bringing crucial changes in Corporate Governance in India through the formulation of clause 49 of listing

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16 Indrajit Dube, Corporate Governance 8 (Lexis Nexis Butterworths Wadhwa, New Delhi, 2009).
Agreements. Concurrent with the Initiatives by the SEBI, The Ministry of Corporate Affairs, The Ministry of Finance of the Government of India also began contemplating improvements in Corporate Governance. These efforts include the establishment of a study group to operationalize the Birla Committee recommendations in 2000, the Naresh Chandra Committee on Corporate Audit and Governance in 2002, and the expert committee on Corporate Law (The J.J.Irani Committee) in 2004. All these efforts were aimed at reforming the existing Companies Act of 1956 still forms the backbone of corporate law in India.

The last decade has seen significant coverage of corporate fraud in the Indian media. While the Indian government has passed several laws aimed at curbing fraud, poor enforcement has diluted the intended impact. With the rise of new business models backed by technology, fraud has spawned new variants and seems to be on the rise. Insufficient mechanisms to prevent and detect fraud, as well as limited enforcement of internal controls are likely to be the reasons that organizations continue to experience traditional fraud. Specifically in the area of bribery and corruption, organizations have, in the past, considered bribery as the ‘cost of doing businesses, and hence demonstrated a degree of acceptability towards this practice. But with increased scrutiny by foreign regulators, and the Indian government taking a tough stand on bribery by enforcing legislations like the Prevention of Corruption Act while passing judgments on cases, we are seeing several companies taking efforts to address the risk of bribery and corruption.

With the sophistication of fraud, companies need to take a long term view of fraud risk management and adopt comprehensive frameworks to mitigate fraud. As organisations strive to create a high performance culture, they must back these efforts by creating strong controls, pro-active supervision through use of technology and independent monitoring of key performance parameters to create deterrence for misbehaviour. While one cannot deny the challenges in fraud

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17 In the last decade and a half India has enacted the following legislations aimed to curb fraud - the Prevention of Corruption Amendment Act 2011, the new Companies Act, 2013, The Whistleblowers Protection Act, 2011, The Right to Information Act, 2005 (RTI), The Information Technology Act 2000 (IT Act), and The Prevention of Money Laundering Act, 2002 (PMLA).
prevention and detection from external factors such as regulation/ law enforcement, one should realize that change comes from within. Some companies have demonstrated this by showing that business can be done in India ethically.\(^{18}\) India’s position on legislations to curb corporate fraud is still evolving. The Companies Act 2013 is a significant development in the evolution of India’s regulatory environment. This law is the first in the country to focus comprehensively on fraud risk management and prescribes stringent punishment upon the violation of its provisions. The Act includes specific provisions to address the risk of fraud, alongside prescribing greater responsibility and increased accountability for independent directors and auditors. It goes beyond professional liability for fraud and extends to personal liability, prescribing penalties for directors, key management personnel, auditors and employees. The Companies Act 2013 calls for the establishment of a vigil mechanism for directors and employees to report concerns about unethical behavior, suspected fraud or violations of the company’s code of conduct or ethics policy. However, the effectiveness of a vigil mechanism is not guaranteed by its mere existence, but by the confidence that stakeholders place in its functioning. According to the Deloitte India’s Whistle blowing Survey 2014\(^ {19}\) , it was felt that a whistleblower program, should necessarily have Anonymity & confidentiality, Adequate whistleblower protection, Transparency and Independence, as required by the legislation, and to provide for an objective view a dedicated team to handle whistleblower complaints (third party or internal) and a well-documented process of addressing complaints, feedback and communication.\(^ {20}\)

**Chapter III** offers conceptual framework related to corporate governance and corporate social responsibility, development of the concept of corporate governance in various countries, various definitions of corporate social


There is an evolving interplay between corporate governance and corporate social responsibility.\(^{21}\) Both these mechanisms hold economic and legal features. These may be altered through socio-economic processes in which competition within the product market is the most powerful force.\(^{22}\) Corporate governance and corporate social responsibility are complementary and are closely linked with market forces. Their objectives are not concurrent; they may act as tools for attaining each other’s goals, though their setups as corporate frameworks are different. As corporate governance becomes increasingly driven by ethical norms and the need for accountability, and corporate social responsibility adapts to prevailing business practices, a potential convergence between them surfaces. Where there were once two separate sets of mechanisms, one dealing with "hard core" corporate decision-making and the other with "soft," people-friendly business strategies, but these days a more hybridized, synthesized body of laws and norms regulating corporate practices have developed. Those public policies which were traditionally imposed by formal regulatory bodies, such as workplace anti-discrimination and environmental protection boards, are now being collaboratively addressed through participation, negotiations, and dialogue between the public and private sectors. In fact, internal governance policies that emphasize social responsibility through transparency and coordination have been more successful in bringing about ethical corporate conduct than traditional command-and-control structures.

