CHAPTER - I
INTRODUCTION

The subject of corporate governance leapt to global business limelight from relative obscurity after a string of collapses of high profile companies. Enron, the Houston, Texas based energy giant, and WorldCom, the telecom behemoth, shocked the business world with both the scale and age of their unethical and illegal operations. Worse, they seemed to indicate only the tip of a dangerous iceberg. While corporate practices in the US companies came under attack, it appeared that the problem was far more widespread. Large and trusted companies from Parmalat in Italy to the multinational newspaper group Hollinger Inc., revealed significant and deep-rooted problems in their corporate governance. Even the prestigious New York Stock Exchange had to remove its director, Dick Grasso, amidst public outcry over excessive compensation. It was clear that something was amiss in the area of corporate governance all over the world.

Corporate governance has, of course, been an important field of query within the finance discipline for decades. Researchers in finance have actively investigated the topic for at least a quarter century¹ and the father of modern economics, Adam Smith¹; he had recognized the problem over two centuries ago. There have been debates about whether the Anglo-Saxon market-model of corporate governance is better than the bank-based models of Germany and Japan.

However, the differences in the quality of corporate governance in these developed countries fade in comparison to the chasm that exists between corporate governance standards and practices in these countries as a group and those in the developing world. Corporate governance has been a central issue in developing countries long before the recent spate of corporate scandals in advanced economies made headlines. Indeed corporate governance and economic development are intrinsically linked. Effective corporate governance systems promote the development of strong financial systems – irrespective of whether they are largely bank-based or market-based – which, in turn, have an unmistakably positive effect on economic growth and poverty reduction. There are several channels through which the causality works. Effective corporate governance enhances access to external financing by firms, leading to greater investment, as well as higher growth and employment. The proportion of
private credit to GDP in countries in the highest quartile of creditor right enactment and enforcement is more than double that in the countries in the lowest quartile. As for equity financing, the ratio of stock market capitalization to GDP in the countries in the highest quartile of shareholder right enactment and enforcement is about four times as large as that for countries in the lowest quartile. Poor corporate governance also hinders the creation and development of new firms.

The term ‘Corporate Governance’ is much in use these days; everybody and anybody who has anything to do with the corporate sector talks about Corporate Governance. As is the case with anything popular, the term ‘Corporate Governance’ has almost become rhetoric; like all rhetoric’s it is the most spoken and the least meant.

The conjunction of the two words, Corporate and Governance provokes some interesting and somewhat cynical reactions. Some say that corporate governance is eligible to be the title of a book. Others refer immediately to the scandals of the eighties and the nineties where governance has been clearly overlooked in favor of profits.

Corporate Governance deals with laws, procedures, practices and implicit rules that determine A Company’s ability to take managerial decisions vis-à-vis its claimants—in particular, the shareholders, creditors, the state and the employees. There is a global consensus on the objective of good corporate governance: maximizing long-term shareholder value. Also there is a diversity of opinion regarding beneficiaries of corporate governance. The Anglo-American system tends to focus on shareholders and various classes of creditors. Continental Europe, Japan and South Korea believe that a company should also discharge their obligation towards employees, local committees, suppliers, ancillary units and so on.

The companies have the fundamental aim to maximize profits through good governance. The permanent search of the firms for increasing productivity and competitiveness leads to economic growth. If the companies present a good performance, based in the best practices of Corporate Governance, they assure their permanency in the market. This translates into employment for the families, as social responsibility and wealth for the country. On the contrary, if the firms do not achieve this favorable performance, they can fail and originate problems of unemployment,
migration and violence.

Knowing the internal variables of Corporate Governance that improve the firm’s performance is important, not only for the company but also for the society in general. Though it is clear that the Corporate Governance influences the firm performance, which does not remain clear is what mechanisms of Corporate Governance they favor to this performance. Even, some policies of Corporate Governance can be favorable (or harmful) for companies of certain countries (and not of others); also, some mechanisms of Corporate Governance can give different results depending on the situation especially.

The Corporate Governance is intimately related to the firm performance, as they show it La Porta et al. (1997; 1998; 2000; 2002)\(^2\). Hutchinson and Gul (2004)\(^3\) conclude that this relation is especially relevant for the companies that present opportunities of growth. Lowenstein (1996)\(^4\) suggests that the good practices that should be had of Corporate Governance make the financial transactions more transparent.

This allows the capital suppliers to better calculate the risk of his investments and diminish the cost of financing. In synthesis, though it is clear that the Corporate Governance influences the firm performance, what does not remain clear is what mechanisms of Corporate Governance would help the performance.

In a nutshell, Corporate Governance is about promoting corporate fairness, transparency and accountability. Let us see how corporate governance has been defined.

Corporate Governance can be traced back to early nineties when due to a series of corporate mismanagement and failures were reported in UK that led to the formation of Adrian Cadbury committee who came out with first document, laying the foundation of the present day format of the corporate governance. This report was primarily based on the frauds perpetrated by some of the unscrupulous directors usurping stakeholders’ money for their personal benefits. So the terms of reference of this committee was mainly on the financial aspects of the corporations and focused on the roles of the institutional investors, auditors and remuneration of the top executives
along with some measures on internal controls. The Cadbury Committee’s terms of reference were mainly restricted to issues related to accountability.

There is considerable difference of opinions on what corporate governance is all about. But one thing is very clear is that corporate governance is nothing but a method of enhancing the corporate performance by monitoring and controlling the management performance at one hand ensuring the accountability of the management to all stakeholders on the other hand. Governance and accountability are two sides of the same coin and combination of these two factors should lead to both efficiency and marshalling all the resources of the organization to increase not only shareholder value but should work for the benefit of all stakeholders.

One of the major issues in this period (even in the early 21st century for that matter) was misappropriation of funds of the shareholders by so called professional managers (read non-owner manager).

Corporate governance has been defined by scholars and market practioners as per the perspective with which they were analyzing the subject. The practioner’s point of view that was powerfully conveyed was that of N.R. Narayana Murthy, Chairman, Committee on Corporate Governance, Securities and Exchange Board of India, 2003 and he himself a highly successful and globally acclaimed entrepreneur who built Infosys on the premise and foundations of a strong corporate governance “The term “corporate governance”, is susceptible both to broad and narrow definitions. In fact, many of the codes do not even attempt to articulate what is encompassed by the term. The important point is that corporate governance is a concept, rather than an individual instrument. It includes debate on the appropriate management and control structures of a company. Further, it includes the rules relating to the power relations between owners, the Board of Directors, management and, last but not least, the stakeholders such as employees, suppliers, customers and the public at large:”.

Corporate governance is a concept, rather than an individual instrument. It includes debate on the appropriate management and control structures of a company. It includes the rules relating to the power relations between owners, the board of directors, management and the stakeholders such as employees, suppliers, customers as well as the public at large.
Corporations around the world are increasing recognizing that sustained growth of their organization requires cooperation of all stakeholders, which requires adherence 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.

**Meaning of Corporate Governance**

The system by which companies are directed and controlled, (Sir Adrian Cadbury, the Committee on the Financial Aspects of Corporate Governance).

"Corporate Governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The corporate 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, corporations and society" (Sir Adrian Cadbury in 'Global Corporate Governance Forum', World Bank, 2000)

Corporate governance is the relationship between corporate managers, directors and the providers of equity, people and institutions who save and invest their capital to earn a return. It ensures that the board of directors is accountable for the pursuit of corporate objectives and that the corporation itself conforms to the law and regulations.

- International Chamber of Commerce .

**Players in Corporate Governance**

It is possible to broadly identify sets of players in the corporate governance system. They can be identified as law, which is the legal system; regulators; the board of directors, employees, auditors, financial intermediary; markets and self-regulatory organizations. There is a dynamic balance among them that determines the prevailing corporate governance system, and the balance varies from country to country.
**Regulatory Bodies:** The companies act generally guides the legal structure, internal management, control and administration of corporate. The regulatory framework, includes, Company Law Board Security and Exchange Board of India, Registrar of Companies, Statutory Auditors, Stock Exchanges, Financial Institutions and Banks.

**Board of Directors:** The board is accountable in various ways to number of different stakeholders. The directors are expected to achieve a harmonious balance between competing interest, viz., shareholders, investors, consumers, employees, government and the society at large. The board should maintain a proper balance between short-term policies and long term priorities of the company.

**Market Forces:** What triggered interest in corporate governance issues was replacement of government controls by market forces? Since, by their very nature market forces are dynamic and vibrant, corporate governance cannot be a static set of rules.

**Shareholders:** A large number of individual shareholders are scattered across a wide area and hold investments of small size i.e., 100 to 1000 shares on an average basis. The objective of this class of shareholders is to simply make a better return on their investments than is available in the traditional modes of investments. Majority of them do not attach any importance to analyze the information sent by the investee company or keep general track of the company.

**Auditors:** An auditor has a crucial responsibility of certifying the truth and fairness of the financial statements of a company under the Companies Act, 1956. Common criticism of Indian accounting norms is that they enable management hide more than what they reveal in the accounts. In the case of many companies, growth in size was not matched by corresponding growth in accounting controls.
Corporate Governance Down The Ages

Corporate Governance in India must be understood against the following backdrops. Firstly, promoters who belong to the business houses control very large proportions of the corporate sector. Their attitudes are mostly feudalistic and the general impression they seek to create is that the consumers of their products as well as the shareholders obtain value addition as a result of their benevolence. These areas to be basic underlying attitude despite some one it swearing by total quality management and delighting the consumers. Democratic tenets of corporate governance, even if they are defined in the legal procedures, are not a virtue of corporate India.

Secondly, the multinational corporations control a significant proportion of the corporate sector. The one fundamental fact that strikes even a casual observer is that the court are overburdened and are unable to punish the errant corporate making it nearly impossible for the small shareholders to obtain any protection. The third important point is that unless the political process discourages major shareholding by a few, it is virtually useless to create corporate governance mechanism fashioned after industrialized societies.

Managing Agency 1850-1955: Traditionally “Managing Agency” system occupied the most important place in corporate governance in India. The managing agents were the promoters, financiers and managers of the companies and they contributed in a significant way in the early industrial development in India. Managing agency houses had dominated in major business families in India. Due to several shortcomings and increasing malpractice’s in the managing agency system, many restrictions were initially imposed on the working of managing agents and subsequently the system was completely abolished. After that the board of directors as the top most corporate governing organ was super imposed through the legislative provisions by the government Thus the rise of board of directors was not through the evolutionary process but was artificially created from their socio-cultural background.

Managing agents are individuals or partnership firms who enter into a contract with joint stock companies to manage the affairs of the latter. The provisions
within the contract would help them to ensure that the shareholders could not readily remove them. Managing agents had wide range of powers. The were not only the managers but also exercised the functions of corporate governance. In many cases the companies, which the managing agents managed, did not even have boards, or if they did, the boards were entirely composed of the managing agents.

The two significant aspect of corporate governance- i.e., shareholders control, maximizing their wealth was sidetracked. Financial irregularities, lack of professional management, concentration of economic power resulting in oligopolistic markets were the major criticisms against this model. Thus corporations systematically acted in ways that were contrary to shareholders rights and spirit of fair market competitions.

**The Promoter Model 1956-1970:** The terms “promoter” and “promoter system” are widely referred to in the Indian industrial literature. The post Independence economy was characterized by the combination of import substituting industrialization, economic planning, and wide range of government support programs. The Companies Act, 1956 had shaped new form of corporate governance referred as promoter model. The word promoter refers to any person or group of people who floated new ventures. Later times, it referred not only to founders but also to a controlling individual or a group in a company.

With the shift from the managing agency model to promoter model a variety of changes were made in company law, which were designed to promote the shareholders to exercise their control over the firm. These included disclosure norms, rules for AGMs, standards for maintenance of records, limits on the number of directorships an individual could hold, restrictions on members of the same family serving on a board, the ability to remove director etc., In practice, however, little changed with respect to the ability of private investors to exercise any control over the firm. Hence promoters who week to survive and prosper would do well to remember that the main aim of their business is to maximize shareholders returns. No promoter should be allowed to improve his position at the expense of the shareholders. Good corporate governance
improves the capital market, the willingness of the people to save and invest in equity and thus improve the whole economy. The attempt of the promoters to increase control should attract the takeover code provisions.

**1970s An Era of Nominee Directors:** The 1970s marked the significance of nominee directors. The Central Government issued guidelines in 1971 to public financial institutions for the appointment of nominee directors. The purpose of having nominee directors is to prevent economic concentration and to guide the corporations to serve public interest.

The Nominee directors are expected to devote their wholehearted attention to the affairs of the concerns on whose boards they are nominated and safeguard the interest of institutions. They are accountable to the institutions, which they represent. They should prevent any abuse of powers by promoters and offer constructive suggestions to the management in all-important operational matters.

**The Decade of 1980s – Professional Investors Being Major Players:** By early 1980s the concept of professional investors came to light. IDBI, IFCI, ICICI, UTI and GIC had become among the largest shareholders in 63% of all publicly held companies. The tremendous increase in equity holdings by public institutions implied great potential for improving shareholder democracy. However there were several obstacles on this path. Initially government institutions were largely passive shareholders. For this reason, promoters liked institutions such as UTI, because they provided them equity without threatening their control over the firm.

**1990s A Revolution of Corporate Governance:** The decade 1990 brought into effect lot of revolutionary changes in the corporate sector. Economic policy reforms introduced in 1991 had brought in an era of liberalization, privatization and globalization. Change in the profile of corporate ownership, capital market reforms, disinvestments by Government of India by Government of India in Public Sector undertakings are all the factors to the growing significance of corporate governance.
The CII had taken the initiative to find ways of changing this culture of corporate governance. It had to educate the promoter on the proper role of the board, on the long-term advantage of good corporate governance practices and show that these practices contribute to improving long-term corporate performance. It had to convince business leaders that corporate governance will not be as irrelevant as in the past and that the success of Indian businesses in the liberalized market environment depends on the legitimacy and acceptability of Indian corporations in a global society.

**Corporate Governance in India – A Historical Background**

The system of corporate governance is India operates in an administered environment. Administrative control is seen as arbitrary and enforcement as poor, as many recent scams has demonstrated.

Directors from the promoter’s family have traditionally dominated the Indian boards. Professionals and other persons close to them constitute the majority on the board. Positions of chairman and managing director and executive directors are filled in from among the above persons. In most of the Indian companies there is no separation of roles of the Chairman and Managing Directors and one individual combines both the positions.

Most boards of directors, inspire of having nominees of Government controlled financial institutions, have little information about illegal or unethical conduct of their executive. The boards find it difficult to monitor the compliance of the company to the various legal requirements. The monitoring of professional standards by professional association such as of chartered accounts and auditors is also considered lax and discretionary.

