CHAPTER - II

CONCEPTUAL STUDY OF CORPORATE CRIMINAL LIABILITY

This study basically is concerned with the institution which is known as a company or a corporation. The owners, the managers and employees of this institution, sometimes exploit the situation and conduct themselves in such a way that their conduct amounts to the violation of law and is considered to be a corporate crime. The behavior of the companies, their officers and employees in any shady transaction is the subject matter of this study. The two major themes of this work are the companies or corporations and the crimes which are of a particular type.

Before analyzing any particular crime of the companies the researcher considers it necessary to describe the basic features of the companies and the basic elements of the criminal conduct of the companies and their officials which assume the character of corporate criminality.

With regard to the first segment of the subject, namely, the companies and the second segment of the study, i.e., the corporate criminality the study involves two aspects, namely, the theoretical conception and the operational conception. This is because the phenomena of companies as well as the crimes under study require a clarification as to what they were in the past and what they are at present. The conceptual study undertaken in this chapter clearly brings out the attributes of the institution called a corporate body and the menace with which the society is affected by their conduct, i.e., the corporate crimes. Both the aspects of the study have been covered in detail in this chapter.

The institution of a corporation exists since good old days; originally it had its own features and was meant for performing certain functions for the good of the society. It was an abstract entity in the sense that the institution was considered to be different from the natural persons of whom it consisted. The institution of a church, a college, a hospital or a charitable organization were the examples of the corporations. In order to enable them to perform their legitimate functions they were endowed with certain privileges and immunities. But later on the institution of corporation assumed the role of a commercial institution. A company or corporation was the entity which was regarded as having the same privileges and immunities as were made available to non-commercial entities.

Yet another development with regard to the institution of a Corporation was that it assumed the responsibility of collaborating with governmental institutions besides maintaining its original character of a an abstract entity like a commercial institution, in that capacity it
claimed the privileges which went to a commercial institution. It is this change in the nature and functioning of the corporations which brought the company in conflict with law in several matters. The change in the role of a company however was to the detriment of the commercial interests of the businessmen and the economic interests of the society; it also caused harm to the administrative interests of the State.

In order to deal with the defects that had crept into the functioning of the companies experts in the field of commerce, economics, business and State administration have examined the problems that had arisen in the functioning of the companies and corporations, which activity had come to be known as ‘corporate governance’.

In line with the themes envisaged above the methodology adopted in presenting the discussion in this chapter is to cover in Section A the concept of a company or corporation, covering at the same time the suggestions which have emanated from the experts to improve the organizational set up of the companies and to cover in Section B the concept of Corporate Criminal Liability.

Section A - Theoretical Concept of a Corporation

(i) Corporations in General

The common man’s definition of a corporation is a group of individuals coming together to carry on business. Corporation is a creation of law, a business entity recognized by law. Though English Law establishes the origin of Modern Corporation in the 17th century or so, yet some authors are of the view that the origin of corporation could be sought in the twelfth century or perhaps in the Roman law where, juristic persons was said to have been recognized. Sir Henry Maine suggested that a sort of corporation (as opposed to individual) responsibility was at the very heart of the primitive legal system. Society was not what it is assumed to be at present a collection of individuals but in view of others it is an aggregation of families.

Today, a corporation is an artificial entity that the law treats as having its own legal personality, separate from and independent of the persons who make up the corporation¹. This means, for example, that a corporation can own and sell property, sue or be sued, or commit a

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Salomon v. Saloman (1897) 22
criminal offence because; a corporation is made up of and run by people, acting as agents of the corporation. A corporation has an existence separate from the shareholders constituting it and they cannot be held liable for the wrongs committed by the corporation. The corporations are run by natural persons and these peoples' actions can be criminal in nature and can sometimes even result in great economical as well as human loss to the society. Hence, for a better understanding of the concept of corporate criminal liability, it is necessary to trace the origin and meaning of corporation first.

Corporations are as much part of our society as are any other social institution. Corporations represent a distinct and powerful force at regional, national and global levels and they wield enormous economic power. Besides governments and governmental agencies, it is the corporation that is the more and more effective agent of action in our society.

But, corporations, as we understand today, have not been the same as they were in the past. The multitude of roles the corporations play in the present day human life have been necessitated by the demands of the society, as it kept on „developing. The development of the society, at various points of time, has had a direct influence on the structure and functioning of the corporation. This had led to an ever increasing demand for the law to recognise the change and suit its application, accordingly. Over the last few decades nature and form of a corporate sector has grown complex. In the last two decades of 20th century, we saw globalization and privatization of every type of business entities all over the world and this globalization further paved the way for “Global Village”, which considerably made the changes in the form of business organisation.2

Section B: Operational Concept of a Corporation

The changing character of the corporations has brought in the rules of Public Law. The identity of a corporation no longer remains the subject matter of Company Law but has become a major aspect of Public Law. In the sphere of Public Law, particularly in relation to matters of State Administration the concept of a corporation calls for an examination of the status of a corporation as an ‘authority of the state’. Thus, in the sphere of Public Law one of the basic