Corporate social responsibility operates in a free-form manner, whereas corporate governance issues operate within well defined and accepted structures.\(^{23}\) Corporate governance is an umbrella term.\(^{24}\) In its narrower sense, it describes the


\(^{23}\) Supra n.1 at 279.

\(^{24}\) For details of corporate governance see Shleifer and Vishny, supra n. 2; Shann Turnbull, ‘Corporate Governance: its Scope, Concerns and theories’ (1997) 5(4) Corporate Governance 180; Oliver Hart, ‘Corporate Governance: Some Theory and Implications’ (1995) 105(430)
formal system of accountability of corporate directors to the owners of companies. In a broader sense, the concept includes the entire network of formal and informal relationships involving the corporate sector and the consequences of these relationships for society in general. These two senses are not concurrent; rather, they are complementary. Corporate governance has been described as the ways in which suppliers of finance to corporations assure themselves of obtaining a return on their investment.\(^{25}\) However, it could also implicate ‘the whole set of legal, cultural, and institutional arrangements that determine what publicly traded corporations can do, who controls them, how that control is exercised, and how the risks and returns from the activities they undertake are allocated’.\(^{26}\) Taking these senses together, corporate governance is no longer merely about maximizing stock value; rather, it concerns the ‘relationships among the many players involved (the stakeholders) and the goals for which the corporation is governed.’\(^{27}\)

In the marketplace, corporate governance is an old actor, whereas corporate social responsibility is comparatively new. It is worth noting that the sophistication of consumers in the 1960s, the environmental movement of the 1970s and the increasing interest in the social impacts of business in the 1990s have all helped corporate social responsibility reach the heart of corporate governance.\(^{28}\) In almost every instance, these events did not specifically actuate corporate social responsibility initiatives; rather, these instances set the global scene for the intersection between corporate social responsibility and corporate governance. Several of these events have been important drivers of this intersection: the global social urge to include the previously excluded social costs of production and the hidden costs incurred by the environment as a result of business activities with the corporate balance sheet; the lack of confidence in the institutions of the market

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\(^{25}\) Supra n. 2

\(^{26}\) Margaret Blair, Ownership and Control: Rethinking Corporate Governance for the Twenty-First Century (1995) 3.


\(^{28}\) Supra n.10.
economy; and the demand for ensuring sustainable development. ‘Consumerism’ and ‘corporate scandals’ are the most important drivers underpinning this development. These two factors are, indeed, closely related to market competition, and hence, they act as strong drivers for corporate governance and corporate social responsibility to develop the required framework by which a company can demonstrate its responsibility to society through its performance. To corporate governance, this intersection largely contributes by reconciling the tension between corporate governance’s engagement with shareholder and stakeholder interest; it has become attuned to constituency concerns in corporate governance. To corporate social responsibility, this intersection establishes corporate social responsibility.

In India, the concept of corporate social responsibility is governed by clause 135 of the Companies Act, 2013, which was passed by both Houses of the Parliament, and had received the assent of the President of India on 29 August 2013. The corporate social responsibility provisions within the Act is applicable to companies with an annual turnover of 1,000 crores and more, or a net worth of 500 crores and more, or a net profit of five crores and more. The new rules, which will be applicable from the fiscal year 2014-15 onwards, also require companies to set-up a corporate social responsibility committee consisting of their board members, including at least one independent director.

The Act encourages companies to spend at least 2% of their average net profit in the previous three years on corporate social responsibility activities. The ministry’s draft rules, that have been put up for public comment, define net profit as the profit before tax as per the books of accounts, excluding profits arising from branches outside India.

The Act lists out a set of activities eligible under corporate social responsibility. Companies may implement these activities taking into account the local conditions after seeking board approval. The indicative activities which can

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29 Ibid.
30 Kakabadse, above n 1, 279; for a detailed study on this issue, see Maurice Thevenet, ‘Viewpoint: Global Responsibility and Individual Exemplarity’ (2003) 3(3) Corporate Governance 114.
be undertaken by a company under corporate social responsibility have been specified under Schedule VII of the Act.

Chapter IV deals with the appointment, removal, duties, powers and remuneration of the directors. The role played by the directors and the board in corporate governance is fully discussed.