In government corporations the boards are a mere legal formally. The elaborate system of accountability of public enterprises operates through the means of parliamentary committees, independent vigilance officers and the comptroller and auditor general of India. Accountability has remained more in form than in substance. Major decisions such as appointments, investments, purchase contract, selling arrangements, collaborations, and industrial relation agreements have moved out of
the corporation ambit into the bureaucracy and the political arena, bringing into focus the widespread corruption. None of the stakeholders-boards, the stock market, the banker, the financial institutions, the trade unions, and government-exercise major monitory role over the inappropriate actions taken by the top management in the corporate sector.

The Indian corporate sector, largely represented by family-owned companies, has come to realize that managing company affairs demonstrably in the interest of shareholders is the only way to attract capital. There is evidence of a fundamental shift from management-dominated boards to shareholder sensitive ones and this strength is likely to be further strengthened.

The historical development of Indian corporate laws has been marked by many interesting contrasts. At independence, India inherited one of the world’s poorest economies but one which had a factory sector accounting for a tenth of the national product. The country also inherited four functioning stock markets (predating the Tokyo Stock Exchange) with clearly defined rules governing listing, trading and settlements, a well-developed equity culture (if only among the urban rich), and a banking system replete with well-developed lending norms and recovery procedures. In terms of corporate laws and financial system, therefore, India emerged far better endowed than most other colonies. The 1956 Companies Act built on this foundation, as did other laws governing the functioning of joint-stock companies and protection of investors’ rights.

Early corporate developments in India were marked by the managing agency system. This contributed to the birth of dispersed equity ownership but also gave rise to the practice of management enjoying control rights disproportionately greater than their stock ownership. The turn towards socialism in the decades after independence, marked by the 1951 Industries (Development and Regulation) Act and the 1956 Industrial Policy Resolution, put in place a regime and a culture of licensing, protection, and widespread red-tape that bred corruption and stilted the growth of the corporate sector. The situation worsened in subsequent decades and corruption, nepotism, and inefficiency became the hallmarks of the Indian corporate sector. Exorbitant tax rates encouraged creative accounting practices and gave firms incentives to develop complicated emolument structures with large “under-the-table”
compensation at senior levels.

In the absence of a stock market capable of raising equity capital efficiently, three central (federal) government development finance institutions (the Industrial Finance Corporation of India, the Industrial Development Bank of India and the Industrial Credit and Investment Corporation of India), together with about thirty other state-government owned development finance institutions, became the main providers of long-term credit to companies. Along with the central government-owned and managed mutual fund, the Unit Trust of India, these institutions also held (and still hold) large blocks of shares in the companies to which they lent, and invariably had representations on their boards in the form of nominee directors, though they traditionally played very passive roles in the boardroom.

**Legal Frame Work**

An effective regulatory and legal framework is indispensable for the proper and sustained growth of the company. In rapidly changing national and global business environment, it has become necessary that regulation of corporate entities is in tune with the emerging economic trends, encourage good corporate governance and enable protection of the interests of the investors and other stakeholders. Further, due to continuous increase in the complexities of business operation, the forms of corporate organizations are constantly changing. As a result, there is a need for the law to take into account the requirements of different kinds of companies that may exist and seek to provide common principles to which all kinds of companies may refer while devising their corporate governance structure.

The important legislations for regulating the entire corporate structure and for dealing with various aspects of governance in companies are Companies Act, 1956 and Companies Bill, 2004. These laws have been introduced and amended, from time to time, to bring more transparency and accountability in the provisions of corporate governance. That is, corporate laws have been simplified so that they are amenable to clear interpretation and provide a framework that would facilitate faster economic growth.
Secondly, the Securities Contracts (Regulation) Act, 1956, Securities and Exchange Board of India Act, 1992 and Depositories Act, 1996 have been introduced by Securities and Exchange Board of India (SEBI), with a view to protect the interests of investors in the securities markets as well as to maintain the standards of corporate governance in the country.

**Companies Laws:** The Ministry of Corporate Affairs (MCA) is the main authority for regulating and promoting efficient, transparent and accountable form of corporate governance in the Indian corporate sector. It is constantly working towards improvement in the legislative framework and administrative set up, so as to enable easy incorporation and exit of the companies, as well as convenient compliance of regulations with transparency and accountability in corporate governance. It is primarily concerned with administration of the Companies Act, 1956 and related legislations.

**The Companies Act, 1956** is the central legislation in India that empowers the Central Government to regulate the formation, financing, functioning and winding up of companies. It applies to whole of India and to all types of companies, whether registered under this Act or an earlier Act. It provides for the powers and responsibilities of the directors and managers, rising of capital, holding of company meetings, maintenance and audit of company accounts, powers of inspection, etc. That is, it empowers the Central Government to inspect the books of accounts of a company, to direct special audit, to order investigation into the affairs of a company and to launch prosecution for violation of the Act. These inspections are designed to find out whether the companies conduct their affairs in accordance with the provisions of the Act, whether any unfair practices prejudicial to the public interest are being resorted to by any company or a group of companies and to examine whether there is any mismanagement which may adversely affect any interest of the shareholders, creditors, employees and others.

The main objectives with which this Act has been introduced are to:-

(i) help in the development of companies on healthy lines; (ii) maintain
a minimum standard of good behavior and business honesty in company promotion and management; (iii) protect the interests of the shareholders as well as the creditors; (iv) ensure fair and true disclosure of the affairs of companies in their annual published balance sheet and profit and loss accounts; (v) ensure proper standard of accounting and auditing; (vi) provide fair remuneration to management and Board of Directors as well as to company's employees; etc.

The Companies Act, 1956 has elaborate provisions relating to the Governance of Companies, which deals with management and administration of companies. It contains special provisions with respect to the accounts and audit, directors’ remuneration, other financial and non-financial disclosures, corporate democracy, prevention of mismanagement, etc.

Every company shall in each year, hold in addition to any other meetings, a general meeting as its annual general meeting and shall specify the meeting as such in the notices calling it; and not more than fifteen months shall elapse between the date of one annual general meeting of a company and that of the next. At each annual general meeting, every company shall appoint an auditor or auditors to hold office from the conclusion of that meeting until the conclusion of the next annual general meeting and shall, within seven days of the appointment, give intimation thereof to every auditor so appointed.

Every auditor of a company shall have a right of access at all times to the books and accounts and vouchers of the company, whether kept at the head office of the company or elsewhere, and shall be entitled to require from the officers of the company such information and explanations as the auditor may think necessary for the performance of his duties as auditor.

The auditor shall inquire:- (i) whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are not prejudicial to
the interests of the company or its members; (ii) whether transactions of the company which are represented merely by book entries are not prejudicial to the interests of the company; etc.

In the case of every company, a meeting of its Board of directors shall be held at least once in every three months and at least four such meetings shall be held in every year. Every director of a company, who is in any way, whether directly or indirectly, concerned or interested in a contract or arrangement, or proposed contract or arrangement, entered into or to be entered into, by or on behalf of the company, shall disclose the nature of his concern or interest at a meeting of the Board of directors.

No director of a company shall, as a director, take any part in the discussion of, or vote on, any contract or arrangement entered into, or to be entered into, by or on behalf of the company, if he is in any way, whether directly or indirectly, concerned or interested in the contract or arrangement; nor shall his presence count for the purpose of forming a quorum at the time of any such discussion or vote; and if he does vote, his vote shall be void.

Every company shall keep one or more registers in which shall be entered separately particulars of all contracts or arrangements, including the following particulars to the extent they are applicable in each case, namely:- (i) the date of the contract or arrangement; (ii) the names of the parties thereto; (iii) the principal terms and conditions thereof; (iv) in the case of a contract or arrangement to which this Act applies, the date on which it was placed before the Board; (v) the names of the directors voting for and against the contract or arrangement and the names of those remaining neutral. Further, every company shall keep at its registered office a register of its directors, managing director, managing agent, secretaries and treasurers, manager and secretary.
The remuneration payable to the directors of a company, including any managing or whole-time director, shall be determined, either by the articles of the company, or by a resolution or, if the articles so require, by a special resolution, passed by the company in general meeting; and the remuneration payable to any such director determined as aforesaid shall be inclusive of the remuneration payable to such director for services rendered by him in any other capacity. However, any remuneration for services rendered by any such director in any other capacity shall not be so included if:-(i) the services rendered are of a professional nature; and (ii) in the opinion of the Central Government, the director possesses the requisite qualifications for the practice of the profession.

A director may receive remuneration by way of a fee for each meeting of the Board, or a committee thereof, attended by him. A director who is neither in the whole-time employment of the company nor a managing director may be paid remuneration, either by way of a monthly, quarterly or annual payment with the approval of the Central Government; or by way of commission if the company by special resolution authorizes such payment. However, the remuneration paid to such director, or where there is more than one such director, to all of them together, shall not exceed:- (i) one per cent of the net profits of the company, if the company has a managing or whole-time director, a managing agent or secretaries and treasurers or a manager; (ii) three per cent of the net profits of the company, in any other case.

Every public company having paid-up capital of not less than five crores of rupees shall constitute a committee of the Board known as 'Audit Committee' which shall consist of not less than three directors and such number of other directors as the Board may determine of which two thirds of the total number of members shall be directors, other than managing or whole-time directors. The annual report of the company shall disclose the composition of the Audit Committee. The auditors, the internal auditor, if any, and the director-in-charge of
finance shall attend and participate at meetings of the Audit Committee but shall not have the right to vote.

The Audit Committee should have discussions with the auditors periodically about internal control systems, the scope of audit including the observations of the auditors and review the half-yearly and annual financial statements before submission to the Board and also ensure compliance of internal control systems. It shall have authority to investigate into any matter in relation to the items specified by the Board and for this purpose, shall have full access to information contained in the records of the company and external professional advice, if necessary. The recommendations of the Audit Committee on any matter relating to financial management, including the audit report, shall be binding on the Board. If the Board does not accept the recommendations of the Audit Committee, it shall record the reasons thereof and communicate such reasons to the shareholders.

Besides, a listed public company may, and in the case of resolutions relating to such business as the Central Government may, by notification, declare to be conducted only by postal ballot, shall, get any resolution passed by means of a postal ballot, instead of transacting the business in general meeting of the company. Where a company decides to pass any resolution by resorting to postal ballot, it shall send a notice to all the shareholders, along with a draft resolution explaining the reasons thereof, and requesting them to send their assent or dissent in writing on a postal ballot within a period of thirty days from the date of posting of the letter. If a resolution is assented to by a requisite majority of the shareholders by means of postal ballot, it shall be deemed to have been duly passed at a general meeting convened in that behalf. However, if a shareholder sends his assent or dissent in writing on a postal ballot and thereafter any person fraudulently defaces or destroys the ballot paper or declaration of identify of the shareholder, such person shall be punishable with imprisonment for a term which may extend to six months or with fine or with both.
Companies Bill, 2004: In the competitive and technology driven business environment, while corporate require greater autonomy of operation and opportunity for self-regulation with optimum compliance costs, there is a need to bring about transparency through better disclosures and greater responsibility on the part of corporate owners and management for improved compliance. In response to such changing corporate climate, the Companies Act, 1956 has been amended from time to time so as to provide more transparency in corporate governance and protect the interests of small investors, depositors and debenture holders, etc.

The important step in this direction has been the Companies Bill, 2004, which has been introduced to provide the comprehensive review of the company law. It contained important provisions relating to corporate governance, like, independence of auditors, relationship of auditors with the management of company, independent directors with a view to improve the corporate governance practices in the corporate sector. It is subjected to greater flexibility and self-regulation by companies, better financial and non-financial disclosures, more efficient enforcement of law, etc.

This amendment to the Companies Act 1956 mainly focused on reforming the audit process and the board of directors. It mainly aimed at:- (i) laying down the process of appointment and qualification of auditors, (ii) prohibiting non-audit services by the auditors; (iii) prescribing compulsory rotation, at least of the Audit Partner; (iv) requiring certification of annual audited accounts by both CEO and CFO; etc. For reforming the boards, the bill included that remuneration of non-executive directors can be fixed only by shareholders and must be disclosed. A limit on the amount which can be paid would also be laid down. It is also envisaged that the directors should be imparted suitable training. However, among others, an independent director should not have substantial pecuniary interest in the company’s shares.
SEBI Laws: Improved corporate governance is the key objective of the regulatory framework in the securities market. Accordingly, Securities and Exchange Board of India (SEBI) has made several efforts with a view to evaluate the adequacy of existing corporate governance practices in the country and further improve these practices. It is implementing and maintaining the standards of corporate governance through the use of its legal and regulatory framework, namely:-

Securities Contracts (Regulation) Act, 1956: This Act was enacted to prevent undesirable transactions and to check speculation in the securities by regulating the business of dealing therein. Any stock exchange, which is desirous of being recognised, may make an application in the prescribed manner to the Central Government. Every application shall contain such particulars as may be prescribed, and shall be accompanied by a copy of the bye-laws of the stock exchange for the regulation and control of contracts as well as a copy of the rules relating in general to the constitution of the stock exchange, and in particular to:- (i) the governing body of such stock exchange, its constitution and powers of management and the manner in which its business is to be transacted; (ii) the powers and duties of the office bearers of the stock exchange; (iii) the admission into the stock exchange of various classes of members, the qualifications for membership, and the exclusion, suspension, expulsion and re-admission of members there from or there into; (iv) the procedure for the registration of partnerships as members of the stock exchange, in cases where the rules provide for such membership; and the nomination and appointment of authorized representatives and clerks.

Every recognized stock exchange shall furnish the Central Government with a copy of the annual report, and such annual report shall contain such particulars as may be prescribed. It may make rules or amend any rules made by it to provide for all or any of the following matters, namely:- (i) the restriction of voting rights to members only in respect of any matter placed before the stock exchange at any meeting; (ii) the
regulation of voting rights in respect of any matter placed before the
stock exchange at any meeting so that each member may be entitled to
have one vote only, irrespective of his share of the paid-up equity
capital of the stock exchange; (iii) the restriction on the right of a
member to appoint another person as his proxy to attend and vote at a
meeting of the stock exchange; etc.

If, in the opinion of the Central Government, an emergency has arisen
and for the purpose of meeting the emergency, the Central Government
considers it expedient so to do, it may, by notification in the Official
Gazette, for reasons to be set out therein, direct a recognized stock
exchange to suspend such of its business for such period not exceeding
seven days and subject to such conditions as may be specified in the
notification, and, if, in the opinion of the Central Government, the
interest of the trade or the public interest requires that the period
should be extended, it may, by like notification extend the said period
from time to time. Securities Contracts (Regulation) Amendment Act,
2007 has been enacted in order to further amend the Securities
Contracts (Regulation) Act, 1956, with a view to include securitization
instruments under the definition of 'securities' and provide for
disclosure based regulation for issue of the securitised instruments and
the procedure thereof. This has been done keeping in view that there is
considerable potential in the securities market for the certificates or
instruments under securitization transactions. Further, replication of the
securities markets framework for these instruments would facilitate
trading on stock exchanges and, in turn, help development of the
market in terms of depth and liquidity.