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questions pertaining to the status of companies and corporations has been the legal personality of a corporation. Precisely, the question is whether a corporation is an instrumentality or agency of the State? As things stand, a corporation may be created in one of two ways. It may be either established by statute or incorporated under a law such as the Companies Act, 1956 or the Societies Registration Act, 1860. Where a Corporation is wholly controlled by Government not only in its policy making but also in carrying out the functions entrusted to it by the law establishing it or by the Charter of its incorporation, there can be no doubt that it would be an instrumentality or agency of Government. But ordinarily where a corporation is established by statute, it is autonomous in its working, subject only to a provision, often times made, that it shall be bound by any directions that may be issued from time to time by Government in respect of policy matters. So also a corporation incorporated under law is managed by a board of directors or committee of management in accordance with the provisions of the statute under which it is incorporated. When does such a corporation become an instrumentality or agency of Government? The courts have considered various factors and the case law on the subject and decided the question as explained below. The questions considered to be relevant are: Whether there is any financial assistance given by the State, and if so what is the magnitude of such assistance, whether there is any other form of assistance, given by the State, and if so, whether it is of the usual kind or it is extraordinary, whether there is any control of the management and policies of the corporation by the State and what is the nature and extent of such control, whether the corporation enjoys State conferred or State protected monopoly status and whether the functions carried out by the corporation are public functions closely related to governmental functions. This particularisation of relevant factors is however not exhaustive and by its very nature it cannot be, because with increasing assumption of new tasks, growing complexities of management and administration and the necessity of continuing adjustment in relations between the corporation and Government calling for flexibility, adaptability and innovative skills, it is not possible to make an exhaustive enumeration of the tests which would invariably and in all cases provide an unfailing answer to the question whether a corporation is governmental instrumentality or agency. Moreover even amongst these factors which we have described, no one single factor will yield a satisfactory answer to the question and the court will have to consider the cumulative effect of these various factors and arrive at its decision on the basis of a particularised inquiry into the facts and circumstances of each case.
In Sarabjit Tewari v. Union of India and Ors. the question was whether the Council of Scientific and Industrial Research was an 'authority' within the meaning of Article 12. The Court no doubt took the view on the basis of facts relevant to the Constitution and functioning of the Council that it was not an 'authority', but we do not find any discussion in this case as to what are the features which must be present before a corporation can be regarded as an 'authority' within the meaning of Article 12. This decision does not lay down any principle or test for the purpose of determining when a corporation can be said to be an 'authority'. If at all any test can be gleaned from the decision, it is whether the Corporation is "really an agency of the Government". The Court seemed to hold on the facts that the Council was not an agency of the Government and was, therefore, not an 'authority'.

After referring to various authorities, the court summarized the relevant tests which are to be gathered from the International Airport Authority of India's case as follows (at pages 96-7):

(1) 'One thing is clear that if the entire share capital of the corporation is held by Government it would go a long way towards indicating that the corporation is an instrumentality or agency of Government.'

(2) 'Where the financial assistance of the State is so much as to meet almost entire expenditure of the corporation, it would afford some indication of the corporation being impregnated with governmental character.'

(3) 'It may also be a relevant factor . . . whether the corporation enjoys monopoly status which is the State conferred or State protected.'

(4) 'Existence of deep and pervasive State control may afford an indication that the Corporation is a State agency or instrumentality.'

(5) 'If the functions of the corporation of public importance and closely related to governmental functions, it would be a relevant factor in classifying the corporation as an instrumentality or agency of Government'.

A Company incorporated under the Companies Act is a juristic person. A company
indisputably has a distinct and separate entity vis-a-vis its shareholders.

The next development to which a reference is necessary is the advent of public companies, particularly the Multinational Companies. A practice has developed of the companies acquiring various other institutions as their subsidiaries; the pattern of merger and acquisition has raised a number of problems in their transactions with the overseas employees.

Whatever be the nature of the companies today in relation to the governments under whose regulations they are formed, the basic character of a company is an institution which is engaged in trade and commerce either as an independent entity or as a corporation associated with the agencies of the State under a public law. It is with such institutions that this work is concerned.

II. Theoretical Concept of Crime:

(i) Crime in General

The Concept of Crime is an unusually difficult one since it is not understood in the same way everywhere. A crime is usually defined by the laws of national jurisdiction and there are sometimes vast differences with regard to the definition of one and the same crime in various jurisdictions. What may be a criminal behavior in one jurisdiction according to one law may not be a criminal behavior according to the law of another country and hence not punishable there. A slight difference in crime may be treated as a serious crime elsewhere.