Directors are regarded as being the Key Managerial Persons of a company, with special importance to the listed companies. They can hold multiple high and responsible positions in the companies, such as the Managing Director, Manager, Whole Time Director, or an Independent Director. Thus, efficient, flawless, and rather progressive management of a company, and the desired growth and profitability of its businesses, are certainly largely dependent on the competence and trustworthiness of its directors. By the way, a Director means a Director appointed to the Board of a company; and, the Board of a company represents the collective body of its directors.

Stipulation and elucidation of the duties and responsibilities of the directors of a company, especially the public limited companies, are welcome and great contribution of the new company law of India, the Companies Act of 2013, to better corporate governance and security, and the best possible growth and prosperity in the corporate world of India. The former company law of India, the Companies Act of 1956, was disgustingly deficient in this respect. The new Companies Act, 2013 can be seen as offering a landmark piece of legislation in this regard, which duly and explicitly clarifies, redefines, and enlarges the ambit of duties and responsibilities of the directors. These newly introduced provisions by Companies Act, 2013 regarding the duties and responsibilities of the directors, including the independent directors, not only provide greater certainty to the directors regarding their conducts and responsibilities, and thus, ensuring better and impeccable corporate management and governance; but also enable and empower the beneficiaries, regulators, and the courts, to judge, regulate, and control the activities and obligations of the directors more objectively and effectively. Ours this well-drafted web-article offers very useful and fertile information exclusively about these new provisions of the Indian Companies Act.
of 2013, connected with the roles, duties, and responsibilities of the directors and independent directors of public limited companies.

This prudent legislation of the Companies Act, 2013 over the duties and liabilities of the directors, is further supported and supplemented by the revised corporate governance norms (Revised and New Clause 49 of the Listing Agreement) of SEBI [the Securities and Exchange Board of India], in order to bring the SEBI's corporate governance norms in connection with the listed companies, in close harmony and consistency with the provisions of the Companies Act, 2013.

The new Indian Companies Act of 2013 is certainly a very innovative and landmark legislation in respect of the duties and responsibilities of the directors (of companies) also. Both broad categories of directors, namely, the directors having pecuniary relationship with the company, and the independent directors, have been properly considered under this mature legislation for directors. It is quite obvious from above illustrations that the Companies Act, 2013 sincerely seeks to make the corporate management and governance in India rather efficient, fully accountable, transparent, and maximally beneficial to all stakeholders and related professionals, through this intelligent legislation over duties and responsibilities of directors in Indian companies. It is noticed that in respect of number of matters, the Central Government has to prescribe by Rules the limits for payments or procedure to be followed. Some stringent and minimum and maximum fines will be levied for contravention of these provisions. Punishment in the form of imprisonment of defaulting directors and Officers can also be awarded for such contravention of these provisions. Such provisions indicate that those in management are required to be vigilant about the compliance with provisions of the law and about Corporate Governance. It appears that in enacting such stringent provisions the Government has taken care of some of the deficiencies of the existing Act and tried to remove the same. Further, an attempt is made to address the issues which have arisen in some cases of corporate failures and Corporate Scams which have so far come to light. It is hoped that the Companies Act, 2013, if properly implemented and administered brings more discipline in the matter of Corporate Governance in the future.
Chapter V focuses on the role of the government, Stock Exchange Board of India and the role of the judiciary in corporate governance in India.

Recent corporate scandals have led to public pressure to reform business practices and increase regulation. Of course, dishonesty, greed, and cover-ups are not new societal concerns. The public outcry over the recent scandals have made it clear that the status quo is no longer acceptable; the public is demanding accountability and responsibility in corporate behaviour. It is widely believed that it will take more than just leadership by the corporate sector to restore public confidence in our capital markets and ensure their ongoing vitality. It will also take effective government action, in the form of reformed regulatory systems, improved auditing, and stepped up law enforcement.

These responses make clear that the governance of corporations has become a central item on the public policy agenda. The recent scandals themselves demonstrate that lax regulatory institutions, standards, and enforcement can have huge implications for the economy and for the public. Of course, government responses to scandals should be well considered and effective. Regulatory reforms those overreact or those address symptoms while ignoring underlying causes can be costly and counterproductive. Government’s task is to restore corporate integrity and market confidence without stifling the dynamism that underlies a strong economy.\(^{31}\)

In India, myriad initiatives have been taken in the past by the Ministry of Corporate Affairs and Stock Exchange Board of India to ascertain that those entrusted with the responsibility of governing shareholder wealth are adequately regulated and made accountable. Over the past years, there have been many reforms in the corporate governance framework starting from constitution of the Kumar Mangalam Committee (1999), introduction of Clause 49 in the listing agreement (2000), revision in Clause 49 on recommendations of the Narayana Murthy Committee (2006), issue of voluntary guidelines on corporate governance (2009), issue of guiding principles on corporate governance (2012) based on

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recommendation of the Adi Godrej Committee, enactment of the revised Companies Act (2013) and finally the new corporate governance norms by Securities Exchange Board of India (2014).