Securities and Exchange Board of India Act, 1992: This Act was
enacted to protect the interests of investors in securities and to promote
the development of, and to regulate, the securities market and for
matters connected therewith or incidental thereto. For this purpose, the
SEBI (the Board), by regulation, specify:- (i) the matters relating to
issue of capital, transfer of securities and other matters incidental
thereto; and (b) the manner in which such matters shall be disclosed by the companies.

No stock-broker, sub-broker, share transfer agent, banker to an issue, trustee of trust deed, registrar to an issue, merchant banker, underwriter, portfolio manager, investment adviser and such other intermediary who may be associated with securities market shall buy, sell or deal in securities except under, and in accordance with, the conditions of a certificate of registration obtained from the Board in accordance with the regulations made under this Act.

No depository, participant, custodian of securities, foreign institutional investor, credit rating agency, or any other intermediary associated with the securities market as the Board may by notification in this behalf specify, shall buy or sell or deal in securities except under and in accordance with the conditions of a certificate of registration obtained from the Board in accordance with the regulations made under this Act.

Further, no person shall sponsor or cause to be sponsored or carry on or caused to be carried on any venture capital funds or collective investment scheme including mutual funds, unless he obtains a certificate of registration from the Board in accordance with the regulations.

Every application for registration shall be in such manner and on payment of such fees as may be determined by regulations. The Board may, by order, suspend or cancel a certificate of registration in a prescribed manner, as may be determined by regulations under this Act. However, no order shall be made unless the person concerned has been given a reasonable opportunity of being heard.

**Depositories Act, 1996:** This Act was enacted to provide for regulation of depositories in securities and for matters connected therewith or incidental thereto. It provides for the introduction of scrip
less trading system and settlement, which is considered necessary for the effective functioning of the securities markets. As per the Act, the term 'depository' means "a company formed and registered under the Companies Act, 1956 and which has been granted a certificate of registration under sub-section (1A) of section 12 of the Securities and Exchange Board of India Act, 1992".

No depository shall act as a depository unless it obtains a certificate of commencement of business from the Board (the SEBI). The Board shall grant a certificate only if it is satisfied that the depository has adequate systems and safeguards to prevent manipulation of records and transactions. However, a certificate shall not be refused unless the depository concerned has been given a reasonable opportunity of being heard.

A depository shall enter into an agreement with one or more participants as its agent, in such form as may be specified by the bye-laws. Any person, through a participant, may enter into an agreement, in such form as may be specified by the bye-laws, with any depository for availing its services. Any such person shall surrender the certificate of security, for which he seeks to avail the services of a depository, to the issuer in such manner as may be specified by the regulations. The issuer, on receipt of certificate of security, shall cancel the certificate of security and substitute in its records the name of the depository as a registered owner in respect of that security and inform the depository accordingly. A depository shall, on receipt of information, enter the name of the person referred in its records, as the beneficial owner.

On receipt of intimation from a participant, every depository shall register the transfer of security in the name of the transferee. If a beneficial owner or a transferee of any security seeks to have custody of such security, the depository shall inform the issuer accordingly. Every person subscribing to securities offered by an issuer shall have the option either to receive the security certificates or hold securities with a depository. Where a person opts to hold a security with a
depository, the issuer shall intimate such depository the details of allotment of the security, and on receipt of such information the depository shall enter in its records the name of the allottee as the beneficial owner of that security.

A depository shall be deemed to be the registered owner for the purposes of effecting transfer of ownership of security on behalf of a beneficial owner. However, it shall not have any voting rights or any other rights in respect of securities held by it. The beneficial owner shall be entitled to all the rights and benefits and be subjected to all the liabilities in respect of his securities held by a depository.

The Board, on being satisfied that it is necessary in the public interest or in the interest of investors so to do, may, by order in writing:- (i) call upon any issuer, depository, participant or beneficial owner to furnish in writing such information relating to the securities held in a depository as it may require; or (ii) authorise any person to make an enquiry or inspection in relation to the affairs of the issuer, beneficial owner, depository or participant, who shall submit a report of such enquiry or inspection to it within such period as may be specified in the order.

Corporate Governance and Law Reforms in India

Corporate governance has been a buzzword in India since 1998. But the need to have a good mechanism started since the beginning of 1990s when the Indian stock market rocked with many scams. On account of the interest generated by Cadbury Committee Report (1992) in UK, the Confederation of Indian Industries (CII), the Associated Chambers of Commerce and Industry (ASSOCHAM) and the Securities and Exchange Board of India (SEBI) constituted Committees to recommend initiatives in Corporate Governance. The recommendations of the Kumar Mangalam Birla Committee, constituted by SEBI, led to the addition of Clause 49 in the Listing Agreement. These recommendations, aimed at improving the standards of Corporate Governance, are divided into mandatory and non-mandatory recommendations. The recommendations have been made applicable
to all listed companies, their directors, management, employees and professionals associated with such companies. The ultimate responsibility for putting the recommendations into practice lies directly with the Board of Directors and the management of the company. The latest developments include constitution of a high-powered Committee by Department of Company Affairs, Government of India, headed by Shri Naresh Chandra, on August 21, 2002, to examine various corporate governance issues.

Other developments include the constitution of a Committee by SEBI under the Chairmanship of Shri N.R. Narayana Murthy, for reviewing implementation of the corporate governance code by listed companies and issue of revised clause 49 based on its recommendations; setting up of a proactive Standing Company Law Advisory Committee by Department of Company Affairs to advise on several issues like inspection of corporate for wrong doings, role of independent auditors and directors and their liability and suggesting steps to enhance imposition of penalties. Another Committee has been constituted by the Department of Company Affairs known as the Working Group for examination of suggestions received on good corporate governance. A High Powered Central Coordination and Monitoring Committee (CCMC), co-chaired by Secretary, Department of Company Affairs and Chairman, SEBI was set up to monitor the action taken against the vanishing companies, and unscrupulous promoters who misused the funds raised from the public. It was decided by this Committee that Seven Task Forces be set up at Mumbai, Delhi, Chennai, Kolkata, Ahmadabad, Bangalore and Hyderabad with Regional Directors/ Registrar of Companies of respective regions as convener, and Regional Offices of SEBI and Stock Exchanges as Members. The main task of these Task Forces was to identify the companies, which have disappeared, or which have mis-utilised the funds mobilized from the investors, and suggests appropriate action in terms of Companies Act or SEBI Act. SEBI says that the Corporate governance norms introduced for listed companies vide clause 49 of the listing agreement on the basis of the Kumaramanagalam Birla Committee Report, 1999 have met with encouraging success, since most of the ‘A’ Group companies listed on BSE and NSE have complied with the Norms. However, the corporate governance has remained more on paper is clear from
The following facts emerged from the report:

- The predominant form of corporate governance in India is ‘insider model’ where promoters dominate governance in every possible way. Indian corporate which reflect the pure ‘outsider model’ are relatively small in number.
- A distinguishing feature of the Indian Diaspora is the implicit acceptance that corporate entities belong to founding families.
- The listing agreement, the main instrument, through which SEBI ensures implementation of corporate governance, is a weak instrument, as its penal provisions are not stringent. The maximum penalty a stock exchange can impose on any company that does not follow the corporate governance norms is suspension of trading in its shares. This penalty hurts the investor community more than the management of the company that violates the listing agreement.
- Regional stock exchanges where a large number of companies are listed lack effective organization and skills to monitor effective compliance with corporate governance norms.
- A vast majority of companies that are not listed remain outside the purview of SEBI’s measures.
- The financial institutions that have large shareholdings in most of the listed companies have been passive observers in the area of corporate governance and do not effectively exercise their rights as shareholders.
- The autonomy of the Boards of Public Sector Units and public sector banks has been seriously eroded due to special legislative provisions or notifications and day to day interference by the concerned administrative ministries.

It is interesting to note that despite corporate governance in the form of clause 49 was already introduced in the year 2000; it could not prevent securities scam of 2002. Events in the stock exchanges have exposed the lack of ethical conduct by many Indian corporate:
• Rampant insider trading by the promoters in league with big market players.
• Massive price rigging/ manipulation by the promoters in league with big market players prior to mergers and takeovers.
• Gross misuse of bank funds for clandestine stock market operations.
• Criminally motivated investment in violation of laid down norms.
• Many companies, which raised money from the capital market through public issues, have not paid any dividend for more than five years.
• The total amount of money (collected through public offerings) duped by the vanishing companies is calculated to be Rs 66,861 billion;
• Non-performing assets of scheduled commercial banks amounted to Rs 58,554 billion as on 31 March 2003.

In addition small investors have lost their hard earned money in the stock markets for the following reasons:

• Lack of ethics, selfish conscience, and breach of trust on the part of the promoters.

• Lack of adequate compliance mechanism, supervision, proper inspection, effective regulation and preventive action by regulators like Department of Company Affairs, Registrar of Companies, Board of Stock Exchanges as well as SEBI.
• Lack of professional ethics on the part of professionals, like Chartered Accountants, Company Secretaries etc, who are holding onerous positions in companies.

It all establish that no matter that most of the companies may be fully complying with the corporate governance norms laid down by clause 49, but absence of good conscience on the part of the promoters to observe ethical practices have created little impact in practice.

A number of proposals have been made to improve corporate governance. The various suggested reforms include:

• strengthening the position of internal and outside auditors;
• allowing mergers and acquisitions approved by a panel;
• requiring more independent outside directors on boards;
• introducing the supervisory board or two-tier system;
• allowing banks to own greater equity in shares of the companies;
• enhanced disclosure through consolidated balance sheets and enforcement of accounting standards.

An important mechanism required to make the capital marked discipline is liberalization of restrictions on mergers and acquisitions. Secondly, the bankruptcy provisions are allowed to operate without any government interference. Another important commitment necessary on the part of government is that it should discontinue directed lending and permit commercial banks and government financial institutions to be run by their boards in the interest of their shareholders rather than the government.

In India, the four clusters of legal arrangements have been developed to respond to corporate governance problems. These are securities market regulations, the fiduciary responsibilities of directors and officers, laws governing takeovers, and rules governing shareholder voice. The two most important laws that control the listed companies are the Securities Contracts (Regulation) Act, 1956 which regulate all new public offerings, dealings in stock market and the functioning of the stock exchanges in India and the Securities and Exchange Board of India Act, 1992 which created the Securities and Exchange Board of India (SEBI), giving it the authority to administer the Securities Contracts (Regulation) Act, and all the other regulation of securities. The major purpose of these laws is to require regular, accurate, and timely public disclosure of financial

Information by any company that issued publicly traded securities and to instill public confidence in the reliability and accuracy of information so reported. A new law called the Indian Competition Act, 2002 has been enacted to replace the MRTP Act, 1969. The objective of the new law is to prevent practices having adverse effect on competition, to promote and sustain competition in markets, to protect the interest of consumers and to ensure freedom of trade carried on by other participants in markets and for matters connected therewith or incidental thereto.
Organizational Framework: The organizational framework for corporate governance initiatives in India consists of the Ministry of Corporate Affairs (MCA) and the Securities and Exchange Board of India (SEBI). The first formal regulatory framework for listed companies specifically for corporate governance was established by the SEBI in February 2000, following the recommendations of Kumarmangalam Birla Committee Report. It was enshrined as Clause 49 of the Listing Agreement.

Thereafter SEBI had set up another committee under the chairmanship of Mr. N. R. Narayana Murthy, to review Clause 49, and suggest measures to improve corporate governance standards. Some of the major recommendations of the committee primarily related to audit committees, audit reports, independent directors, related party transactions, risk management, directorships and director compensation, codes of conduct and financial disclosures.

The Ministry of Corporate Affairs had also appointed a Naresh Chandra Committee on Corporate Audit and Governance in 2002 in order to examine various corporate governance issues. It made recommendations in two key aspects of corporate governance: financial and non-financial disclosures: and independent auditing and board oversight of management.

It had also set up a National Foundation for Corporate Governance (NFCG) in association with the CII, ICAI and ICSI as a not-for-profit trust to provide a platform to deliberate on issues relating to good corporate governance, to sensitise corporate leaders on the importance of good corporate governance practices as well as to facilitate exchange of experiences and ideas amongst corporate leaders, policy makers, regulators, law enforcing agencies and non-government organizations.

Ministry of Corporate Affairs (MCA): Ministry of Corporate Affairs, earlier known as Department of Corporate Affairs under Ministry of Finance, is primarily concerned with the administration of the Companies Act, 1956, and other allied Acts, etc framed there-under for regulating the functioning of the corporate sector in accordance with
the law. It is also responsible for administering the Competition Act, 2002 and exercises supervision over the three professional bodies, namely, Institute of Chartered Accountants of India (ICAI), Institute of Company Secretaries of India (ICSI) and Institute of Cost and Works Accountants of India (ICWAI), which have been constituted for proper and orderly growth of the professions concerned.

It also has the responsibility of carrying out the functions of the Central Government relating to administration of Partnership Act, 1932, the Companies (Donations to National Funds) Act, 1951 and Societies Registration Act, 1980.

**Naresh Chandra Committee Report on Corporate Audit and Governance:** The Ministry of Corporate Affairs had appointed a high level committee in August 2002 to examine various corporate governance issues. The committee had 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 Sarbanes Oaxley Act (SOX Act), and if so, its constitution; and
• role of independent directors, and how their independence and effectiveness can be ensured.

The Committee's recommendations relate to:

• Disqualifications for audit assignments;
• List of prohibited non-audit services;
• Independence Standards for Consulting and Other Entities that are Affiliated to Audit Firms;
• Compulsory Audit Partner Rotation;
• Auditor's disclosure of contingent liabilities;
• Auditor's disclosure of qualifications and consequent action;
• Management's certification in the event of auditor's replacement;
• Auditor's annual certification of independence;
• Appointment of auditors;
• Setting up of Independent Quality Review Board;
• Proposed disciplinary mechanism for auditors;
• Defining an independent director;
• Percentage of independent directors;
• Minimum board size of listed companies;
• Disclosure on duration of board meetings/committee meetings;
• Additional disclosure to directors;
• Independent directors on Audit Committees of listed companies;
• Audit Committee charter;
• Remuneration of non-executive directors;
• Exempting non-executive directors from certain liabilities;
• Training of independent directors;
• SEBI and Subordinate Legislation;
Corporate Serious Fraud Office; etc.