In some countries the Criminal Law is contained in a single statute called the Penal Code; for example, in India the Criminal Law is in the form of a Penal Code called the Indian Penal Code which was framed during the British regime in the year 1860. But the Englishmen themselves have never had a single Penal Code. Their earliest form of law was the Common Law which was formulated by the Judges of the Royal Courts based on Customs and traditions of the people. On certain subjects Statutes were enacted to introduce penal liability, and efforts were made to have a common Penal Code. Criminal Law Commissioners were appointed for the purpose during the 19th century but the task was found to be difficult and therefore abandoned. The statutes which were enacted at different times were consolidated and penal law of the country is operating in the form of the Common Law and the piecemeal statutes that were of
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Common Law and the Statutes enacted by the Parliament represent the conventional crimes, in this category of offences were offences which have been there since ages together, such as, theft, burglary, defamation, nuisance etc. The source of law on common law offences was the judicial activity because the English judges believed that they had authority to recognize new offences. The offences which have been enforced under the Common Law and Statutes since several centuries are called Traditional offences. But in the wake of changes in business methods there has emerged a new kind of criminality which is entirely governed by Statute law and has certain new principles as well to fasten liability on the offenders of such offences. This new type of offences is known as White Collar Crimes.

The traditional crimes were committed mostly by the poor and the needy persons, who was because of pressure of necessity indulged in criminal activity, but the new type of criminality was one which arose not because of the need but the greed of persons who indulged in such activities to further the cause of their business or occupation by hook or crook. The traditional kind of criminality therefore covered law breaking among the middle and upper classes, but the new type of criminality was noticed in the higher strata of society. In certain legal systems the White collar Crimes are known as Welfare offence or Socio Economic offences. In India, the white collar crimes are known as social and economic offences. One peculiar thing about this criminality is that the behavior of the socio-economic criminals under the State law whether the punishment is penal, administrative or civil regardless of the offender’s status.

Based on these two kinds of criminal behavior law breaking is divided into two categories: conventional crimes which are usually punishable under the traditional rules of criminal law; and white collar crimes which are punishable apart from the conventional rules, by a set of new principles and procedures. For example, an apprehended prisoner may be punished by the Jail authorities with a fine or departmental action, a legal practitioner may be punished by his service organization through revocation of his licence; the businessmen may be punished by the punishment of civil damages, suspension of licence to do business, the seizure or destruction of commodities.

In view of the social backing which the penalties of common law offences received the law on the subject of white collar crimes also received the approval of the society, because of which several offences were recognized.
III. Operational Concept of Crime:

(a) The Concept of White Collar Crimes:

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(b) The Concept of Corporate Crime:

Corporate Crime is a white collar crime no doubt but it is of a particular type. In this type
of criminality there may any act committed by a company or a corporation which is liable to
punishment by the State regardless of whether it is under administrative law, civil law or criminal
law. So the first two significant features in respect of these crimes are that the perpetrators of
crime may be the companies or corporations and the kind of punishment may be under the
provisions of a civil law, administrative law or a penal law.

It may be pointed out that a corporate crime differs from occupational crime and needs to
be distinguished from the perpetrators of corporate crimes. The perpetrators of corporate crime
may be the corporate officials, such as, the general manager, or chief accountant or purchasing
officers who violate the law in acting for the corporation, but if they violate the law for a
personal gain that will be an occupational crime. Corporate crime involves corporations and not
individuals as such its perpetrators may not be sent to prisons as occupational crime offenders. In
a very comprehensive study of 582 corporations during 1975 and 1976 in USA, Clinard and
Yeager found that the corporations were frequently involved in six main types of corporate
illegal behavior:-

1. **Administrative Violation:** This kind of corporate offence involved non-compliance with
the requirements of an agency or court, such as failure to obey an agency or a court order
given to reinforce an agency order; refusal to produce information required by officials,
improper keeping of records; failure to submit periodic reports to officials, failure to
report cases of pollution discharge and failure to apply for permits.

2. **Violation of The Environment:** This comprised cases of air and water pollution,
including oil and chemical spills.

3. **Financial Violation:** This included illegal payments and many illegal financial
transactions including tax violations involving fraudulent returns and deficiency in tax
liability, accounting malpractices, internal control violations, false entries, improper
accounting cost etc.

4. **Labour Violations:** These included all types of discrimination in employment (regarding
race, sex, national origin or religion), occupational safety and health hazards, unfair labour practices, wage and hour violations;

5. **Violation of Manufacturing Regulations:** Such violations included electric shock hazards, chemical and environmental hazards such as poisoning and other injuries that result from handling, using or ingesting toxic substances and chemical agents that cause injuries discernible only years after exposure, fire and thermal burn hazards.

6. **Unfair Trade Practices:** These included abuse of competition, monopolization, misrepresentation, price discrimination, credit violation, maintaining resale conditions with coercion and prevention of fair competition.

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**IV. The Concept of Corporate Criminal Liability**

The operational concept of crimes with which this research work is concerned are the crimes with which the officials of the companies are charged.

Corporate crimes with which the company officials are usually charged may be divided into two categories.