There is a move towards increased transparency on conducting board matters and articulated several changes in the roles and responsibilities of the board, board committees and independent directors. This also indicates the intent of the regulators to align with the global standards on corporate governance.32

The Stock Exchange Board of India Act leaves open the room for Stock Exchange Board of India to perform such other functions as may be prescribed.33 The Stock Exchange Board of India Act empowers Stock Exchange Board of India to make rules and regulations governing various aspects of the functioning of the securities market.34 A wide range of powers has also been delegated by the Central Government to Stock Exchange Board of India under the Securities Contract Regulation Act, 1956.35 Stock Exchange Board of India pronounces regulations proactively and sometimes in response to developments that potentially challenge the functioning of the market mechanism.

Several of the functions that Stock Exchange Board of India discharges are based on powers that it draws from the Securities Contract Regulation Act, 1956 (14 of 1956) (SCR Act, hereafter) and the rules made there under, the Securities Contract Regulation Rules, 1956 (SCR Rules, hereafter). The object of the SCR Act is to provide for the regulation of stock exchanges and of securities dealt in on them with a view to preventing undesirable speculation in them. It also seeks to regulate the buying and selling of securities outside stock exchanges through its various provisions. Two amendments in 1995 and 199936 brought about several important changes to the scope and the administration of the SCR Act, resulting in the current form of the law.

33 S 11(m) of the SEBI Act, 1992.
Securities Exchange Board of India also draws some of its authority from the Companies Act,\textsuperscript{37} which empowers Securities Exchange Board of India to administer a number of provisions of the Companies Act.\textsuperscript{38} These sections pretty much govern the capital mobilization process (issuance of capital), liquidity creation process (transfer) and the realization of return (dividend), the three important aspects of the issuer’s relationship with investors.

Stock Exchange Board of India 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’. Clause 49 remains the most significant corporate governance reform and established a new corporate governance regime. A certificate of compliance on terms contained in Clause 49 is required to be signed by the director and auditors/ company secretary of the company is to be annexed to the annual report. Some elements of the role of the Board of Directors of a company collectively and that of directors individually have been dealt with under the Companies Act, long before corporate governance emerged as the hot topic that it is currently.\textsuperscript{39}

Securities Exchange Board of India’s initiatives starting with the deliberations of two committees in succession\textsuperscript{40}, culminated in the introduction of Clause 49 in the listing agreement. Thus, Stock Exchange Board of India drafts regulations in its legislative capacity, conducts investigations and authorizes enforcement action in

\textsuperscript{37} S 55A of the Companies Act.
\textsuperscript{38} The sections identified are Sections 55 to 58, 59 to 84, 108, 109, 110, 112, 113, 116, 117, 118, 119, 120, 121, 122, 206, 206A and 207 of the Companies Act. The sections of the Companies Act broadly (not in seriatim) relate to issuance and contents of the prospectus and responsibility of those authorizing the issuance of the prospectus, procedure for issuance and allotment of shares and debentures, payment of brokerage and commission, buyback of shares, issue of shares at a premium or discount, further issue of capital (rights or otherwise), issue and redemption of preference share capital, administration of share capital, transfer of shares, provisions and payment of dividend.
\textsuperscript{39} The Companies Act has provisions governing the constitution of the board of directors of a company (Section 255 to Section 266), disqualification of directors (Section 274), restrictions on maximum number of directorships (Section 275 to Section 278), remuneration of directors (Section 309 to Section 311), vacation of office by directors (Section 283 and Section 284), procedure to be followed in the case of business in which directors are interested (section 299 to Section 302), powers of the board (section 291 to section 293). Further, Section 211 requires that the accounts presented to shareholders will be authenticated by the directors of the company and Section 224 states that the accounts will have to be audited.
\textsuperscript{40} The two committees were headed by Mr Kumar Mangalam Birla and Mr. N R Narayananmurthy respectively.
its executive function, passes rulings and orders in its judicial capacity. Though
this makes it very powerful, there is an appeal process to ensure fairness and
accountability through a Securities Appellate Tribunal. Securities Appellate
Tribunal was formed in 1995 to act as a form of justice to appeal against the
orders passed by Stock Exchange Board of India Board or the adjudicating officer
appointed under Stock Exchange Board of India Act, 1992.