**National Foundation for Corporate Governance (NFCG):** Ministry of Corporate Affairs has set up a National Foundation for Corporate Governance (NFCG) in association with CII, ICAI and ICSI, as a not-for-profit trust. It provides a platform to deliberate on issues relating to good corporate governance, to sensitize corporate leaders on importance of good corporate governance practices as well as facilitate exchange of experiences and ideas amongst corporate leaders, policy makers, regulators, law enforcing agencies and non-government organizations.

The NFCG has a three-tier structure for its management, viz, the Governing Council under the Chairmanship of Minister of Corporate Affairs, the Board of Trustees and the Executive Directorate.

NFCG had framed an action plan, which includes development of good corporate governance principles on identified themes i.e. (i) corporate governance norms for institutional investors, (ii) corporate governance norms for independent directors, and (iii) corporate governance norms for audit.

The foundation has been set up with the mission to:

- foster a culture for promoting good governance, voluntary compliance and facilitate effective participation of different stakeholders;
- create a framework of best practices, structure, processes and ethics;
- make significant difference to Indian corporate sector by raising the standard of corporate governance in India towards achieving stability and growth

**Securities and Exchange Board of India (SEBI):** Securities and Exchange Board of India (SEBI) was established on April 12, 1992 in
accordance with the provisions of the Securities and Exchange Board of India Act, 1992. It monitors and regulates corporate governance of listed companies in India through Clause 49 of the Listing Agreement. This clause is incorporated in the listing agreement of stock exchanges and it is compulsory for them to comply with its provisions. It was first introduced in the financial year 2000-01 based on the recommendations of Kumar Mangalam Birla committee.

Committees and Codes on Corporate Governance in India

CII Code of Corporate Governance\(^7\): In December 1995, the CII set-up a Committee under the chairmanship of industrialist Rahul Bajaj to prepare a comprehensive voluntary code of corporate governance for listed companies. The final draft report was released in April 1998. The CII Code on corporate governance recommended that the: key information to be reported, listed companies to have audit committees, corporate to give a statement on value addition, consolidation of accounts to be optional. Main emphasis was on transparency, as stated by Shear Data, the then President of CII, in the foreword to the Report:

“Corporate Governance is a phrase which implies transparency of management systems in business and industry, be it private or public sector –all of which are corporate entities. Just as industry seeks transparency in Government policies and procedures, so, corporate governance seeks transparency in corporate sector.

UTI Code of Corporate Governance\(^8\): In the year 1999, the Unit Trust of India (UTI) also formulated a code of corporate governance. This was followed by the professional bodies like the Institute of Company Secretaries of India (ICSI) to focus the attention of the Indian corporate sector, on the norms of governance and it set up a National award of Excellence in Corporate Governance.
Birla Committee Report on Corporate Governance: SEBI constituted a Committee on corporate governance with as many as 18 members under the chairmanship of Shri Kumar Managalam Birla, to promote and raise the standards of corporate governance in respect of listed companies on 7\textsuperscript{th} May 1999. This Committee, after a good deal of deliberations with industrial associations and professional bodies, submitted its report on 25\textsuperscript{th} January 2000, and recommended various new norms of corporate governance. SEBI accepted the recommendations, which culminated in the introduction of clause 49 in the standard Listing Agreement for implementation by all stock exchanges for all listed companies, within a time frame of three years commencing from the financial year 2000-2001. The main recommendations of this Committee related to the composition of the board including independent directors, constitution of audit committee in certain sized companies to look into the financial aspects of a company, remuneration of directors, director’s report to include management discussion and analysis report, better disclosure norms to the shareholders through annual report, etc.

Regarding the composition of the board of directors of a company, the Committee was of the view that the composition of the board of directors is critical to the independent functioning of the board as it determines the ability of the board to collectively provide the leadership and ensures that no one individual or group is able to dominate the board. The committee recommended that the board of a company should have an optimum combination of executive and non-executive directors, with not less than fifty percent of the board comprising the non-executive directors. As the executive directors are involved in the day-to-day management of companies, the non-executive directors bring external and wider perspective and independence to the decision-making.

It has been the practice of most of the companies in India to fill the board with representatives of the promoters of the company
as independent directors. This has undergone a change and now the boards comprise of following groups of directors: Promoters’ directors, Executive directors, non-executive directors, and a part of who are independent.

Based on these recommendations, the Companies (Amendment) Act 2000 introduced many provisions relating to corporate governance including (a) additional ground of disqualification of directors in certain cases, (b) setting up of audit committees, (c) director’s responsibility statement in the directors’ report, (d) introduction of postal ballot for transacting certain items of business in the general meeting, and (e) enforcement of accounting standards.

Corporate governance was also introspected by the Advisory Group constituted by the Standing Committee on International Finance Standards and Codes of the Reserve Bank of India under the Chairmanship of Dr. Y.V.Reddy the then Deputy Governor and later on the Governor of RBI. All these efforts focused the attention of the corporate boards that they should manage the affairs of companies with better accountability to shareholders and achieve transparency of operations with disclosure of both financial and non-financial data through annual report and other periodical reports. As a result, annual report of listed Indian companies, now reflect in adequate measure the new norms of governance.

**Basel Committee— For Banking Organisations:** Basel Committee published its report on Corporate Governance for Banking Organisation in September, 1999. According to the committee the boards of directors add strength to the corporate governance of a bank when they

- understand their supervisory role and their “duty of loyalty” to the bank and its shareholders;
- serve as a “checks and balances” function Vis-à-vis the day-to-day management of the bank;
• Feel empowered to question the management and are comfortable insisting upon straightforward explanations from management.
• Recommend sound practices gleaned from the other situations;
• Provide dispassionate advice;
• Are not ever extended
• Avoid conflicts of interest activities with, and commitment to, other organizations;
• Meet regularly the senior management and internal audit to establish and approve polices, establish communication lines and monitor progress toward corporate objectives.
• Absent themselves from decisions when they are incapable of providing objective advice;
• Do not participate in day-to-day management of the bank.

It is found that in a number of countries, bank boards have found it beneficial to establish certain specialized committees. Let us look at a few of them”
• Risk Management Committee: it provides oversight of the senior management’s activities in managing credit, market liquidity, and operational legal and other risks of the banks.
• Audit Committee: it provides oversight of the bank’s internal and external auditors, approving their appointment and dismissal, reviewing and approving audit scope and frequency, receiving their reports and ensuring that management is taking appropriate corrective actions in a timely manner to control weaknesses, non-compliance with policies, laws and regulations, and other problems identified by auditors.
• Compensation Committee: it provides oversight of remuneration of senior management and other key personnel ensuring that compensation is consistent with the bank’s culture, objectives, strategy and control environment.
• Nomination Committee: it provides important assessment of board effectiveness and directs the process of renewing and replacing board members.
Naresh Chandra Committee Report on Corporate Audit and Governance (2002): The Enron debacle in July 2002, involving the hand-in-glove relationship between the auditor and the corporate client and various other scams in the United States, and the consequent enactment of the stringent Sarbanes – Oxley Act in the United States were some important factors, which led the Indian government to wake up. The Department of Company Affairs in the Ministry of Finance on 21 August 2002, appointed a high level committee, popularly known as the Naresh Chandra Committee, to examine various corporate governance issues and to recommend changes in the diverse areas involving the auditor-client relationships and the role of independent directors. The Committee submitted its Report on 23 December 2002.

In its report, the Committee commented on:

- the poor structure and composition of the board of directors of Indian companies,
- scant fiduciary responsibility,
- poor disclosures and transparency,
- inadequate accounting and auditing standards,

The need for experts to go through the minutest details of transactions among companies, banks and financial institutions, capital markets etc. On the auditor - company relationship, the Committee recommended that the proprietary of auditors rendering non-audit services is a complex area, which needs to be carefully dealt with. The recommendations of this Committee are more or less in line with the Rules framed by the Securities & Exchange Commission (SEC) in accordance with the provisions of the Sarbanes-Oxley Act 2002. The recommendations of the Naresh Chandra Committee are expected to play a vital role in strengthening the composition and effectiveness of the regulatory framework for good corporate governance.
Narayana Murthy Committee Report on Corporate Governance: In the year 2002 SEBI analyzed the statistics of compliance with clause 49 by listed companies and felt that there was a need to look beyond the mere systems and procedures, if corporate governance was to be made effective in protecting the interests of the investors. SEBI, therefore, constituted a committee under the Chairmanship of N.R. Narayana Murthy, Chairman of Infosys Technologies Ltd to review the performance of corporate governance in India and make appropriate recommendations. The Committee included representatives from the stock exchanges, chambers of commerce and industry, investor associations and professional bodies. The Narayana Murthy Committee submitted its report on 8 February 2003.

In the meantime many of the recommendations of the Naresh Chandra Committee found their acceptance in the form of the Companies (Amendment) Bill of 2003, which was introduced in the Parliament in May 2003, but now had been withdrawn. The mandatory recommendations of the Committee relate to:

- the role and functions of the Audit committee,
- the risk management and minimization procedures,
- the uses and the application of funds received from the initial public offers,
- code of conduct for the board,
- nominee directors and independent directors.

Concept of Corporate Excellence: Corporate excellence is a way ahead of corporate governance. The Department of Company Affairs (DCA) in 2000 appointed a study group under the chairmanship of Dr. P.L. Sanjeeva Reddy, Secretary DCA to suggest ways and means of achieving corporate excellence and to explore the possibility of putting in place an implementable system and develop firm infrastructure. The study group constituted a Task Force under the Chairmanship of S. Rajagopalan, former Chairman, Mahanagar Telephone Nigam Limited (MTNL). This
task force inter-acted with the delegates of Commonwealth Secretariat on Centre for Corporate Governance, various chambers of commerce and professional bodies.

The key recommendations of the study group were:

- Setting up an independent autonomous centre for corporate excellence, with a view to accord accreditation to promote policy research and studies, training and education awards etc. In the field of corporate excellence through improved corporate governance.
- Introducing measures for greater shareholders’ participation, through multiple location meetings, and electronic media etc.
- Introducing recognition of corporate social responsibility with Triple-bottom Line Accounting and Reporting.
- Clearer distinction between direction and management to ensure that executive directors are held responsible for legal and other compliance with non-executive directors being charged with strategic and overall responsibilities.
- Highlighting directors’ commitment and accountability through fewer and more focused board and committee membership, tighter independence criteria and minimization of interest-conflict potential.
- Suggesting application of corporate governance principles to public sector undertakings both in the listed and unlisted companies and upgrading their board with independent directors.

**Corporate Governance Voluntary Guidelines 2009 (December 24, 2009):** On December 24, the Ministry of Corporate Affairs (MCA) published the "Corporate Governance Voluntary Guidelines 2009". While the Ministry sought recommendations from a number of parties for these Guidelines, they are based mainly on recommendations from two reports: the Naresh Chandra-Confederation of Indian Industry (CII) corporate governance task force report, and the "ICSI (Institute of Company Secretaries India) Recommendations to Strengthen Corporate Governance Framework".12n

38
The six issues the Guidelines cover are:

- Board of directors;
- Responsibilities of the board;
- Audit committee of the board;
- Auditors;
- Secretarial audit; and
- Institution of mechanism for whistle blowing.

The Ministry has stated that it will visit the Guidelines again in a year after it receives feedback from various quarters.

**Guidelines on Corporate Governance for Central Public Sector Enterprises 2007:** Reform of central public sector enterprises (CPSEs) is high on the Indian government’s agenda as they are essential in “employment generation and as an important source of R& D in our industrial sector”. Strong PSEs, the government believes, would be better prepared to enter the capital market to raise funds, which means practices must be in place to ensure accountability. The push by the government has resulted in these guidelines issued by the Department of Public Enterprises in June 2007.

The main issues these guidelines cover are:

- Board of Directors
- Setting up of Audit Committees and its roles and powers
- Issues relating to subsidiary companies
- Disclosures
- Accounting Standards
- Risk Management

Even though the guidelines are voluntary, all CPSEs, both listed and non-listed, are meant to follow them, with compliance of these guidelines to be referred to in the Directors’ report, Annual report and the chairman’s speech during the Annual General Meeting. The Department will grade the
companies on the basis of their compliance with the guidelines Issued on an experimental basis for a year, they will be revised “in the light of experience gained”.

**Expert Group Headed by Justice M H Kania (former chief justice of India) for Suggesting Amendments to SEBI Act, 1992 (July 2005):** The SEBI Act 1992 has been amended three times, in 1995, 1999 and 2002 to reflect the changes and developments in the securities market. However, it was felt more was needed to be done to remove any ambiguities that exist and to bring the ACT in line with IOSCO, the World Bank and the IMF’s benchmark Financial Services Assessment Programme (FSAP) standards. An internal group consisting of SEBI senior officers proposed amendments to the SEBI Act to achieve this, and in 2004 the SEBI Board formed an expert group under Justice M H Kania, former chief justice of India, to study the proposals. One of the proposals studied was the consolidation of existing securities laws into one Act along the lines of the Financial Services and Market Act, 2000 of the UK.

The committee, consisting of relevant stakeholders, produced its final report in July 2005. Some key recommendations included establishing a separate investor protection to promote investor education and awareness and to compensate small investors who are victims of among other things fraud, adding a provision that ensures monies or securities that clients have with an intermediary be held in the form of a trust, which could not be attached or seized by any authority. However, it fell short of endorsing the consolidation of securities laws, instead stating that the Central Government should make the decision through a policy statement. All its recommendations were approved by SEBI in March 2006 and the report has been forwarded to the Law Ministry.

**Expert Committee on Company Law (May 2005):** In December, 2004, the Ministry of Company Affairs set up the Expert Committee under the Chairmanship of Dr. J. J. Irani, Director, Tata Sons, to advise the Government on proposed revisions to the Companies Act, 1965. The Government wanted "to have a simplified compact law that will be able to
address the changes taking place in the national and international scenario, enable adoption of internationally accepted best practices as well as provide adequate flexibility for timely evolution of new arrangements in response to the requirements of ever-changing business models".

Prior to the setting up of the Committee, a Concept Paper was produced in-house by the Ministry of Company Affairs and put up on its website. Interested parties then gave their feedback and it was this Paper with the suggestions from a number of organisations, professional bodies and individuals which was given to the Committee to deliberate on, with the proviso "not to feel constrained or limited by the concept paper or feedback".

The Expert Committee consisted of 13 members and 6 special invitees. They included members from trade and industry, chambers of commerce, professional institutes, representatives of Banks and lawyers, while Government Ministries and regulatory bodies concerned with the subject were represented through special invitees.

**Corporate Governance Codes across the World**

In the changing global scenario, it has become necessary to bring in effective governance practices in the corporate sector. Various important and valuable lessons have been learned from the series of corporate collapses that occurred in different parts of the world. Accordingly, several codes, guidelines and principles have been made and implemented covering varied aspects of corporate governance. They were introduced in order to restore investors' confidence as well as to enhance corporate transparency and accountability. They seek to establish the accountability standards of Directors and CEOs; as well as define the roles and responsibilities of the Board of Directors and stakeholders in the company.