The first are crimes where individual wrongdoers are truly acting on behalf of the firm, in that the individual committing (or orchestrating) the crime only benefits if the firm benefits, both in the short and long run, and also fully suffers any liability costs (including those imposed on
the firm) proportionate with his share of the benefit.

The second category is crimes committed for private benefit, often at the long-run expense of the firm. Crimes by owner-managers of closely-held firms generally fall into the first category. Owner-managers tend to commit corporate crimes to increase the firm’s profits and benefit from the crime only through the effect of the crime on the value of their shares. In this situation, the social benefit of crime is given by the benefit of the crime to the firm. The individual wrongdoer’s private benefit of crime equals his equity share in the firm’s benefit, as given by $ab$, where $a$ is the portion of the firm that he owns.

It is with these two kinds of crimes that the liability is sought to be imposed on the companies and their officials who get involved in such crimes, but the problem is it is not easy to impose liability on them on account of the old theories of criminal liability which are relevant even today.

Generally, the common law did not allow a corporation to be convicted of a crime. There were exceptions and these exceptions were based on the doctrine of *respondeat superior* or vicarious liability – the master is liable for the conduct of his servant in the course of employment. The doctrine of vicarious liability was created in the law of tort in the seventeenth century in order to provide compensation to third parties and justified on the ground that since the master acquired the benefits of the servant’s work, he should also carry the burdens.

While the common law recognized the appropriateness of vicarious liability for tort compensation, it rejected vicarious liability for crimes since crimes required mens rea or guilty minds. The mere existence of the master-servant relationship was not considered to be a sufficient criterion for imputing personal fault to the master. However, there were three common law crimes which did not require mens rea. These include public nuisance, criminal libel and contempt of court. In these categories of offences, the courts applied vicarious liability, allowing the master (which could be either an individual or a corporation) to be convicted for offences of his servant. Apart from these vicarious liability exceptions, corporations were immune from liability under the criminal law.

Corporate criminality “challenges or nags at our sense of reality.” It is this characteristic that makes corporate crime a tricky issue. The development of corporate criminal liability has become a problem which a growing number of prosecutors and courts have to deal with at the present time. In the common law world, following standing principles of Tort law, English courts
began sentencing corporations in the middle of the last century for statutory offenses. On the other hand, a large number of European continental law countries have not been able to or not been willing to incorporate the concept of corporate criminal liability into their legal systems. The fact that crime has shifted from almost solely individual perpetrators only 150 years ago, to white-collar crimes on an ever increasing scale has not yet been taken into account in many legal systems. At the same time, crime has also become increasingly international in nature. Courts are especially likely to impose criminal liability on a corporation when the criminal act is requested, authorized, or performed by the board of directors, an officer or another person having responsibility for formulating company policy or high level administrator having supervisory responsibility over the subject matter of the offence and acting within the scope of his employment.

The concept of Corporate Criminal Liability is fairly important in the context of business transactions. The idea of a corporation being treated as a separate entity is a very good idea; such an idea was adopted in respect of the institutions donated established by the Church, the universities, colleges, hospitals etc. established for the welfare of the people. But in the business world what is noticed that the idea has been exploited for unlawful gains. Such exploitation has caused harm to the interests of the state on account of which the authorities of the state invoked the penal powers. But problem arose about fastening liability to such entities on account of the legal theories which were already functioning such as the theory of mens rea and the theory of natural persons alone being subject to the punishment of imprisonment. Although the statute defined a person as including a company or a corporation yet the interpretative process has created hurdles in the way of imposing penal liability. The efforts made by the Law Commission and other authorities in clarifying the situation have not rendered the task easy; the problem is still bothering the authorities about liability of the companies and corporations.

V. The Concept of Corporate Governance:

(i) **Meaning & Definition of Corporate Governance**

In a narrow sense, corporate governance involves a set of relationships amongst the company’s management, its board of directors, its shareholders, its auditors and other stakeholders. These relationships, which involve various rules and incentives, provide the
structure through which the objectives of the company are set, and the means of attaining these objectives as well as monitoring performance are determined. Thus, the key aspects of good corporate governance include transparency of corporate structures and operations; the accountability of managers and the boards to shareholders; and corporate responsibility towards stakeholders.

While corporate governance essentially lays down the framework for creating long term trust between companies and the external providers of capital, it would be wrong to think that the importance of corporate governance lies solely in better access of finance. Companies around the world are realizing that better corporate governance adds considerable value to their operational performance:

- It improves strategic thinking at the top by inducting independent directors who bring a wealth of experience, and a host of new ideas
- It rationalizes the management and monitoring of risk that a firm faces globally
- It limits the liability of top management and directors, by carefully articulating the decision making process
- It assures the integrity of financial reports
- It has long term reputational effects among key stakeholders, both internally and externally

In a broader sense, however, good corporate governance- the extents to which companies are run in an open and honest manner- is important for overall market confidence, the efficiency of capital allocation, the growth and development of countries’ industrial bases, and ultimately the nations’ overall wealth and welfare. It is important to note that in both the narrow as well as in the broad definitions, the concepts of disclosure and transparency occupy centre-stage. In the first instance, they create trust at the firm level among the suppliers of finance. In the second instance, they create overall confidence at the aggregate economy level. In both cases, they result in efficient allocation of capital.