Chapter VI deals with the offence of insider trading, its provisions under
the Companies Act, 2013, development of the insider trading laws, Stock
Exchange Board of India (Prohibition of Insider Trading) Regulations.

Insider trading refers to transaction in securities of a public listed
company, by any insider or any person connected with the company, based on any
material yet non-published information, which have the ability to impact on said
company's securities market price, for their personal advantage. Corporate
insiders such as employees, directors, managers, and other connected persons get
access to the critical price sensitive information easily. When these persons use
this price sensitive and non-public information for their own economic advantage,
they not only breach the fiduciary duty they have been imposed with, but also
impair the interests of shareholders. The act of insider trading is a result of
asymmetric information. Insiders enjoy the privilege of being in the company and
close to the primary source of information while general shareholders at large are
dependent upon the secondary sources of information.

The rationale behind the prohibition of Insider Trading is the obvious need
and understandable concern about the damage to public confidence which insider
dealing is likely to cause and the clear intention to prevent, so far as possible,
what amounts to cheating when those with inside knowledge use that knowledge
to make a profit in their dealings with others. Permitting few people to take
advantage of Unpublished Price Sensitive Information before it not only affects
the performance of the company but also integrity of the financial market. Any
market that is not fair in its dealings or cannot effectively control unfair dealings
in companies will not be an attractive investment destination for investors.
Rampant market manipulation and fluctuations will be frowned upon by the
investors and will dry up the inflow of investment into such markets. Since,
absolute prohibition of share trading by the insiders is not feasible; insider trading is restricted and monitored through a series of measures in different jurisdictions.

India’s Company Law was enacted in 1956. However, it did not include any provisions to charge the directors and the managing agents of companies for making the unfair use of inside information. Although the Thomas Committee had pointed out the lack of a special legislation to deal with the ‘unfair use of inside information’ in 1948 itself, it took a few decades to actually formulate a legislation to curb insider trading.\(^4\) The provisions relating to Insider Trading were incorporated in the Companies Act, 1956 under Sections 307 and 308, which required shareholding disclosures by the directors and managers of a company. Due to inadequate provisions of enforcement in the companies Act, 1956, the Sachar Committee in 1979, the Patel Committee in 1986 and the Abid Hussain Committee in 1989 proposed recommendations for a separate statute regulating Insider Trading. The concept of Insider Trading in India started fermenting in the 80's and 90's and came to be known and observed extensively in the Indian Securities market. The rapidly advancing Indian Securities market needed a more comprehensive legislation to regulate the practice of Insider Trading, thus resulting in the formulation of the SEBI (Insider Trading) Regulations in the year 1992, which were amended in the year 2002 after the discrepancies, observed in the 1992 regulations. The amendment in 2002 came to be known as the SEBI (Prohibition of Insider Trading) Regulations, 1992. The regulations of 1992 seemed to be more punitive in nature while the 2002 amendment regulations on the other hand are preventive in nature. The amendment required all the listed companies, market intermediaries and advisers to follow the regulations and also take steps in advance to prevent the practice of insider trading. These preventive measures ensured the reduction of the cases involving the practice of Insider Trading and also informing the persons who indulge in such practices, of the laws relating to Insider Trading. These regulations particularly emphasize on the delegation of powers on the entities themselves to conduct internal investigations before they present their case before the Stock Exchange Board of India in

relation to insider trading. The guidelines provide for a definite set of procedures and code of conduct for the entities whose employees, directors and owners are most expected to be in a position to take an undue advantage of confidential inside information for their personal profits. Various committees were constituted in India from time to time to assess the corporate regulation frame work in India.

Corporate Governance Corporate governance thus is a means of self governance by companies whereby a company increases its ‘firm value’ by higher and qualitatively superior disclosure as well as more responsible action. It must be distinguished from regulations which are imposed by the law and which mandate behaviour at the risk of penalty.

The 2002 amendments to the Regulations provide extensive suggestions and also extensive regulations couched in the language of corporate good governance. Most of the good governance provisions are provided for as mandatory provisions.

Unfortunately with the unearthing of large frauds, even though India is not unique in this, the concept of corporate good governance has been lost in the war cry for blood. And as a result, the government has gotten into overregulation and micromanagement by converting good governance into statutory provisions. We tend to forget that fraudulent action cannot be stamped out by micromanagement; it can only be reduced by effective enforcement of the laws which should prohibit obvious illegalities.