Over the years, the issue of corporate governance has received a high level of attention. There are several reports and recommendations of the International Committees/ Associations, etc. on the development of appropriate framework for
promoting good corporate governance standards, codes and practices to be followed globally. These are:-

- Global Principles of Accountable Corporate Governance (1999)
- King Committee On Corporate Governance (2002)
- Sarbanes Oxley Act (2002)
- The Combined Code on Corporate Governance (2006)
- The Combined Code on Corporate Governance (2008)

These recommendations and principles have been mainly focused on structure of the company, financial and non-financial disclosures, compliance with codes of corporate governance, competitive remuneration policy, shareholders rights and responsibilities, financial reporting and internal controls, etc. All these efforts at international level, in turn, helps to bring favorable changes in the operating systems of Board of Directors, Company's management and administration; as well as improve face of relationship between supervisory and executive bodies. Some of the main codes and principles on the Corporate Governance are as follows:

**Cadbury Committee Report (1992):** The 'Cadbury Committee' was set up in May 1991 with a view to overcome the huge problems of scams and failures occurring in the corporate sector worldwide in the late 1980s and the early
1990s. It was formed by the Financial Reporting Council, the London Stock of Exchange and the accountancy profession, with the main aim of addressing the financial aspects of Corporate Governance. Other objectives include: (i) uplift the low level of confidence both in financial reporting and in the ability of auditors to provide the safeguards which the users of company's reports sought and expected; (ii) review the structure, rights and roles of board of directors, shareholders and auditors by making them more effective and accountable; (iii) address various aspects of accountancy profession and make appropriate recommendations, wherever necessary; (iv) raise the standard of corporate governance; etc. Keeping this in view, the Committee published its final report on 1st December 1992. The report was mainly divided into three parts:-

**Reviewing the structure and responsibilities of Boards of Directors and recommending a Code of Best Practice:** The boards of all listed companies should comply with the Code of Best Practice. All listed companies should make a statement about their compliance with the Code in their report and accounts as well as give reasons for any areas of non-compliance. The Code of Best Practice is segregated into four sections and their respective recommendations are:-

- **Board of Directors** - The board should meet regularly, retain full and effective control over the company and monitor the executive management. There should be a clearly accepted division of responsibilities at the head of a company, which will ensure a balance of power and authority, such that no one individual has unfettered powers of decision. Where the chairman is also the chief executive, it is essential that there should be a strong and independent element on the board, with a recognised senior member. Besides, all directors should have access to the advice and services of the company secretary, who is responsible to the Board for ensuring that board procedures are followed and that applicable rules and regulations are complied with.
• **Non-Executive Directors** - The non-executive directors should bring an independent judgment to bear on issues of strategy, performance, resources, including key appointments, and standards of conduct. The majority of non-executive directors should be independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgment, apart from their fees and shareholding.

• **Executive Directors** - There should be full and clear disclosure of directors’ total emoluments and those of the chairman and highest-paid directors, including pension contributions and stock options, in the company's annual report, including separate figures for salary and performance-related pay.

• **Financial Reporting and Controls** - It is the duty of the board to present a balanced and understandable assessment of their company’s position, in reporting of financial statements, for providing true and fair picture of financial reporting. The directors should report that the business is a going concern, with supporting assumptions or qualifications as necessary. The board should ensure that an objective and professional relationship is maintained with the auditors.

**Considering the role of Auditors and addressing a number of recommendations to the Accountancy Profession:** The annual audit is one of the cornerstones of corporate governance. It provides an external and objective check on the way in which the financial statements have been prepared and presented by the directors of the company. The Cadbury Committee recommended that a professional and objective relationship between the board of directors and auditors should be maintained, so as to provide to all a true and fair view of company's financial statements. Auditors' role is to design audit in such a manner so that it provide a reasonable assurance that the financial statements are free of material misstatements. Further, there is a need to develop more effective accounting standards, which provide
important reference points against which auditors exercise their professional judgment. Secondly, every listed company should form an audit committee which gives the auditors direct access to the non-executive members of the board. The Committee further recommended for a regular rotation of audit partners to prevent unhealthy relationship between auditors and the management. It also recommended for disclosure of payments to the auditors for non-audit services to the company. The Accountancy Profession, in conjunction with representatives of preparers of accounts, should take the lead in:- (i) developing a set of criteria for assessing effectiveness; (ii) developing guidance for companies on the form in which directors should report; and (iii) developing guidance for auditors on relevant audit procedures and the form in which auditors should report. However, it should continue to improve its standards and procedures.

Dealing with the Rights and Responsibilities of Shareholders: The shareholders, as owners of the company, elect the directors to run the business on their behalf and hold them accountable for its progress. They appoint the auditors to provide an external check on the directors’ financial statements. The Committee's report places particular emphasis on the need for fair and accurate reporting of a company's progress to its shareholders, which is the responsibility of the board. It is encouraged that the institutional investors/shareholders to make greater use of their voting rights and take positive interest in the board functioning. Both shareholders and boards of directors should consider how the effectiveness of general meetings could be increased as well as how to strengthen the accountability of boards of directors to shareholders.

Hampel Committee: Rom Hampel was given the task of chairing the “Committee on corporate governance” with an objective to keep up the momentum by assessing the impact of Cadbury Committee and developing further guidance.
The final report submitted by the committee chaired by Ron Hampel had some important and progressive elements, notably the extension of Directors’ responsibilities to business risks assessment and minimizing the risk of fraud.

The combined code was subsequently derived from Ron Hampel Committee’s Final Report and from the Cadbury Report and Greenbury Report. The Combined code is appended to the listing rules of the London Stock Exchange. As such, compliance is mandatory for all listed companies in the U.K.

The stipulations contained in the Combined Code require, among other things, that the Boards should maintain a sound system of internal control to safeguard shareholders’ investment and the company’s assets. The directors should, at least annually, conduct a review of the effectiveness of internal control system. The review should cover all controls, including financial, operational controls and risks management.

Subsequent developments with regard to corporate governance in U.K, led to the publication of Turnbull Guidance in September 1999, which required the board of directors to confirm that there was an on-going process for identifying, evaluating and managing the key business risks.

In this context, it was observed that the one common denominator behind the past failures in the corporate world was the lack of effective Risk Management. As a result Risk Management subsequently grew in importance and is now seen as highly crucial to the achievement of business by the corporate.

It was clear, therefore, that boards of directors were not only responsible but also needed guidance not just reviewing the effectiveness of internal controls but also for providing assurance that all significant risks had been managed and embedded risk management process was in place.

**Blue Ribbon Committee (U.S.A):** The Blue Ribbon Committee was formed under the auspices of the United States Securities and Exchange Commission to develop a series of recommendations to enable audit committees to function
as the ultimate guardian of investor interest and corporate accountability. It has recommended that exchange listing requirements be amended to require audit committees to adopt a formal writer, charter and review and assess it annually. The following points are worth noting.

- Members of the Audit Committee shall be considered independent if they have no relationship to the corporation that may interfere with the exercise of their independence from management and the corporation.
- All the members of the Audit committee should be Financial Literates.
- Requirement that the audit committee has to disclose whether it has satisfied its own responsibilities during the prior year in compliance as per its character.
- Requirement that all companies have to include a letter from Audit Committee in the Company’s Annual Report to the shareholders.
- The Generally Accepted Auditing Standards (GASS) requires that a company’s outside auditor discuss with the Audit Committee, the auditors judgment about the quality and acceptability of the company’s accounting principles.

**King Committee – Africa:** In the year 1994, a committee was set up in South Africa consisting of 15 individuals who in their own right were all experts in the area of corporate governance, with Meriyn King as the chairman. This committee was set up at the instance of the Institute of Directors in South Africa, with support from the South African Chamber of Business and the Chartered Institute of Secretaries and Administrators, The South African Institute of Chartered Accountants, The Johannesburg Stock Exchange and the South African Institute of Business Ethics.

The King’s Committee recommends that

- The boards should be balanced between executive and non-executive directors.
- Roles of chairperson and chief executive officer should be split and in the board, in the absence of split, there should be at least two non-executive directors.
The director’s report should incorporate a statement on their responsibilities in respect of financial statements, accounting records, accounting standards, internal audit, adherence to the code of corporate practices and conduct and details of non-adherence.

Shareholders should properly use the meetings by asking questions on the accounts for which forms should be provided in the annual reports.

Corporate should have an effective internal audit function and establish an audit committee with written terms of reference from the board.

In respect of external audit, the committee recommended observance of the highest level of business and professional ethics; legal backing for accounting standards and it should be brought in line with international standards etc.

**Sarbanes Oxley Act (2002):** The Sarbanes Oxley Act was enacted in the year 2002 with a view to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws and for other purposes. Some of the main provisions of the Act are:-

- The Act called for establishment of the Public Company Accounting Oversight Board, whose duties are to:-
  - register and regulate all public accounting firms that prepare audit reports;
  - establish or adopt, or both, by rule, auditing, quality control, ethics, independence, and other standards relating to the preparation of audit reports;
  - conduct inspections of registered public accounting firms;
  - conduct investigations and disciplinary proceedings concerning, and impose appropriate sanctions were justified upon, registered public accounting firms and associated persons of such firms;
  - perform such other duties or functions as the Board determines are necessary or appropriate to promote high professional standards among, and improve the quality of audit services offered by, registered public accounting firms and associated persons thereof, or otherwise to
carry out this Act, in order to protect investors, or to further the public interest;

- enforce compliance with professional standards, and the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, by registered public accounting firms and associated persons thereof; and
- set the budget and manage the operations of the Board and the staff of the Board.

- It prohibits any public accounting firm from providing non-audit services while auditing firm. These services include:-
  - bookkeeping or other services related to the accounting records or financial statements of the audit client;
  - financial information systems design and implementation;
  - appraisal or valuation services, fairness opinions, or contribution-in-kind reports;
  - actuarial services;
  - internal audit outsourcing services;
  - management functions or human resources;
  - broker or dealer, investment adviser, or investment banking services;
  - legal services and expert services unrelated to the audit; and
  - any other service that the Board determines, by regulation, is impermissible.

- The lead audit and reviewing partner must rotate off the audit every 5 years. It shall be unlawful for a registered public accounting firm to provide audit services to an issuer if the lead (or coordinating) audit partner (having primary responsibility for the audit), or the audit partner responsible for reviewing the audit, has performed audit services for that issuer in each of the 5 previous fiscal years.

- The Act calls for the formation of an independent and competent audit committee, which is directly responsible for the appointment, compensation, and oversight of the work of any registered public accounting firm and of auditor's activities. It requires that each member of a firm’s audit committee be a member of the board of directors and be
'independent'. In order to be considered independent, a member of an audit committee may not accept any consulting, advisory, or other compensatory fee from the issuer; or be an affiliated person of the issuer or any subsidiary thereof.

- Each registered public accounting firm that performs for any issuer any audit shall timely report to the audit committee of the issuer:- (i) all critical accounting policies and practices to be used; (ii) all alternative treatments of financial information within generally accepted accounting principles that have been discussed with management officials of the issuer, ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the registered public accounting firm; and (iii) other material written communications between the registered public accounting firm and the management of the issuer, such as any management letter or schedule of unadjusted differences.

- Each audit committee shall establish procedures for:- (i) the receipt, retention and treatment of complaints received by the issuer regarding accounting, internal accounting controls, or auditing matters; and (ii) the confidential, anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters.

- The Act requires that the principal executive officer or officers and the principal financial officer or officers, or persons performing similar functions, to certify that the financial statements accurately and fairly represent the financial condition and results of operations of the company, in each annual or quarterly report filed or submitted.

- The Act requires rapid disclosure of material changes in the financial conditions or operations of the firm, which may include trend and qualitative information and graphic presentations, as necessary or useful for the protection of investors and in the public interest.

- It prohibits loans to any of the firm’s directors or executives. It shall be unlawful for any issuer to extend or maintain credit, to arrange for the extension of credit, or to renew an extension of credit, in the form of a personal loan to or for any director or executive officer (or equivalent thereof) of that issuer.
It requires that each annual report contain an internal control report. This report shall state the responsibility of management for establishing and implementing adequate procedures for financial reporting, as well as contain an assessment of effectiveness of internal control structure and procedures, any code of ethics and contents of that code.

**OECD Principles of Corporate Governance (2004):** The OECD Principles of Corporate Governance were developed with a view to assist OECD and non-OECD governments in their efforts to evaluate and improve the legal, institutional and regulatory framework for corporate governance in their countries, and to provide guidance and suggestions for stock exchanges, investors, corporations, and other parties that have a role in the process of developing good corporate governance. Although, these principles mainly focuses on publicly traded companies (both financial and non-financial), they also act as a useful tool to improve corporate governance in non-traded companies, for example, privately held and state owned enterprises.

These principles majorly include:-

- An effective corporate governance framework should be developed with a view to its impact on overall economic performance, market integrity and the incentives it creates for market participants as well as for the promotion of transparent and efficient markets. The legal and regulatory requirements that affect corporate governance practices in a jurisdiction should be consistent with the rule of law, transparent and enforceable. They should clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.

- The corporate governance framework should protect and facilitate the exercise of basic shareholders’ rights, which should include the right to: (i) secure methods of ownership registration; (ii) convey or transfer shares; (iii) obtain relevant and material information on the corporation on a timely and regular basis; (iv) participate and vote in general shareholder meetings; (v) elect and remove members of the board; and (vi) share in the profits of the corporation. Shareholders should have the right to participate
in, and to be sufficiently informed on, decisions concerning fundamental corporate changes, such as, amendments to the statutes or articles of incorporation; authorization of additional shares; etc.

- Capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership should be disclosed. The rules and procedures governing the acquisition of corporate control in the capital markets, and extraordinary transactions, such as mergers and sales of substantial portions of corporate assets, should be clearly articulated and disclosed so that investors understand their rights and recourse. Transactions should occur at transparent prices and under fair conditions that protect the rights of all shareholders according to their class.

- All shareholders of the same series of a class, including minority and foreign shareholders, should be treated equally. Within any series of a class, all shares should carry the same rights. All investors should be able to obtain information about the rights attached to all series and classes of shares before they purchase. Besides, all shareholders should have the opportunity to obtain effective redress for violation of their rights.

- Insider trading and abusive self-dealing should be prohibited.

- The corporate governance framework should recognise the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs and the sustainability of financially sound enterprises. Further, it should be complemented by an effective, efficient insolvency framework and by effective enforcement of creditor rights.

- Performance-enhancing mechanisms for employee participation should be permitted to develop.