Some of the important definitions of Corporate Governance are:-

1. “Corporate Governance deals with the ways in which suppliers of finance to
corporations assure themselves of getting a return on the investment.” “Corporate Governance is about promoting corporate fairness, transparency and accountability.”

2. “Corporate Governance – which can be defined narrowly as the relationship of a company to its shareholders, or, more broadly, as its relationship to society…”

3. “Corporate Governance is the system by which business corporations are directed and controlled. The Corporate Governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance.”

4. “Corporate Governance is a field in economics that investigates how corporations can be made more efficient by the use of institutional structures such as contracts, organizational designs and legislation. This is often limited to the question of shareholder value i.e. how the corporate owners can motivate and/or secure that the corporate managers will deliver a competitive rate of return.

Ever since the first writings on the subject appeared in the academic domain, there have been many debates on the true scope and nature of corporate governance mechanisms around the world. More specifically on the question ‘Who should corporate governance really represent?’ This issue of whether a company should be run solely in the interest of the shareholders or whether it should take account the interest of all constituents has been widely discussed and debated for a long time now. Two definitions of Corporate Governance highlight the variation in the points of view:

‘Corporate governance is concerned with ways of bringing the interests of investors and manager into line and ensuring that firms are run for the benefit of investors’.

Corporate governance includes ‘the structures, processes, cultures and systems that engender the successful operation of organizations’.

The issue in the regard to the concept corporate governance is whether the recognition of

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3 J.Wolfenson, President of the World Bank as quoted by an article in Financial Times June 21, 1999
4 Financial Times 1997
5 OECD April 1999 (OECD’s definition is consistent with the one presented by Cadbury, 1992)
6 Mathiesen (1999)
claims of a wider set of stakeholders, than those of shareholders alone, is the legitimate concern of corporate governance. If it can be established that there are groups other than shareholders with legitimate claims on companies, and that their involvement in corporate decision making is both a right and is also economically beneficial, then the task of policy makers is to consider: ‘How should the company be regulated so as to enhance its effectiveness as a mechanism for enhancing the overall wealth or well-being of all stakeholders?’

Governance in relation to a business organization concerns with the intrinsic nature, purpose, integrity and identity of the organization and focuses primarily on the relevance, continuity and fiduciary aspects of the organization. It involves monitoring and overseeing strategic direction, socio-economic and cultural context, externalities and constituencies of the organization. Hence, Corporate Governance may be called as an umbrella term encompassing specific issues arising from interactions among senior management personnel, shareholders, and board of directors, other constituencies and the society at large. It deals with the exercise of power over the directions of enterprise, the supervision of executive actions, and acceptance of a duty to be accountable and regulations of the affairs of the corporation.

(ii) Global Landmarks in the Emergence of Corporate Governance

There were several frauds and scams in the corporate history of the world. It was felt that the system for regulation is not satisfactory and it was felt that it needed substantial external regulations. These regulations should penalize the wrong doers while those who abide by rules and regulations, should be rewarded by the market forces. There were several changes brought out by governments, shareholder activism, insistence of mutual funds and large institutional investors, that corporate they invested in adopt better governance practices and in formation of several committees to study the issues in depth and make recommendations, codes and guidelines on Corporate Governance that are to be put in practice. All these measures have brought about a metamorphosis in corporate that realized that investors and society are serious about corporate governance.

(iii) Developments in USA

Corporate Governance gained importance with the occurrence of the Watergate scandal in United States. Thereafter, as a result of subsequent investigations, US regulatory and legislative
bodies were able to highlight control failures that had allowed several major corporations to make illegal political contributions and to bribe government officials. This led to the development of the Foreign and Corrupt Practices Act of 1977 that contained specific provisions regarding the establishment, maintenance and review of systems of internal control. This was followed in 1979 by Securities and Exchange Commission’s proposals for mandatory reporting on internal financial controls. In 1985, following a series of high profile business failures in the US, the most notable one of which being the savings and loan collapse, the Tradway Commission was formed to identify the main cause of misrepresentation in financial reports and to recommend ways of reducing incidence thereof. The tradway Report published in 1987 highlighted the need for a proper control environment, independent audit committees and an objective internal audit function and called for published reports on the effectiveness of internal control. The commission also requested the sponsoring organizations to develop an integrated set of internal control criteria to enable companies to improve their control.

(iv) Developments in UK

In England, the seeds of modern corporate governance were sown by the Bank of Credit and Commerce International (BCCI) Scandal. The Barings Bank was another landmark. It heightened people’s awareness and sensitivity on the issue and resolve that something ought to be done to stem the rot of corporate misdeeds. These couple of examples of corporate failures indicated absence of proper structure and objectives of top management. Corporate Governance assumed more importance in light of these corporate failures, which was affecting the shareholders and other interested parties.