It should not be forgotten that what is sought to be caught is crime and treating all insiders as inherently tending towards a presumption of unfair dealing should be avoided. Standards of corporate governance should be left at the helm of the managers of the company. The regulator should specify in the Schedule to the regulations a list of optional procedure for limiting the possibilities of insider trading. What should be mandated instead should be a statement in the annual report of the degree of compliance with the standards of set forth in the Schedule. Thus companies which do not follow corporate governance guidelines in substance would be penalized by its shareholders. Introduction of corporate governance ratings, similar to debt ratings which would pressure management to comply with such measures. This could be the missing link providing a simple
number which can be appreciated and understood by the masses and would indicate the processes a company has put in place for the benefit of their non-insider shareholders.

**Suggestions**

I. There are various pitfalls in the provision of Companies Act relating to Independent Directors. The independent directors appointed by promoters cannot be independent in true sense. It is difficult to ascertain that the independent directors appointed by promoters are truly independent. Most Independent Directors diminish; in fact, end up adorning corporate boards without the time or commitment to work in the interests of shareholders. It is suggested that although the concept of Independent directors is good but there should be stringent regulations governing the appointment of independent directors

II. Independent Directors can take up 20 directorships each, it will be difficult for them to serve each of those companies to serve diligently hence number of directorships should be reduced.

III. The New Companies Act has not defined the term corporate social responsibility. The only obligation is to set aside the funds, form a committee, formulate a CSR policy, and spend the cash. If members don’t spend the money, they will have to explain the reason for not doing it in the annual report. It is suggested that CSR should be defined so that the companies can carry out their obligation under the act properly.

IV. In order to make directors accountable, the new Companies Act mandates that every director shall register himself or herself with the government and obtain a Director Identification Number (DIN), which is supposed to give every Indian resident a unique identity and prevent fraud, the DIN will enable the government to monitor the number of directorships any person holds and also his/her track record. Considering India’s track record, where bureaucratic supervision of corporate affairs more often than not leads to corruption and bribery, how many directors will want to risk being on the government’s watch list? This tends to discourage more competent people from taking up directorships.
V. It is suggested that an effort must be made to resolve the ambiguities in the provisions relating to CSR to ensure adoption of healthy practices by companies. Proper regulatory system for management and allocation of funds must be developed to ensure compliance with the 2% mandatory spending rule. Also, proper mechanism must be devised to gauge the effect of CSR initiatives adopted by the companies and a penalty must be included in section 135.

VI. It has been suggested that MCA should mandate all companies which are governed by section 135 to develop specific policies in tune with ethical business practices, and which acknowledge human rights and environment concerns. Also, it must be ensured that companies adhere to the rules and practices of corporate governance and any violation of the same shall not be tolerated.

VII. It is suggested that a trained and well-organized team must be formed by every company to ensure that the law is followed in its true letter and spirit. One step forward has been put forward by Indian Institute of Corporate Affairs (IICA) in this regard since the Institute plans to initiate a certificate programme on Corporate Social Responsibilities activities for working executives.

VIII. Though the new Act has strengthened the provisions relating to inspections and investigations, severe punishments for violations and non-compliance however, speedy disposal of cases relating to corporate offences is desirable.

IX. There is a problem relating to coordination among companies in choosing their respective CSR activities. This is a concern, particularly because the Rules recommend that the companies give preference to local areas in their CSR spending. To prevent duplication in particular types of CSR projects by companies within a particular region, formal partnerships or consortiums can be set up to achieve better coordination of CSR activities among companies within that region.

X. To protect investors and to tackle corporate fraud, the Act now allows “class action” lawsuits and gives the government’s investigative arm, the
Serious Fraud Investigation Office (“SFIO”), additional statutory powers. The class action suits may be misused for frivolous litigation. The courts need to be judicious while considering whether to accept such cases. The government should provide the SFIO the necessary infrastructure to exercise its oversight power.

XI. The Act provides for mandatory auditor rotation for listed and other prescribed companies every five years, depending on whether the auditor is an individual or a firm. One of the risks posed by mandatory audit term is the loss of historical expertise in the manner in which the company operates. This could have a huge negative impact on the functioning of a company.

XII. Improving investor education and awareness for better participation and deliberations at General Meetings - Investor education has been hailed as the key for improving governance standards and preventing abusive RPTs. This would not only improve the level of participation in General Meetings but also in improving the quality of deliberations happening at the General Meetings.