- The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, operating results, objectives, performance, ownership, remuneration policy and governance of the company. Information should be prepared and disclosed in accordance with high quality standards of accounting and financial and non-financial disclosure.
• An annual audit should be conducted by an independent, competent and qualified auditor in order to provide an external and objective assurance to the board and shareholders, such that the financial statements fairly represent the financial position and performance of the company in all material respects. External auditors should be accountable to the shareholders and owe a duty to the company to exercise due professional care in the conduct of the audit.

• The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and its shareholders. That is, the Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders. It should review and guide corporate strategy, major plans of action, risk policy, annual budgets, business plans, performance objectives, etc. as well as monitor the effectiveness of company's governance practices and make changes, wherever needed.

**UNCTAD Guidance on Good Practices in Corporate Governance Disclosure:** UNCTAD has undertaken various actions to strengthen their regulatory frameworks in order to restore investor confidence as well as enhance corporate transparency and accountability. Accordingly, it has issued 'Guidance on Good Practices in Corporate Governance Disclosure' in 2006 for promoting improved corporate governance standards. This guidance is a voluntary technical aid for, among others, regulators and companies in developing countries and transition economies. Its purpose is to assist the preparers of enterprise reporting in producing disclosures on corporate governance, which will address the major concerns of investors and other stakeholders. This is most relevant for enterprises eager to attract investment, regardless of their legal form or size. This guidance is also useful for promoting awareness in countries and companies that are not sufficiently adhering to international good practices and are consequently failing to satisfy investors’ expectations regarding corporate governance disclosures.
The guidance revisits the content of major corporate governance codes and regulations with a focus on financial disclosures, a range of non-financial disclosures, disclosures in relation to general meetings, the timing and means of disclosures, and the disclosure of the degree of compliance with local or other codes of corporate governance. The recommendations under these guidelines include:-

- One of the major responsibilities of the board of directors is to ensure that shareholders and other stakeholders are provided with high-quality disclosures on the financial and operating results of the entity. The quality of financial disclosure depends significantly on the robustness of the financial reporting standards on the basis of which the financial information is prepared and reported. Thus, the board’s responsibilities and duties regarding financial communications like overseeing the process of producing the financial statements should be disclosed.

- Enterprises should fully disclose significant transactions with related parties. However, in circumstances where the financial reporting requirements are less stringent, as a minimum, the board of directors should provide the following disclosures that are generally considered best-practice: significant related-party transactions and any related-party relationships where control exists; disclosure of the nature, type and elements of the related-party transactions; and related-party relationships where control exists (irrespective of whether there have been transactions with parties under common control). The decision making process for approving related-party transactions should also be disclosed. Members of the board and managers should disclose any material interests in transactions or other matters affecting the company.

- The objectives of the enterprise should be disclosed, such as governance objectives, like 'why does the company exist?', etc. The objectives of enterprises may vary according to the values of society.

- The beneficiary ownership structure of an enterprise is of great importance in an investment decision, especially with regard to the equitable treatment of shareholders, and thus, it should be fully disclosed to all interested
parties. Changes in the shareholdings of substantial investors should be disclosed to the market as soon as a company becomes aware of them.

- Disclosure should be made of the control structure and of how shareholders or other members of the organisation can exercise their control rights through voting or other means. Any arrangement under which some shareholders may have a degree of control disproportionate to their equity ownership, whether through differential voting rights, appointment of directors or other mechanisms, should be disclosed. Any specific structures or procedures which are in place to protect the interests of minority shareholders should be disclosed. Rules and procedures governing the acquisition of corporate control in the capital markets and extraordinary transactions such as mergers and sales of substantial portions of corporate assets should be disclosed.

- The composition of the board should be disclosed, in particular the balance of executives and non-executive directors, and whether any of the non-executives have any affiliations (direct or indirect) with the company. The board’s role and functions must be fully disclosed. The existence of an enterprise code of ethics and governance structures should be disclosed. In particular, the board should disclose structures put in place to prevent conflicts between the interests of the directors and management on the one side, and those of shareholders and other stakeholders on the other.

- The composition and functions of any groups or committees, which have been established to facilitate fulfillment of certain of the board’s functions and address some potential conflicts of interest, should be fully disclosed. Committee charters, terms of reference or other company documents outlining the duties and powers of the committee or its members should also be disclosed, including whether or not the committee is empowered to make decisions which bind the board, or whether the committee can only make recommendations to the board.

- The number, type and duties of board positions held by an individual director should be disclosed. An enterprise should also disclose the actual board positions held, and whether or not the enterprise has a policy limiting the number of board positions any one director can hold. There should be sufficient disclosure of the qualifications and biographical
information of all board members to assure shareholders and other
stakeholders that the members can effectively fulfill their responsibilities.
There should also be disclosure of the mechanisms which are in place to
act as 'checks and balances' on key individuals in the enterprise. The board
should also disclose facilities which may exist to provide members with
professional advice as well as whether those facilities have been used
during the reporting period.

- The board should disclose whether it has a performance evaluation process
in place, either for the board as a whole or for individual members.
Disclosure should be made of how the board has evaluated its performance
and how the results of the appraisal are being used.

- Directors should disclose the mechanism for setting directors’
remuneration and its structure. A clear distinction should be made between
remuneration mechanisms for executive directors and non-executive
directors. Disclosure should be comprehensive to demonstrate to
shareholders and other stakeholders whether remuneration is tied to the
company’s long-term performance as measured by recognized criteria.
Information regarding compensation packages should include salary,
bonuses, pensions, share payments and all other benefits, financial or
otherwise, as well as reimbursed expenses. Where share options for
directors are used as incentives but are not disclosed as disaggregated
expenses in the accounts, their cost should be fully disclosed using a
widely accepted pricing model. The length of directors’ contracts and the
termination of service notice requirements, as well as the nature of
compensation payable to any director for cancellation of service contract,
should be disclosed.

- The board should give appropriate disclosures and assurance regarding its
risk management objectives, systems and activities. It should disclose
existing provisions for identifying and managing the effects of risk bearing
activities. It should report on internal control systems designed to mitigate
risks. Such reporting should include risk identification mechanisms.

- The board should disclose that it has confidence that the external auditors
are independent and their competency and integrity have not been
compromised in any way. The process for the appointment of and
interaction with external auditors should be disclosed. Disclosures should cover the selection and approval process for the external auditor, any prescriptive requirements of audit partner rotation, the duration of the current auditor, what percentage of the total fees paid to the auditor involves non-audit work, etc.

- Enterprises should disclose the scope of work and responsibilities of the internal audit function and the highest level within the leadership of the enterprise to which the internal audit function reports. Enterprises with no internal audit function should disclose the reasons for its absence.

- Disclosure should be made of the process for holding and voting at annual general meetings and extraordinary general meetings, as well as all other information necessary for shareholders to participate effectively in such meetings. Notification of the agenda and proposed resolutions should be made in a timely fashion, and be made available in the national language (or one of the official languages) of the enterprise as well as, if appropriate, an internationally used business language. The results of a general meeting should be communicated to all shareholders as soon as possible.

- All material issues relating to corporate governance of the enterprise should be disclosed in a timely fashion. The disclosure should be clear, concise, and precise and governed by the 'substance over form' principle. Some issues may require continuous disclosure. Relevant information should be available for users in a cost effective way, preferably through the websites of the relevant government authority, the stock exchange on which the enterprise is listed (if applicable) and the enterprise itself.

- Where there is a local code on corporate governance, enterprises should follow a 'comply or explain' rule whereby they disclose the extent to which they followed the local code's recommendations and explain any deviations. Where there is no local code on corporate governance, companies should follow recognized international good practices. The enterprise should disclose awards or accolades for its good corporate governance practices.
UNCTAD Guidance on Good Practices in Corporate Governance

Disclosure (Combined Code): The Combined Code on Corporate Governance (‘the Code’) is being published by the Financial Reporting Council (FRC) to promote confidence in corporate reporting and governance as well as to support its following outcomes, namely:- (i) contribution of good corporate governance towards better performance of company by helping a board discharge its duties in the best interests of shareholders; (ii) facilitation by good governance for efficient, effective and entrepreneurial management that can deliver shareholder value over the longer term; etc. The Code is not a rigid set of rules, rather it is a guide to the components of good board practice distilled from consultation and widespread experience over many years.

The 'Code on Corporate Governance' published in the year '2008' has provided several principles relating to various sections like Board of Directors, Chairman and Chief executive of Company; Remuneration Policy; Accountability and Auditing (Financial Reporting and Internal Controls); as well as relations with shareholders; etc. These principles majorly include:-

- Every company should be headed by an effective board, which is collectively responsible for the success of the company. The board’s role is to provide entrepreneurial leadership of the company within a framework of prudent and effective controls which enables risk to be assessed and managed. It should set the company’s strategic aims, ensure that the necessary financial and human resources are in place for the company to meet its objectives as well as review management performance. It should set the company’s values and standards and ensure that its obligations to its shareholders and others are understood and met.
- All directors must take decisions objectively in the interests of the company. The board should meet sufficiently regularly to discharge its duties effectively. There should be a formal schedule of matters specifically reserved for its decision.
- The annual report should identify the chairman, the deputy chairman (where there is one), the chief executive, the senior independent director and the chairmen and members of the nomination, audit and remuneration
committees. It should set out the number of meetings of the board and those committees and individual attendance by directors. It should include a statement of how the board operates, including a high level statement of which types of decisions are to be taken by the board and which are to be delegated to management.

▪ There should be a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company’s business. No one individual should have unfettered powers of decision.

▪ The board should include a balance of executive and non-executive directors (and in particular independent non-executive directors) such that no individual or small group of individuals can dominate the board’s decision taking.

▪ There should be a formal, rigorous and transparent procedure for the appointment of new directors to the board. Appointments to the board should be made on merit and against objective criteria. Care should be taken to ensure that appointees have enough time available to devote to the job.

▪ The board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties. All directors should receive induction on joining the board and should regularly update and refresh their skills and knowledge. They should have access to the advice and services of the company secretary, who is responsible to the board for ensuring that board procedures are complied with.

▪ The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors. The board should state in the annual report how performance evaluation has been conducted.

▪ All directors should be subject to election by shareholders at the first annual general meeting after their appointment, and to re-election thereafter at intervals of no more than three years. The names of directors submitted for election or re-election should be accompanied by sufficient
biographical details and any other relevant information to enable shareholders to take an informed decision on their election.

- Levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the company successfully, but a company should avoid paying more than is necessary for this purpose. The performance-related elements of remuneration should form a significant proportion of the total remuneration package of executive directors and should be designed to align their interests with those of shareholders and to give these directors keen incentives to perform at the highest levels. Levels of remuneration for non-executive directors should reflect the time commitment and responsibilities of the role.

- The board should, at least annually, conduct a review of the effectiveness of the group’s system of internal controls and should report to shareholders that they have done so. The review should cover all material controls, including financial, operational and compliance controls and risk management systems.

- The board should establish formal and transparent arrangements for considering how they should apply the financial reporting and internal control principles and for maintaining an appropriate relationship with the company’s auditors.

- The chairman should ensure that the views of shareholders are communicated to the board as a whole, as well as discuss governance and strategy with major shareholders. The senior independent director should attend sufficient meetings with a range of major shareholders to listen to their views in order to help develop a balanced understanding of the issues and concerns of major shareholders. The board should keep in touch with shareholder opinion in whatever ways are most practical and efficient.

- The board should use the Annual General Meeting (AGM) to communicate with investors and to encourage their participation.

- Institutional shareholders should enter into a dialogue with companies based on the mutual understanding of objectives. When evaluating companies’ governance arrangements, particularly those relating to board structure and composition, institutional shareholders should give due
weight to all relevant factors drawn to their attention. Most importantly, they have a responsibility to make considered use of their votes.

The Companies Act, 1956 and the Listing Agreement

The opening of the Indian economy and the necessity to have good corporate governance, made the government of India to take number of steps through suitable provisions in the Companies Act, 1956 and through the Listing Agreement. If a company intends to offer its shares or debentures to the public for subscription by the issue of a prospectus, it must, before issuing such prospectus, apply to recognized stock exchange for permission to have the shares or debentures intended to be so offered to the public to be dealt with in stock exchange in terms of section 73 of the Companies Act, 1956. Section 73 of the Companies Act makes listing compulsory where a company makes a public issue of shares or debentures by prospectus. It may be noted that Securities Contract (Regulation) Act, 1956 does not make listing of securities compulsory.

The listing agreement is required to be compiles by only listed companies with stock exchanges in which the concerned company’s shares are listed. While the requirements in relation to corporate governance set out in the Companies Act apply to all companies and the Department of Company Affairs administrates the Companies Act; the listing agreement apply to listed companies and is administered by stock exchanges under the supervision of SEBI, i.e., under the Securities Contracts (Regulation) Act, 1956 and the SEBI Act, 1992.

The requirements in the listing agreement are inserted through the directives issued by the SEBI to which the Ministry of Finance has delegated powers. The number of requirements under the Companies Act and in the listing agreement is uniform, but on some major aspects, including the composition of the board, they vary. This obviously creates practical problems for listed companies.

SEBI has put a modern regulatory framework with rules and regulations governing the behavior of major market participants such as stock exchanges, brokers, merchant Bankers and mutual funds. It also regulates activities such as takeovers and insider trading which have implications for investor protection. SEBI has
liberalized the regulation of new issues, including allowing book building. It has also increased information requirements for listed shares. The governing structure of stock exchanges has also been modified to make the boards of exchanges more broad based and less dominated by brokers.

**Provisions of Clause 49 of the Listing Agreement:**

**Board of Directors:** Board of directors of a 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. All pecuniary relationship or transactions of the non-executive directors viz-a-viz the company should be disclosed in the Annual Report.

**Audit Committee:** A qualified and independent audit committee shall be set up and that:

- 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;
- chairman of the committee shall be an independent director;
- chairman shall be present at Annual General Meeting to answer shareholder queries;
- 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;

- company secretary shall act as the secretary to the committee.

The audit committee shall meet at least thrice a year. One meeting shall be held before finalisation 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.

The audit committee shall have powers, which should include the following to:

- investigate any activity within its terms of reference.
- seek information from any employee.
- obtain outside legal or other professional advice.
- secure attendance of outsiders with relevant expertise, if it considers necessary.

The role of the audit committee shall include the following.