As a result of these corporate failures and lack of regulatory measurers from authorities as an adequate response to check them in future, the Committee of Sponsoring Organizations (COSO) was born. The report produced in 1992 suggested a control framework and was endorsed a refined in four subsequent UK reports: Cadbury, Ruthman, Hampel and Turbull.

There were several other corporate failures in the companies like Polly Peck, British & Commonwealth and Robert Maxwell’s Mirror Group News International were all victims of the boom-to-bust decade of the 1980s. Several companies, which saw explosive growth in earnings, ended the decade in a memorably disastrous manner. Such spectacular corporate failures arose primarily out of poorly managed business practices.
The publication of a series of reports consolidated into the Combined Code on Corporate Governance (The Hampel Report) in 1998 resulted in major changes in the area of corporate governance in United Kingdom. The corporate governance committees of last decade have analyzed the problems and crises besetting the corporate sector and the markets and have sought to provide guidelines for corporate management. Studying the subject matter of the corporate codes and the reports produced by various committees highlighted the key practical problem and concerns driving the development of corporate governance over the last decade.

Corporate Governance Committees

The main committees, known by the names of the individuals who chaired them are discussed hereunder.

Cadbury Committee on Corporate Governance (1992)

The stated objectives of the Cadbury Committee was “To help raise the standards of corporate governance and the level of confidence in financial reporting and auditing by setting out clearly what it sees as the respective responsibilities of those involved and what it believes his expected of them. The committee investigated the accountability of the board of directors to shareholders and to society. It submitted its report and associated “Code of Best Practices” in 1992 wherein it spelt out the methods of governance needed to achieve a balance between the essential power of the board of directors and their proper accountability. Its recommendations were not mandatory. The Cadbury code of best practices had 19 recommendations. The recommendations are in the nature of guidelines relating to the board of directors, non-executive directors, executive directors and those on reporting and control. The stress in the Cadbury committee report is on the crucial role of the board and the need for it to observe the Code of Best Practices. Its important recommendations include the setting up of an audit committee with independent members.

b) The Paul Ruthman Committee

The committee was constituted later to deal with the said controversial point of Cadbury.
Report. It watered down the proposal on the grounds of practicality. It restricted the reporting requirement to internal financial controls only as against “the effectiveness of the company’s system of internal control” as stipulated by the Code of Best Practices contained in the Cadbury Report. The final report submitted by the Committee chaired by Ron Hampel had some important and progressive elements, notably the extension of directors’ responsibilities to “all relevant control objectives including business risk assessment and minimizing the risk of fraud….”

c) The Greenbury Committee

This committee was setup in January 1995 to identify good practices by the Confederation of British Industry (CBI), in determining directors’ remuneration and to prepare a code of such practices for use by public limited companies of United Kingdom. The committee aimed to provide an answer to the general concerns about the accountability by the proper allocation of responsibility for determining directors’ remuneration, the proper reporting to shareholders and greater transparency in the process.

The committee produced the Greenbury Code of Best Practice which was divided into the four sections: Remmuneration Committee, Disclosures, Remuneration Policy and Service Contracts and Compensation. The Greenbury committee recommended that UK companies should implement the code as set out to the fullest extent practicable, that they should make annual compliance statements, and that investor institutions should use their power to ensure that the best practice is followed.

d) The Hampel Committee

The Hampel committee was setup in November 1995 to promote high standards on Corporate Governance both to protect investors and preserve and enhance the standing of companies listed on the London Stock Exchange. The committee developed further the Cadbury report. And it made the following recommendations.

i) The auditors should report on internal control privately to the directors.

ii) The directors maintain and review all controls.

iii) Companies should time to time review their need for internal audit function and control.

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9 Greenbury Committee Report (1994) investigating board members’ remuneration and responsibilities.
10 The Hampel Committee Report (1998)
It also introduced the combined code that consolidated the recommendation of earlier corporate governance reports (Cadbury Committee and Greenbury Committee).

e) The Combined Code

The combined code was subsequently derived from Ron Hampel Committee’s Final Report, Cadbury Report and the Greenbury Report. The combined code is appended to the listing rules of the London Stock Exchange. As such, compliance of the code is mandatory for all listed companies in UK. The stipulations contained in the Combined Code require, among other things, that the boards should maintain a sound system of internal control to safeguard shareholder’s investments and the company’s assets. The directors should, at least annually, conduct a review of the effectiveness of the group’s system of internal control covering all controls, including financial, operational and compliance and risk management, and report to shareholders that they have done so.

f) The Turnbull Committee

The Turnbull Committee was set up by the Institute of Chartered Accountants in England and Wales (ICAEW) in 1999 to provide guidance to assist companies in implementing the requirements of the Combined Code relating to internal control. The committee provided guidance to assist companies in implementing the requirements of the Combined Code relating to internal control. It recommended that where companies do not have an internal audit function, the board should consider the need for carrying out an internal audit annually. The committee also recommended that board of directors confirm the existence of procedures for evaluation and managing key risks. Corporate Governance is constantly evolving to reflect the current corporate economic and legal environment. To be effective, corporate governance practices need to be tailor to particular needs, objectives and risk management structure of an organization.

