A SUMMARY ON
ROLE OF GOVERNMENT IN
CORPORATE GOVERNANCE IN INDIA:
A CRITICAL STUDY

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Problem Profile

Corporate governance has become one of the most commonly used phrases in the current business vocabulary. The notorious corporate failures have focused international attention on the role of corporate governance in prevention of these failures. The problem of Indian corporate legal framework is its enforcement and implementation in letter as well as spirit. There are loopholes and drawbacks in the Indian Corporate laws dealing with ‘Corporate Governance’. Corporate governance has assumed crucial role in the Indian context because of the scams that occurred since liberalization from 1991, for e.g. the UTI scam, Ketan Parekh scam, Harshad Mehta scam & the latest & the biggest of them all the Satyam Fraud scam. The failure of the corporate communication structure, therefore, has made the financial community realize that “there is a great need for skilled professionals that can identify, expose, and prevent structural weaknesses in three key areas: poor corporate governance, flawed internal controls, and fraudulent financial statements. In addition, the corporate governance framework needs to be first of all strengthened and then implemented in “letter as well as in right spirit”. The increasing rate of white-collar crimes, without doubt, demands stiff penalties and punishments. Comprehensive legislation combined with strong enforcement can be a big deterrent to fraud.

Research Hypothesis

In India the concept of corporate governance is not provided in a comprehensive manner and the laws, rules, regulation etc. do not provide standard norms or code for the establishment and development of good corporate governance.

Research Methodology

The present research study is doctrinal in nature. For the fulfillment of the research work will include primary and secondary sources. The study material will
include case laws, reports of the commissions, rules, regulations, orders, by-laws, text books, laws journals and commentaries.

**Tools Applied**


3. **Periodical Writings:** Use of Indian and Foreign Law Journals on the point.

4. **Reports of Committees etc.:** Use of reports of various committees like The Kumarmangalam Birla Committee, Report of Stock Exchange Board of India, Naresh Chandera Committee, N.R. Narayana Murthy Committee etc.

**Introduction**

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. 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. 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.

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

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1 Indrajit Dube, corporate governance, (Lexis Nexis Butterworths Wadhwa, New Delhi, 2009).p.4.
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.\(^3\)

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 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.

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 that overreact or that 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.⁴

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 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).

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. The 2013 Act, significantly changes the way companies are governed.

India’s Companies Amendment Act of 2015, 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.

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.

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.

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.

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.

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.

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.

Thesis is divided into seven chapters:

**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 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 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. 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. 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. 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.

**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. 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. India’s position on legislations to curb corporate fraud is still evolving. 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. 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.

**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 responsibility, provisions of corporate social responsibility under the Companies Act, 2013. 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. There is an evolving interplay between corporate governance and corporate social responsibility. ⁵ 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. ⁶ Corporate social responsibility operates in a free-form manner, whereas corporate governance issues operate within well defined and accepted structures. ⁷ Corporate governance is an umbrella term. ⁸ In its narrower

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⁷ Supra n.1 at 279
sense, it describes the formal system of accountability of corporate directors to the owners of companies. 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 crore and more, or a net worth of 500 crore and more, or a net profit of five crore and more. The new rules, which are 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 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 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. 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. 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. 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 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). The Stock Exchange Board of India drafts regulations in its legislative capacity, conducts investigations and authorizes enforcement action in 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 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 framework in India.

**CHAPTER VII** Conclusion and Suggestions covers the conclusions arrived at as a result of the discussions in the various chapters. An attempt has also been made to point out the shortcomings and lacunae in the present laws and to suggest the remedial measures to ensure good corporate governance. Based on the study following, suggestions are made:
Suggestions

I. There should be stringent regulations governing the appointment of independent directors.

II. Numbers of directorships taken by Independent Directors should be reduced.

III. It is suggested that CSR should be defined so that the companies can carry out their obligation under the act properly.

IV. 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.

V. 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.

VI. Improving investor education and awareness for better participation and deliberations at General Meetings is desirable.

VII. Independent directors should be properly trained on the various aspects of identifying; analysing and preventing abusive RPTs. Periodic training may be mandated.