- Oversight of the company's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.
- Recommending the appointment and removal of external auditor, fixation of audit fee and also approval for payment for any other services.
- Reviewing with management the annual financial statements before submission to the board, focusing primarily on;
  - Any changes in accounting policies and practices.
  - Major accounting entries based on exercise of judgement by management.
  - Qualifications in draft audit report.
  - Significant adjustments arising out of audit.
  - The going concern assumption.
- Compliance with accounting standards.
- Compliance with stock exchange and legal requirements concerning financial statements
- Any related party transactions i.e. transactions of the company of material nature, with promoters or the management, their subsidiaries or relatives etc. that may have potential conflict with the interests of company at large.
- Reviewing with the management, external and internal auditors, and the adequacy of internal control systems.
- Reviewing the adequacy of internal audit function, including the structure of the internal audit department, staffing and seniority of the official heading the department, reporting structure coverage and frequency of internal audit.
- Discussion with internal auditors any significant findings and follow up there on.
- Reviewing the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the board.
- Discussion with external auditors before the audit commences, nature and scope of audit as well as have post-audit discussion to ascertain any area of concern.
- Reviewing the company's financial and risk management policies.
- To look into the reasons for substantial defaults in the payment to the depositors, debenture holders, shareholders (in case of nonpayment of declared dividends) and creditors.

If the company has set up an audit committee pursuant to provision of the Companies Act, the said audit committee shall have such additional functions / features as is contained in the Listing Agreement.

**Remuneration of Directors:** The remuneration of non-executive directors shall be decided by the board of directors.
The following disclosures on the remuneration of directors shall be made in the section on the corporate governance of the annual report.

- All elements of remuneration package of all the directors i.e. salary, benefits, bonuses, stock options, pension etc.
- Details of fixed component and performance linked incentives, along with the performance criteria.
- Service contracts, notice period, severance fees.
- Stock option details, if any – and whether issued at a discount as well as the period over which accrued and over which exercisable.

**Board Procedure:**

- The board meeting shall be held at least four times a year, with a maximum time gap of four months between any two meetings.
- The director shall not be a member in more than 10 committees or act as Chairman of more than five committees across all companies in which he is a director. Furthermore it should be a mandatory annual requirement for every director to inform the company about the committee positions he occupies in other companies and notify changes as and when they take place.

**Management:** As part of the directors' report or as an addition there to, a Management Discussion and Analysis report should form part of the annual report to the shareholders. This Management Discussion & Analysis should include discussion on the following matters within the limits set by the company's competitive position:

- Industry structure and developments.
- Opportunities and Threats.
- Segment-wise or product-wise performance.
- Outlook
- Risks and concerns.
- Internal control systems and their adequacy.
- Discussion on financial performance with respect to operational performance.
- Material developments in Human Resources / Industrial Relations front, including number of people employed.

Disclosures must be made by the management to the board relating to all material financial and commercial transactions, where they have personal interest that may have a potential conflict with the interest of the company at large (for e.g. dealing in company shares, commercial dealings with bodies, which have shareholding of management and their relatives etc.)

**Shareholders**: In case of the appointment of a new director or re-appointment of a director the shareholders must be provided with the following information:

- A brief resume of the director;
- Nature of his expertise in specific functional areas; and
- Names of companies in which the person also holds the directorship and the membership of Committees of the board.

The information like quarterly results, presentation made by companies to analysts shall be put on company's web-site, or shall be sent in such a form so as to enable the stock exchange on which the company is listed to put it on its own web-site.

A board committee under the chairmanship of a non-executive director shall be formed to specifically look into the redressing of shareholder and investors complaints like transfer of shares, non-receipt of balance sheet, non-receipt of declared dividends etc. This Committee shall be designated as 'Shareholders/Investors Grievance Committee'.

To expedite the process of share transfers the board of the company shall delegate the power of share transfer to an officer or a committee
or to the registrar and share transfer agents. The delegated authority shall attend to share transfer formalities at least once in a fortnight.

**Report on Corporate Governance:** There shall be a separate section on Corporate Governance in the annual reports of company, with a detailed compliance report on Corporate Governance. Non-compliance of any mandatory requirement i.e. which is part of the listing agreement with reasons thereof and the extent to which the non-mandatory requirements have been adopted should be specifically highlighted.

**Compliance:** A company shall obtain a certificate from the auditors of the company regarding compliance of conditions of corporate governance as stipulated in this clause and annexed the certificate with the directors' report, which is sent annually to all the shareholders of the company. The same certificate shall also be sent to the Stock Exchanges along with the annual returns filed by the company.

**Kumar Mangalam Birla Committee**

In early 1999, Securities and Exchange Board of India (SEBI) had set up a committee under Shri Kumar Mangalam Birla, member SEBI Board, to promote and raise the standards of good corporate governance. The report submitted by the committee is the first formal and comprehensive attempt to evolve a ‘Code of Corporate Governance', in the context of prevailing conditions of governance in Indian companies, as well as the state of capital markets.

The Committee's terms of the reference were to:

- suggest suitable amendments to the listing agreement executed by the stock exchanges with the companies and any other measures to improve the standards of corporate governance in the listed companies, in areas such as continuous disclosure of material information, both financial and non-
financial, manner and frequency of such disclosures, responsibilities of independent and outside directors;

- draft a code of corporate best practices; and
- suggest safeguards to be instituted within the companies to deal with insider information and insider trading.

The primary objective of the committee was to view corporate governance from the perspective of the investors and shareholders and to prepare a 'Code' to suit the Indian corporate environment.

The committee had identified the Shareholders, the Board of Directors and the Management as the three key constituents of corporate governance and attempted to identify in respect of each of these constituents, their roles and responsibilities as also their rights in the context of good corporate governance.

Corporate governance has several claimants – shareholders and other stakeholders - which include suppliers, customers, creditors, and the bankers, the employees of the company, the government and the society at large. The Report had been prepared by the committee, keeping in view primarily the interests of a particular class of stakeholders, namely, the shareholders, who together with the investors form the principal constituency of SEBI while not ignoring the needs of other stakeholders.

**Mandatory and Non-mandatory Recommendations:** The committee divided the recommendations into two categories, namely, mandatory and non-mandatory. The recommendations which are absolutely essential for corporate governance can be defined with precision and which can be enforced through the amendment of the listing agreement could be classified as mandatory. Others, which are either desirable or which may require change of laws, may, for the time being, be classified as non-mandatory.

**Mandatory Recommendations:**

- Applies To Listed Companies With Paid Up Capital Of Rs.3 Crore And Above
- Composition Of Board Of Directors – Optimum Combination Of Executive & Non-Executive Directors
- Audit Committee – With 3 Independent Directors With One Having Financial And Accounting Knowledge.
- Remuneration Committee
- Board Procedures – Atleast 4 Meetings Of The Board In A Year With Maximum Gap Of 4 Months Between 2 Meetings. To Review Operational Plans, Capital Budgets, Quarterly Results, Minutes Of Committee's Meeting. Director Shall Not Be A Member Of More Than 10 Committee And Shall Not Act As Chairman Of More Than 5 Committees Across All Companies
- Management Discussion And Analysis Report Covering Industry Structure, Opportunities, Threats, Risks, Outlook, Internal Control System
- Information Sharing With Shareholders

Non-Mandatory Recommendations:
- Role Of Chairman
- Remuneration Committee Of Board
- Shareholders’ Right For Receiving Half Yearly Financial PerformancePostal Ballot Covering Critical Matters Like Alteration In Memorandum Etc
- Sale Of Whole Or Substantial Part Of The Undertaking
- Corporate Restructuring
- Further Issue Of Capital
- Venturing Into New Businesses

As per the committee, the recommendations should be made applicable to the listed companies, their directors, management, employees and professionals associated with such companies, in accordance with the time table proposed in the schedule given later in this section. Compliance with the code should be both in letter and spirit and should always be in a manner that gives precedence
to substance over form. The ultimate responsibility for putting the recommendations into practice lies directly with the board of directors and the management of the company.

The recommendations will apply to all the listed private and public sector companies, in accordance with the schedule of implementation. As for listed entities, which are not companies, but body corporates (e.g. private and public sector banks, financial institutions, insurance companies etc.) incorporated under other statutes, the recommendations will apply to the extent that they do not violate their respective statutes, and guidelines or directives issued by the relevant regulatory authorities.

The Committee recognizes that compliance with the recommendations would involve restructuring the existing boards of companies. It also recognizes that some companies, especially the smaller ones, may have difficulty in immediately complying with these conditions.

The recommendations were implemented through Clause 49 of the Listing Agreements, in a phased manner by SEBI.

**Structure of Corporate Ownership**

**Family and Business Groups Ownership:** For the purpose of ownership, Indian companies can be classified into four categories: publicly held companies, privately held companies, family controlled companies, and the state owned (Government) companies. The structure of the ownership, even in the publicly held companies is unusual. Most of these companies, even the listed ones, have a dominant owner who is very often involved in the management of the company. Business groups are notable feature of the Indian corporate sector. They are organized through extensive cross-ownership and are often dominated by a controlling family, who has good contacts in the government. Thus, Indian companies are still controlled by the founder
promoter and his family members who on an average own a minority of shares, often as few as 10 percent, and through cross-holding control another 30% to 40%, of the group member firms. These controlling groups are known as promoters, as in the distant past, they did promote the companies. In listed companies, a large block of equity of about 30 - 50% is held by public financial institutions (both foreign and domestic), which seldom sell their shares and rarely challenge the promoters.

This type of ownership structure has its roots in the pre-independence managing agency system that was abolished on 1 April, 1970. But there are few signs of a well-functioning corporate control in this structure. One reason for this is that a typical public corporation is closely held and in most of the cases is dominated by the founder and his family or his associates. Secondly, the external equity is relatively small part of capital structure. The bulk of finance is supplied by bank debt and retained earnings. Bank debt is often provided on a subsidized basis from government-controlled banks. Given these financing sources, along with the limited legal rights of minority shareholders, public companies face little pressure for change until the “crisis” hits the company. The government has also pursued a number of policies with the aim of achieving wider shareholding and discouragement of any active market in shares. The takeover code also provides that ‘no one’ may raise shareholding above 10 percent without making a prior public announcement of intention and a public offer to purchase 20% holding at the average market price of the previous six months, and thus acquire at least a 30 percent holding. Listing on the first-tier of the stock exchange now requires that over 40% of the company’s stock be held by shareholders owning less than 1%, and that the principal owner and his family own not more than 51%. Cross-shareholdings by a firm may not exceed 25% of its net equity capital. A bank cannot without the permission of the RBI own more than 10% of a company’s shares.

**Institutional Shareholders:** Financial Institutions own more corporate equity than individual shareholders. Mutual funds have become more acceptable investment vehicle. Financial assets held by financial institutions exploded
after 1991. The holding of the Financial Institutions is concentrated in the larger companies. While any one institution typically owned a relatively small portion of a corporation’s equity, some institutions hold substantial, if taken as a group. These institutional owners are professional owners. They exercise almost all the rights and privileges of equity ownership. They buy and sell, they vote proxies, make proxy proposals, monitor portfolios firms, and communicate their concerns to management.

The fiduciary duty empowers and legally requires Financial Institutions to act conservatively and vigorously to promote their beneficiaries’ interests. This has led institutional investors to promote corporate governance reforms that strengthen their ability to act as owners, to vigorously monitor under-performing portfolio companies, and to oppose management when they determine that it is not acting in the best interests of the shareholders.

**Foreign Institutional Investors:** An Economic Times analysis\(^1^8\) of FII holding in BSE 200 scrips as on December 31, 2003 indicates that foreign institutional investors control 13.3% of the total market capitalization. The total market capitalization of the BSE 200 scrips is Rs 10,19,6630 million out of which the market capitalization of FII holdings is Rs.1, 35, 5410 million. According to latest Morgan Stanley research, only foreign institutional investors (FII) now on an average own 30% stake in the top Ten Indian Corporations and their stake in the top 50 companies is, on an average, more than 17.5%. The FIIs in India own more than a third of the non-promoter group holding.

**Government Ownership:** Government is a major shareholder in the corporate sector. The Government has holdings in private sector either through the public financial institutions or a government company’s subsidiary.

**Shareholder v. Stakeholder:** To maximize the value of shareholders’ investment is considered as primary corporate objective. This objective is reflected in different corporate governance reports made in India, which emphasize the duty of board to represent stakeholders’ interest and
maximize shareholder value. It has been observed that board’s main aim is to protect and enhance the shareholders investment in the company, though some emphasis is placed on a broader range of stakeholders such as employees, creditors and other constituents. But this view is not strongly advocated in the governance guidelines and codes or listing Agreement. However, there is growing recognition to address stakeholder interests in order to maximize shareholder value over the long run.

The Naresh Chandra Committee recognizes that ‘the board responsibilities to shareholders as well as to customers, employees, suppliers and the communities in which the company operates are all founded upon the successful perpetuation of the business.’ Thus, it is presumed that shareholders and stakeholders interests are compatible in the success of the company in the long run.

**Corporate Governance in the World**

During 1990s, financial scams have rocked the U.K. and billions of pounds were lost which forced the U.K., U.S. and Europe corporate word to look into corporate governance. In India, Mr. Harshad Mehta’s time ‘Creative Accounting’ practices was found in corporate reports and forced to form a committee for the corporate governance. The term Corporate Governance has a great deal of importance academically and professionally since the decade of the 1980s.

**European Union:** Charlie McCreevy in the “Regulatory Regime: Focus in Europe” in 2007 stated that he EU’s approach to corporate governance matters is principle-based. It seeks to ensure the adoption of certain key specific standards throughout the EU, while leaving it to Member States and market participants to determine how to best apply these standards. The EU corporate governance framework, which consists of a mix of binding and non-binding rules, has as its cornerstone the ‘comply or explain’ principle. Every listed EU Company is under an obligation to make an annual statement indicating which Code of corporate governance it applies and declaring whether it complies with all the provisions of that Code. If that company does not comply with some provision of the Code, it must state to what extent and give a justification. Alongside the corporate governance statement, the Commission
has adopted two non-binding recommendations on the remuneration of directors and on the role of independent directors, which contain key substantive standards. With these measures, the Commission seeks to encourage national governance codes to converge gradually. The European Corporate Governance Forum, set up by the Commission and composed of fifteen high level experts, seeks to reinforce this through exchanges of views on best practices to promote the convergence of national corporate governance practices within the European Union.

**UK:** Kerrie Waring\(^{20}\), Corporate regarding European Developments in June 2007 revealed that the EU adopted the Shareholder Rights Directive to create consistent standards across Member States and simplify cross-border investment. It aims to reduce problems associated with cross-border investment which include: a lack of sufficient information on a timely basis; the inability to trade shares ahead of general meetings (share blocking); and inefficient voting procedures and constraints. National governments are required to implement the Directive within two years. Some of the key measures of the Directive are:

- Share-blocking is banned. Instead, companies are required to set a record date within a 30-day period before the election, giving the vote to whoever holds shares on that day.
- Notice of Annual General Meetings (AGM) must be at least 21 days in advance, or 14 days for special meetings.
- Shareholders must be able to ask questions related to AGM agenda items.
- Shareholders must have the opportunity to vote by post.
- Companies must disclose results on resolutions and this should be published on its website no more than 15 calendar days after the AGM. In April 2007 the Financial Reporting Council (FRC) issued a consultation on the ‘Review of the Impact of the Combined Code’. It will address the effectiveness of the ‘comply or explain’ regime, the impact of the Combined Code on smaller companies, how it supports board performance and whether disclosures are considered useful and proportionate in terms of cost to companies.