World Bank on Corporate Governance

The World Bank, involved in sustainable development was one of the earliest economic organization to study the issue of corporate governance and suggest certain guidelines. The World Bank report on corporate governance recognizes the complexity of the concept and

focuses on the principles such as transparency, accountability, fairness and responsibility that are universal in their applications. Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible, the interests of individuals, organizations and society. The foundation of any corporate governance is disclosure. Openness is the basis of public confidence in the corporate system and funds will flow to those centers of economic activity, which inspire trust. This report points the way to establishment of trust and the encouragement of enterprise. It marks an important milestone in the development of corporate governance.

**OECD Principles**

Organization for Economic Co-operation and Development (OECD) was one of the earliest non-governmental organizations to work on and spell out principles and practices that should govern corporate in their goal to attain long-term shareholder value.\(^\text{12}\)

The OECD were trend setters as the Code of Best practices are associated with Cadbury report. The OECD principles in summary include the following elements.

i) The rights of shareholders

ii) Equitable treatment of shareholders

iii) Role of stakeholders in corporate governance

iv) Disclosure and Transparency

v) Responsibilities of the board

The OECD guidelines are somewhat general and both the Anglo-American system and Continental European (or German) system would be quite consistent with it.

**VI. Corporate Governance Initiatives in India**

Corporate governance initiatives in India began in 1998 with the Desirable Code of Corporate Governance – a voluntary code published by the CII, and the first formal regulatory framework for listed companies specifically for corporate governance, established by the SEBI. The latter was made in February 2000, following the recommendations of the Kumarmangalam

\(^\text{12}\) Principles of Corporate Governance: A report by OECD Task Force on Corporate Governance (1999)
Corporations pool capital from a large investor base both in the domestic and in the international capital markets. In this context, investment is ultimately an act of faith in the ability of a corporation’s management. When an investor invests money in a corporation, he expects the board and the management to act as trustees and ensure the safety of the capital and also earn a rate of return that is higher than the cost of capital. In this regard, investors expect management to act in their best interests at all times and adopt good corporate governance practices.

Corporate governance is the acceptance by management of the inalienable rights of shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders. It is about commitment to values, about ethical business conduct and about making a distinction between personal and corporate funds in the management of a company.

It was the belief of the Securities and Exchange Board of India (“SEBI”) that efforts to improve corporate governance standards in India must continue. This is because these standards themselves were evolving in keeping with market dynamics. Accordingly, the Committee on Corporate Governance (the “Committee”) was constituted by SEBI, to evaluate the adequacy of existing corporate governance practices and further improve these practices. The Committee comprised members from various walks of public and professional life. This includes captains of industry, academicians, public accountants and people from financial press and from industry forums.

The issues discussed by the Committee primarily related to audit committees, audit reports, independent directors, related parties, risk management, directorships and director compensation, codes of conduct and financial disclosures. The Committee’s This report’s recommendations in the final report were selected based on parameters including their relative importance, fairness, accountability, transparency, ease of implementation, verifiability and enforceability. The key mandatory recommendations focus on strengthening the responsibilities of audit committees; improving the quality of financial disclosures, including those related to related party transactions and proceeds from initial public offerings; requiring corporate executive boards to assess and disclose business risks in the annual reports of companies; introducing responsibilities on boards to adopt formal codes of conduct; the position of nominee directors; and stock holder approval and improved disclosures relating to compensation paid to non-executive directors. Non-mandatory recommendations include moving to a regime where
corporate financial statements are not qualified; instituting a system of training of board members; and the evaluation of performance of board members. The Committee believes that these recommendations codify certain standards of “good” governance into specific requirements, since certain corporate responsibilities are too important to be left to lose concepts of fiduciary responsibility. When implemented through SEBI’s regulatory framework, they will strengthen existing governance practices and also provide a strong incentive to avoid corporate failures. Some people have legitimately asked whether the costs of governance reforms are too high. In this context, it should be noted that the failure to implement good governance procedures has a cost beyond mere regulatory problems. Companies that do not employ meaningful governance procedures will have to pay a significant risk premium when competing for scarce capital in today’s public markets.

a) Naresh Chandra Committee Report

The initial stimulus for corporate governance reforms came after the South-East and East Asian crisis of 1997-98. Governments, multilateral institutions, banks and companies recalled that the devil lay in the details - the nitty-gritty of transactions among companies, banks, financial institutions and capital markets; corporate laws, bankruptcy procedures and practices; the structure of ownership and crony capitalism; stock market practices; poor boards of directors with scant fiduciary responsibility; poor disclosures and transparency; and inadequate accounting and auditing standards.