XIII. It is suggested that the definition of RPTs should be hybrid in nature: a principles-based definition ensuring better coverage, supported by objective rules ensuring better enforceability. The definition should also take into account direct and indirect influence, and not be confined to the control element for identifying a related party.

XIV. Currently, RPTs are disclosed to stock exchanges on a periodic basis. This limits the effectiveness of the disclosure, as the information is available to investors considerably later than when the transactions were concluded. It is suggested that the disclosures should be Immediate and continuous rather than periodic ones.

XV. Requiring approval by shareholders for divestment of major divisions/subsidiaries- Divestment of major subsidiaries and the hiving off of major divisions of an undertaking do not require shareholders’ approval under the existing legal framework. There have been cases where a major subsidiary or division was transferred to controlling shareholders after
getting the approval of the board of directors. Section 292 of the Companies Act 1956 provides that the powers for investing funds of the company have to be exercised by the board only in its meeting by means of resolutions passed at the meeting (i.e. they cannot be passed through circulation). Section 293 (1) (a) of the Companies Act 1956 requires shareholders’ approval for selling off the whole or a substantial part of an undertaking. There is, however, no specific requirement regarding the sale of the shares in a subsidiary (i.e. divestment) in the Act. This has led to abuses committed by controlling shareholders divesting the major subsidiaries, without proper valuation, to the companies, that are indirectly owned by them. The Companies Act 2013 is silent on this issue. As SEBI’s powers under the SEBI Act 1992, to prescribe listing conditions are in addition to but not in derogation of the provisions of the Companies Act, it is suggested that SEBI amend the listing agreement requiring the listed companies to obtain shareholders’ approval in the case of divestment of shares in major subsidiaries.

XVI. Section 188 of the Companies Act 2013 prohibits interested shareholders from voting in related party-transaction approvals. In line with this, it is suggested to consider requiring companies to obtain approval by shareholders whereby interested/related parties abstain from voting on managerial remuneration beyond a certain limit.

XVII. Controlling shareholders, better known as promoters in India, who manage the company owe a fiduciary responsibility to the minority shareholders and to the company as a whole. There have been cases where controlling shareholders have used the company for their personal interest while sacrificing the overall interest of the company and of its shareholders; mostly through abusive RPTs. Current laws/regulations do not explicitly set forth the fiduciary responsibilities of the controlling shareholders. It is suggested that Stock Exchange Board of India should consider introducing specific fiduciary responsibilities for controlling shareholders and evaluate the feasibility of mandating a relationship agreement between the company
and the controlling shareholder specifying the duties and responsibilities of controlling shareholders.

XVIII. Providing training to independent directors on the business of the company-Independent directors should be properly trained on the various aspects of identifying; analysing and preventing abusive RPTs. Periodic training may be mandated. It is suggested that formal training may be required only for newly appointed directors, and induction programme for independent directors to improve their competency and effectiveness. In addition, it was suggested that the training be based on a gap analysis, with provisions in the articles enabling and encouraging the training of directors.

XIX. It is provided that every company shall have at least one director who has stayed in India for a period of not less than 182 days in previous calendar year. It is recommended that private companies be exempted from meeting these requirements to avoid any practical difficulties since such companies may have two directors and if due to genuine business requirements if they stay out of India for more than 182 days, than it will be difficult for such private companies to comply with these requirements. Since the section requires every company to have one director resident in India for a period of 182 days or more in the previous calendar year, it can cause hardship particularly for foreign companies as they may not be able to find a resident director at the time of incorporation of an Indian subsidiary. Therefore, we suggest that in the first year of incorporation this condition may be waived or suitably modified to allow companies to have first directors who previously may not have been residents in India but will be residents for at least 182 days a year from the date incorporation of the Company. Further, as the Companies Act 2013 measures various aspects on a financial year basis, we recommend that the criteria for residency may be measured on a financial year basis rather than calendar year.