**United States:** As per Roel C. Campos\(^{21}\) in the United States, investor protection being governed by the federal and state laws, in addition to the
implementation of the Sarbanes-Oxley corporate governance norms, different states have brought in several laws. These include; Under Delaware law:

- Any stockholder can inspect and copy a corporation’s stock ledger, a list of stockholders, and certain books and records of the corporation;
- Any stockholder can sue for an appraisal by the chancery court of the fair value of the stockholder’s stock in connection with certain mergers; and
- Interested director transactions are subject to heightened approval requirements.

Further, the US federal securities laws and the SEC’s rules also contain provisions aimed at protecting individual shareholders, such as:

- Requiring heightened disclosure for going private transactions;
- Requiring issuers to send proxy materials to all shareholders (not just certain shareholders); and
- Mandating significant disclosures for related-party transactions.

Simultaneously rigorous work on further areas of reforms on the governance is being actively pursued and these include;

- Improved quality in compensation disclosure;
- Advisory votes on executive compensation;
- Access to the management proxy for shareholder designated board candidates;
- Reform of shareholder communications and proxy voting mechanics;
- Promotion of global corporate governance standards and cross-border voting protections;
- Transparency in stock lending, empty voting and the governance impact of hedging and derivative trading strategies;
- Reduction of regulatory costs;
- Use of technology in disclosure and communications;
- Alleviation of short-term investment and business focus;
- Maintaining financial market efficiency and competitiveness.
China: Daochi Tong’s22 “Progress and Challenges of China” stated that the total market capitalisation at the end of March 2007 was RMB12.36 trillion, representing about 55% of the country’s GDP last year. From only about a dozen listed companies in 1990, there were 1459 listed companies by March of 2007. There are now 116 securities firms, with over 100,000 practitioners, and 82 million investor accounts. From 1991 to 2005, total funds raised by Chinese companies through public offerings reached RMB 1,159 billion. One of CSRC’s major reforms is the requirement to have independent directors on the board to overcome the “insider control” problem in many of China’s listed companies. The CSRC Guidelines on Independent Directors (August 2001) required that each listed company should have at least one third of the board made up of independent directors by June 2003. Independent directors are required to serve as chairs of audit, compensation, and nomination committees and major related-party transactions of the company have to be approved by independent directors. A recent survey showed that, as of December 2005, 4,640 independent directors had been appointed at shareholder meetings for the 1,381 listed companies in China. In most companies now at least one-third of the board are independent directors and it is evident that they are playing a more important role in corporate governance. A listed company is required to publish an audited annual report as well as a semiannual report. From 2002, listed companies are also required to publish un-audited quarterly reports. The rules have recently been revised to simplify and streamline the format of these reports so that they would be more readable and easily understood by investors. To better protect the rights and interests of public investors, the CSRC issued The Provisions on Strengthening the Protection of Rights & Interests of Public Shareholders (December 2004). According to the Provisions, listed companies’ major business decisions, such as rights issues and issuing additional new shares, and equity-for-debt plans, should receive a majority of the votes from holders of tradable-shares present at the general shareholders meeting.

France: According to Josiane Fanguinovery23 in “Corporate Governance Progress in France” a law passed in July 2005 set things on course by requiring shareholder approval of the pension schemes of executive directors
as well as golden parachutes and retirement schemes of managing directors. Another positive step was made with the introduction of a legal requirement for the chairman of the board of directors/ supervisory board to explain the remuneration policy to shareholders, who generally do not find these explanations satisfactory. 1) The compensation review must be exhaustive, 2) compensation must be seen by reference to the relevant business lines, 3) performance criteria must correspond to corporate targets and be simple to determine. Current trends in AGM voting indicate that shareholders are voting against the following: • Authorities to issue shares without preferential subscription rights. • Poison pills and other takeover defenses. • Allocation of free shares to employees and stock option plans. • Amendments to the articles of association relating to the threshold disclosure requirements. • Share buys backs.

**Germany:** The survey of Christian Stranger\(^{24}\) “The Progress of Corporate Governance in Germany-The Quality Question” shows that independent non-executive directors today comprise only 28% compared to the European average of 54%. Just 27% of the major companies have an independent chairman. The proportion of independent members of audit and remuneration committees in Germany is only 26% and 23% respectively. Only 7% of German supervisory boards are international board members compared to the UK with 31% and Switzerland with 45%. However, the 8th EU Directive (auditor directive) to be implemented by June 2008 could lead to a change of this proportion since it requires an independent chairman for the audit committee.

**Russia:** A survey conducted by Igor Belikov and other Russia Institute of Directors\(^{25}\) on the corporate governance in Russia brings out the following features. Major areas of where improvement was evident included;

- The practice of recording the property title;
- Board authority to approve material transactions;
- Regulation of using insider information;
▪ Ways of disclosing information to shareholders before the general meeting;
▪ Cross-ownership of shares;
▪ Dividend payments on common and preferred stock;
▪ The adoption of a corporate governance code. In respect of governance and control, major improvements were evident in;
▪ Bringing external (independent) directors to the boardroom;
▪ The regularity of board meetings;
▪ The establishment of board committees;
▪ Having a regulatory framework for the board and the executive body;
▪ The introduction of board members’ remuneration practices;
▪ Putting in place the procedures for identifying possible conflicts of interests in the board and amongst top managers;
▪ The establishment of internal control functions. Improvements observed in the disclosure standards include;
▪ Information about the company’s strategy;
▪ Information about the composition of the company’s governance and control bodies;
▪ Disclosure about general practices of corporate governance. Weaknesses that persist include; deficiencies in the procurement of goods and services;
▪ The involvement of independent appraisers;
▪ The practice of hiring external auditors;
▪ The existence of an approved dividend policy;
▪ The absence of formal corporate documents that outline the principles used for the calculation of dividends and the minimal share of net profit; the formalistic nature of many board committees;
▪ Insufficient attention to the professional development of board members;
▪ The absence of a clear and understandable procedure of executive and board evaluation; the loose link between executive remuneration and the company’s performance;
▪ Poorly developed succession practices and succession planning;
- Low level of independence and efficiency in the work of the audit commissions. Poor disclosure of beneficiary ownership;
- Poor disclosure about individual remuneration of members of the governance and control bodies and the principles on which such remuneration is based, insufficient use of available disclosure channels such as the annual report and corporate website.

**South Africa:** Some of the key reforms proposed in a recent Bill\(^\text{26}\) on the corporate governance include;

- There should be a uniform accounting standard to ensure that any financial information published by a company is calculated in accordance with generally accepted accounting practice (GAAP), which has to be comparable with the international standards adopted by the International Accounting Standards Board.
- A companies’ ombud is created which provides a forum for alternative dispute resolution on company issues.
- The Bill introduces three categories of companies, with the one category, namely a public interest company, having greater responsibility to a wider public and more demanding disclosure and transparency provisions.
- The Bill creates a capital maintenance regime based on solvency and liquidity requirements which is a shift from a regime based on par value.
- The chapter on corporate governance provides for the codification of directors’ duties, provisions addressing conflicts of interest and an increase in directors’ liability.
- The Bill sets out simplified and flexible processes for approval of transactions that will fundamentally alter the structure of a company. The provisions deal with the disposal of substantially all of a company’s assets or an undertaking, a scheme of arrangement or a merger or amalgamation. Minority shareholders are also afforded better protection in line with modern international corporate law.

79
Business rescue is being introduced in place of judicial management. Business rescue will be conducted by an independent supervisor and subject to court intervention. The interests of shareholders, creditors and employees are recognized in the development and approval of a business rescue plan. Notably, the interests of workers are protected by recognizing them as creditors of the company, with a voting interest to the extent of any unpaid remuneration.

The Bill tends to decriminalize non-compliance and uses a system of administrative enforcement

**Middle East:** According to Hawkamah\(^{27}\) the first Code of corporate governance was launched in Oman as early as 2002. Egypt has published two corporate governance Codes, one for listed companies and one for State Owned Enterprises. Egypt has sought to strengthen its listing rules and is focusing on implementation by launching the Egyptian Institute of Directors and a series of training programs being conducted by the Egyptian Banking Institute for bank directors. Bahrain, Morocco, Qatar, and Tunisia have facilitated the review of their legal and regulatory framework and are in the process of preparing a corporate governance Code. Jordan is developing a model corporate governance Code for listed companies. Lebanon has conducted a bank corporate governance survey and conducted a legal review followed by the Central Bank issuing a corporate governance regulation. Additionally the Lebanese corporate governance Task Force has spearheaded the development of a Code of corporate governance for non-listed companies and is working with Lebanese companies for voluntary compliance. In the UAE, the Central Bank has drafted corporate governance guidelines for banks, and the UAE’s Securities and Commodities Authority has issued a corporate governance Code, setting a national governance standard, for both the Dubai Financial Markets and the Abu Dhabi Securities Market. Similarly, Saudi Arabia’s Capital Market Authority launched corporate governance regulations for its listed companies, and the banking sector is seriously looking at improving corporate governance standards. The West Bank/Gaza is also in the process of developing a Code of Corporate Governance, after a series of corporate governance awareness programs organized by business associations
and regulatory authorities. Corporate governance plays an important role in investment decisions. In Brazil, Sao Paulo Stock Exchange launched a new market segment in 2001, The Novo Mercado where companies listed in this exchange have to comply with international standards and not those applicable to the companies listed in the main board. Institutional investors invested teams of people responsible for reviewing corporate governance practices in the companies in which they are investing.

Corporate governance as “If a country does not have a reputation for strong corporate governance practices, capital will flow elsewhere. If investors are not confident with the level of disclosure, capital will flow elsewhere. If a country opts for a lax accounting and reporting standards, capital will flow elsewhere. All enterprises in that country- regardless of how steadfast a particular company’s practices may be- suffer the consequences. Markets exist by the grace of investors. And it is today’s more empowered investors that will determine which companies and markets will stand the test of time and endure the weight of greater competition. It serves us well to remember that no market has a divine right to investors’ capital”.

Organization of Economic Cooperation and Development (OECD) which spearheaded the design and development of corporate governance principles and guidelines defined it as” Corporate governance involves a set of relationships between a company’s management, its board, its shareholders, and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set and the means of attaining those objectives and monitoring performance are determined”

An institutional point of view presented by Ira Millstein, who worked on drafting the OECD corporate governance guidelines as also the co-chairman of the NYSE-NASDAQ constituted Blue Ribbon Committee (1998) that looked into important aspects of the audit committees, defined “Corporate governance refers to that blend of law, regulation and appropriate voluntary private sector practices which enables the corporation to attract financial and human capital, perform efficiently and thereby perpetuate itself by generating long term
economic value for its stakeholders, while respecting the interests of stakeholders and society as a whole”.

From an academic perspective based on extensive surveys and studies on the subject, Shleifer and Vishny (1997) define corporate governance as the ways in which suppliers of finance to corporations assure themselves of getting a return on their investments.

**Future Prospects**

The issues of governance, accountability and transparency in the affairs of the company, as well as about the rights of shareholders and role of Board of Directors have never been so prominent as it is today. The corporate governance has come to assume a centre stage in the Board room discussions.

India has become one of the fastest emerging nations to have aligned itself with the international trends in Corporate Governance. As a result, Indian companies have increasingly been able to access to newer and larger markets around the world; as well as able to acquire more businesses. The response of the Government and regulators have also been admirably quick to meet the challenges of corporate delinquency. But, as the global environment changing continuously, there is a greater need of adopting and sustaining good corporate governance practices for value creation and building corporations of the future.

It is true that the 'corporate governance' has no unique structure or design and is largely considered ambiguous. There is still lack of awareness about its various issues, like, quality and frequency of financial and managerial disclosure, compliance with the code of best practice, roles and responsibilities of Board of Directories, shareholders rights, etc. There have been many instances of failure and scams in the corporate sector, like collusion between companies and their accounting firms, presence of weak or ineffective internal audits, lack of required skills by managers, lack of proper disclosures, non-compliance with standards, etc. As a result, both management and auditors have come under greater scrutiny.
But, with the integration of Indian economy with global markets, industrialists and corporates in the country are being increasingly asked to adopt better and transparent corporate practices. The degree to which corporations observe basic principles of good corporate governance is an increasingly important factor for taking key investment decisions. If companies are to reap the full benefits of the global capital market, capture efficiency gains, benefit by economies of scale and attract long term capital, adoption of corporate governance standards must be credible, consistent, coherent and inspiring.

Quality of corporate governance primarily depends on following factors, namely:- integrity of the management; ability of the Board; adequacy of the processes; commitment level of individual Board members; quality of corporate reporting; participation of stakeholders in the management; etc. Since this is an important element affecting the long-term financial health of companies, good governance framework also calls for effective legal and institutional environment, business ethics and awareness of the environmental and societal interests.

Hence, in the years to come, corporate governance will become more relevant and a more acceptable practice worldwide. This is easily evident from the various activities undertaken by many companies in framing and enforcing codes of conduct and honest business practices; following more stringent norms for financial and non-financial disclosures, as mandated by law; accepting higher and appropriate accounting standards; enforcing tax reforms coupled with deregulation and competition; etc.

However, inapt application of corporate governance requirements can adversely affect the relationship amongst participants of the governance system. As owners of equity, institutional investors are increasingly demanding a decisive role in corporate governance. Individual shareholders, who usually do not exercise governance rights, are highly concerned about getting fair treatment from controlling shareholders and management. Creditors, especially banks, play a key role in governance systems, and serve as external monitors over corporate performance. Employees and other stakeholders also play an important role in contributing to the long term success and performance of the corporation. Thus, it is necessary to apply governance practices in a right manner for better growth of a company.
References

6. The Advisory Group on “Corporate Governance” was set up w.e.f. Feb. 8, 2000, under the Chairmanship of Dr. R.H.Patil. It submitted its report on March 24, 2001, see http://www.rbi.org.in
9. The Standing Committee was constituted by the RBI, in consultation with the Government of India, in December, 1999. The Committee submitted its Report in May, 2002. The Report indicated that its main objective was to essentially sensitize the authorities and markets to international practices and to bench-mark Indian market practices with international standards and codes.
11. The Government of India, in August 2002, constituted a High Power Naresh Chandra Committee to examine the Auditor-company relationship, to examine the role of independent directors and how their independence and effectiveness can be ensured. The Committee submitted its report to the Finance Minister on 23rd December 2002. The Committee recommended that audit committee to be set-up composed of independent auditors, companies to have at least 50 percent independent directors, certain professional assignments should not be undertaken by auditors, every five years audit partner should rotate but no need for audit firm’s rotation.
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