India has not been in the middle of this global and Asian reform movement, as a reaction to corporate and financial crises. First, unlike South-East and East Asia, this movement did not start because of a national or region-wide macroeconomic and financial collapse. Indeed, the Asian crisis barely touched India. Secondly, unlike other Asian countries, the initial drive for better corporate governance and disclosure, perhaps as a result of the 1992 stock market "scam", ' and the onset of international competition consequent on the liberalisation of economy that began in 1990, came from all-India industry and business associations, and in the Department of Company Affairs. Thirdly, from April 2001, listed companies in India need to follow very stringent guidelines on corporate governance, which rank among some of the best in the world. Sadly, there is a wide gap between prescription and practice. Worse, adverse legal consequences, for the defaulters, almost always get caught in the web of inefficiency, corruption and the intricate, dilatory legal system. Thus, while corporate governance reforms in India far outstrips that of many other countries, the performance in either lags very much behind.
After the Enron debacle of 2001, came other scandals involving large US companies such as WorldCom, Qwest, Global Crossing, and the auditing lacunae that eventually led to the collapse of Andersen. These scandals triggered another phase of reforms in corporate governance, accounting practices and disclosures - this time more comprehensive than ever before. In July 2002, less than a year from the date when Enron filed for bankruptcy, the Sarbanes-Oxley Bill (popularly called SOX) was enacted. The Act brought with it fundamental changes in virtually every area of corporate governance - and particularly in auditor independence, conflicts of interest, corporate responsibility, enhanced financial disclosures, and severe penalties, both fines and imprisonment, for willful default by managers and auditors. It is fair to predict that the SOX Act will do more to change the contours of board structure, auditing, financial reporting and corporate disclosure than any other previous law in US history.

On 21 August 2002, the Department of Company Affairs (DCA) under the Ministry of Finance and Company Affairs appointed this High Level Committee to examine various corporate governance issues. Among others, this Committee has been entrusted to analyse and recommend changes, if necessary, in diverse areas such as:

- the statutory auditor-company relationship, so as to further strengthen the professional nature of this interface;
- the need, if any, for rotation of statutory audit firms or partners;
- the procedure for appointment of auditors and determination of audit fees;
- restrictions, if necessary, on non-audit fees;
- independence of auditing functions;
- measures required to ensure that the management and companies actually present ‘true and fair’ statement of the financial affairs of companies;
- the need to consider measures such as certification of accounts and financial statements by the management and directors;
- the necessity of having a transparent system of random scrutiny of audited accounts;
- adequacy of regulation of chartered accountants, company secretaries and other similar statutory oversight functionaries;
- advantages, if any, of setting up an independent regulator similar to the Public Company Accounting Oversight Board in the SOX Act, and if so, its constitution; and
• the role of independent directors, and how their independence and effectiveness can be ensured.

As is evident, the terms of reference to this Committee (Appendix 1) lie at the heart of corporate governance. Given below are the recommendations of the Committee.

b) Kumara Mangal Committee Report (2000)

SEBI had constituted a Committee on Corporate Governance under the Chairmanship of Shri Kumar Mangalam Birla, Member, SEBI Board to promote and raise the standard of Corporate Governance in respect of listed companies. The SEBI Board in its meeting held on January 25, 2000 considered the recommendation of the Committee and decided to make the amendments to the listing agreement in pursuance of the decision of the Board, it is advised that a new clause, namely clause 49, be incorporate in the listing agreement as under:

I. Board of Directors
A) The company agrees that the board of directors of the company shall have an optimum combination of executive and non-executive directors with not less than fifty percent of the board of directors comprising of non-executive directors. The number of independent directors would depend whether the Chairman is executive or non-executive. In case of a non-executive chairman, at least one-third of board should comprise of independent directors and in case of an executive chairman, at least half of board should comprise of independent directors.

Explanation: For the purpose of this clause the expression ‘independent directors’ means directors who apart from receiving director’s remuneration, do not have any other material pecuniary relationship or transactions with the company, its promoters, its management or its subsidiaries, which in judgement of the board may affect independence of judgement of the director.

I Audit Committee
A) The company agrees that a qualified and independent audit committee shall be set up and that:

a) The audit committee shall have minimum three members, all being non-executive
directors, with the majority of them being independent, and with at least one director having financial and accounting knowledge;
b) The chairman of the committee shall be an independent director;
c) The chairman shall be present at Annual General Meeting to answer shareholder queries;
d) The audit committee should invite such of the executives, as it considers appropriate (and particularly the head of the finance function) to be present at the meetings of the committee, but on occasions it may also meet without the presence of any executives of the company. The finance director, head of internal audit and when required, a representative of the external auditor shall be present as invitees for the meetings of the audit committee;
e) The Company Secretary shall act as the secretary to the committee.

B) The audit committee shall meet at least thrice a year. One meeting shall be held before finalization of annual accounts and one every six months. The quorum shall be either two members or one third of the members of the audit committee, whichever is higher and minimum of two independent directors.