XX. Every listed company and every other public company having (a) paid–up share capital of one hundred crores rupees or more or (b) turnover of three hundred crore rupees or more shall have a woman director. The thresholds
for the requirement for woman director for unlisted companies should be reviewed and considerably enhanced. Mandating gender diversity may not be supported by a practical viewpoint in India. Board power needs to be enriched by bringing together the right mix of members with the desirable skills required for the efficient running of the business. An inclusive Board would be one which has a diversity of skills, thought, experience, knowledge, understanding, perspective and age. Board members are leaders who evolve in their respective fields to be fit for the hierarchical role in the organization. Mandating a legal requirement for this may pose a challenge since one cannot be fit for a Board member’s role by dint of law since it has to come through the right education, skill, work experience, training and expertise in the business. It is also provided that any intermittent vacancy of a woman director shall be filled-up by the Board at the earliest but not later than immediate next Board meeting or three months from the date of such vacancy whichever is later. The period of 3 months is very short for finding the right candidate since quality of board is critical - there should be same rigor for women as for other directors. Also the culture needs to be embedded into the organization so that diversity is nurtured throughout the Confederation of Indian Industry Page 6 hierarchy and not followed only at the director level. The period may thus be enhanced to at least 6 months.

XXI. While Section 178 provides that the Nomination and Remuneration Committee shall carry out evaluation of every director’s performance, the code of conduct in Schedule IV provides that the performance evaluation of independent directors shall be carried by entire board. It is suggested that the methodology of evaluation should be left on to the corporate. Nomination Committee / the Board should be responsible to ensure existence of proper evaluation methodology. The contradictions in the language used in Section 178 and the Code should be removed.

XXII. Appointment of Auditors- It has been clarified as an explanation to Rule 3 that if the appointment of auditor is not ratified by the shareholders, Board should appoint a new auditor. It is suggested that it should be clarified, in
such case, what would be the process of removal of the earlier auditor, or is the office automatically terminated and vacated. Clarity is required from a procedural perspective.

XXIII. Appointment of Company Secretary- Chapter XII has specified that every listed Company and every other public Company having a paid up share capital of Rs. 10 Crores or more shall have a whole time Company Secretary, whereas the previous Act required every company having a paid up capital of Rs. 5 Crores to have a whole time company secretary. Company Secretaries are regulated professionals and they render services critical for companies. A company needs a Company Secretary to strengthen its governance and compliance. Hence, increase in the limit is unjustifiable and the earlier limit should prevail.

In the fitness of things it is imperative to highlight the changes in the Companies Act, 2013 via Amendment Act of 2015, effective May 26. It updates the previous 2013 amendment with new provisions designed to improve ease of doing business. It addresses issues such as incorporation, corporate governance and management of subsidiaries. Provisions that will affect foreign companies doing business in the country:

I. Incorporation and Business Commencement

Incorporation processes have become much easier under the amendment.

The 2013 law required minimum paid-up capital of up to Rs. 0.1 million for private companies and Rs 0.5 million for public companies. These requirements have been removed completely; no initial capital will be required to incorporate a private or a public limited company. Requirements for a common seal for all official authorizations and attestations have been made optional. The amendment accepts a company director’s signature as a substitute for a common seal. Under the 2013 law, businesses needed to apply for a certificate to commence business in India after incorporation. This requirement has been removed.

II. Board Resolution Confidentiality

Under the 2013 law, Board resolutions were public and could be accessed from the Registrar of Companies (RoC). The amendment removes this provision;
no individual will be able to obtain copies of board resolutions passed by a company and filed with the RoC.

**III. Loans to Wholly Owned Subsidiaries**

The amendment clarifies that holding companies can lend to their wholly-owned subsidiaries. They can provide guarantees on a loan made by a bank or financial institution to the subsidiary. However, holding companies can only lend to their wholly-owned subsidiaries under the condition that the funds will be utilized by the subsidiary for its principal business activities.

**IV. Related Party Transactions**

Under amendments made to section 188, related party transactions above Rs 10 million can now be approved with a resolution instead of a special resolution. Additionally, no resolutions need to be passed for related party transactions between a holding company and its wholly-owned subsidiaries if their accounts are consolidated and placed before shareholders in a general meeting for approval.

**V. Punishments for failing to repay deposits**

The amendments provide specific punishments to deal with failure to pay back depositors under Section 73 and Section 76 of the 2013 law. A company, in addition to paying the amount of deposit or interest due, will be punishable with a fine which shall not be less than Rs 10 million but which may extend to Rs 100 million. Also, every officer of a company who is in default shall be punishable with imprisonment, which may extend to seven years, or with a fine which shall not be less than Rs 2,50,000 but which may extend to Rs 20 million or both.

While the amendments clarify certain legal provisions and loopholes, other barriers to doing business remain. The amendments to the Companies Act, 2013 demonstrates that the government is committed to making the law more responsive to the domestic business and foreign investment community. Although many in the private sector had hoped that the government would enact a more comprehensive Companies Act reform, the Companies Amendment Act, 2015 will improve the ease of doing business and will prove to be a step in the right direction.